

PART II

ARTICLES ON THE GOVERNANCE OF THE IMF

Stuffing New Wine Into Old Bottles: The Troubling Case of the IMF

The Governance of the IMF: The need for comprehensive reform

Operational Policies and Procedures and an Ombudsman

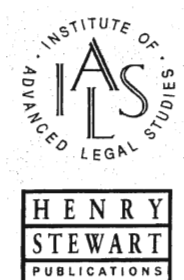


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Stuffing new wine into old bottles: The troubling case of the IMF

Daniel D. Bradlow

International Legal Studies Program, American University, Washington College of Law, 4801 Massachusetts Avenue, Washington DC 20016-8084
tel: +1 (202) 274 4205; fax: +1 (202) 274 4116; e-mail: bradlow@wcl.american.edu

Daniel D. Bradlow is Professor of Law and Director of the International Legal Studies Program at the Washington College of Law, American University, Washington, DC. His current scholarship focuses on the Bretton Woods institutions, the international legal aspects of sustainable and equitable development, and the legal aspects of debt and financial management.

ABSTRACT

This paper argues that IMF is failing because its decision-making structure and procedures have not adapted to its changing functions and role in the global economy. This results in poor policy decisions and causes distortions in the IMF's relations with its member states, non-state actors, and other international organisations, and problems with some of the IMF's interpretations of its articles. This paper also proposes a set of short-, medium- and long-term reforms that, if adopted by the IMF, would make its decision-making procedures more compatible with its current functions and changed relations with its member states.

INTRODUCTION

Since the collapse of the Bretton Woods system in the mid-1970s the International Monetary Fund (IMF) and the World Bank have helped the world avoid the horrors of a systemic collapse. However, when

looking at the volatility in financial markets, however, the growing income inequality both within and between countries, and the fact that nearly half the world's population lives on less than \$2 per day, about 22 per cent live on less than \$1 per day, and hundreds of millions of people live without safe sources of running water, shelter, education or health care, it is clear that they are failing in their mandate to reduce poverty, promote and maintain high levels of employment, real income and a stable international monetary system, and shorten the duration and lessen the degree of payments disequilibria.¹

Unfortunately, they are failing at a time when the world badly needs them to be functioning effectively. The increasingly integrated global financial system, with its apparently endemic volatility and uncertainties and unbalanced allocation of resources, desperately needs some form of effective global governance.

In this paper the reasons for the IMF's failure to adequately carry out its mandate explored. It is argued that, while the suitability of the IMF's policies and the appropriate scope of its activities are certainly open to debate, an important and often underemphasised cause of its unsatisfactory performance is its failure to adapt its structure and operating practices to its changing

functions. In fact, without correcting this latter set of problems it will never be able to fulfil its responsibilities effectively.

The thesis of this paper is that since the collapse of the Bretton Woods system of relatively fixed exchange rates, the IMF has lost influence over its richest member states, particularly the G7 countries, and has steadily gained influence over its developing country member states. This process has resulted in the IMF slowly mutating from a monetary organisation into a macroeconomically oriented development financing institution. These developments have important implications for the IMF's relations with its member states, the citizens of those member states and other international organisations. Unfortunately the IMF has not yet adequately acknowledged these implications. Consequently, the IMF is experiencing serious problems that are caused by the distortions that arise from it trying to squeeze its new functions and relations into its old structures. These problems are undermining its ability to function effectively. They are leading many in the developing world and in international civil society to view the IMF as an uncaring bully that is more responsive to the concerns of its richest member countries than to the real problems of the citizens of the countries in which it operates.²

The paper also proposes a reform programme for the IMF that is designed to adapt its existing structures to its new functions. The reforms will also make it more accountable, democratic and responsive to the challenges that its developing country member states face. Without these changes, the IMF will fail in its responsibility to ensure that the global financial system is able to contribute to the resolution of the serious problems of poverty and inequality that exist in the world today.

While this paper will focus on the IMF, the lessons drawn from this case study are applicable to other international economic

organisations, like the World Bank, in which industrialised countries are perceived to have a disproportionate share of the power and developing countries, which are directly affected by the policies and actions of the organisation, have very limited influence. It also has relevance for those international organisations, primarily the UN's specialised agencies, which, because they are perceived by the richest countries as being too responsive to the concerns of developing countries, have lost power to the IMF and the World Bank over the past 20 years.

In order to establish this thesis, the paper is divided into a number of sections. The following section of this paper gives an overview of the IMF's structure and functions and will briefly describe the evolution in its operations since its creation. The third section describes five distortions that have arisen from the combination of the evolution in the IMF's functions and the inflexibility of its decision-making structures. The next section briefly reviews the problems that have resulted from these five distortions, and the final section considers the possible responses to the current problematic situation of the IMF and concludes that the most desirable option is a substantial programme of structural reform. It also contains a set of short-, medium- and long-term proposals for reforming the IMF.

THE EVOLUTION OF THE IMF'S OPERATIONS

At the Bretton Woods Conference in 1944, the 44 participating countries agreed to surrender some of their monetary sovereignty to the IMF in exchange for the benefits of a rules-based monetary system.³ The states agreed that the post-war international monetary system would be based on a fixed link between gold and the US dollar. Every other participating country would set the value of its currency, known as its 'par value', in terms of the US dollar. The participants created the IMF to oversee the

system. Its primary function was to ensure that members were following economic policies that were consistent with maintenance of the par value they had established for their currency. The countries also agreed that they would not let the value of their currency change more than a specified amount without the permission of the IMF. To encourage the participating countries to comply with these obligations and as part of the benefits of membership in the IMF, it was empowered to provide financial support to any member state that was experiencing balance of payments problems.⁴

In order to perform its oversight functions, the IMF was required, pursuant to Article IV of its Articles of Agreement, to conduct an annual consultation with each of its member states. During these annual consultations, sometimes referred to as surveillance missions, the IMF focused its attention on those macroeconomic variables that influenced the ability of the country to maintain the par value of its currency. Thus, the primary focus of the IMF was on such macroeconomic variables as exchange rates, interest rates, inflation rates, the balance of payments, and growth in money supply and credit.⁵ Given the nature of its interest, it made sense for the member states to stipulate in the IMF's Articles of Agreement that the IMF should limit its interactions with its member states to the state's central bank and ministry of finance.⁶ These were the two agencies in the member country that had jurisdiction over the variables of interest to the IMF.

The IMF's specialised international monetary mission also placed limits on the conditions it would attach to the financing it offered its member countries. These conditions were limited to such issues as the size of the currency devaluation, the required cut in the budget deficit, and the expected limits on the growth in money supply and credit. The fact that the conditions were focused on macroeconomic

issues meant that the recipient state was free to choose the precise policy measures for meeting these conditions. During the period of the par value system many countries, including the USA, made use of the IMF's services.⁷

Since the IMF was designed to be a monetary and not a development institution, it operated on the basis of uniform treatment for all member states. The justification for this was that all states were participants in the same monetary system and that the ability of each state to maintain its par value was influenced by the same variables and they were all vulnerable to the same types of balance of payments problems. The IMF thus offered each member state access to its financing facilities on the same terms and conditions. Similarly, the IMF's annual consultations with each member state covered essentially the same ground. The IMF concretised this uniformity of treatment by adopting a principle of uniformity as one of its key operating principles.⁸

The IMF's original governance structure was designed on the assumption that in an international monetary system based on par values all countries could potentially run into balance of payments problems and need to make use of the IMF's financing facilities. Thus, even though the IMF's system of weighted voting meant that some countries had more influence in the IMF than others, they all had an interest in developing policies that were acceptable to states that actually used the IMF's services. Since even the most powerful states could one day need the IMF's support, they were unlikely to advocate policies that were unduly burdensome for member states.⁹ They understood that the policies they supported in the IMF could one day directly affect their own citizens and they could be held accountable for them.

The governance structure was also built around the expectation that the IMF's



board of executive directors would exercise firm control over the IMF's management and staff. The board would thus hold the staff and management accountable for their actions and decisions. During the period of the par value system, this expectation was realistic because the number of IMF programmes was relatively small and the scope of the programmes was limited to the key macroeconomic variables relevant to the par value system.

After the collapse of the par value system, which was formalised with the adoption of the Second Amendment to the IMF's Articles of Agreement in 1978, the IMF lost its well-defined monetary mission.¹⁰ The Second Amendment gave each member state the right to choose its own exchange rate policy. This created a problem for the IMF. If the member state was not expected to maintain any particular value for its currency and could choose its own exchange rate policy, then what was the IMF supposed to be monitoring in its annual consultations with the country?

The amended Article IV provides only limited guidance. It requires each member state to 'endeavour to direct its economic and financial policies toward ... fostering orderly economic growth ...' and to 'seek to promote stability by fostering orderly underlying economic and financial conditions' and to 'follow exchange rate policies compatible with the undertakings' of Article IV.¹¹ The lack of specificity of this language suggests, as in fact has become the case, that the IMF needs to look at any aspect of the member state's economic and financial policies that could affect its 'orderly economic growth', its external balance of payments and the value of its currency. In other words, the Second Amendment resulted in the IMF dramatically expanding the scope of its Article IV consultations.¹²

It has also resulted in an expansion in the range of conditions that the IMF attaches

to the financing it provides to member states. In fact, in some cases IMF financing arrangements have contained over 100 conditions covering such issues as privatisation, reform of tax administration, adoption of new laws such as bankruptcy codes, and budgetary allocations for health and education, in addition to the more 'traditional' macroeconomic conditions.¹³

The Second Amendment had disparate impacts on different groups of IMF member states. The IMF lost its significance in the case of those countries, all of which were industrialised, that knew that they would not need to use or had no intention of using the IMF's services in the foreseeable future. On the other hand, if the country knew that it needed or may need the IMF's financial support, it necessarily had to pay careful attention to the views of the IMF and the advice it offered during the annual Article IV consultations. These views would inform the conditions that the IMF would attach to the financing it would offer the member state. Thus, an unintended effect of the Second Amendment was to create a *de facto* distinction between those countries that used or intended using IMF financing and those that did not.

In fact, since the Second Amendment, IMF member states can be classified into two groups. The first group, which can be called 'IMF supplier states', consists of those countries that, because of their wealth, their access to alternate sources of funds and for political reasons, have no intention of using the IMF's services in the foreseeable future.¹⁴ These countries do not need to pay particular attention to the views of the IMF.¹⁵ For these countries, the most important of which are the G7 countries, the Second Amendment meant that they regained their monetary sovereignty from the IMF and escaped from its control. These countries, in fact, do not seem to pay much attention to the IMF's



advice. For example, during the 1980s the IMF consistently and ineffectively called for the USA to reduce its budget and trade deficits.¹⁶ Similarly, its advice on such issues as interest rates and exchange rates in the G7 countries do not appear to have had any real influence over the policies these countries adopt. Instead, these countries rely on their own judgments and the discussions that take place among themselves in making policies on these issues.

The second group, which consists of those member states that need or know they may need IMF financing in the foreseeable future, can be called the 'IMF consumer' countries. These states must pay careful attention to the views of the IMF because they will influence the conditions that the IMF will attach to the funds it provides the state. The IMF can also influence these countries' access to other sources of funds.

INSTITUTIONAL IMPLICATIONS OF THE CHANGING ROLE OF THE IMF: THE FIVE DISTORTIONS

The IMF has attempted to fulfil its current expanded range of activities without making any significant changes in its decision-making structures or governance arrangements. It has also allowed its new role to develop without any serious public debate over the institutional and legal implications of this development. The result is that the IMF has 'forced' its new broader functions into its existing decision-making structures and governance arrangements and its existing interpretation of its mandate. This has resulted in five distortions that are undermining the effectiveness of its operations and are increasing hostility to the IMF around the world.

These five distortions are:

- three legal issues;
- the IMF's relations with the industrialised countries, in particular the G7;

- the IMF's relations with developing countries that utilise or expect to utilise its financial services;
- the IMF's relations with the citizens of its member countries; and
- the IMF's relations with other international organisations.

Each of these problem areas is discussed in more detail below.

Three legal issues

According to its Articles of Agreement, some of the IMF's primary purposes are:¹⁷

- to 'promote international monetary cooperation';
- to 'facilitate the expansion and balanced growth of trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and the development of the productive resources of all members';
- to 'assist in the establishment of a multilateral system of payments in respect of current transactions'; and
- to provide financial resources to member countries experiencing balance of payments difficulties so that they can overcome these difficulties without resorting to measures that are destructive of international or national prosperity.

As was explained above, the IMF, in implementing this mandate, developed the principle of uniformity. This principle results in the IMF granting all states equal access to its financing and other services without drawing any distinctions between its member states based on their wealth, size, level of development, or importance in the international monetary system. Thus, unlike the World Bank, the World Trade Organization (WTO) or the United Nations, the IMF does not divide its mem-

bership into different categories based on their wealth or level of economic development. The uniformity principle has had the effect of protecting the richest countries from having to grant special treatment to developing countries in the use of the IMF's general resources. It has also offered developing countries some protection against being discriminated against by the richer member states.¹⁸

The Articles of Agreement also require the IMF, when conducting its annual consultations with its member states and when designing the conditions it attaches to its funding, to pay due regard to social and political conditions in the country.¹⁹ The IMF has historically interpreted this requirement as prohibiting it from being influenced by political (that is non-economic) considerations in its dealings with its member states.²⁰

These two interpretations of its legal mandate pose a number of problems for the IMF. First, the principle of uniformity made sense when the IMF functioned purely as a monetary institution and all its member states, in fact, were utilising its services. It does not make sense, however, when its services are only being utilised by its developing country member states. An example of the problems that this creates is the Enhanced Structural Adjustment Facility (ESAF), now renamed the Poverty Reduction and Growth Facility (PRGF). When the IMF decided that it needed to create a special facility exclusively for the poorest of its member states, it could not do so with its general resources but had to create a special fund for this purpose. Since this requires contributions from all member states, the PRGF has inevitably become politicised, subject to multiple demands and, as indicated by the external review of the ESAF, impaired in its functioning.²¹ This suggests that the IMF would be better off if it could treat different categories of its member states differ-

ently in regard to all its services and resources. For example, it would enable the IMF more easily to design facilities that are only suitable for certain member states. It would also allow it to consider whether or not it needs to restructure some of its decision-making procedures to make them more responsive to the needs of its poorer and weaker member states.

Similarly, the IMF's interpretation of the requirement that it pay due regard to social and political conditions in its member countries may have made sense when the IMF's operations were limited to monetary issues. It is, however, neither prudent nor principled for an organisation that attaches conditions to its funding that relate to governance, corruption, budgetary allocations and privatisation to pretend that it should not be influenced by social and political considerations. The only function that the current interpretation serves is to obscure what political considerations the IMF does view as relevant to its operations, what principles it applies in making these judgments and what process it follows in reaching these decisions. The lack of clarity on this issue also leaves undefined the outer limits of the IMF's specialised economic mandate.²²

A good example of the problems that can arise in this regard are human rights issues. There are occasions when the IMF will take human rights into account, for example in Indonesia in 1997. But there are also occasions in which it does not do so, for example in Mexico in 1994 or in Turkey in 2000. In all three of these cases the country was experiencing serious human rights problems. Furthermore, it is not clear that in Indonesia the human rights problems themselves were worse than in the other two cases or that they were causing more serious economic problems than in the other cases. There are no clear principles, however, that stipulate how the IMF should incorporate 'political'

issues like human rights into its calculations. Without such principles, the decisions of the IMF appear arbitrary or determined by the interests of its richer and more powerful member states. This inevitably undermines confidence in the fairness of the IMF.

A third legal problem for the IMF arises from the IMF's characterisation of the legal nature of the standby arrangement through which it provides much of its financing to its member states. The standard documentation used in these transactions is a letter of intent, usually written by the government of the member state to the IMF, followed by the decision of the IMF's executive board. For many years the IMF has argued that this arrangement is *sui generis* and is not a legal contract.²³ Consequently, the IMF does not treat the arrangement as an international agreement. This means that a member state that does not meet the performance criteria or other requirements of the standby arrangement will not incur any legal liability. Until recently, the IMF also relied, in part, on this characterisation to avoid publicising the member state's letter of intent.²⁴

The IMF's formalistic interpretation of the nature of this transaction had a certain utilitarian value when the IMF functioned as the manager of the par value system, and the conditions attached to the financing included a change in the par value of a currency. It is not clear, however, that the same considerations apply to its current development functions. In fact, the IMF seems to have recognised as much. In recent years, as part of its efforts to promote transparency, it has encouraged its member states to publish their letter of intent to the IMF.²⁵ Nevertheless, the IMF has not yet reviewed its decision regarding the nature of the transaction. The result is that the transactions are still not viewed by the IMF as contractual and, therefore, are still not considered as international agree-

ments. This is problematic for two reasons. First, if the arrangements, like World Bank contracts, were classified as international agreements they would be registered with the United Nations and would become public documents.²⁶ Consequently, the IMF could require, rather than encourage, member states to publish these letters of intent. This would more effectively advance the IMF's goal of promoting transparency than the current arrangements.

Secondly, as IMF transactions become more complex and the IMF increases the number of conditions it attaches to its standby arrangements there is a greater need for these agreements to be subjected to predictable principles of interpretation. The reason is that, when dealing with conditionalities related to governance, for example, it is possible for disagreements to arise about what constitutes sufficient compliance with the conditions of the standby to justify allowing the country to obtain the next tranche of the funds. If these transactions were viewed as international agreements, they would be subject to public international law rules for interpreting international agreements.²⁷ Under the current IMF view that the transactions are *sui generis*, there are no obviously applicable rules of interpretation. Consequently, the transactions are amenable to *ad hoc* and arbitrary interpretation. This reduces our ability to hold either the member state or the IMF accountable for the execution and interpretation of these arrangements.

Relations between the IMF and the industrial countries

Since the adoption of the Second Amendment to the IMF Articles of Agreement in 1978, the industrial countries have relied on their own resources and the private financial markets to meet their financial needs. They have in effect concluded that the IMF is not a politically or economically feasible



source of funds for them. The embarrassment of having to accept the conditions attached to IMF financing is viewed as politically unacceptable to these countries and financially too costly in terms of its impact on their future access to private financial markets.

The fact that these countries do not intend using the IMF's financing facilities has freed them from any need to defer to any advice the IMF may offer them in their annual consultations. This means that they are free to choose their own exchange rate system and manage (or mismanage) it as they choose. In other words, they have regained from the IMF the sovereignty that they surrendered to the IMF at the Bretton Woods Conference in 1944.

This does not, however, mean that they have regained full monetary sovereignty. The world's economy has become too integrated for that. Instead, these countries, particularly the G7, have in effect agreed to resolve all monetary and financial issues that may arise between them in an alternate set of international fora. These issues are now resolved through the G7, the Organization for Economic Cooperation and Development (OECD), the Bank for International Settlement (BIS) and the Committee of Bank Regulators associated with it and the International Organization of Securities Commissions (IOSCO).

When these are not deemed adequate, the G7 have been willing to create additional fora. For example, after the Asian financial crisis and the near bankruptcy of Long Term Capital Management, the G7 became concerned about the regulatory framework for the international financial markets. These countries decided that they needed a mechanism through which they could coordinate national regulation of financial markets and financial institutions. Consequently, they created the Financial Stability Forum²⁸ in which the regulators of the banking, securities and insurance

industries of major industrial countries and financial centres meet together with representatives of the IMF, the World Bank and the BIS to discuss regulatory issues of mutual concern. They also created the G20,²⁹ which consists of the G7 plus some other key industrial and emerging market countries. The purpose of this group is to ensure that the regulatory frameworks existing in all countries that participate in the international financial markets are consistent with the demands of the increasingly integrated international financial market.

Since the industrialised countries that participate in these fora have no need for the IMF's services, it is reasonable to question the purpose of having the IMF participate in the meetings of these fora. It would seem that the IMF's function is to ensure that those countries not invited to participate in these fora undertake the necessary economic and regulatory adjustments to enable them to participate in the international financial system being shaped by the richest and most powerful countries.

Similarly, the G7 have continued to support the IMF because they find its influence over poor countries and middle-income countries undergoing transformations or experiencing serious debt problems useful. In particular, they appreciate its ability to compel these countries to adopt stabilisation and adjustment policies that the G7 deem acceptable. They also support its role as the crisis manager in countries experiencing debt problems. In short, they value having an international organisation that can focus on the problematic areas of the global financial system while they are free to shape that system to suit their own needs.

The wealth and independence of the industrialised countries, particularly the USA, Japan, Germany, the UK and France, also ensures that they are the dominant force within the decision-making structures of the IMF. Their dominance is

significantly enhanced by two developments that have occurred in the IMF since its formation in 1944. The first relates to the composition of the voting rights of each member state. Each state's vote consists of 250 basic votes plus one vote for each special drawing right (SDR) 100,000 it contributes to the IMF's general resources. The basic vote is intended to reflect the general principle of the sovereign equality of states. The remaining portion of the vote is intended to reflect the size of the country and its importance in the world economy. Since the establishment of the IMF in 1946, the number of total votes in the IMF has been increased to accommodate the IMF membership growing from 39 in 1946 to 182 in 2000 and the need to expand the total resources of the IMF. There has been no change, however, in the basic vote. The result is that today the basic votes form a significantly smaller portion of the total vote than was the case in 1946. In 1946 the basic votes accounted for 11.3 per cent of the total vote. By 1982 they only accounted for 5.6 per cent. In 2000 the basic vote accounted for only 2.2 per cent of the total vote. This means that the portion of the IMF's voting system that offered the smaller and weaker states some counterweight to the dominance of the richest and biggest countries in the IMF has been reduced in importance and the dominance of these richer and bigger countries has been enhanced.³⁰

The second development is that the number of IMF executive directors has grown more slowly than the number of IMF member states. The original 39 member states were represented by a 12-member board of directors. Today, the 182 members are represented by a board of 24 members. Originally, only the five biggest shareholders had their own executive directors and the remaining 34 member states were represented by the other seven directors. This meant that each of these

seven directors represented on average slightly less than five states. Today, of the 24-member board, in addition to the five executive directors representing the five largest shareholders another three directors represent single countries. Thus, today, 16 directors represent the remaining 174 member states. This means that each of these directors represents on average slightly less than 11 states. In fact, some executive directors — for example, the two directors representing sub-Saharan Africa — represent considerably more than 11 states.³¹

This change in the average size of the constituencies represented by the executive directors has an important impact on the power relations in the IMF's decision-making process. It means that those states that have permanent representation on the board have a distinct advantage in having their views heard in the board and also in developing expertise in how to function effectively in the IMF. It is unlikely that a director who represents 10–11 states can advocate for the views of each of those states as effectively as a director who only represents one state. It is also unlikely that such a director can play the same active role in policy issues in the IMF as an executive director who represents only one state can play.

The influence of the industrialised countries on the IMF executive board is further enhanced by the fact that in all six cases in which an executive director represents both developing and industrialised countries, the executive director is always from an industrialised country.³² The result is that of the 24 directors, 11 are from industrialised countries. Each of the 7 countries always has a national of their country on the executive board, despite the fact that only five of the seven countries have appointed executive directors. The net effect of this development is that on balance, the G7 countries and the other indus-



trialised countries have an even larger influence over the institution than their voting domination alone would suggest.

The numerical advantage of the industrialised countries on the executive board and the permanency of the G7's representation is significant even though the board always operates by consensus. The reason is that these countries, because of their permanent presence on the board, are able to develop institutional memories and expertise in how to function in the IMF. This enhances their ability to negotiate effectively and to shape the issues and the decisions around which the consensus must form.³³

The result is that, *de facto*, the G7 countries control the policy agenda in the IMF; however, because these countries are effectively independent of the IMF, they never have to live with the consequence of the policies that they make for the IMF's operations. This means that they can make policy that is only of limited interest to their own citizens. The policy is, of course, of immense interest to people in developing countries who have no ability to hold them accountable for their decisions or actions. This situation of decision makers having power with accountability to people who do not have to live with the consequences of their decisions but without accountability to those most affected by their decisions is a situation ripe with potential for abuse.

Relations between the IMF and its consumer member states

Since 1978 all the states that have utilised the financial services of the IMF are developing countries or the so-called 'transition countries'. For present purposes these countries can be divided into two groups. The first group consists of those countries that are classified as emerging markets and, under normal circumstances, have access to private financial markets. Many countries

in this group need the IMF's support to satisfy private investors that they have adopted and are implementing good macroeconomic policies and that they are 'suitable' for private investment. Thus, even though this group of countries only needs IMF funding when they are unable to raise sufficient funds from private sources because of a debt or some other financial crisis, they are dependent on the IMF giving their economic policy performance a favourable review. This in turn is influenced by how they respond to the advice the IMF gives them in their annual consultations. Mexico, Argentina, Turkey and Thailand are examples of this group of countries.

The second group consists of those countries that, because of their poverty or unstable political conditions, are dependent on official sources of funds. This group, in addition to needing the IMF's financial support, depends on the IMF's approval of their policies because their other official funders tend to rely on the IMF's advice in making their funding decisions. Uganda, Malawi, Haiti and Laos are good examples of countries in the second group.

In addition to being a source of funds for all the consumer member states, the IMF has effectively become a gatekeeper which regulates access to other possible sources of external financing for these countries.

While there are significant differences both within and between the countries in these two groups of IMF consumer states, they all share a common characteristic. Although the challenges that these countries face have a macroeconomic dimension, the primary cause of their social and economic, including macroeconomic, problems lies in the governance of their societies. In particular their problems are caused by weaknesses in their institutional arrangements and technical capacities which limit their ability to make and

implement policy effectively.³⁴ Although these structural issues are outside the scope of the IMF's specialised area of competence, it has attempted to address them.³⁵ This means that increasingly in both its policy advice and the conditions that it attaches to its financing, the IMF is addressing non-monetary and non-macroeconomic issues like bankruptcy laws, legal and judicial reform, allocations of public budgets, privatisation, environmental issues, social safety nets, and banking reform. The specificity and micro nature of these requirements highlight the evolution of the IMF from a monetary institution to a development financing organisation.

The broadening range of its interests and the increasing specificity of IMF advice during its annual surveillance missions and in the conditions it attaches to the funding it provides to these developing countries is changing the nature of the relationship between the IMF and these countries.³⁶ It is turning the IMF into an important actor in the policy-making process of its member countries. In the days of the par value system, the IMF limited its influence over national policy making by concentrating its advice and the conditions attached to its finance to specific macroeconomic variables. This imposed a restraint on the IMF's involvement in domestic policy making because it left the member state's government free to decide on the actual measures needed to achieve these macroeconomic targets. The increased range of issues the IMF considers and the specificity with which it addresses these issues means that the restraint has now been removed. The result is that the IMF has now become an active part of the policy-making process of its developing country member states. Given the important influence it has over these countries' access to external financing, the IMF is often the decisive voice in these countries' policy-making processes.

The combination of the IMF's gate-

keeping functions and its *de facto* role in national policy making further tips the balance of bargaining power in favour of the IMF in both the annual consultations and the negotiations over the policy conditions to be attached to IMF financing. Moreover, given the dominance of the G7 and the other industrialised countries in the IMF, there is a significant risk (that has often in fact been realised³⁷) that these countries will use the IMF to impose their views of good political and economic policies on the developing countries. In fact, many people in developing countries already see the IMF more as a political organisation that is biased in favour of the rich countries and their interests than as the technically specialised and politically neutral organisation that it was intended to be.

The IMF's expanded role in its developing country member states has also changed the range of actors with whom it must directly interact in these states. Prior to 1978, the IMF could reasonably limit its direct interactions to the makers of monetary and macroeconomic policy in the member states, namely to the central banks and the ministries of finance.³⁸ Today, however, the IMF's operations directly affect many, if not all, government ministries and the lives of all those people who will be governed by the policies that the IMF helps to make. This means that it is no longer feasible for the IMF to limit its interactions to the Central Bank or the Ministry of Finance. In fact, without directly interacting with a broader range of both governmental and non-governmental actors in the member states, the IMF is unlikely to obtain all the information it needs to play an effective policy-making role. For example, it needs to consult with government ministries whose budgets and policies will be affected by the IMF's funding conditionalities. It also needs to consult with the legislators who must pass the laws that the IMF policies require. To be an



effective and credible policy maker, the IMF should also hear the views of all those stakeholders who will be affected by the specific policy decisions it is influencing. These stakeholders have the ability to influence the success or failure of those policy decisions. To date, the IMF, utilising informal procedures, has consulted with some of these actors. However, it has not yet developed formal procedures for ensuring that all relevant stakeholders are consulted.

The principles of good governance that the IMF advocates require that all players in the policy-making process should be held accountable for their actions and decisions. To date, the IMF has not established any mechanism through which the citizens of these member countries or the governments of these countries can hold the IMF accountable for its actions in the policy-making process. In other words, the changes in the IMF's functions have resulted in the IMF acquiring great power over, but being effectively unaccountable to, its developing country member states or their citizens.

IMF relations with the citizens of its member states

The creators of the IMF, like the creators of most international organisations, believed that it was not necessary for the IMF to have any direct interaction with non-state actors. This belief was premised on the sovereignty of its member states. It was also based on the belief that for the IMF to perform its specialised monetary responsibilities effectively it only needed to interact with each member state's central bank and ministry of finance. Restricting the IMF's interactions with its member states to these two institutions had the added benefit of reinforcing the limits on the extent to which the IMF could impinge on the sovereignty of its member states.

The creators of the IMF also assumed that they had built sufficient accountability

into the IMF by making sure that it would be accountable to its member states' governments through their representatives on the board of governors and the executive board. The creators also assumed that these representatives could be held accountable by their governments and, through elections, by their citizens. This indirect form of IMF accountability to non-state actors was deemed to be sufficient.

These beliefs about the relationship of the IMF to non-state actors are no longer valid. Given, as was shown above, that the IMF is now an active participant in the policy-making processes of those member states that utilise its resources, it is no longer adequate for the IMF to limit its interactions to their central banks and the ministries of finance. For the IMF to be an effective actor in the policy-making process it must consult with both other governmental agencies and non-governmental actors. This means that the IMF is now effectively entering into direct interactions with non-state actors and the policies it is helping to make are directly affecting these non-state actors.

If nothing else, the basic principles of good governance which the IMF advocates so eloquently to the governments of its member states should determine its conduct towards those directly affected by its policy-making activities. After all, there is no obvious reason why the IMF, when it 'descends' into the national policy-making process, should be less accountable to those people directly affected by its decisions than other actors in this process. This means that the IMF needs to offer the citizens of its developing countries a formal means for holding the IMF accountable for its actions in the national policy-making process. It is no longer sufficient for the IMF to assume that it can rely on indirect forms of accountability to these non-state actors. To be sure there may be practical difficulties in designing an accountability



mechanism that is suitable for an international organisation and respectful of the member state's sovereignty. These problems have been dealt with in the case of the World Bank, however, and there is no reason why they could not be overcome in the case of the IMF.³⁹

The IMF's lack of accountability is exacerbated by the fact that the IMF executive board does not provide much guidance on how the management should conduct itself in the national policy-making process. Unlike the World Bank, the IMF does not have a publicly available operations manual that contains its operating rules and procedures. Such a manual would inform interested persons about how the IMF conducts its business and could be used by them to hold the IMF management accountable for its actions and decisions. The effect of the lack of such a document is to grant the IMF management and staff great discretion in its operations.

The developing countries and their citizens are unable to limit the staff and management's discretion effectively. While the executive board is the most appropriate body for controlling the management, as we have seen above the consumer states are imperfectly represented on this body. Furthermore, it is unrealistic to assume the citizens of the consumer states can hold the IMF accountable through their representatives on the board of governors. There are two reasons for this. The first is that this is not the appropriate body in which to challenge individual operational management decisions and the way in which these decisions were made or their effects. Second, even if this were possible, it is not realistic to assume that the state's IMF governor will be willing to raise its complaints or those of its citizens in this way. This is particularly relevant in the case of IMF consumer states because of their governance problems. Almost by definition, this means that the mechanisms through which people

can communicate their views to their own government, can participate in their own government's policy making, and can hold their own government accountable for individual decisions are imperfect. It also means that often they will not have access to the information necessary to persuade the government to act on their behalf.

It is also unrealistic for the IMF to assume that the citizens of all its developing country member states can hold their governments accountable for the conduct of the state's relations with the IMF. As was discussed above, the primary problem in most developing countries is governance. This means, *inter alia*, that the mechanisms through which the people can communicate their views to the government are unlikely to function effectively and the people are unlikely to have access to the information needed to make an informed opinion about the government's conduct of its relation with the IMF. This means that, in fact, the ability of the people to hold their governments accountable for their dealings with the IMF is likely to be impaired or non-existent. It is also not realistic to assume that the electorate will always make its voting decision based only on the way in which the government managed its relations with the IMF.

There are other problems that arise because the IMF has no formal channels through which it can communicate with non-state actors in its member states. Under the current operating principles, the IMF, out of respect for the sovereignty of its member states, only communicates with non-state actors in a member state if it obtains the consent of the government to do so. In some cases governments do not agree to the IMF having unrestricted access to non-state actors. This means that in many cases the IMF does not actually meet with the full range of non-state actors in its member states. Consequently, it is at high risk of making policy decisions for the



country on the basis of inadequate information about the likely reception that the policies will receive in the country and their chances of success.

The IMF's current approach to communications with non-state actors may have made sense before it assumed such an active role in the policy-making process of its member states. It does not make sense, however, given the expanded role that the IMF is playing in its developing country. This new role requires direct communication with non-state actors. The IMF's failure to establish formal communications mechanisms which are independent of the government has an adverse impact on the IMF's policies and its relations with the citizenry of these countries. They come to see the IMF as unapproachable and as an elitist, ideological institution that is uninterested in learning about the views of those who will be most affected by its policies.

Another dimension to the IMF's changing relationship with the citizens of its member countries is the impact of its changed activities on its relations with the citizens of its industrialised member countries. The citizens of these countries are not directly affected by the actions of the IMF. Many of them, however, acting usually through NGOs, see themselves as being indirectly affected by the IMF's operations. They argue that it is their taxes that support the IMF and that, currently, these taxes are being spent to support policies and operating principles, which they oppose. Consequently, these citizens have begun demanding changes in the operations of the IMF and have lobbied their governments to push for these changes in the IMF. The industrialised country NGOs have also used their access to their own governments and to the media in the industrial world to raise the concerns of their partners in the developing countries. These NGOs have had some success in

influencing the IMF. For example, the involvement of the IMF in the environment and its activities in regard to corruption, military expenditure, debt relief and poverty are all attributable, at least in part, to the campaigns of non-state actors in industrialised countries. Ironically, the influence of these NGOs in the IMF is attributable in part to the disproportionate influence and power of the industrialised countries in the IMF.

It can therefore be seen that the IMF's increasing role in the policy-making process in its developing country member states and its lack of accountability to those affected by this role is causing it to have tense relations with non-state actors in both its developing and developed member states. The failure of the IMF to address the causes of these tensions is leading many non-state actors to question the fairness of the IMF. The failure of the IMF to address this perception adequately is leading some of these non-state actors even to begin questioning the legitimacy of the IMF. The significance of these developments can be gauged from the impact non-state actors have had on the ability of the IMF to obtain funding from key member states, such as the USA,⁴⁰ and from the demonstrations against the IMF at its 2000 spring meeting in Washington and its annual meeting in Prague in autumn 2000.

The IMF's relations with other international organisations

The original conception of the creators of the specialised agencies of the United Nations (UN) system was that each agency would exercise its authority within the limited scope of its specialisation and that the UN Economic and Social Council would be the forum in which their activities would be coordinated. Each specialised agency, in part to facilitate coordination, entered into a relationship agreement with the UN. This relationship agreement



ostensibly clarified the fact that the specialised agency was subordinate to the UN and clarified how it would relate to the UN. The relationship agreement between the IMF and the UN,⁴¹ however, amounts in effect to a declaration of independence. While it acknowledges that the IMF is a specialised agency of the UN, it relieves the IMF of any significant responsibilities to the UN and denies the UN any meaningful role in the affairs of the IMF.

The effective independence of the IMF from the UN has become a problem as the scope of the IMF's operations has expanded beyond its original monetary function. Now that the IMF is involved in such issues as law reform, poverty alleviation, labour issues, social welfare, environment and trade liberalisation, its operations are encroaching into the jurisdiction of other specialised international organisations like the World Bank, the WTO, the International Labour Organization (ILO), the World Health Organization (WHO) and the United Nations Children's Fund (UNICEF).

PROBLEMS CREATED BY THE FIVE DISTORTIONS

The five distortions mentioned above are creating a number of problems for the IMF. The most significant of these problems are discussed below.

The disconnect between power and responsibility

As was discussed above, the industrialised countries, particularly the G7, have accumulated great power in the IMF even though they are not interested in the services of the IMF for themselves. This enables them to make policy for the IMF without having to live with the consequences of the IMF's policies and actions. Consequently, most of their own constituents have little interest in the IMF or its policies and limited incentive to support

their government's financial contributions to the IMF. The governments of these countries, therefore, are free to develop their policies for the IMF without paying appropriate attention to the concerns of the developing countries or to the situations in which these policies must be implemented. The most prominent example of this reality is the debates in the US Congress about the IMF. In addition, this situation amplifies the voices of those NGOs who have an interest in the IMF and other international development issues. While many NGOs have utilised this situation to achieve a great deal of good, the reality is that they, like their governments, can influence the policy of the IMF without having to live with the consequences of their proposals.

One result of this situation is that proposals that impose substantial burdens on already overloaded developing country governments or that make unrealistic assumptions about the access of these countries to private financing are able to receive serious consideration. For example, the US government and Congress seem to believe that developing countries in financial difficulty, even though a major cause of their problems is deficiencies in their governance arrangements, can implement complex adjustment programmes in relatively short periods of time.⁴²

The IMF's lack of accountability

The IMF still operates on the erroneous assumption that its existing channels of accountability are sufficient. The IMF structure provides for two channels of accountability: the IMF's board of executive directors, and the board of governors. The board of executive directors is not an adequate channel of accountability to those member states most affected by the IMF's actions for three reasons. The first is that, as we have seen, most consumer member states are only indirectly represented on it.



In fact, the link between each consumer member state and the executive director who represents it on the executive board has weakened as the number of countries each executive director represents has grown. Secondly, the executive directors from the key supplier member states dominate the board.

The third reason is that IMF programmes have become too numerous and complex for the executive directors to be able to exercise firm oversight over the staff. The executive directors representing the consumer states do not have sufficient staff or time in the day to understand adequately all the programmes in which the IMF is involved. Nor do they have the capacity to play an active role in making operational policy for the IMF and in dealing with the numerous organisational issues that the board of any organisation as complex as the IMF must address. The result is that IMF staff and management are making decisions about IMF programmes and are interpreting IMF policies without any substantive accountability to IMF consumer member states. For example, it is the management and staff who design the conditions attached to IMF financing for a country and who make the decision that the country has sufficiently complied with the multiple conditions attached to IMF financing to warrant asking the board to release the next tranche of IMF funding.

The board of governors is also not a sufficient channel of operational accountability even though each member state is represented on it. The board, which only meets once a year, is the highest body in the organisation and is not the appropriate body to deal with the operational issues that may arise in the relationship between the IMF and a consumer member state. Furthermore, even if the governor from a consumer member state were willing to raise an operational issue in the board of governors, it is unlikely that he or she

would have adequate knowledge of the impact of the IMF's policies and programmes in his or her country on its citizens. The reason for this is that these countries suffer from governance problems which mean that they are unlikely to have adequate channels of information about these impacts.

The problems in the existing channels of accountability have three important operational implications for the IMF. The first is that the IMF staff and management are effectively operating without any accountability. If the IMF staff are making policy in the member states, however, there is no obvious reason why they should be less accountable to those affected by the policies than the other participants in the policy-making process. In fact, it undermines the IMF staff and management's credibility when they advocate accountability as an aspect of good governance in member states but do not apply the principle to themselves.

The second is that the IMF does not provide much guidance to the staff on how they should perform their responsibilities when they act in this policy-making capacity. For example, it does not clarify to whom they owe their primary responsibility, what obligations they owe to those affected by the policies, what factors they should consider in making decisions in this process, etc. The lack of such guidance results in each staff member or mission team exercising great discretion in their policy-making activities in each member country. It also makes it hard to hold the staff accountable. In this regard it is important to note that, unlike the World Bank, the IMF does not have an operational manual that contains the detailed operational policies and procedures which its staff should follow in the conduct of their duties.

Thirdly, the IMF is performing its policy-making functions without establish-

ing any formal mechanisms through which those non-state actors most affected by its actions can communicate directly with the IMF. In fact, the IMF is not unaware of this problem and it often engages in informal communications with these affected parties.⁴³ This means, however, that the IMF, in consultation with the government of the member state, is choosing which non-state actors it communicates with, and is setting the terms for this communication. A more formal procedure for communication with these non-state actors — such as a requirement that all IMF missions hold a public hearing in the country they are visiting or an explicitly recognised right to make written submissions — would ensure that many more interested non-state actors have a meaningful opportunity to communicate with the IMF. The IMF's failure to establish such procedures contradicts the principles of participation and the need for transparent governance procedures that it advocates to its member states. It also suggests that the IMF is often making policy without having access to all the relevant information.

Another aspect of the IMF's lack of accountability is its continued adherence to the principle of uniformity.⁴⁴ While it is important that international organisations treat all similarly situated member states equally, it is also important that it treat all member states fairly. Given the difference in the nature of the IMF's relations with the industrialised and developing countries it is no longer adequate to contend that since all states participate in the same international monetary system they all should receive uniform treatment. In reality, as discussed above, some IMF consumer states do not have access to the financial markets that the G7 utilise. Furthermore, very few, if any, of the IMF consumer states are able to have any substantial input into the workings of the international monetary and financial systems or influence in their

governance arrangements and institutions. This suggests that the uniformity principle has become a means of justifying unfair treatment for the developing countries. For example, it precludes the IMF from offering certain groups of member states disproportionately favourable access to its general resources or special considerations in its decision-making procedures.

The IMF and other international organisations

The expansion of the IMF's scope of operations has resulted in the IMF encroaching into the areas of responsibility of other specialised agencies. For example, the IMF is beginning to deal with budgetary allocations for health and education⁴⁵ but without involving the WHO or UNESCO in these activities. While in some cases the IMF may attempt to have communications with these organisations, there is no formal agreement designed to ensure regular communications at the staff level. The only specialised agency with which the IMF has a formal arrangement is the World Bank.⁴⁶ The result of this situation is that the IMF is making policies and taking action in these new areas without necessarily having the technical expertise to do so and without adequate consultation with the appropriate specialised agency.⁴⁷ It may hire consultants to work on these issues, but it does not have the in-house expertise to evaluate the work of the consultants. This situation will continue until it either hires people with the necessary technical skills or establishes some sort of cooperative arrangement with the relevant specialised agencies. This creates a significant risk that the IMF will have inadequate policies in these areas or that it will assign a lower priority to these issues than may be appropriate in particular situations.

The UN specialised agencies' implicit acquiescence in the IMF usurping parts of their responsibilities also has adverse conse-

quences for the functioning of the UN system as a whole. It is resulting in a concentration of power in organisations like the IMF and the World Bank. This exacerbates the IMF's tendency to maintain that it has the 'correct' answer for the major development challenges that its member states face. The inability of other specialised agencies to challenge the IMF's position effectively increases the risk of the IMF giving wrong policy advice. Furthermore, the developing countries, because of the IMF's gate-keeping functions, have no real choice but to follow the advice of the IMF.

Interpretation of Articles of Agreement

The IMF has not fully recognised the expanding scope of its activities is calling into question its interpretation of its own Articles of Agreement. In particular, it raises questions about the limits on its permissible scope of activities and about the IMF's claim to be a 'non-political' body. The IMF has failed to define the limits of its mandate or to stipulate a principled basis on which it determines what issues it is willing to address and which issues are outside its mandate because of their inherently political or non-economic nature. This failure makes it hard for outsiders to understand why the IMF is willing to address certain issues, for example human rights in Indonesia, but not other issues, such as human rights in Mexico in 1994 or Turkey. It also subjects the IMF to the charge that it is acting in an arbitrary and capricious fashion in interpreting its articles.

A PROPOSED SOLUTION TO THE PROBLEMS CAUSED BY THE FIVE DISTORTIONS

There are three basic approaches that could be taken to resolving the problems with the IMF. The first is to conclude that the IMF is irredeemably flawed and should be abolished. The second is to conclude that

the IMF is a necessary organisation in today's integrated global economy but that the policies that it advocates are flawed and must be changed. Implicit in this view is the belief that if the IMF changed its policies the distortions identified in this paper would lose their significance. The third approach builds on the second approach and argues that changes in the IMF's policies alone, while necessary, are not sufficient to ensure that the IMF will effectively fulfil its responsibilities in the world. It argues that policy reform is unlikely to be sustainable unless the IMF first undergoes substantial structural reform.

Approach 1: The IMF should be abolished

There are two different groups who advocate this approach. The first argues that the market is the most efficient and best means for allocating resources and that all state interventions into the market merely impair its functions.⁴⁸ Consequently, they oppose all state-sponsored interventions in the functioning of the market. From their perspective the operations of the IMF are merely a form of state intervention and are *per se* suspect. This group further argues that their only effect is to create a moral hazard problem. The IMF is accused of doing so by leading both investors and governments to believe that they can engage in excessively risky economic activities because the IMF will bail them out if they fail.

The second group comprises the opponents of the current power relations in the world. They contend that international organisations are merely a reflection of these power relations and that they will always be used by the rich and powerful nations to keep poorer and weaker developing countries in 'their place'. These groups also argue that developing countries would be better off if they followed more independent policies that did not rely so



heavily on international organisations that are controlled by the G7.⁴⁹

While the political perspectives of these two groups are clearly very different, they both believe that the IMF as currently constituted is irredeemably flawed. Consequently, they agree that the IMF should be abolished. These groups can draw support for their position from the mutation of the IMF from a monetary organisation into a development financing one. They can argue that the IMF's record as a development financing organisation is not impressive, citing the controversial record of the IMF's involvement in Russia and in the countries that have used the IMF's Enhanced Structural Adjustment Facility as evidence.⁵⁰

These groups can also contend that if the IMF has no monetary role left to perform, why do we need two international organisations offering development financing services? They can cite the fact that the World Bank exists to fund development and that there is already a great degree of overlap between the functions of the two organisations. Consequently, it would be more efficient either to merge the two organisations or shut down the IMF and let the Bank assume those development financing activities that only the IMF currently performs.⁵¹

These critics can also point out that the industrialised countries, who as we saw above control the IMF, do not have any intention of allowing the IMF to become an effective manager of the international monetary system. In support of this position, they can offer the fact that when serious financial or monetary issues arise in the global economy, the rich countries have not turned to the IMF. Instead they have turned to the G7, the BIS or the OECD. In addition, they have been willing to create new fora, such as the Financial Stability Forum and the G20, whenever they see a missing element in their ability

to control the international monetary and financial system. The only role they assign the IMF in these arrangements is essentially the developmental one of ensuring that the developing countries will be 'structurally adjusted' to fit into the financial system that the industrialised countries are shaping.

While these arguments raise important issues and have persuasive power, they are ultimately unrealistic. The increasingly integrated global financial system needs international organisations which have the specialised mandate to help those countries that are either *de facto* not full participants in the global financial system because of their extreme poverty or that are experiencing difficulties in becoming a full participant in the global system. Even if the sovereignty of many of these states in fact is illusory, it is not politically or economically feasible for the richest and most powerful states to control them directly or to force all of them directly to adjust to their economic and political requirements. The industrialised states have also conclusively demonstrated that they are not willing and may not have the capacity to help these countries address the complex development challenges that they face. Furthermore, it is unrealistic to expect that private financial markets will be willing to fund important primary health and education projects in very poor or unstable countries on financially feasible terms. It is also unrealistic (and even of questionable desirability) to count on private investors to provide sufficient balance of payments support to governments facing serious monetary or debt crises. Consequently, there is an absolute need for international organisations that can fund development in the poorest countries, and work with emerging markets to help them gain secure and adequate access to the financial resources available from the international capital markets. There is

also a need for international financial organisations that can provide a forum where the developed and the developing countries can communicate about issues of mutual concern relating to the global financial system.

This means that while it may be possible to abolish the IMF, it is not possible to eliminate the need for an organisation like the IMF. It is therefore irresponsible to suggest abolishing the IMF unless one can be confident that it is politically possible to create an alternative organisation that will effectively and equitably perform its legitimate monetary and macroeconomic functions. It is clear that the political conditions for creating new international organisations do not exist and are unlikely to exist in the near future. Consequently, the only option is to reform the ones that currently exist.

Alternative 2: Change the policies of the IMF

Those supporting this position accept that conditions have changed and that the IMF must change to fit the new conditions. They believe, however, that what must change is the substance of the IMF's policies and its *modus operandi*. Those who advocate for this position can be divided into two sub-groups. The first sub-group's argument with the IMF is over the expanding range of its operations. They contend that the IMF was established as a specialised organisation with a mandate to focus on macroeconomic issues and that the IMF should not let its scope of operations expand beyond this set of issues.⁵² In their eyes any conditions relating to issues such as governance, legal reform or regulatory issues that the IMF attaches to its financing are illegitimate. These issues either fall within the mandate of the World Bank or within the sovereign prerogatives of the member state. This group therefore argues for a reduction in the

scope of the IMF's operations and a return to its original focus on macroeconomic issues.

The second sub-group's fight with the IMF is not so much over the scope of its operations but over the content of its policies. This sub-group argues that the IMF is insensitive to the impact of its policies on the poor, the environment and human rights. Consequently, this group advocates for the IMF to adopt new policies that are more pro-poor, pro-environment and pro-human rights.⁵³

Those who criticise the IMF's policies for being insensitive to the poor and the environment share a problem with the IMF. They can also be criticised for not recognising any clear limits on the permissible scope of IMF operations. The logical endpoint of their suggestions, and of the current IMF expansion, is that it will be the pre-eminent international organisation with *de facto* authority over all issues related to economic and social policy and with great influence over such issues as human rights, environment and political process. As was suggested above, this great accumulation of power without any obvious checks or balances on its power is troubling and contrary to the principles of good governance.

Some members of this sub-group focus more on the economic content of the IMF's policies and the conditions that it attaches to its financial support than on its social and environmental impacts. For example, they argue that the IMF offers bad policy advice on such issues as exchange rate policies, including exchange controls, capital controls and budget deficits. Consequently, they call on the IMF to change the assumptions and economic model it uses in developing its policies towards its developing country member states and challenge the specific policy measures contained in individual agreements between the IMF and its member states.⁵⁴



This second approach is more realistic than the 'abolish the IMF' approach. Its call for more critical assessment of IMF policies and the scope of IMF operations is important and needs to be heeded if the IMF's performance is to begin improving. In fact, any coherent approach to reforming and improving the IMF must include this as at least one element of the reform agenda. This 'reform the policies' approach is, however, ultimately inadequate. It is addressing the symptom rather than the real cause. The policies of the IMF arise from the power relations within the organisation and from its policy and decision-making structure. Without changing these structural features, the IMF will always adopt policies that are heavily biased towards the interests of its supplier member states and that are insufficiently responsive to the needs of its consumer member states. Thus, policy changes that leave the basic structural features of the IMF intact will ultimately fail to achieve their intended results.

Alternative 3: Reform the IMF⁵⁵

The third approach argues for a comprehensive reform programme for the IMF which has as its primary focus correcting the structural problems with the IMF. This approach accepts the necessity for an intergovernmental financial institution like the IMF but contends that it must be structured and must function according to the same principles of good governance — transparency, participation and accountability — that the IMF advocates should apply at the national and sub-national level. This means that the IMF must be reformed so that its basic structures and operating policies and principles are transparent. In addition, those who are most directly affected by its policies and actions must be able to participate in the IMF's policy-making processes and must be able to hold its decision makers accountable for

their decisions and the actions based on those decision. It also means that there should be appropriate checks and balances on the power of the IMF. The proponents of this approach argue that if the structural problems with the IMF are corrected, the organisation will be more responsive to the needs of its consumer member states and their citizens. This in turn should result in the IMF adopting more acceptable policies.

The appeal of this reform option is further strengthened by the reality of international power relations and the inherent difficulties of making changes at the international level. This reality leads to the conclusion that before we reject the existing international organisations we need to be confident that we have exhausted all feasible possibilities for reforming them. In the case of the IMF, very little effort has been made to reform it. Consequently it is relatively easy to identify a programme of reform that has the potential to correct the problems identified in this paper.

Given the complexity of the nature of the relations between international organisations and their member states and the current hostility to international organisations in such key countries as the USA, it is likely that carrying out the structural reforms being advocated in this paper will be a long-term project. It is possible, however, to divide this reform programme into short-, medium- and long-term proposals. The distinction between these categories is not only based on how possible it is to achieve these proposals but also on the basis of who must act to implement the reform proposal. Thus, short-term items are those which only require action by the IMF staff and the executive board acting on their own authority. Medium-term items are those that are more politically difficult and will require the participation of the governors of the IMF. The third



category are those items that will require amendment to the Articles of Agreement or at least will require the agreement of each of the member states, including the agreement of their legislatures. It should be noted that the IMF has begun to implement at least some aspects of the proposed reform agenda.

Short-term reform agenda: Those actions that the managing director and board of directors acting on their own authority can take

These actions can be divided into the following five categories:

- (1) Actions to make the IMF more responsive to its developing country member states.
 - (a) Allow the member state's governor to the IMF or his/her representative to participate in any discussion in the executive board on the member state. This would include discussions about the staff report following the annual IMF surveillance mission to the country and about any proposed IMF programme and financing for the country.⁵⁶ It should be noted that this reform is roughly analogous to the situation in the United Nations Security Council.⁵⁷ In this case, states that are not members of the council but that have a direct interest in the matter being considered by the council can ask for permission to address the council and participate in the Security Council discussions, but not its vote. For many countries the issues being discussed about the country in the IMF executive board can be as momentous as those that can arise in the UN Security Council.
 - (b) Give more resources to the executive directors representing IMF

consumer countries so that they can more effectively represent their constituents.⁵⁸

- (c) Establish formal procedures for how the IMF will consult with non-state actors during its Article IV consultations with its member countries and when developing a programme for any member state that wishes to use its financing facilities. This procedure should create a meaningful opportunity for non-state actors to submit information and express their views to the IMF.
- (d) Establish a formal mechanism through which non-state actors as well as civil servants who feel that they cannot safely or freely participate in any meetings that the IMF might hold with non-state actors can communicate with the IMF. This mechanism should enable such actors to make written submissions to the IMF. It would also provide a mechanism for communication with non-state actors in those states in which the government will not allow the IMF to meet with non-state actors.
- (e) Establish an IMF-NGO liaison committee in which a group of NGO representatives, elected on a regional basis, can meet on a regular basis with senior IMF staff to discuss issues of concern to NGOs and other non-state actors around the world.⁵⁹
- (f) The IMF should adopt a policy of publicly releasing drafts of all official reports and policies, redacted to remove all market-sensitive information, and submitting them to public comment before the final reports or policies are adopted. The IMF has improved its information disclosure policy but it



- usually only releases final reports and policies.⁶⁰
- (g) An external review panel should evaluate the policies of the IMF to assess their impacts on poverty and the environment. This panel should also be charged with making recommendations on how the IMF, acting consistently with its mandate (see below), could improve its policies so that their potential to have a positive effect on poverty and the environment is maximised. The soon-to-be-established IMF Evaluation Office should perform this role.⁶¹
- (2) Actions to make the IMF more accountable.
- (a) Establish a permanent and independent evaluation unit in the IMF. The IMF is in fact in the process of establishing such a unit.⁶²
- (b) Establish an ombudsman at the IMF who has the power to receive and investigate complaints from any person, organisation or state that feels that the IMF has not been acting in conformity with its mandate. This official should have the power to publish an annual report that discusses the investigations he/she has conducted and to make recommendations to the board of directors on how to reform the functioning of the IMF.⁶³
- (3) Actions to coordinate the IMF's activities better with other international organisations.
- (a) Establish an expert panel to review the IMF's relations with other international organisations and to make recommendations on how the IMF, acting in conformity with its limited mandate (see below), can most effectively coordinate its activities with these organisations.
- (4) Actions to match IMF skills better to the tasks it performs.
- (a) Change the skill mix in the IMF to make it more suitable to the functions the IMF defines as within its mandate (see below). This will mean hiring more people with expertise in social sciences other than economics. This action will be less necessary if the IMF has better coordinated relations with other international organisations.
- (5) Legal actions.
- (a) The board of directors, after a notice and comment period, should issue a decision defining the scope of the IMF's mandate.
- (b) The board of directors should abandon the principle of uniformity and should explicitly categorise countries according to their wealth and level of economic development.
- (c) The board of directors should acknowledge the contractual nature of stand-by arrangements.
- Medium-term actions: Those actions that require the approval of the board of governors*
- (1) Actions to make the IMF more responsive to its developing country member states.
- (a) The IMF should increase the number of alternate directors that can assist each director in more effectively representing the members of his/her constituency. Since this will lead to a more unwieldy board, the IMF may need to give thought to delegating more responsibility to board committees.
- (b) The IMF should consider moving from its current practice of making decisions on the basis of consensus to making decisions on a basis that

better reveals the preferences of those who will be most affected by the decisions. One possibility would be for the IMF to require the board of directors to make decisions on the basis of formal votes, rather than consensus. The results of these votes could be made public.

(2) Actions to make the IMF more accountable.

(a) The IMF should develop detailed operating principles and procedures. These policies and procedures should be made public. This publication would be analogous to the World Bank's operating manual.⁶⁴ This publication would detail the responsibilities of the IMF staff and the procedures that they should follow in each situation. The publication of this information would enable those people affected by the IMF's actions to understand how IMF policy is made and whether the IMF has acted in conformity with its own rules and procedures in all cases. It would also facilitate efforts by these people to hold the IMF staff accountable for their actions.

(3) Actions to improve the IMF's relations with other international organisations.

(a) Establish formal and more extensive links between the IMF and other relevant international organisations (eg WTO, World Bank, UNICEF, WHO, ILO, etc) at both the senior management and staff levels. These links should include regular meetings, staff exchanges, regular exchanges of information and reports and other publications, participation in joint missions to countries and formal agreements on the division of labour and responsibility between these organisations. It should also include a

means for resolving any disputes that may arise between the parties.

(b) The IMF should renegotiate its relationship agreement with the UN. The objective of this exercise would be to clarify the IMF's responsibilities to the UN and to enhance the ability of the UN to ensure the IMF fully respects the jurisdiction of other specialised agencies.

(c) The IMF should establish an independent review commission, with members drawn from the institutions, the member states and non-state actors, to consider the optimal division of responsibilities between the IMF and the World Bank. One option that the commission should consider is defining their responsibilities not according to function but according to the level of wealth of the country and the type of financing sources on which it relies. Under this proposal the IMF would deal only with the problems of emerging markets that have access to private markets. The World Bank would deal exclusively with countries that are dependent on official sources of funds. The issues of primary concern to industrialised countries would be addressed in other fora. The IMF and World Bank would only participate in these fora to the extent necessary to understand how the issues being discussed would affect their areas of responsibility.

Long-term actions: Those actions that require ratification by the member states

(1) Actions to make the IMF more responsive to its developing country member states.

(a) Amend the Articles of Agreement



to increase the basic votes to at least their original proportion in the total votes at the IMF.

- (b) Amend the Articles of Agreement to introduce a qualified voting procedure that ensures that in votes on policy issues, those countries that use the resources of the IMF vote separately from the industrial countries and the policy measure must obtain the support of a majority of both groups.
- (2) Actions to alter the structure and functions of the IMF to recognise the changing responsibility of the IMF.
 - (a) Implement the findings of the independent review commission that investigated the division of responsibilities between the IMF and the World Bank.

CONCLUSION

The IMF is suffering from serious structural distortions that have slowly developed since the Second Amendment to the Articles of Agreement. These problems create a substantial barrier to the effective functioning of the IMF. They can only be corrected through a broad-ranging reform programme that will overhaul the structure and operating principles of the IMF. Without undertaking this reform programme, it is unclear if the IMF will ever be able effectively to make any useful contributions to solving the complex problems of poverty, inequality and inadequate governance which plague developing countries today.

Unfortunately the problems that exist in the IMF are only the most extreme version of a problem that exists in all international organisations. All those organisations that have great economic power in the developing world — the World Bank, the regional development banks and the WTO — share, although it may be in less extreme forms, the same problems. Those UN specialised agencies that lack adequate resources, influ-

ence and power — such as UNESCO, FAO, UNICEF, WHO — often suffer from the reverse problem. They lack influence and power because they are deemed to be too sensitive to developing countries. The result is that industrialised countries lose interest in them. If international organisations are to perform the global governance functions that were envisaged for them and if they are to play an effective role in dealing with the complex problems that exist in the developing countries and the extreme inequalities of power and wealth that exist between developing and developed countries, they will need to undergo their own reform programmes, that will be complementary to the one this paper proposes for the IMF.

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- South End Press, Boston, MA.; Danaher, K. (ed.) (1994) *Fifty Years Is Enough: The Case Against the World Bank and the International Monetary Fund*, South End Press, Boston, MA.
- (3) See de Vries, M. G. (1986) *The IMF in a Changing World 1945-1985*, IMF, Washington, DC, pp. 14-20.
- (4) See IMF (1944) Articles of Agreement, Art. I (stating purposes of IMF) [hereinafter IMF Articles].
- (5) See de Vries, ref. 3; Blecker, R. A. (1999) *Taming Global Finance*, Economic Policy Institute, Washington, DC, pp. 1-7; Bradlow, D. D. (1996) 'The World Bank, the IMF, and Human Rights', 6 *Transnational Law and Contemporary Problems*, 47, pp. 68-69.
- (6) See IMF Articles, ref. 4, at Art. V, s. 1.
- (7) See Gold, J. (1984) *Legal and Institutional Aspects of the International Monetary System: Selected Essays II*, IMF, Washington, pp. 647-650; Bradlow, ref. 5.
- (8) See Gold, J. (1979) *Legal and Institutional Aspects of the International Monetary System: Selected Essays I*, IMF, Washington, DC, pp. 469-519.
- (9) A good example of this point is that the IMF originally adopted the view that the standby arrangement is not a contract under the influence of the industrialised countries. These countries, which at the time were still using the financing facilities of the IMF, did not wish to be seen by their citizens or other countries as entering into a binding contract with the IMF. They also did not wish to be seen as breaching their obligations if they failed to effect the policies set out in the letter of intent that formed part of their standby arrangement with the IMF. See Gold, J. (1996) *Interpretation: The IMF and International Law*, p. 371 n.125.
- (10) See IMF (1978) Articles of Agreement, amendment I, at <http://www.imf.org/external/pubs/ft/aa/index.htm>; Gold, ref. 7, at pp. 108-113.
- (11) See IMF Articles, ref. 4, at Art. IV, s. 1 (adopted 22nd July, 1944, entered into force 1945, amended effective 1st April, 1978).
- (12) See Gold, ref. 8, at pp. 573-574.
- (13) The IMF's financial arrangements with Russia and Indonesia contained over 100 conditions each. These conditions dealt with most of the issues cited in the text. In the case of the heavily indebted poor countries (HIPC), the IMF requires them to follow participatory processes in developing their poverty reduction strategy papers and to allocate certain portions of their savings from debt reduction to primary health and education budgets. For more information see the IMF website: www.imf.org.
- (14) None of these countries has used the financial resources of the IMF since 1978. See de Vries, ref. 3, at p. 119 (noting that during 1972 to 1978, the IMF approved standby arrangements for Italy and the UK).
- (15) Despite this the IMF continues to devote a considerable amount of resources to its surveillance of these countries. See *Evaluation of Surveillance*, ref. 2.
- (16) See eg IMF, *World Economic Outlook*, from 1982 to 1986.
- (17) See IMF Articles, ref. 4, at Art. I.
- (18) A good example of how the uniformity principle worked in favour of developing countries is the original decision to allocate SDRs among all member states according to their quotas rather than to limit them to the richest countries. See Gold (1979), ref. 8, at pp. 469-470; Ferguson *The Third World and Decision Making in the International Monetary Fund*, Pinter, pp. 119-147.
- (19) See IMF Articles, ref. 4, at Art. IV, s. 3.
- (20) See Gold.
- (21) See *External Evaluation of ESAF*, ref. 2.
- (22) See Bradlow, ref. 5, at pp. 66-70.
- (23) See Gold, ref. 8, at p. 52, pp. 464-466.
- (24) *Ibid.*
- (25) For the text of IMF agreements, see <http://www.imf.org>
- (26) See UN Charter, Art. 102 (1945).
- (27) These rules would include the Vienna Convention on International Agreements and the Vienna Convention on Agreements Between International Organizations and States (not yet entered into



- force). Also see Gold, ref. 8, at pp. 446–447.
- (28) For information on the Financial Stability Forum, see <http://www.fsforum.org>: 'The Financial Stability Forum (FSF) was convened in April 1999 to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. The *Forum* brings together ... national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.' The members of the FSF are Australia, Canada, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Singapore, the UK and the USA.
- (29) For information on the G20, see <http://www.g20.org/indexe.html> (describing the G20 as an informal mechanism for dialogue among systemically important countries within the framework of the Bretton Woods institutional system). 'The G-20 promotes discussion, and studies and reviews policy issues among industrialized countries and emerging markets with a view to promoting international financial stability.' The members of the G20 are Argentina, Australia, Brazil, Canada, China, the European Union, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the UK and the USA.
- (30) This information has been derived from IMF Annual Reports. Also see Gold, ref. 8, at pp. 292–294.
- (31) See IMF Survey, Special Supplement, September 2000 (for list of executive directors and their constituencies); Woods, N. (1988) 'Governance in international organizations: The case for reform in the Bretton Woods institutions', in, *International Financial and Monetary Issues*, Research Papers for the G24, United Nations, New York and Geneva.
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- (34) See eg World Bank (2000) *Can Africa Claim the 21st Century?*; World Bank (1997) *World Development Report: The State in a Changing World*.
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- (36) See Bradlow, ref. 5, at pp. 66–72; Kapur and Webb, ref. 35.
- (37) See Kapur (1998), ref. 35, at p. 98 (quoting a supporter of the IMF in the US Congress: the IMF 'is in fact one of the best possible deals we could ever imagine: Its programs cost us nothing yet it provides enormous benefits for our economy and our foreign policy').
- (38) See IMF Articles, ref. 4, at Art. V, s. 1.
- (39) The World Bank has established the inspection panel partly for this purpose. See generally Bradlow, D. D. (1994) 'International organizations and private complaints: The case of the World Bank inspection panel', *Virginia Journal of International Law*, Vol. 34, p. 553; Shihata, I. F. I. (2000) *The World Bank Inspection Panel: In Practice*, 2nd edn., Oxford University Press, New York.
- (40) See eg the complex range of conditions that were attached to the US legislation authorising the USA to participate in the most recent IMF quota increase. The legislation was only passed after intense debate and a great deal of lobbying. See Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, Pub. L. No. 105-277, ss. 597(b), 602, 610–612, 112 Stat. 2681.
- (41) See the Agreement between the United Nations and the International Monetary Fund, entered into force 15th November, 1947, 109 UNTS 340.
- (42) See eg Omnibus Consolidated and Emer-



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- (43) See eg *Evaluation of Surveillance*, ref. 2; *External Evaluation of ESAF*, ref. 2.
- (44) See Gold, ref. 8.
- (45) See IMF, 'Progress Report on the Heavily Indebted Poor Countries (HIPC) Initiative and Poverty Reduction Strategy Papers (PSRP) Program and Work Priorities in 2001', at <http://www.imf.org/external/np/hipc/2001/020601.htm>.
- (46) See Polak, J. (1997) 'The World Bank and the IMF: A changing relationship', in Kapur, D., Lewis, J. P. and Webb, R. (eds) *The World Bank: Its First Half Century*, Vol. II, Brookings Institution, Washington, DC, p. 473.
- (47) See generally Bradlow, D. D. and Grossman, C. (1995) 'Limited mandates and intertwined problems: A new challenge for the World Bank and the IMF', *Human Rights Quarterly*, Vol. 17, p. 411.
- (48) See eg Meltzer Commission, ref. 2; Schultz, G., Simon, W. E. and Winston, W. B. (1998) 'Who needs the IMF?', *Wall Street Journal*, p. A22, 3rd February.
- (49) See eg Danaher, ref. 2.
- (50) See *Evaluation of Surveillance*, ref. 2; *External Evaluations on ESAF*, ref. 2; Kapur, ref. 35; Woods (2000), ref. 33; 'The IMF: Doctor, savior — Or wastrel?', *Business Week*, 28th December, 1998, p. 12 (criticising the IMF for 'throw[ing] \$22 billion at an economic basket case like Russia ... after billions had disappeared in that black hole before'). The article also discusses the IMF's involvement in Mexico in 1995.
- (51) This position has been advocated by people other than those who are implacable foes of the IMF. See eg Mikesell, R. (1995) *Proposals for Changing the Functions of the International Monetary Fund*, Jerome Levy Economics Institute, Bard College, Working Paper No. 150.
- (52) See eg Feldstein, ref. 2; Browne, R. S. (1996) 'Rethinking the IMF on its fiftieth anniversary', in Griesgraber and Gunter, ref. 2, p. 1.
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- (54) See Blecker, ref. 5 at pp. 39–53.
- (55) For an interesting overview of reform initiatives in the IMF, see Wood, A. (2001) 'Structural Adjustment for the IMF', at www.brettonwoodsproject.org.
- (56) See ref 19, By-laws of the IMF and De Gregorio, J., Eichengreen, B., Ito, T. and Wyplose, C. (1999) *An Independent and Accountable IMF: Geneva Reports on the World Economy, Vol. I*, International Center for Monetary and Banking Studies, Geneva.
- (57) See eg Kirgis, F. L. Jr (1993) *International Organizations in their Legal Setting*, 2nd edn, West Publishing, St Paul.
- (58) The IMF has begun to provide some more resources to the African executive directors.
- (59) The World Bank has had such a committee for a number of years.
- (60) For the IMF information disclosure policy, see <http://www.imf.org>. The IMF set an important precedent for releasing drafts of policies and procedures when it published its draft decision on establishing an independent evaluation office before the decision was taken by the board to do so. Ultimately the board decided to establish such an office and it is in the process of doing so.
- (61) See IMF (2000) 'Making the IMF's Independent Evaluation Office Operational' (August), at <http://www.imf.org/external/np/eval/evo/2000/Eng/evo.htm>.
- (62) *Ibid*.
- (63) See Bradlow, D. (1999) 'An Ombudsman for the IMF', Letter to the *Washington Post*, 24th September.
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The Governance of the IMF: The Need for Comprehensive Reform*

Daniel D. Bradlow**

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** Professor of Law and Director, International Legal Studies Program, American University, Washington College of Law, Washington D.C. and Research Associate, Centre for Human Rights, Faculty of Law, University of Pretoria, Tel: (202)274-4205, email: bradlow@wcl.american.edu

The Governance of the IMF: The Need for Comprehensive Reform¹

Daniel D. Bradlow²

I. Introduction

This paper focuses on the governance of the International Monetary Fund (IMF)³. It argues that the IMF's current governance arrangements are characterized by non-responsiveness to the concerns of key stakeholders in the IMF, lack of accountability, non-representative decision-making, lack of transparency, and poorly defined relations with other international organizations.

It further contends that the basic cause of the IMF's current problems is its failure to adequately adapt its decision-making arrangements and operating practices to the changes that have occurred in the nature and scope of its operations over the past 30 years as it has slowly mutated from a monetary organization into a macro-economically oriented development

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² Professor of Law and Director, International Legal Studies Program, American University, Washington College of Law, Washington D.C. and Research Associate, Centre for Human Rights, Faculty of Law, University of Pretoria, Tel: (202)274-4205, email: bradlow@wcl.american.edu .

³ There is an extensive literature, from many different political perspectives on the many policy and program problems with the IMF. *See, for example, See generally* Joseph E. Stiglitz, GLOBALIZATION AND ITS DISCONTENTS (W.W. Norton & Company, 2002); Paul Blustein, THE CHASTENING: INSIDE THE CRISIS THAT ROCKED THE GLOBAL FINANCIAL SYSTEM AND HUMBLLED THE IMF (PublicAffairs, 2001) (exploring the Asian financial crisis of 1997 and the IMF's role in that crisis); Paul Blustein, AND THE MONEY KEPT ROLLING IN (AND OUT) (PublicAffairs, 2005) (looking at the interconnectedness and causal relationships among Wall Street, the IMF, and Argentina's bankruptcy in 2001). INTERNATIONAL MONETARY FUND, EXTERNAL EVALUATION OF IMF SURVEILLANCE (1999), at <http://www.imf.org/external/pubs/ft/extev/surv/eval.pdf> [hereinafter EVALUATION OF SURVEILLANCE]; EXTERNAL EVALUATION OF THE ESAF, Report by a Group of Independent Experts (June 1998), at <http://www.imf.org/external/pubs/ft/extev/index.htm> [hereinafter EXTERNAL EVALUATION ON ESAF]; Jeffrey D. Sachs, *The IMF and the Asian Flu*, THE AMERICAN PROSPECT, Mar.-Apr. 1998, at 16-21; Anna J. Schwartz, *Time to Terminate the ESF and the IMF*, FOREIGN POLICY Briefing No. 48, Washington, D.C.: Cato Institute (Aug. 26, 1998); Martin Feldstein, *Refocusing the IMF*, FOREIGN AFFAIRS 77(2), at 20-33 (1998); MELTZER COMMISSION, REPORT OF THE INTERNATIONAL FINANCIAL INSTITUTION ADVISORY COMMISSION (2000); J.M. Griesgraber and B. Gunther, THE WORLD'S MONETARY SYSTEM (1996); FIFTY YEARS IS ENOUGH: THE CASE AGAINST THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND, (Kevin Danaher, ed., 1994).

financing institution. Its attempt to squeeze its new functions and relations into its old structures has resulted in distortions in the IMF's relations with its member states and their citizens and with other international organizations, and in its internal governance arrangements.

The problems caused by these distortions are now coming to a head. The reason is that, while the ability of the IMF to provide satisfactory services to its developing country member states has been widely challenged for at least 2 decades, its ability to effectively manage the international monetary system, to respond to the interests of the rising new economic powers, and to deal with the financial and monetary issues of most interest to the rich countries is now also being questioned by leading officials in its most powerful member states.⁴

It follows from this analysis that the current governance reform proposals of the IMF Managing Director⁵—to increase the votes of certain particularly under-represented member states, and to significantly increase the basic votes for all member states—are an inadequate response to the IMF's problems. Even if implemented, they will only address one dimension of the problem.

In order to establish this thesis, the paper is divided into a number of sections. The next

⁴ See, for example, Timothy D. Adams, "The IMF: Back to Basics", in REFORMING THE IMF FOR THE 21st CENTURY, Edwin M. Truman (ed) (2006); King, Mervyn, Reform of the International Monetary Fund, at 2 (speech given at the Indian Council for Research on International Economic Relations in New Delhi, India) (Feb. 20, 2006) (warning that the IMF could slip into obscurity); Dodge, David, The Evolving Monetary Order and the Need for an Evolving IMF, Lecture to the Woodrow Wilson School of Public Affairs, Princeton, March 30, 2006, available at www.bankofcanada.ca/en/speeches/2006/sp06-6.html (arguing for reforms in the IMF's functions and governance so that it can more effectively fulfill its role in the global economy) see also Interview with Lorenzo Bini Smaghi, "Eurozone 'Needs Bigger IMF Role'", Financial Times (London), March 29, 2006 (stating that the IMF "risks becoming a 'mere secretariat' for international policymakers"). (Timothy Adams is the Under-Secretary for International Affairs in the U.S. Treasury, Mervyn King is the governor of the Bank of England, David Dodge is the Governor of the Bank of Canada and Lorenzo Bini Smaghi is a European Central Bank executive board member).

⁵ IMF, The Managing Director's Report on the Funds Medium-Term Strategy (September 15, 2006), at <http://www.imf.org/external/np/omd/2005/eng/091505.pdf>; IMF, The Managing Director's Report on Implementing the Fund's Medium Term Strategy (April 5, 2006), at <http://www.imf.org/external/np/pp/eng/2006/040506.pdf>. Rodrigo De Rato, Progress in Implementing the Fund's Medium-Term Strategy (speech given at the Foreign Correspondent's Club in Tokyo, Japan) (August 3, 2006), available at <http://www.imf.org/external/np/speeches/2006/080306.htm>.

section briefly discusses some key points of the IMF's original governance arrangements and of the impact of the evolution in its operations over the past three decades on its institutional arrangements. Section III describes 5 distortions that have arisen from the combination of the evolution in the IMF's functions and the inflexibility of its decision making structures. Section IV briefly reviews the key governance problems that have resulted from these five distortions. Section V contains a detailed proposal for a comprehensive governance reform program for the IMF.

II. The IMF's Original Governance Arrangements and the Evolution in Its Operations

At the Bretton Woods Conference in 1944, the 44 participating countries, agreed to surrender some of their monetary sovereignty to the IMF in exchange for the benefits of a rules-based monetary system⁶. The participants created the IMF to oversee the system. Its primary function was to ensure that members were following policies that were consistent with the maintenance of the par value they had established for their currency. To encourage compliance with these obligations and as part of the benefits of membership, the IMF provided financial support to any member state experiencing serious balance of payments difficulties⁷.

The operating practices and governance arrangements for the IMF were designed to support these original regulatory and financing functions. Some of their features deserve mention because of their relevance to the IMF's current governance problems.

First, the annual surveillance missions that the IMF conducted in each member state, pursuant to Article IV of its Articles of Agreement, focused on those macroeconomic variables that influenced the ability of the country to maintain the par value of its currency.⁸ Given the

⁶ See Margaret Garritsen de Vries, *THE IMF IN A CHANGING WORLD 1945-1985* 14-20 (1986).

⁷ See, International Monetary Fund, *Articles of Agreement art. I* (1944) (stating purposes of IMF) [hereinafter *IMF Articles*].

⁸ See Garritsen, *supra* note 5; ROBERT A. BLECKER, *TAMING GLOBAL FINANCE* 1-7 (1999); Daniel D. Bradlow, *The World Bank, the IMF, and Human Rights*, 6 *TRANSNAT'L L. & CONTEMP. PROBS.* 47, 68-69 (1996).

nature of its interest, it made sense for the member states to stipulate in the Articles of Agreement, that the IMF should limit its interactions with the member state to its Central Bank and Ministry of Finance⁹.

Second, maintenance of the par value system also placed limits on the conditions the IMF would attach to the financing it offered its member countries. These conditions focused on those macro-economic and monetary issues that were relevant to the restoration of a sustainable balance of payments and par value for the currency. The nature of these conditions placed some limits on the IMF's intrusion into the policy-making process of its member states because it left the recipient state free to choose the specific policy measures for meeting these conditions.

It should be noted that the sensitivity of a change in the par value of a currency led the IMF to seek to keep the substance of the standby arrangements, particularly the Letter of Intent, confidential. Consequently, it developed a formalistic interpretation of the legal nature of a standby arrangement, which denied that the relationship was contractual. This avoided both the obligation to treat the arrangements, as an international agreement that, pursuant to the United Nations Charter, must be made public¹⁰ and the vexing issue of potential liability that could result from states failing to comply with the terms of the standby arrangement¹¹.

Third, since the IMF was designed to be a monetary and not a development institution, it did not formally distinguish between its member states on the basis of their wealth or level of development. Its justifications for this approach were that since all states were participants in the same monetary system, that the ability of each state to maintain its par value was influenced by the same variables, and that they were all vulnerable to the same types of balance of payments problems, they should all be treated in a "uniform" manner. This approach resulted in the IMF offering all member states access to its financing facilities on the same terms and conditions. Similarly, the IMF's annual consultations with each member state covered essentially the same

⁹ See IMF ARTICLES, *supra* note 6, at art. V, § 1.

¹⁰ See U.N. CHARTER art. 102 (1945).

¹¹ See Joseph Gold, The legal character of the Fund's stand-by arrangements and why it matters, IMF (1980).

issues. The IMF concretized this approach by adopting a principle of uniformity as one of its key operating principles¹². The principle made sense during the period of the par value system when many of the rich countries, including the United States, in fact, did make use of the IMF's financing services¹³.

Fourth, the IMF's original governance structure contained some checks on the power of the richest member states, even though the IMF's system of weighted voting gave these countries the greatest influence in the IMF. Since the richest and most powerful states could anticipate having to use the financing services of the IMF, they were unlikely to advocate policies that were unduly burdensome for those states that did use the IMF's services¹⁴. They understood that the policies they supported in the IMF could one day directly affect their own citizens and they could be held accountable for them.

Fifth, the governance structure was also build around the expectation that the IMF's Board of Executive Directors, acting on behalf of the membership, would exercise firm control over the IMF's management and staff.¹⁵ During the period of the par value system, this expectation was realistic because the number of IMF programs was relatively small, the scope of the programs was limited, and the Board was reasonably representative of the IMF membership—the original 39 member states were represented by 12 Executive Directors.

¹² See Joseph Gold, *Legal and Institutional Aspects of the Int'l Monetary System: Selected Essays I*, at 469-519 (1979) [hereinafter Gold I].

¹³ See Joseph Gold, *Legal and Institutional Aspects of the Int'l Monetary System: Selected Essays II*, at 647-650 (1984) [hereinafter Gold II]; Bradlow, *supra* note 8.

¹⁴ A good example of this point is that the IMF originally adopted the view that the standby arrangement is not a contract under the influence of the industrialized countries. These countries, who at the time were still using the financing facilities of the IMF, did not wish to have their policy making options constrained by a publicly available agreement with the IMF. They also did not wish to be seen as breaching their obligations if they failed to affect the policies set out in the Letter of Intent that would form part of their standby arrangement with the IMF. See JOSEPH GOLD, *INTERPRETATION: THE IMF AND INTERNATIONAL LAW* 371 n.125 (1996).

¹⁵ When the IMF was established, John Maynard Keynes had argued for a part-time Board that was less actively involved in the day-to-day affairs of the IMF. However, he lost this argument and the Board became a full time Board that plays an active role in the operations of the IMF. Skidelsky, Robert. *JOHN MAYNARD KEYNES: FIGHTING FOR FREEDOM 1937-1946*. Vol. 3. (Viking, 2000). This suggestion has recently been revived by the Governor of the Bank of England. See King, *supra* note 5.

After the collapse of the par value system, which was formalized with the adoption of the Second Amendment to the IMF's Articles of Agreement in 1978, the IMF lost its well-defined monetary mission¹⁶. If a member state was not expected to maintain any particular value for its currency and could choose its own exchange rate policy, then what was the IMF supposed to be monitoring in its annual consultations with the country?

The amended Article IV provides only limited guidance. It requires each member state to “endeavour to direct its economic and financial policies toward...fostering orderly economic growth...”; to “seek to promote stability by fostering orderly underlying economic and financial conditions”; and to “follow exchange rate policies compatible with the undertakings” of Article IV.¹⁷ The lack of specificity of this language suggests, as in fact has become the case, that the IMF needs to look at any aspect of the member state's economic and financial policies and policy making arrangements that could affect its “orderly economic growth”, its external balance of payments and the value of its currency.¹⁸ In other words, the Second Amendment has resulted in the IMF dramatically expanding the scope of its Article IV consultations.¹⁹ It has also led to an expansion in the range of conditions that the IMF attaches to its financing.²⁰

The Second Amendment had disparate impacts on different groups of IMF member states. In fact, for most of the period since the Second Amendment, IMF member states could be

¹⁶ See IMF ARTICLES OF AGREEMENT, amend. I (1978), at <http://www.imf.org/external/pubs/ft/aa/index.htm>; GOLD II, *supra* note 9, at 108-113.

¹⁷ See IMF ARTICLES, *supra* note 6, at art. IV, § 1 (adopted July 22, 1944, entered into force 1945, amended effective April 1, 1978).

¹⁸ In recent years, as the process of globalization has intensified, the IMF has been forced to expand its surveillance beyond a national focus to include regional and even global considerations. See de Rato, Rodrigo. “The IMF's Medium-Term Strategy: New Priorities, New Directions,” pp. 1, 3. Feb. 9, 2006; de Rato, Rodrigo. “New Priorities for an Era of Globalisation,” p. 3. Jan. 2, 2006; IMF. “The Managing Director's Report on the Fund's Medium-Term Strategy,” pp. 4-6. Sept. 15, 2005.

¹⁹ See Gold I, *supra* note 10, at 573-4.

²⁰ The IMF's financial arrangements with Russia and Indonesia contained over 100 conditions each. These conditions dealt with most of the issues cited in the text. In the case of the HIPC countries, the IMF requires them to follow participatory processes in developing their Poverty Reduction Strategy Papers and to allocate certain portions of their savings from debt reduction to primary health and education budgets. For more information see IMF website <www.imf.org>.

classified into two groups. The first group, which can be called “IMF supplier states”, consists of those countries which, because of their wealth, their access to alternate sources of funds and for political reasons, have no intention of using the IMF’s services in the foreseeable future²¹. These countries do not need to pay particular attention to the views of the IMF²². For these countries, the most important of which are the G-7 countries, the Second Amendment meant that they regained their monetary sovereignty from the IMF and escaped from its control.

The second group, which consists of those member states that need or know they may need IMF financing in the foreseeable future can be called the “IMF consumer” countries. These states must pay careful attention to the views of the IMF because they will influence the conditions that the IMF will attach to the funds it provides the state. The IMF can also influence these countries’ access to other sources of funds.

In recent years, a third group of states has emerged. This group consists of those countries that have good access to private financial markets and have accumulated sufficiently large reserves that they can effectively “self-insure” against the risk of payments and capital account crises.²³ The states in this group, like the IMF supplier states, appear to be in the process of “buying” their independence from the IMF. In fact, it can be argued that a key motivation for the Managing Director’s current governance reform proposal is to give this emerging third group

²¹ None of these countries have used the financial resources of the Fund since 1978. *See* DE VRIES, *supra* note 6, at 119 (noting that during 1972 to 1978, the IMF approved stand-by arrangements for Italy and the United Kingdom).

²² Despite this, the IMF continues to devote considerable amount of resources to its surveillance of these countries. *See* EVALUATION OF SURVEILLANCE, *supra* note 4.

²³ For example, China’s gross official reserves were projected at \$829 billion for 2005, India’s reserves were projected at \$139.5 billion for 2005/2006, and Korea’s reserves are projected by IMF staff to be at \$3.9 billion for 2005. *See* IMF Executive Board Article IV Consultation Reports for data on each country, available at <http://www.imf.org>. Andrew Ball and Richard McGregor. *G20 Calls for Reform of IMF and World Bank*. FINANCIAL TIMES, Oct. 16, 2005; G20, *The G20 Statement on Reforming the Bretton Woods Institutions* (calling for improvement in governance, strategy, and operations of both the IMF and the World Bank). For an interesting discussion of the significance of the size of the reserves, *see* Lawrence H. Summers, *Reflections on Global Account Imbalances and Emerging Market Reserve Accumulation*, L.K.Jha Memorial Lecture, Reserve Bank of India, March 24, 2006, available at www.president.harvard.edu/speeches/2006/0324_rbi.html (showing that reserves of emerging market Asian and oil exporting countries exceed short term debt due within one year by about \$2 trillion and growing each year by several hundred million dollars)

of states an incentive to remain actively engaged with the IMF.²⁴

III. Institutional Implications of the Changing Role of the IMF: The Five Distortions

Since the adoption of the Second Amendment in 1978, the IMF has attempted to implement its expanding range of activities without making any significant changes in its governance arrangements. This means that the IMF has “forced” its new broader functions into its existing decision-making structures and governance arrangements and its existing interpretation of its mandate. This has resulted in five distortions that are undermining the effectiveness of its operations, are increasing hostility to the IMF around the world, and are raising questions about its relevance.

These five distortions are:

- a) The IMF’s relations with the industrialized countries, in particular the G-7;
- b) The IMF’s relations with developing countries that utilize or expect to utilize its financial services;
- c) The IMF’s relations with the citizens of its member countries;
- d) The IMF’s relations with other international organizations; and
- e) Three legal issues.

Each of these problem areas is discussed in more detail below.

A. Relations Between the IMF and The Industrial Countries

Since the adoption of the Second Amendment, the industrial countries, in fact, have relied on their own resources and the private financial markets to meet their financial needs. They have not made use of the resources of the IMF. They have in effect concluded that the IMF is not a politically or economically feasible source of funds for them.

²⁴ See, *supra* notes 4 and 5. See also Peter Costello, *The Global Monetary Fund Needs to Reform Its Quotas*, FINANCIAL TIMES, Aug. 21, 2006 at 9.

The fact that these countries do not intend using the IMF's financing facilities has freed them from any need to defer to any advice the IMF may offer them in their annual consultations. In other words, they have regained the sovereignty that they surrendered to the IMF at the Bretton Woods Conference in 1944.

This does not, however, mean that they have regained full monetary sovereignty. The world's economy has become too integrated for that. Instead these countries, particularly the G-7 have used an alternate set of international fora to resolve all monetary and financial issues that may arise between them. These fora include the G-7, the Organization of Economic Cooperation and Development (OECD), the Basel Committee of Bank Regulators, and the International Organization of Securities Commissions (IOSCO).

When these are not deemed adequate, the G-7 have been willing to create additional fora. For example, after the Asian financial crisis and the near bankruptcy of Long Term Capital Management in 1998, the G-7 became concerned about the regulatory framework for the international financial markets. These countries decided that they needed a mechanism through which they could coordinate national regulation of financial markets and financial institutions. Consequently, they created the Financial Stability Forum²⁵ in which the regulators of the banking, securities and insurance industries of major industrial countries and financial centers meet together with representatives of the IMF, the World Bank and the BIS to discuss regulatory issues of mutual concern. They also created the G-20²⁶, which consists of the G-7 plus some

²⁵ For information on the Financial Stability Forum, see <http://www.fsforum.org> ("The Financial Stability Forum (FSF) was convened in April 1999 to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. The *Forum* brings together . . . national authorities responsible for financial stability in significant international financial centers, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts."). The members of the FSF are: Australia, Canada, France, Germany, Hong Kong, Italy, Japan, Netherlands, Singapore, United Kingdom, and the United States.

²⁶ For information on the G-20, see <http://www.g20.org/indexe.html> (describing the G-20 as an informal mechanism for dialogue among systemically important countries within the framework of the Bretton Woods institutional system). "The G-20 promotes discussion, and studies and reviews policy issues

other key industrial and emerging market countries.

Since the industrialized countries have no intention of using the IMF, it is reasonable to question why the G-7 have continued to support the IMF. The reason is that they find its influence over poor and middle income countries undergoing transformations or experiencing serious macro-economic and monetary problems useful. In particular, they appreciate its ability to compel these countries to adopt stabilization and adjustment policies that they deem acceptable. They also support its role as the crisis manager in countries experiencing debt problems. In short, they value having an organization that can focus on the problematic areas of the global financial system, leaving them free to shape that system to suit their own needs.

The wealth and independence of the industrialized countries, particularly the United States, Japan, Germany, Great Britain and France, also ensures that they are the dominant force within the decision making structures of the IMF. Their dominance is significantly enhanced by two developments that have occurred in the IMF since its formation in 1944. First, the number of IMF Executive Directors has grown more slowly than the number of IMF member states. The original 39 member states were represented by a 12 member board of directors. Today the 184 members are represented by a board of 24 members. Originally, only the 5 biggest shareholders had their own executive directors and the remaining 34 member states were represented by the other 7 directors. This meant that each of these 7 directors represented on average slightly less than 5 states. Today, of the 24 member Board, in addition to the 5 executive directors representing the five largest shareholders another 3 directors represent single countries. Thus, today 16 directors represent the remaining 176 member states. This means that each of these directors represents on average slightly less than 11 states. In fact, some executive directors, for example the two directors representing sub-Saharan Africa represent considerably more than 11 states²⁷.

among industrialized countries and emerging markets with a view to promoting international financial stability.” The members of the G-20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, and the United States. *Id.*

²⁷ See, IMF SURVEY, Special Supplement, September 2005 (for list of Executive Directors and their

This change in the average size of the constituencies represented by the executive directors has an important impact on the power relations in the IMF's decision making process. It means that those states that have permanent representation on the Board have a distinct advantage in having their views heard in the Board. It is unlikely that a director who represents 10-11 states can advocate for the views of each of those states as effectively as a director who only represents one state. It is also unlikely that such a director can play the same active role in policy issues in the IMF as an executive director who represents only one state.

In this regard, it is important to note that each of the G-7 countries always has a national of their country on the Executive Board, despite the fact that only 5 of the 7 countries have appointed Executive Directors. In addition, the Eurozone member states hold 6-8 of the 24 seats on the Executive Board. Furthermore, in 5 out of 6 cases in which an Executive Director represents both developing and industrialized countries, the Executive Director is from an industrialized country, and the in the other 1, the Executive Director is usually from an OECD member state²⁸. The result is that of the 24 directors, 11 are currently from OECD countries and 9 are from industrialized countries.

The numerical advantage of the industrialized countries' representation on the Executive Board is significant even though the Board tends to operate by consensus. The reason is that these countries, because of their permanent presence on the Board, are able to develop institutional memories and expertise in how to function in the IMF. This enhances their ability to negotiate effectively and to shape the issues and the decisions around which the consensus must form²⁹.

constituencies); Ngaire Woods, "Governance in International Organizations: The Case for Reform in the Bretton Woods Institutions" in INTERNATIONAL FINANCIAL AND MONETARY ISSUES (UNDP, 1988); Rustomjee, Cyrus, IMPROVING SOUTHERN VOICE ON THE IMF BOARD: QUO VADIS SHAREHOLDERS? IN ACCOUNTABILITY OF THE INTERNATIONAL MONETARY FUND, at 23-25 (Cairn & Wood, eds.) (Ashgate Publishing, 2005).

²⁸ See, IMF SURVEY, *supra*, note 27.

²⁹ See Ngaire Woods, *Governance in International Organizations: The Case for Reform in the Bretton Woods Institutions*, Woods, Globalization and International Institutions, in THE POLITICAL ECONOMY OF

The result has been to enhance the G-7's control over the policy agenda in the IMF. However, because these countries are effectively independent of the IMF, they never have to live with the consequence of the policies that they make for the IMF's operations. This means that they can make policy that is only of limited interest to their own citizens but that is of immense interest to people in developing countries who have no ability to hold them accountable for their decisions or actions. This situation of decision makers having power with accountability to people who do not have to live with the consequences of their decisions but without accountability to those most affected by their decisions is a situation ripe with potential for abuse.

The second development relates to the composition of the voting rights of each member state. Each state's vote consists of 250 basic votes plus 1 vote for each SDR 100,000 it contributes to the IMF's general resources. The basic vote is intended to reflect the general principle of the sovereign equality of states. The remaining portion of the vote is intended to reflect the size of the country and its importance in the world economy. Since the establishment of the IMF in 1946, the number of total votes in the IMF has been increased due to the IMF membership growing from 39 in 1946 to 184 today and the need to expand the total resources of the IMF. However, there has been no change in the basic vote. The result is that today the basic votes form a significantly smaller portion of the total vote than was the case in 1946. In 1946 the basic votes accounted for 11.3% of the total vote. Today the basic vote accounts for only 2.1%. This means that the portion of the IMF's voting system that offered the smaller and weaker states some counterweight to the dominance of the richest and biggest countries in the IMF has been reduced in importance³⁰.

GLOBALIZATION, at 208-209. Carlo Cottarelli, *Efficiency and Legitimacy: Trade-offs in IMF Governance*, IMF Working Paper WP/05/107, 21-24 (2005) (discussing the overall scarcity of human resources at the IMF). Kahler, Miles, *Internal Governance and IMF Performance* 1-6 (prepared for Institute of International Economics' Conference on IMF Reform, 2005) available at <http://irpshome.ucsd.edu/faculty/mkahler/>; Rustomjee, *supra* note 27.

³⁰ This information has been derived from IMF Annual Reports. Also see GOLD I, *supra* note 9, at 292-294; Baira, Ariel, *The Governance of the IMF in a Global Economy*, in CHALLENGES TO THE WORLD BANK AND IMF 13, 14-15. Anthem Press, 2003; Carin, Barry and Angela Wood. ACCOUNTABILITY OF

B. Relations Between the IMF and Its Consumer Member States

Since 1978 all the states which have utilized the financial services of the IMF are low or middle-income developing countries or the so-called transitional countries. For present purposes these consumer states can be divided into two groups. The first group consists of those countries that are classified as emerging markets and, under normal circumstances, have access to private financial markets. Many countries in this group need the IMF's support to satisfy private investors that they have adopted and are implementing good macroeconomic policies and that they are "suitable" for private investment. Thus even though this group of countries only needs IMF funding when they are unable to raise sufficient funds from private sources because of a debt or some other financial crisis, they are dependent on the IMF giving their economic policy performance a favorable review. This in turn is influenced by how they respond to the advice the IMF gives them in their annual consultations.

It is interesting to note that a number of these countries have recently pre-paid their obligations to the IMF so that they can try and escape from its oversight³¹. In addition, a number of the Asian countries have attempted to escape the constraints that the IMF may impose on them by building up sufficient reserves to withstand any future payments crisis that they may face³².

THE INTERNATIONAL MONETARY FUND at 10-13. Ashgate Publishing, 2005; Rapkin, David P. and Jonathan R. Strand, *Reforming the IMF's Weighted Voting System*, 13-14 (Blackwell Publishing 2006); Truman, Edwin M., *A Strategy for IMF Reform* (Institute for International Economics, 2006).

³¹ See, for example, IMF Press Release No. 05/19, Russian Federation Completes Early Repayment of Entire Outstanding Obligations to the IMF (Feb. 2, 2005); IMF Press Release No. 05/278, Argentina Announces Its Intention to Complete Early Repayment of Its Entire Outstanding Obligations to IMF (Dec. 15, 2005); IMF Press Release No. 05/275, Brazil Announces Intention to Complete Early Repayment of Entire Outstanding Obligations to IMF (Dec. 13, 2005); Chris Giles and Andrew Balls, Call for IMF Reform Draws Muted Echo, *FINANCIAL TIMES*, Feb. 24, 2006, at 3.

³² For example, China's gross official reserves were projected at \$829 billion for 2005, India's reserves were projected at \$139.5 billion for 2005/2006, and Korea's reserves are projected by IMF staff to be at \$3.9 billion for 2005. See IMF Executive Board Article IV Consultation Reports for each country, available at <http://www.imf.org>. For an interesting discussion of the significance of the size of the reserves, see Lawrence H. Summers, *Reflections on Global Account Imbalances and Emerging Market Reserve Accumulation*, L.K.Jha Memorial Lecture, Reserve Bank of India, March 24, 2006, available at www.president.harvard.edu/speeches/2006/0324_rbi.html (showing that reserves of emerging market

These efforts have been interpreted as a vote of no-confidence in the IMF and are posing an important financial challenge to the IMF³³. Furthermore, to the extent that these countries succeed in their efforts to assert monetary independence, they will become a third group of member states that can relate to the IMF in ways that are more similar to those of an IMF supplier country than to those of consumer countries. To a significant extent, the current interest in governance reform at the IMF is attributable to the institution's and its more powerful member states' interest in keeping this emerging third group of countries engaged in the IMF.

The second group consists of those countries which because of their poverty or unstable political conditions are substantially dependent on official sources of funds. This group, in addition to needing the IMF's financial support, require its approval of their policies because their other official funders tend to rely on the IMF's advice in making their funding decisions.

While there are significant differences between the countries in the second group of IMF consumer states, they all share a common characteristic. Although the challenges that these countries face have a macroeconomic dimension, the primary cause of their social and economic, including macroeconomic, problems lies in the governance of their societies. In particular their problems are caused by weaknesses in their institutional arrangements and technical capacities which limit their ability to effectively make and implement policy.³⁴ Although these structural issues are outside the scope of the IMF's specialized area of competence it has attempted to address them³⁵. This means that increasingly, in both its policy advice and in the conditions that it attaches to its financing, the IMF is addressing issues like bankruptcy laws, legal and judicial reform, allocations of public budgets, privatization, environmental issues, social safety nets, and banking reform that are not monetary or macro-economic issues. The specificity and micro

Asian and oil exporting countries exceed short term debt due within one year by about \$2 trillion and growing each year by several hundred million dollars)

³³ Andrew Balls and Richard McGregor, *G20 Calls for Reform of IMF and World Bank*, FINANCIAL TIMES, Oct. 16, 2005.

³⁴ See, for example, The World Bank, *Can Africa Claim the 21st Century?* (2000); The World Bank, *World Development Report: The State in a Changing World* (1997).

³⁵ See Devesh Kapur, *The IMF: A Cure or a Curse?*, FOREIGN POL'Y (June 1998) (hereinafter *The IMF*); Devesh Kapur and Richard Webb, *Governance Related Conditionalities of the International Financial Institutions*, G-24 Discussion Paper Series No.6 (2000); THE POLITICAL ECONOMY OF GLOBALIZATION.

nature of these requirements highlight the evolution of the IMF from a monetary institution to a development financing organization.

The broadening range of issues addressed in its annual surveillance missions and in the conditions it attaches to its funding is changing the nature of the relationship between the IMF and these countries³⁶. In the days of the par value system, the IMF limited its influence over national policy making by concentrating its advice and the conditions attached to its finance to discrete macroeconomic variables. This imposed a restraint on the IMF's involvement in domestic policy making because it left the member state's government free to decide on the actual measures it would adopt to achieve these macroeconomic targets. The increased range of issues the IMF considers and the specificity with which it addresses these issues means that this restraint has now been removed. The result is that the IMF has become an active participant in the policy making process of this group of member states. In fact, because of its influence over their access to external financing, the IMF is often the decisive voice in this processes.

The combination of the IMF's gate keeping functions and its *de facto* role in national policy-making further tips the balance of bargaining power in favor of the IMF in both the annual consultations and in the negotiations with the consumer states over the policy conditions to be attached to IMF financing. Moreover, given the dominance of the G-7 and the other industrialized countries in the IMF, there is a significant risk (that has often in fact been realized³⁷) that these countries will use the IMF to impose their views of good political and economic policies on the developing countries. In fact, many people in developing countries already see the IMF more as a political organization that is biased in favor of the rich countries and their interests than as the technically specialized and politically neutral organization that it was intended to be.

³⁶ *Id.*

³⁷ See Kapur, *The IMF*, *supra note 47*, at 98 (quoting a supporter of the IMF in the U.S. Congress: the IMF "is in fact one of the best possible deals we could ever imagine: Its programs cost us nothing yet it provides enormous benefits for our economy and our foreign policy"); Paul Blustein, *The Chastening: Inside the Crisis That Rocked The Global Financial System and Humbled the IMF* (PublicAffairs, 2001) (exploring the Asian financial crisis of 1997 and the IMF's role in that crisis).

This problem is exacerbated because the consumer countries are unable to effectively use the Board of Executive Directors or the Board of Governors to limit the staff and management's discretion in the IMF's operations. As we have seen above, the consumer states are imperfectly represented on the Board of Executive Directors. Furthermore, it is unrealistic to assume that the consumer states can hold the IMF accountable through their representative on the Board of Governors. There are two reasons for this. The first is that this is not the appropriate body in which to challenge individual operational management decisions. Second, it is not realistic to assume that a member state's IMF Governor will be willing to raise specific operational issues during the infrequent meetings of the IMF Governors.

The IMF's expanded role in its developing country member states has also changed the range of actors with whom it must directly interact in these states. Prior to 1978, the IMF could reasonably limit its direct interactions to the Central Banks and the Ministries of Finance³⁸. Today, however, the IMF's operations directly affect many, if not all, government ministries and the lives of all those people who will be governed by the policies that it helps make. This means that it is no longer feasible for the IMF to limit its interactions to the Central Bank or the Ministry of Finance. In fact, without directly interacting with a broader range of both governmental and non-governmental actors in the member states, the IMF is unlikely to obtain all the information it needs to play an effective policy making role. For example, it needs to consult with government ministries whose budgets and policies will be affected by the IMF's funding conditionalities. It also needs to consult with the legislators who must pass the laws that the IMF policies require. To be an effective and credible policy maker, the IMF also should hear the views of all those stakeholders who have the ability to influence the success or failure of those policy decisions and will be directly affected by them. To date, the IMF, utilizing informal procedures has consulted with some of these actors. However, it has not yet developed either formal procedures for ensuring that all relevant stakeholders are consulted or through which the government or citizens of these member countries can hold the IMF accountable for its actions in the policy making process.

³⁸ See IMF ARTICLES, *supra* note 7, at art. V, § 1.

The IMF has recognized that its programs have become unduly intrusive. In 2002, it issued new guidelines on conditionality that are intended to make the conditions more focused on its core areas of competence and to reduce the number of conditions to those that are essential to the achievement of the program's objectives. These new guidelines, however are drafted in relatively non-specific terms and it is not clear how effective they will be in reducing the IMF's intrusion into its members domestic affairs, although they do appear to have resulted in some reduction in the average number of conditions attached to IMF financial programs.³⁹

It is important to note, however, that a reduction in quantity of conditions does not necessarily translate into a reduction in intrusiveness, particularly given that the new guidelines allow the IMF to continue engaging in institutional and governance reform in the monetary and financial area. In addition, the previous IMF guidelines on conditionality also attempted to impose limits on the scope of conditionality but these were largely ignored in practice.⁴⁰

C. IMF Relations with the Citizens of its Member States

The creators of the IMF, like the creators of most international organizations, believed that it was not necessary for the IMF to have any direct interaction with non-state actors. They assumed that it would be sufficient for the IMF to interact with its member states through their representatives on the Board of Governors and the Executive Board and, in its specific operations, through the Ministry of Finance and the Central Bank. The creators also assumed that

³⁹ See IMF, *Guidelines on Conditionality* (2002), available at <http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.pdf>; Buirra, Ariel, ed. *Challenges to the World Bank and IMF: Developing Country Perspectives*, pp. 55-90. Anthem Press, 2003; Eggers, Andrew et. al., *Democratizing the IF* in ACCOUNTABILITY OF THE INTERNATIONAL MONETARY FUND, at 40 (Barry Cairn & Angela Wood, eds.) (Ashgate Publishing, 2005); Eldar, Ofer. "Reform of IMF Conditionality: A Proposal for Self-Imposed Conditionality." 8 JOURNAL OF INT'L ECON. LAW 509 (2005).

⁴⁰ See *Guidelines*, IMF, *Guidelines on Conditionality* (2002), available at <http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.pdf>; Buirra, Ariel. *An Analysis of IMF Conditionality*, in CHALLENGES TO THE WORLD BANK AND IMF: DEVELOPING COUNTRY PERSPECTIVES, at 67-69 (Anthem Press 2003). Eggers, Andrew et al. *Democratizing the IMF*, in ACCOUNTABILITY OF THE INTERNATIONAL MONETARY FUND, *supra* note 19 at 39-40

this arrangement would provide sufficient accountability to all stakeholders because these representatives would be responsible to their governments, who in turn would be held accountable, through elections and administrative procedures, by their citizens.

These beliefs about the relationship of the IMF to non-state actors are no longer valid. Given, that the IMF now actively participates in the policy making processes of those member states that utilize its resources, it is no longer adequate for the IMF to limit its interactions to their Central Banks and Ministries of Finance. For the IMF to be an effective actor in the policy making process it must consult with both other governmental agencies and non-governmental actors. This means that the IMF is now interacting with non-state actors and the policies it is helping to make are directly affecting these non-state actors.

The basic principles of good governance which the IMF advocates so eloquently to the governments of its member states should guide its own conduct towards those directly affected by its policy-making activities⁴¹. After all, there is no obvious reason why the IMF, when it “descends”⁴² into the national policy-making process should be less accountable to those people directly affected by its decisions than other actors in this process. This means that the IMF needs to establish a formal and direct means through which those directly affected by its actions in the national policy making process can hold the IMF accountable. It is no longer sufficient for the IMF to assume that it can rely on indirect forms of accountability to these non-state actors.

To be sure there may be practical difficulties in designing an accountability mechanism

⁴¹ For discussion of developments in and requirements for international organizational accountability, see Int'l Law Assoc. (ILA), *Accountability of International Organisations- Berlin Conference Final Report* (2004) (the author was a member of the ILA committee that drafted this report); Int'l Law Comm. (ILC), *First Report on Responsibility of International Organizations*, UN Doc. No. A/CN.4/532 (2003); ILC, *Second Report on Responsibility of International Organizations*, UN Doc. No. A/CN.4/541 (2004); ILC, *Third Report on Responsibility of International Organizations*, UN Doc. No. A/CN.4/553 (2005).

⁴² The analogy is to the law of sovereign immunity, according to which, a sovereign will lose its immunity to being sued when it “descends” into the market place and engages in activity that by its nature is commercial. See, for example, *Alfred Dunhill v. Republic of Cuba*, 45 U.S. 682, 96, S.Ct 1854 (1974) at 1862 (quoting *Bank of the United States v. Planter's Bank of Georgia*, 22 U.S. 904, (1824) . Also see Foreign Sovereign Immunities Act Foreign Sovereign Immunities Act, 28 U.S.C. §§1602-1611 (1976).

that is both suitable for an international organization and respectful of the member state's sovereignty. However, these problems have been dealt by the multilateral development banks and there is no reason why they cannot be overcome by the IMF⁴³.

There are other problems that arise because the IMF has no formal channels through which it can communicate with non-state actors in its member states. Under the current operating principles, the IMF, out of respect for the sovereignty of its member states, only communicates with non-state actors in a member state if it obtains the consent of the government, which can result in the IMF meeting with an inadequate range of non-state actors in its member states. Consequently, it is at high risk of making policy decisions for the country on the basis of insufficient information about the likely reception that the policies will receive and their chances of success. Furthermore, the failure to establish formal mechanisms through which it communicates with non-state actors and which are independent of the government has an adverse impact on the IMF's policies and its relations with the citizenry of these countries. They come to see the IMF as unapproachable and as an elitist, ideological institution that is uninterested in learning about the views of those who will be most affected by its policies.⁴⁴

Another dimension to the IMF's relationship with non-state actors is the impact of its evolving operations on its relations with the citizens of its supplier states. Although these actors are not directly affected by the actions of the IMF, many of them see themselves as being indirectly affected by the IMF's operations. They argue that it is their taxes that support the IMF and that, currently, these taxes are being spent to support policies and operating principles that they oppose. Consequently, these citizens have begun demanding changes in the operations of

⁴³ The World Bank has established the Inspection Panel partly for this purpose. *See generally* Daniel D. Bradlow, *International Organizations and Private Complaints: The Case of the World Bank Inspection Panel*, 34 VA. J. INT'L L. 553 (1994); IBRAHIM F. I. SHIHATA, *THE WORLD BANK INSPECTION PANEL: IN PRACTICE* (2nd ed., 2000); Daniel D. Bradlow, *Private Complainants and International Organizations: A Comparative Study of the Independent Inspection Mechanisms in International Financial Institutions*, 36 GEO. J. INT'L L. 403, 411-420 (2005).

⁴⁴ The IMF has made some efforts to address this problem. In October 2003 it issued guidelines for IMF staff on interacting with civil society organizations. *See* IMF, *Guide for IMF Staff Relations with Civil Society Organizations*, October 10, 2003, *available at* <http://www.imf.org/external/np/cso/eng/2003/101003.htm>.

the IMF. The NGOs that represent them have used their access to their own governments and to the media in the industrial world to raise these concerns. These NGOs have had some success in influencing the IMF. Ironically, the influence of these NGOs in the IMF is derived in part from the disproportionate influence and power of the industrialized countries in the IMF.

D. The IMF's Relations with Other International Organizations

The original conception of the creators of the United Nations system was that each specialized agency, of which the IMF is one, would exercise its authority within the limited scope of its specialization and that the U.N. Economic and Social Council would be the forum in which their activities would be coordinated⁴⁵. Each specialized agency, in part to facilitate this coordination, entered into a relationship agreement with the United Nations. This relationship agreement was ostensibly based on the fact that the specialized agency was subordinate to the United Nations. The relationship agreement between the IMF and the UN⁴⁶ however amounts to a declaration of independence. While it acknowledges that the IMF is a specialized agency of the UN, it relieves the IMF of any significant responsibilities to the UN and denies the UN any meaningful role in the affairs of the IMF.

The effective independence of the IMF from the UN has become a problem as the scope of the IMF's operations has expanded beyond its original monetary function. Now that the IMF is involved in such issues as law reform, poverty alleviation, labor issues, social welfare, budgetary allocations for health and education, environment, and trade liberalization, its operations are encroaching into the jurisdiction of other specialized international organizations like the World Bank, the ILO, WHO, UNICEF, UNEP and the WTO.

⁴⁵ See UN CHARTER, art. 61-72 (establishing EcoSoc and setting out its purposes and functions).

⁴⁶ See Agreement between the United Nations and the International Monetary Fund, entered into force 15 November 1947, 109 U.N.T.S. 340.

E. Three Legal Issues

The three legal issues are uniformity, the treatment of political considerations by the IMF and the legal nature of the standby arrangement. It is important to note that each of these issues arises from the way in which the IMF has interpreted its mandate and are not explicit requirements of the Articles of Agreements. They are each discussed below.

As was explained above, the IMF, in implementing its mandate, developed the principle of uniformity. This principle results in the IMF granting all states equal access to its financing and other services without drawing any distinctions between its member states based on their wealth, size, level of development, or importance in the international monetary system. It has had the effect of protecting the richest countries from having to grant special treatment to developing countries in the use of the IMF's general resources. It has also offered developing countries some protection against being discriminated against by the richer member states⁴⁷.

The Articles of Agreement also require the IMF, when conducting its annual consultations with its member states and when designing the conditions it attaches to its funding, to pay due regard to social and political conditions in the country.⁴⁸ The IMF has historically interpreted this requirement as prohibiting it from being influenced by political (that is non-economic) considerations in its dealings with its member states.⁴⁹

These two interpretations of its legal mandate pose a number of problems for the IMF. First, the principle of uniformity made sense when the IMF functioned purely as a monetary institution and all its member states, in fact, were utilizing its services. However, it does not

⁴⁷ A good example of how the uniformity principle worked in favor of developing countries is the original decision to allocate SDRs among all member states according to their quotas rather than to limit it to the richest countries. See GOLD I, *supra* note 10, at 469-470; Mohammed, Aziz Ali, *Who Pays for the IMF?* in CHALLENGES TO THE WORLD BANK AND IMF 37 (Ariel Buira, ed.) (Anthem Press, 2003); Ferguson, Tyrone, *The SDR and Related Questions: The Origins of the Quest for Participation in Decision Making in The Third World and Decision Making in the International Monetary Fund: The Quest for Full and Effective Participation* 119-147 (Pinter Publishers 1988).

⁴⁸ See IMF ARTICLES, *supra* note 6, at art. IV, § 3.

⁴⁹ See Gold. See also IMF ARTICLES, *supra* note 6, at art. XII, § 4(c).

make sense when its services are only being utilized by its developing country member states. For example, uniformity precludes the IMF from creating mechanisms that protected the poorest and weakest states from the undue exercise of power by the richest and most powerful states in the decision-making bodies of the IMF. Another example of the problems that uniformity creates is the Poverty Reduction and Growth Facility (PRGF). When the IMF decided that it needed to create a special facility exclusively for the poorest of its member states, it could not do so with its general resources but had to create a special fund for this purpose. Since this requires specific contributions from member states, the PRGF has inevitably become politicized. Both examples serve to demonstrate that the performance of the IMF could be improved if it could distinguish between different categories of member states both in regard to its services and resources and in its governance arrangements.

Similarly, the IMF's interpretation of the requirement that it pay due regard to social and political conditions in its member countries made sense when the IMF's operations were limited to monetary issues. However, it is neither prudent nor principled for an organization that attaches conditions to its funding that relate to governance, corruption, budgetary allocations and privatization to pretend that it does not consider political and social factors in its operations. The only function that the current interpretation serves is to obscure what political considerations the IMF does view as relevant to its operations, what principles it applies in making its decisions, and what process it follows in reaching them. The lack of clarity on this issue also leaves undefined the outer limits of the IMF's specialized economic mandate⁵⁰. This results in IMF decisions appearing arbitrary or influenced by the interests of its richer and more powerful member states, thereby undermining confidence in the fairness and objectivity of the IMF.

A third legal problem for the IMF arises from the IMF's characterization of the legal nature of the standby arrangement through which it provides much of its financing to its member states. The standard documentation used in these transactions are a letter of intent, usually written by the government of the member state to the IMF, and the decision of the IMF's Executive Board. For many years the IMF has argued that this arrangement is *sui generis* and is

⁵⁰ See Bradlow, *supra* note 8, at 66-70.

not a legal contract⁵¹. Until a few years, the IMF relied, in part, on this characterization to avoid publicizing the member state's Letter of Intent⁵². It also justifies this characterization by arguing that it protects a member state that does not meet the performance criteria or other requirements of its standby arrangement from incurring any legal liability.

The IMF's formalistic interpretation of the nature of this transaction had a certain utilitarian value when the IMF functioned as the manager of the par value system, and the conditions attached to the financing included a change in the par value of a currency. It is not, however, clear that the same considerations apply to its current development functions. In fact, the IMF seems to have recognized as much. In recent years, as part of its efforts to promote transparency, it has encouraged its member states to publish its Letter of Intent.⁵³ Nevertheless, the IMF has not changed its view of the legal nature of the standby arrangement. This is problematic for two reasons. First, if the stand by arrangements, like World Bank contracts, were classified as international agreements they would be registered with the United Nations and would become public documents⁵⁴. Consequently, the IMF could require, rather than encourage, member states to publish these letters of intent. This would more effectively advance the IMF's goal of promoting transparency than the current arrangements.

Second, as IMF transactions become more complex and the IMF increases the number of conditions it attaches to its standby arrangements there is a greater need for these agreements to be subjected to predictable principles of interpretation. The reason is that, when dealing with conditionalities like benchmarks or those related to governance, for example, it is possible for disagreements to arise about what constitutes sufficient compliance with the terms of the standby to justify disbursing the next tranche of the funds. If these transactions were viewed as international agreements, they would be subject to predictable public international law rules for

⁵¹ See GOLD I, *supra* note 10, at 52, 464-66.

⁵² See *id.*

⁵³ For the text of IMF agreements, see <http://www.imf.org>. See also IMF, *The Fund's Transparency Policy* (Statement by Horst Kohler) (2002); IMF, Public Information Notice No. 02111 (2002); IMF, ANNUAL REPORT, Chapters 7-8 (April 2005) (providing details on the IMF's attempts at increased transparency for the benefit of stakeholders and other nonofficial groups).

⁵⁴ See U.N. CHARTER art. 102 (1945).

interpreting international agreements⁵⁵. Under the current IMF treatment of standby arrangements there are no obviously applicable rules of interpretation. In addition, if they were seen as international agreements, the standby arrangements would include dispute settlement clauses that would establish clear procedures for resolving disputes between the IMF and the member state over the interpretation and implementation of the standby arrangement⁵⁶.

IV. Problems Created by the Five Distortions

The five distortions discussed above are creating a number of problems for the IMF. The most significant of these are discussed below.

A. The Disconnect Between Power and Responsibility⁵⁷

As was discussed above, the industrialized countries, particularly the G-7, have accumulated great power in the IMF even though they are not interested in the services of the IMF for themselves. This enables them to make policy for the IMF without having to live with the consequences of the IMF's policies and actions. Consequently, most of their own constituents have little interest in the IMF or its policies and limited incentive to support their government's financial contributions to the IMF. The governments of these countries, therefore, are free to develop their policies for the IMF without paying appropriate attention to the concerns of the developing countries or to the situations in which these policies must be implemented. In addition, this situation amplifies the voices of those Northern NGOs who have an interest in the

⁵⁵ These rules would include the Vienna Convention on the Law of Treaties (U.N. Doc. A/CONF. 39/27, May 23, 1969) and the Vienna Convention on the Law of Treaties Between States and International Organizations or Between International Organizations (U.N. Doc. A/CONF. 129-15) (this treaty has not yet entered into force). *Also See* Gold I, *supra* note 10, at 446-447.

⁵⁶ One Model that the IMF could follow in drafting dispute settlement provisions is the arbitration clause contained in the general conditions incorporated in all IBRD loan agreements and all IDA credits. *See* IBRD, *General Conditions for Loans*, July 1, 2005, Article VIII, available at http://siteresources.worldbank.org/INTTOPGENCON/Resources/IBRD_GC_05.pdf; IDA, *General Conditions for Credits and Grants*, July 1, 2005, Article VII, available at http://siteresources.worldbank.org/INTTOPGENCON/Resources/IDA_GC_05.pdf

⁵⁷ *See generally* ILA, *supra* note 52, at Part 1, § 1.

IMF and other international development issues. While many of these NGOs have utilized this situation to achieve a great deal of good, the reality is that they, like their governments, can influence the policy of the IMF without having to live with the consequences of their proposals.

One result of this situation is that proposals that impose substantial burdens on already overloaded developing country governments or that make unrealistic assumptions about the access of these countries to private financing are able to receive serious consideration⁵⁸.

*B. The IMF Management and Staff's Lack of Accountability*⁵⁹

As was discussed above, the IMF's existing channels of accountability are insufficient. The problems in the existing channels of accountability have three important operational implications for the IMF. The first is that the IMF staff and management are effectively operating without any accountability. However, if the IMF staff are making policy in the member states, there is no obvious reason why they should be less accountable to those affected by the policies than the other participants in the policy-making process. In fact, it undermines the IMF staff and management's credibility when they advocate accountability as an aspect of good governance in its member states but do not apply the principle to themselves.

The second is that the IMF does not provide much guidance to the staff on how they should perform their responsibilities when they act in this policy-making capacity. For example, it does not give them formal guidance on such issues as what obligations they owe to those affected by the policies, what factors they should consider in making decisions in this process, and to whom they owe their primary responsibility. The lack of such guidance makes it possible for each staff member or mission team to exercise great discretion in its operations. It also makes it hard to hold the staff accountable. In this regard it is important to note that, unlike the World Bank, the IMF does not have a publicly available operational manual that contains the

⁵⁸ See, for example, Omnibus Consolidated and Emergency Supplemental Appropriations Act, Pub. Law No. 105-277 (1998); Meltzer Commission, Report of the International Financial Institution Advisory Commission (2000).

⁵⁹ See generally ILA, *supra* note 52, at Part 1, § 1.

operational policies and procedures that its staff should follow in the conduct of their duties⁶⁰.

Third, the IMF is performing its policy-making functions without establishing any formal mechanisms through which those non-state actors most affected by its actions can communicate directly with the IMF. In fact, the IMF is not unaware of this problem and it often engages in informal communications with these affected parties⁶¹. However, this means that the IMF, in consultation with the government of the member state, is choosing with which non state actors it communicates and is setting the terms for this communication. A more formal procedure for communication with these non-state actors -- such as an explicit requirement that all IMF missions hold a public hearing in the country they are visiting or an explicitly recognized right to make written submissions -- would ensure that many more interested non-state actors have a meaningful opportunity to communicate with the IMF. The IMF's failure to establish such procedures contradicts the principles of participation and the need for transparent governance procedures that it advocates to its member states. It also suggests that the IMF is often making policy without having access to all the relevant information.

C. The IMF and Other International Organizations

The expansion of the IMF's scope of operations has resulted in the IMF encroaching into the areas of responsibility of other specialized agencies. While in some cases the IMF may attempt to have communications with these organizations, there is no formal agreement designed to ensure regular communications at the staff level. The only international organizations with which the IMF appears to have formal arrangements are the World Bank⁶² and the World Trade Organization. The result of this situation is that the IMF is making policies and taking action in

⁶⁰ Daniel D. Bradlow, *supra* note 54.

⁶¹ See for example, EVALUATION OF SURVEILLANCE, *supra* note 4; External Evaluation of ESAF, *supra* note 4.

⁶² For a history of this relationship, see Jacques Polak, *The World Bank and the IMF: A Changing Relationship*, in THE WORLD BANK: ITS FIRST HALF CENTURY II 473 (1997). For recent developments in it see, IMF Press Release No. 06/65, *IMF Managing Director Rodrigo de Rato and World Bank President Paul Wolfowitz Initiate Deeper Measures to Review and Enhance IMF-World Bank Cooperation* (March 29, 2006).

these new areas without necessarily having the technical expertise to do so and without adequate consultation with the appropriate specialized agency⁶³. It may hire consultants to work on these issues, but it does not have the in-house expertise to fully evaluate the work of the consultants. This situation will continue until the IMF either hires people with the necessary technical skills or establishes some sort of cooperative arrangement with the relevant specialized agencies. This creates a significant risk that the IMF will have inadequate policies in these areas or that it will assign a lower priority to these issues than may be appropriate in particular situations.

The UN specialized agencies' implicit acquiescence in the IMF usurping parts of their responsibilities also has adverse consequences for the functioning of the UN system as a whole. It is resulting in a concentration of power in organizations like the IMF and the World Bank to the detriment of the other specialized agencies. This exacerbates the IMF's tendency to maintain that it has the "correct" answer for the major development challenges that its member states face. The inability of other specialized agencies to effectively challenge the IMF's position increases the risk of the IMF giving wrong policy advice. Furthermore, the developing countries, because the IMF has the money, have no real choice but to follow the advice of the IMF.

D. Interpretation of Articles of Agreement

The IMF has not fully recognized that the expanding scope of its activities is calling into question its interpretation of its own Articles of Agreement. In particular, it raises questions about the limits on its permissible scope of activities and about the IMF's claim to be a "non-political" body. The IMF has failed to define the limits of its mandate or to stipulate a principled basis on which it determines what issues it is willing to address and which issues are outside its mandate because of their inherently political or non-economic nature. This failure subjects the IMF to the charge that it is acting in an arbitrary and capricious fashion in interpreting its articles.

⁶³ See generally Daniel D. Bradlow & Claudio Grossman, Limited Mandates and Intertwined Problems: A New Challenge for the World Bank and the IMF, 17 HUM. RTS. Q. 411 (1995).

V. A Proposed Solution to the Problems Caused By the Five Distortions⁶⁴

The solution proposed in this section is based on three assumptions:

1. Good governance of the international financial and economic system requires an organization like the IMF;
2. Given the current global context it is not politically possible to create a new “ideal” IMF and that therefore we need to focus on reforming the current IMF. Thus, the comprehensive reform program proposed in this section of the paper is designed to create the best IMF possible in the current global context and its likely evolution over the next few years. This means an IMF that:
 - i) has a limited but realistic mandate;
 - ii) makes a positive and coherent contribution to global economic governance; and
 - iii) that wins the confidence and support of all its member states.
3. The IMF, like all international organizations, should conform to the principles of good administrative governance that are applicable to all national and international public institutions. These principles are⁶⁵:
 - a. *transparency*, which means that there should be reasonable access to information for all interested parties and that all stakeholders should be able to see and understand the decision-making process in the institution,
 - b. *predictability*, which means that the decisions and actions taken by the institution should be based on understandable principles and processes that are applied in a consistent manner,
 - c. *participation*, which means that all interested stakeholders should be able to have some input into the decision making process of the institution,

⁶⁴ For an interesting overview of reform initiatives in the IMF, see Angela Wood, *Structural Adjustment for the IMF* (2001), at www.brettonwoodsproject.org. See also generally Carin, Barry and Angela Wood, ACCOUNTABILITY OF THE INTERNATIONAL MONETARY FUND (Ashgate Publishing, 2005); Truman, Edwin M., A STRATEGY FOR IMF REFORM (Institute for International Economics, 2006).

⁶⁵ Benedict Kingsbury et. al., *The Emergence of Global Administrative Law*, LAW & CONTEMP. PROBS., Summer-Autumn 2005, at 37.

- d. *reasoned decision-making*, which means that the institution should provide a rationale for its decisions, and
- e. *accountability*, which means that those affected by the decisions and actions of the institution, its staff, and management should be able to hold these actors responsible for their decisions and actions.

Given the complexity of the nature of the relations between international organizations and their member states, it is likely that carrying out all the proposed reforms will be a long term project. However, it is possible to divide this reform program into short-, medium- and long-term components. The distinction between these categories is based on who must act to implement the reform proposal. Thus, short-term items are those which only require action by the IMF staff and Executive Board acting on their own authority. Medium term items are those that are more politically difficult and will require the participation of the Governors of the IMF. The third category includes those items that will require an amendment to the Articles of Agreement or at least will require the agreement of each of the member states, including the agreement of their legislatures. It should be noted that the IMF has begun to implement at least some aspects of the proposed reform agenda.

A. Short-Term Reform Agenda: Those Actions That the Managing Director and Board of Directors Acting on Their Own Authority Can Take

These actions can be divided into the following 6 categories:

1) Actions to Make the IMF More Responsive to Its Developing Country Member States:

- a) Allow the member state's governor to the IMF or his/her representative to participate in any discussion in the Executive Board on the member state. This would include discussions about the staff report following the annual IMF surveillance mission to the country and about any

proposed IMF program and financing for the country⁶⁶. This reform is roughly analogous to the situation in the United Nations Security Council⁶⁷. In this case, states who are not members of the Council but have a direct interest in the matter being considered by the Council can ask for permission to address the Council and participate in the Security Council discussions but not its vote. For many countries the issues being discussed about the country in the IMF Executive Board can be as momentous as those that can arise in the U.N. Security Council. It should be noted that currently it can happen that a representative of a member state attends Executive Board meetings on that country. However, the proposal is to formalize this process so that it is included in the Board's bylaws and/or operating procedures. Such an action will have two beneficial effects. First, it will encourage member states to engage more actively in Board discussions on the country. Second, it will enhance the channels of communications between the IMF and its consumer member states, particularly those that do not have direct representation on its Board.

- b) Give more resources to the Executive Directors representing IMF consumer countries so that they can more effectively represent their constituents⁶⁸. This includes both more staff and more financial resources.
- c) Establish formal procedures for how the IMF will consult with non-state actors during its Article IV consultations with its member countries and when developing a program for any member state that wishes to use its financing facilities. This procedure should create a meaningful opportunity for non-state actors to submit information and express their views to the IMF.
- d) Establish a formal mechanism through which non-state actors as well as civil servants who feel that they cannot safely or freely participate in any meetings that the IMF might hold with non-state actors can communicate with the IMF. This mechanism should enable such actors to make written submissions to the IMF. It would also provide a mechanism for communication with non-state actors in those states in which the government will not allow

⁶⁶ See Jose De Gregorio et al., *An Independent and Accountable IMF: Geneva Reports on the World Economy* (1999).

⁶⁷ See, eg., Frederic L. Kirgis, Jr., *International Organizations in Their Legal Setting* (2nd ed. 1993).

⁶⁸ The IMF has begun to provide some more resources to the African Executive Directors. See Buira, Ariel, *The Governance of the IMF in a Global Economy*, *supra* note 78, at 24-26.

the IMF to meet with non-state actors.

- e) Establish an IMF-NGO Liaison Committee in which a group of NGO representatives, elected on a regional basis, can meet on a regular basis with senior IMF staff to discuss issues of concern to NGOs and other non-state actors around the world⁶⁹.
- f) The IMF should formalize its participation in the World Bank-Parliamentary Network or create its own network.⁷⁰
- g) Increase the number of staff, particularly senior staff hired from consumer states.

2) Actions to Make the IMF More Transparent

- a) The IMF should adopt a policy of publicly releasing drafts of all official reports and policies, redacted to remove all market sensitive information, and submitting them to public comment before the final reports or policies are adopted. The IMF has improved its information disclosure policy but it usually only releases final reports and policies⁷¹.
- b) The IMF should adopt a policy of releasing the transcripts of its Board Meetings in a timely manner.⁷²
- c) The process for selecting the Managing Director and senior IMF staff should be opened to citizens of all member states and there should be a selection process, including interviews, that is understandable to the public.⁷³
- d) The IMF needs to develop and make publicly available a manual of all its operating policies

⁶⁹ The World Bank has had such a committee for a number of years. See World Bank and Civil Society, available at <http://www.worldbank.org/civilsociety>.

⁷⁰ See IMF, *Report of the Working Group of IMF Executive Directors on Enhancing Communication with National Legislators* (Jan. 15, 2004), available at <http://www.imf.org/external/np/ed/2004/ecnl/index.htm>.

⁷¹ For the IMF information disclosure policy, see <http://www.imf.org>. The IMF set an important precedent for releasing drafts of policies and procedures when it published its draft decision on establishing an independent evaluation office before the decision was taken by the Board to do so. Ultimately, the Board decided to establish such an office and did so in 2002. See <http://www.imf.org/external/np/ieo>. Another important precedent was the IMF's use of notice and comment period following the announcement of the new conditionality guidelines. Bradlow, *supra* note 54.

⁷² See, for example, "A Guide to Meetings of the Board of Governors of the Federal Reserve System, available at <http://www.federalreserve.gov/boarddocs/meetins/sunshine.htm> ;

⁷³ **SUCH A SELECTION PROCESS WAS USED IN FINDING THE NEW DIRECTOR OF UNDP. SEE**

and procedures.⁷⁴ This publication would be analogous to the World Bank's operating manual⁷⁵. While such a manual may not have been necessary when the IMF was operating under the par value system, the increased complexity of its operations makes such a manual a requirement. This publication would detail the responsibilities of the IMF staff and the procedures that they should follow in each situation. The publication of this information would enable those people affected by the IMF's actions to understand how IMF policy is made and whether the IMF has acted in conformity with its own rules and procedures in all cases.

3) Actions to Make the IMF More Accountable:

- a) The IMF Managing Director and the Deputy Managing Directors should be subject to a process of periodic evaluation during their term of office. In this regard, it would be useful for the IMF to consider adopting the example of the New Zealand government, which negotiates a contract with the Governor of its Reserve Bank that establishes performance standards against which the Governor's performance can be evaluated.⁷⁶
- b) The publication of a manual of all the IMF's operating policies and procedures would enable those people affected by the IMF's actions to determine whether the IMF staff and management have acted in conformity with the IMF's operating rules and procedures in all cases and to hold them accountable for non-conforming actions.
- c) Establish an ombudsman at the IMF who has the power to receive and investigate complaints from any person, organization, or state, that feels that the IMF has not been acting in conformity with its mandate. This official should have the power to publish an annual report that discusses the investigations he/she has conducted and to make recommendations to the Board of Directors on how to improve the functioning of the IMF⁷⁷.
- d) An independent review panel should evaluate the policies of the IMF to assess their impacts

⁷⁴ Bradlow, *supra* note 54.

⁷⁵ See, <http://www.worldbank.org>.

⁷⁶ See Reserve Bank of New Zealand, *Policy Targets Agreement 2002* (agreement between the Minister of Finance and the Governor of the Reserve Bank of New Zealand), <http://www.rbnz.govt.nz/monpol/pta/>.

⁷⁷ See, Bradlow, *supra* note 54.

on poverty and the environment. This panel should also be charged with making recommendations on how the IMF, acting consistently with its mandate (see below) could improve its policies so that their potential to have a positive effect on poverty and the environment is maximized. The IMF Evaluation Office may be the appropriate office to perform this role⁷⁸.

4) Actions to Better Coordinate the IMF's Activities with Other International Organizations

- a) Establish an independent expert panel to review the IMF's relations with other international organizations and to make recommendations on how the IMF, acting in conformity with its specialized mandate can most effectively coordinate its activities with these organizations. The IMF is beginning this process by reviewing its relationship with the World Bank⁷⁹. However, it also needs to undertake similar reviews of its relations with the G-20, Financial Stability Forum, and other inter-governmental and international organizations, particularly the other specialized UN agencies.

The commission reviewing the relationship between the World Bank and the IMF should consider such options as merging the two institutions and revising the division of labor between them. For example, one option that it should consider is defining their responsibilities not according to function but according to the level of wealth of the country and the type of financing sources on which it relies. For example, the IMF would deal only with the problems of emerging markets that have access to private markets. The World Bank would have deal exclusively with countries that are dependent on official sources of funds. The issues of primary concern to industrialized countries would be addressed in other fora. The IMF and World Bank would only participate in these fora to the extent necessary to

⁷⁸ See INTERNATIONAL MONETARY FUND, *Making the IMF's Independent Evaluation Office Operational* (Aug. 2000), at <http://www.imf.org/external/np/eval/evo/2000/Eng/evo.htm>.

⁷⁹ See IMF, IMF Managing Director Rodrigo de Rato and World Bank President Paul Wolfowitz Initiate Deeper Measures to Review and Enhance IMF-World Bank Cooperation, Press release March 29, 2006, <http://www.imf.org/external/np/sec/pr/2006/pr0665.htm>.

understand how the issues being discussed would affect their areas of responsibility.⁸⁰

5) Actions to Better Match IMF Skills to the Tasks it Performs:

- a) Change the skill mix in the IMF to make it more suitable to the functions the IMF defines as within its mandate. This will mean hiring more people with diverse social science expertise. This action will be less necessary if the IMF has better coordinated relations with other international organizations.

6) Legal Actions:

- a) The Board of Directors, after a notice and comment period, should issue a decision defining the scope of the IMF's specialized mandate⁸¹. This decision, which would be part of the operational manual referred to above and would also help define the meaning of the restrictions on the IMF taking political considerations into account in its operations⁸². It would also help distinguish the IMF from other international organizations. The resulting clarity about the IMF's mission will enhance both the transparency and accountability of the IMF.
- b) The Board of Directors should abandon the principle of uniformity and should explicitly categorize countries according to their wealth and level of economic development.
- c) The IMF needs to clarify the legal nature of the standby arrangements.

⁸⁰ For a discussion of the problems with the IMF being involved in poverty alleviation and PRGF, *see* Stiglitz, *supra* note 4; Eldar, *supra* note 19, at 515-16, 515 n. 31.

⁸¹ It is not unprecedented for the IMF to use a notice and comment period before finalizing its operational policies. This was done in the case of the 2002 Guidelines on Conditionality. *See* Bradlow, *supra* note 62; *infra* note 85.

⁸² *See* IMF ARTICLES, *supra* note 6, at art. IV, § 3.

B. Medium Term Actions: Those Actions That Require the Approval of the Board Of Governors

1) Actions to Make the IMF More Responsive to its Developing Country Member States:

- a) Begin the process of restructuring the Board so that it includes more developing country representatives. The steps that should be taken in the short term are:
 - i. all Board constituencies that include both consumer and supplier countries should commit to only choosing representatives from consumer countries as its Executive Directors; and
 - ii. the member states of the Euro-zone should publicly state their intention to consolidate their representation on the IMF's Board of Directors over time.⁸³
- b) Make some adjustments in the votes of those member states whose quotas result in them being underrepresented in the deliberations of the IMF. This means there should be both an increase in the votes allocated to those member states whose quotas are not an accurate reflection. It should be noted that this is similar to the Managing Director's current proposal to increase quotas. However, it is unlikely that a change in quotas alone will lead to any significant changes in the operations of or decision making in the IMF⁸⁴.
- c) Change the formula for calculating quotas so that it is based on purchasing power parity exchange rates rather than the current basis. This will have the effect of increasing the voting power of some of the emerging market countries, particularly in Asia.⁸⁵

⁸³ Edwin M. Truman, *Rearranging IMF Chairs and Shares: The Sine Qua Non of IMF Reform*, IIE Conference on IMF Reform (Sept. 23, 2005); Truman, Edwin M., *A STRATEGY FOR IMF REFORM* (Institute for International Economics, 2006).

⁸⁴ The IMF Managing Director acknowledged this in response to a question. See, Rodrigo de Rato, "Transcript of an Address to the Foreign Correspondent's Club of Japan", Tokyo, August 3, 2006 available at <http://www.imf.org/external/np/tr/2006/tr06083.htm> (in response to a question on the likely impact of the change in quotas and votes on IMF policy, he said "...I do not think that the institution will change its views") Also see, IMF, *The Managing Director's Report on the Funds Medium-Term Strategy* (September 15, 2006), at <http://www.imf.org/external/np/omd/2005/eng/091505.pdf>; IMF,

⁸⁵ Buira, Ariel, *The Governance of the IMF in a Global Economy*, in *Challenges to the IMF and World Bank: Developing Country Perspectives* 13, 19-21 (Anthem Press, 2003); Rustomjee, *supra* note 40. It is

- d) The IMF should increase the number of alternate directors that can assist each director in more effectively representing the members of his/her constituency.⁸⁶ In this regard, it should be noted that Trevor Manuel, the South African Minister of Finance, has proposed that there should be one Alternate Executive Director for each 8 countries in a constituency⁸⁷. Since this will lead to a more unwieldy board, the IMF may need to give thought to delegating more responsibility to Board committees.
- e) The Board of Governors can approve the restructuring of Board constituencies so that the Eurozone countries are granted one seat on the Board with the combined voting power of all the Eurozone countries. This will have the effect of freeing up at least 2 seats on the Board which can then be allocate to new constituencies that are constructed to enhance developing country representation at the Board level, for example by reducing the size of the African constituencies.⁸⁸ While reviewing the composition of Board constituencies, it should re-evaluate, within the constraints of its Articles, the desirability of having 3 single country constituency seats on the Board⁸⁹.
- f) The IMF should consider moving from its current practice of making decisions on the basis of consensus to making decisions on a basis that better reveals the preferences of those who will be most affected by the decisions.⁹⁰ One possibility would be for the IMF to require separate votes by those Executive Directors who represent developing countries and those who represent industrialized countries. Any decision would only be adopted if it commanded a majority of both groups.⁹¹ This would improve the responsiveness of the IMF to the

interesting to note that recently there have been suggestions that the US has been calling for the use of purchasing power parity in calculating UN contributions. *See also* Mark Turner, *China and Russia Bridle at Paying UN More*, FINANCIAL TIMES (LONDON), March 25, 2006.

⁸⁶ *See* IMF, *By-Laws, Rules, and Regulations*, § 14 (d). *See* art. XII. § 3.

⁸⁷ Wray, Quentin, *IMF revolution still a long way off, says Manuel*, BUSINESS REPORT, August 4, 2006 at 1.

⁸⁸ *See* Truman, *supra* note 78; Rustomjee, *supra* note 40.

⁸⁹ Article XII Section 3(c), for example, imposes some limits on the ability of the IMF to eliminate these seats on the Board.

⁹⁰ The IMF Articles of Agreement appear to offer some flexibility in voting because they only stipulate that decisions must be made “by a majority of the votes case” without defining how this “majority” is defined. *See* Articles XII Section 5(c).

⁹¹ Other organizations have also adopted this strategy. *For example*, Global Environmental Facility (GEF), *Rules of Procedure for the GEF Council*, § 12, available at http://www.gefweb.org/participants/Council/Council_Rules/English_Council_Rules.pdf.

interests of both its supplier and consumer member states.

2) Actions to Improve the IMF's Relations with other International Organizations:

- a) Establish formal and more extensive links between the IMF and other relevant international organizations (eg. United Nations, WTO, World Bank, UNICEF, WHO, ILO, etc.) at both the senior management and staff levels. These links should include regular meetings, staff exchanges, regular exchanges of information and reports and other publications, participation in joint missions to countries and formal agreements on the division of labor and responsibility between these organizations. It should also include a means for resolving any disputes that may arise between the parties.
- b) The IMF should renegotiate its Relationship Agreement with the UN. The objective of this exercise would be to clarify the IMF's responsibilities to the UN and to enhance the ability of the UN to ensure the IMF fully respects the jurisdiction of other specialized agencies.

C. Long Term Actions: Those Actions That Require Ratification By the Member States

1) Actions to Make the IMF More Responsive to Its Developing Country Member States:

- a) The IMF should amend the Articles of Agreement to increase the basic votes to at least its original proportion in the total votes at the IMF and to facilitate future increases in both basic votes and in the quota formula.⁹² It should be noted that the MD has proposed an increase in the basic votes as part of his governance reform proposals.
- b) Amend the Articles of Agreement to introduce a qualified voting procedure that requires that any decision can only be adopted if it is supported by both a majority of the votes cast and a majority of the member states.⁹³
- c) Amend Article V Section 1 to require the IMF to consult more broadly with all affected

⁹² See Buria, *supra* note 19.

⁹³ Woods, Ngaire and Lombardi, Domenico, Uneven patterns of Governance: How Developing Countries Are Represented in the IMF, 13 REV. INT'L POL. ECON. 480, 495. (2006).

parties in its member states and not to limit its dealings with the member states to their Central Banks and Ministries of Finance.

2) Actions to Alter the Structure and Functions of the IMF to Recognize the Changing Responsibility of the IMF:

- a) Implement the findings of the independent review commission that investigated the division of responsibilities between the IMF and the World Bank.

VII. Conclusion

The IMF is suffering from serious structural distortions that have slowly developed since the Second Amendment to the Articles of Agreement. These problems create a substantial barrier to the effective functioning of the IMF. They can only be corrected through a broad ranging reform program that will overhaul the structure and operating principles of the IMF. Without undertaking this reform program, it is unclear if the IMF will ever be able to effectively make any useful contributions to solving the complex problems of poverty, inequality and inadequate governance which plague developing countries today.

Chapter 5: Operational Policies and Procedures and an Ombudsman
Prepared for
Center for Global Studies, University of Victoria
Study on IMF Accountability¹
Professor Daniel D. Bradlow²

I. Introduction

This paper is about the administrative practices of a public institution, the International Monetary Fund (IMF). The principles of good governance require that the IMF's administrative practices should promote both efficient and effective IMF operations and the accountability of IMF staff and management³. The administrative practices can only promote accountability if they satisfy two conditions. First, the institution's stakeholders and the staff and management themselves must be able to determine if the staff and management's conduct conforms to the appropriate standards for measuring their performance. These standards can be divided into two categories. The first, which can be termed operational policies, establish the substantive requirements that the staff and management must meet in implementing the institution's policies. Examples of operational policies are the World Bank's environmental assessment requirements⁴ and the International Monetary Fund's (IMF) guidelines on conditionality⁵. The second, which can be called operational procedures, explain how the staff and management of the institution should go about making decisions and conducting its operations. Examples of operational procedures are the steps that World Bank staff must take in conducting environmental assessments⁶ and the IMF's guidance note on the guidelines on conditionality⁷. This second category is comparable to administrative procedures in national legal systems.

The second condition is that the institution must have some mechanism for dealing with cases of staff or management non-compliance with the applicable operational policies and procedures and the consequences thereof. Examples of mechanisms established for this purpose include ombudsmen, administrative tribunals and inspection mechanisms, like the World Bank Inspection Panel.

¹ DO NOT QUOTE OR PUBLISH WITHOUT PERMISSION OF AUTHOR OR CENTRE FOR GLOBAL STUDIES.

² Professor of Law and Director, International Legal Studies Program, American University Washington College of Law, Washington D.C. Email: bradlow@american.edu

³ For a general overview of IMF governance, see, L. van Houtven, *Governance of the IMF: Decision Making, Institutional Oversight, Transparency and Accountability* (IMF Pamphlet Series #53, 2002)

⁴ World Bank, Operational Manual, Volume II, Safeguard Policies, *Operational Policy (OP) 4.01: Environmental Assessment*, 1999, available at <http://wbIn0018.worldbank.org/Institutional/Manuals/OpManual.nsf/toc2/9367A2A9D9DAEED38525672C007D0972?OpenDocument>.

⁵ International Monetary Fund, *Guidelines on Conditionality*, 2002, available at <http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.pdf>.

⁶ World Bank, Operational Manual, Volume II, Safeguard Policies, *Bank Procedure (BP) 4.01: Environmental Assessment*, 1999, available at <http://wbIn0018.worldbank.org/Institutional/Manuals/OpManual.nsf/ea5916efc9250d10852565af0054d273/c4241d657823fd818525672c007d096e?OpenDocument>

⁷ International Monetary Fund, *Operational Guidance on the New Conditionality Guidelines*, available at <http://www.imf.org/External/np/pdr/cond/2003/eng/050803.htm>.

This paper examines how well the IMF's administrative practices conform to this principle of good governance. It is divided into four sections. The first section is a review of the existing operational policies and procedures in the IMF and a comparison with the situation in the multilateral development banks (MDBs). The second section evaluates the feasibility of the IMF establishing a comprehensive set of operational procedures. The third section considers the case for establish a mechanism for holding the IMF staff and management accountable for their compliance with a comprehensive set of operational policies and procedures. The final section contains recommendations, based on the lessons learned in the previous sections of the paper. It recommends that the IMF develop a comprehensive set of formal operational policies and procedures and that it establish an ombudsman to deal with the problems created by staff and management non-compliance with these policies and procedures.

II. The Current Situation in the IMF and Comparison with the MDBs

A. *Current Situation in the IMF*

Operational policies and procedures are part of the “internal law” of an international organization. For current purposes, “internal law” refers to the combination of the constitutive documents of the organization and the rules and regulations that it develops to govern the way in which it implements its mandate.

The IMF's internal law consists of the following:

1. *Articles of Agreement*⁸: This is the international agreement, signed and ratified by all IMF member states, that establishes the powers and mandate of the IMF. The issues addressed in the Articles include the purposes of the IMF; its powers to conduct surveillance, to provide financing to its member states and to issue SDRs; its governance structure; and the rights and obligations of IMF member states.
2. *By-Laws*⁹: The Board of Governors adopts these By-laws pursuant to its authority under the Articles of Agreement. They are intended to complement the Articles. They deal with such matters as the conduct of the meetings of the Executive Board and the Board of Governors, the appointment of Executive Directors, voting, the ability of members not entitled to appoint an Executive Director to be represented at meetings of the Executive Board, budgets, audits and membership issues.
3. *Rules and Regulations*¹⁰: These “provide such operating rules and procedures, regulations, and interpretations as are necessary and desirable to carry out the purposes and powers contained in the Articles, as supplemented by the By-Laws.”¹¹ The IMF has 20 rules and regulations, each of which is identified by letter. They cover such issues as the meetings of the Executive Board, the mechanical aspects of transactions with the

⁸ International Monetary Fund, *Articles of Agreement of the International Monetary Fund*, adopted July 22, 1944, available at <http://www.imf.org/external/pubs/ft/aa/aa.pdf>

⁹ International Monetary Fund, *By-Laws of the International Monetary Fund*, adopted March 16, 1946, available at <http://www.imf.org/external/pubs/ft/bl/blcon.htm>.

¹⁰ International Monetary Fund, *Rules and Regulations of the International Monetary Fund*, adopted Sept. 25, 1946, available at <http://www.imf.org/external/pubs/ft/bl/blcon.htm>

¹¹ International Monetary Fund, *Rules and Regulations of the International Monetary Fund*, Rule A-1, Scope of Rules and Regulations, adopted Sept. 25, 1946, amended April 1, 1978, available at <http://www.imf.org/external/pubs/ft/bl/rr01.htm>.

- IMF, accounting and reporting in the IMF, relations with non-member states, staff regulations and the operation of the SDR account. The rule dealing with staff is designated Rule-N. It covers such issues as appointment of staff, the fact that staff owe their loyalty “entirely” to the IMF, individual staff involvement in political affairs, publications by staff, the affirmation that staff make upon their appointment, staff grievances, and staff travel.
4. *Decisions of the Board*¹²: These are formal decisions of the Executive Board that establish clear policies for the IMF. They deal with such issues as the content of conditionality, Article IV consultations and the role of the IMF in governance.
 5. *General Administrative Orders*¹³: These are orders issued by management. They usually deal with personnel issues as opposed to operational issues.
 6. *Codes of Conduct*¹⁴: The IMF has a code of conduct for its staff and management and a separate code for Executive Directors, Alternate Executive Directors and their Advisors. Both codes deal with ethical issues related to the problem of corruption.
 7. *Guidance Documents*: These are policy papers and guidance notes that set out the IMF’s policies on specific issues. Most of these documents are operational policy documents that are intended to provide guidance on the substance of IMF policy in regard to specific activities of the IMF or to specific issues relevant to IMF operations. An example of such a document is the IMF Guidelines on Conditionality¹⁵. Recently, the IMF issued a guidance note to help staff implement the conditionality guidelines¹⁶. This is a rare example of a formal and publicly available IMF operational procedure. Most IMF operational procedures are informal and not publicly available. It is important to note it is unclear if these guidance documents establish binding standards and procedures for IMF staff or are merely precatory in intent. .

The internal law addresses four administrative issues with differing degrees of detail. The most detailed relates to the personnel policies of the IMF, including the rights and responsibilities of IMF employees. One indication of the importance that the IMF attaches to this issue is the number of mechanisms that it has established to “enforce” these personnel policies. This infrastructure, in addition, to less formal grievance procedures¹⁷, consists of the following elements:

1. *Ombudsman*¹⁸: The office of the Ombudsman deals with staff grievances. It seeks to investigate and then help resolve problems that arise between staff and management.
2. *Staff Association Committee*¹⁹: This is a committee of the Staff Association and one of its functions is to advise staff on their rights and responsibilities and to assist in the resolution of cases of staff grievance with IMF management.

¹² International Monetary Fund, *Selected Decisions and Selected Documents of the IMF Twenty-Seventh Issue*, December 31, 2002, available at <http://www.imf.org/external/pubs/ft/sd/index.asp>

¹³ International Monetary Fund, Report of the External Panel, *Review of the International Monetary Fund’s Dispute Resolution System*, Nov. 27, 2001, available at <http://www.imf.org/external/hrd/dr/112701.pdf>.

¹⁴ International Monetary Fund, *Code of Conduct for Staff*, July 31, 1998, available at <http://www.imf.org/external/hrd/code.htm>; International Monetary Fund, *Code of Conduct for Members of the Executive Board of the International Monetary Fund*, July 14, 2000, available at <http://www.imf.org/external/hrd/edscode.htm> .

¹⁵ *Guidelines on Conditionality*, *supra*, note 4.

¹⁶ *Operational Guidance on the New Conditionality Guidelines*, *supra* note 6.

¹⁷ *Review of the International Monetary Fund’s Dispute Resolution System*, *supra* note 12.

¹⁸ International Monetary Fund, *Ombudsperson’s Terms of Reference*, June 30, 1999, available at <http://www.imf.org/external/hrd/ombuds.htm>

¹⁹ *Review of the International Monetary Fund’s Dispute Resolution System*, *supra* note 12.

3. *Administrative Tribunal*²⁰: This is an independent tribunal on which legal experts who are not employees of the IMF serve on a part-time basis. The tribunal's function is to hear formal complaints and grievances of employees of the IMF relating to their treatment by their managers and the IMF as an institution. The Tribunal has the power to overrule management and to provide complainants with compensation for the harm they have suffered and to order their re-instatement.
4. *Ethics Officer*²¹: The IMF has appointed an Ethics Officer to advise all IMF officials on issues arising from the applicable code of conduct.

These mechanisms support the internal law in three ways. First, they help educate staff about what their rights are and the standards with which they can expect their managers to conform. Second, they allow employment problems to be resolved in a way which is effective, impartial and based on the merits of the case. Third, their case records help the IMF learn lessons about the nature of the employment relationship in the institution and how to improve it.

It is important to note that the IMF has established an infrastructure for implementing its personnel law that meets almost all the requirements for accountability mentioned at the beginning of this paper. It has clear policies and procedures, with the possible exception of a rule making process, and a mechanism for monitoring and enforcing compliance with these policies and procedures. Interestingly, this is the only part of the IMF internal law for which this observation is accurate.

The second administrative issue is the rules and practices applicable to the governance of the IMF. These rules and practices deal with such issues as the election of Executive Directors, the conduct of Board of Governors' and Executive Board meetings, and the accounting practices of the organization.

The third issue addressed by the internal law is operational policies. The content of these policies is less detailed than the content of the law in regard to personnel matters. The mechanisms for "enforcing" this law are also less well developed. Examples of IMF operational policies are the new conditionality guidelines²², and the policy documents on surveillance²³, governance²⁴ and poverty reduction strategy papers (PRSPs)²⁵. Until recently the only IMF mechanism for monitoring compliance with these operational policies was the Policy Development and Review Department (PDR) of the IMF. It is interesting to note that PDR, whose staff are regular IMF employees, is responsible for both the development and the review of IMF policies and their

²⁰ International Monetary Fund, *Administrative Tribunal (IMFAT)*, available at <http://www.imf.org/external/imfat/index.htm>

²¹ International Monetary Fund, *Ethics Officer - Terms of Reference*, Feb. 28, 2000, available at <http://www.imf.org/external/hrd/eo.htm>

²² *Guidelines on Conditionality*, *supra* note 3.

²³ International Monetary Fund, Public Information Notice (PIN) No. 03/50, April 10, 2003, Enhancing the Effectiveness of Surveillance: Operational Responses, the Agenda Ahead, and Next Steps, available at <http://www.imf.org/external/np/sec/pn/2003/pn0350.htm>; International Monetary Fund, *Surveillance: A Factsheet, April 2003*, available at <http://www.imf.org/external/np/exr/facts/surv.htm>.

²⁴ International Monetary Fund, *The Role of the IMF in Governance Issues: Guidance Note*, available at <http://www.imf.org/external/np/sec/nb/1997/nb9715.htm#I2>, International Monetary Fund, *Good Governance: The IMF's Role*, 1997, available at <http://www.imf.org/external/pubs/ft/exrp/govern/govern.pdf>.

²⁵ International Monetary Fund, *Poverty Reduction Strategy Papers (PRSP)*, last updated June 16, 2003, available at <http://www.imf.org/external/np/prsp/prsp.asp>

implementation. There is an obvious conflict of interest between the policy development and policy review aspects of PDR's work which has tended to undermine public confidence in the objectivity of PDR reviews of IMF operational policies. Recently, the IMF, in part to address this problem, established an Independent Evaluation Office²⁶, which is independent of IMF management and reports directly to the Executive Board, to evaluate selected aspects of IMF operations. Consequently, to some extent it functions as a monitor of staff and management compliance with the applicable operational policies.

The fourth and least developed area of the IMF's internal law is its formal operational procedures. Two preliminary points must be made about this area of the internal law. First, IMF "operational procedures" can be understood as referring to the way in which the staff and management execute their responsibilities in IMF surveillance, financing, analytical, and technical assistance activities. Second, the focus of this paper is on the establishment of **formal** operational procedures, which means that they have entered into force after a drafting and approval process that results in a Board level decision, and that they are publicly available.

With one exception, the IMF does not have formal operational procedures. This exception is the operational guidance note that the IMF has adopted to assist staff in implementing the conditionality guidelines²⁷. The IMF does have informal procedures in the form of memoranda and notes from management to the staff that provide guidance on how they should conduct IMF operations. These existing procedures are informal in the sense that they have not been presented for Board approval and are not contained in a publicly available document. One example of such an informal operational procedure, identified through references in published materials, is an operational guidance note on surveillance²⁸.

The lack of formal operational policies means, for example, that there are no publicly available documents that external stakeholders can consult to learn how the IMF decides with whom it should consult during surveillance operations or in designing its financing arrangements or its technical assistance programs or in its general analytical and policy work, how it organizes these consultations, or what factors the staff should consider in making specific types of decisions. In addition, there are no mechanisms that stakeholders can use to hold the IMF accountable for the way in which it implements the existing informal operational policies or the one formal policy. Thus, the internal law in regard to operational procedures fails to conform to either of the two standards for good administrative practices identified at the beginning of this paper.

The IMF's failure to develop comprehensive formal operational procedures can be explained. When the IMF was responsible for managing a system of relatively fixed exchange rates, it could limit its interactions in its member states to the financial and monetary authorities. This meant that there was a limited range of officials involved in these interactions. In addition, the IMF

²⁶ International Monetary Fund, *Independent Evaluation Office (IEO) of the IMF*, available at <http://www.imf.org/external/np/ieo/index.htm>.

²⁷ *Operational Guidance on the New Conditionality Guidelines*, *supra* note 6. The IMF has undertaken a participatory process regarding its relations with civil society and it is possible that this process will result in a second formal operational procedure.

²⁸ Footnote 28 in *Enhancing the Effectiveness of Surveillance: Operational Responses, the Agenda Ahead and Next Steps*, prepared by the Policy Development and Review Department in consultation with Other Departments (March 13, 2003) refers to an *Operational Guidance Note for Staff Following the 2002 Biennial Surveillance Review, September 2002*. However, this note is not publicly available.

staff would be sent on mission with detailed and carefully crafted instructions and would be required to refer matters back to headquarters before agreeing to any deviations from what was proposed in these instructions²⁹. The result was that both from the IMF and the member state perspective there was limited need for formal operational procedures. Everyone involved in the discussions between the IMF and the member state knew and understood the *de facto* operational procedures.

However, following the collapse of the par value system and the expansion in the scope of IMF operations that occurred in the course of the 1980s and 1990s the nature of IMF interactions with its member states has changed³⁰. There are at least three changes that are relevant for current purposes:

1. *The political context with which the IMF must operate has changed.* Non-state actors – corporations, NGOs, civic organizations – have begun to play a greater role in international affairs generally and in the work of the IMF in particular. This can be seen, for example, in the consultation requirements in the PRSP process, the efforts the IMF makes to meet with civil society in its missions to its member states, and in its growing informal interactions with civil society over particular policy papers of the IMF. This evolving relationship has increased the pressure on the IMF to disclose more information and was an important factor in the establishment of the Independent Evaluation Office. NGOs and civic organizations, however, continue to criticize the IMF for the lack of transparency in its operating procedures. They argue that they do not fully understand how the IMF makes operational decisions and that it appears that its decision making process is subject to undue influence from the IMF's most powerful member states.
2. *The nature of the IMF's relations with its member states has changed.* Originally the IMF was perceived as and operated like a credit union in which all participants were both contributors to the fund and users of its services. Thus, all member states understood that IMF policy and operational decisions could become directly applicable to them. However, this is no longer the case. Today, the rich countries contribute most of the IMF's funds but never use its financial or technical services while the developing countries contribute a relatively small portion of its resources but use all its services. In addition, the rich countries, both because of the weighted voting structure in the IMF and the structure of its Executive Board, are able to control the institution and make operational policy for it, even though these policies will never be applicable to them or their citizens. The developing countries, who are dependent on the services of the IMF, on the other hand find it much more difficult to participate in policy and decision making of the IMF. The result of these changes is that a power imbalance has developed in the IMF³¹. In this situation, the lack of formal comprehensive operational policies and procedures becomes a problem that affects the perceived fairness of IMF operations and decision making.
3. *The scope of IMF operations has expanded dramatically.* The IMF, in addition to its involvement in monetary, fiscal and exchange rate policy, is now also involved in

²⁹ R.H.R. Harper, *Inside the IMF: An Ethnography of Documents, Technology and Organizational Action* (1998) at 175-230 for a description of an IMF mission.

³⁰ See James M. Boughton, *Silent Revolution: The International Monetary Fund 1979-1989* (2001) for a history of the International Monetary Fund during much of this period.

³¹ See Daniel D. Bradlow, *Stuffing New Wine Into Old Bottles: The Troubling Case of the IMF*, 3 J. OF INT'L BANKING REG. 9 (2001).

advising countries and in supporting their efforts to promote better governance, and to adopt policies that are geared towards poverty reduction as well as towards macro-economic stability. The result is that a member state's Central Bank and Ministry of Finance do not have all the necessary information about the issues of interest to the IMF. Thus, the IMF needs to interact with a much broader array of governmental and non-governmental sources if it is to obtain the necessary information, and effectively design and implement its operations. All these sources can influence the success of its proposed activities. For these additional actors, the lack of clear and predictable IMF operating procedures becomes a problem because they do not know the most effective ways to engage with the IMF and cannot understand its operational needs.

The combined effect of these three changes is that the need for formal and comprehensive IMF operational procedures has become more urgent. The lack of such procedures is undermining the efficacy of the IMF and even threatening its legitimacy.

B. *Situation in The World Bank*³²

The World Bank, unlike the IMF, has formal operational policies and procedures to guide its staff in the conduct of their responsibilities. Both of these are contained in the Bank's Operational Manual³³ which is available at the Bank's website. It addresses such issues as the types of products the Bank offers, the procedures Bank staff should follow in developing their country assistance strategies and other analytical work, the procedures they should follow and the factors they should consider in their project and loan preparatory work, the environmental and social safeguard policies of the Bank, the procedures applicable to loan disbursements and repayments and the staff's responsibilities in monitoring Bank-funded projects.

The Bank's operational policies and procedures consist of a number of different documents. They are³⁴:

1. *Operational Policies (OPs)*: These are short, focused statements that are drawn from the Bank's Articles of Agreement, the general conditions, and policies approved by the Board. They establish the parameters within which Bank operations must be conducted and describe the circumstances under which exceptions to these policies are admissible and who can authorize such exceptions. In the terminology of this paper, the OPs are the Bank's operational policies.
2. *Bank Procedures (BPs)*: These are statements explaining how Bank staff should implement the policies set out in the OPs. They spell out the procedures and documentation that the staff is required to obtain. One of their purposes is ensure Bankwide consistency and quality in the implementation of the OPs. In the terminology of this paper, the BPs are the Bank's operational procedures.

³² The "World Bank" refers to the members of the World Bank Group. The members of this group are the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA) and the International Centre for Settlement of Investment Disputes.

³³ The Operations Manual can be viewed at www.worldbank.org/institutional/manuals/opmanual.nsf. This manual is only applicable to the IBRD and IDA. However, many of its policies and procedures have been incorporated into the operational policies and procedures of IFC and MIGA. [See websites: www.ifc.org; www.miga.org

³⁴ These descriptions are drawn from the definitions of these documents contained in the Operations Manual, *id.*

3. *Good Practices (GPs)*: They contain advice and guidance for staff on implementing the OPs. The GPs contain information on such matters as the history of the issue being addressed in the OP, the sectoral context within which the OP is being implemented, the analytical framework that has informed the substance of the OP, and they provide some best practice examples.
4. *Operational Directives (ODs)*: The ODs contain a mixture of policies, procedures and guidelines. They are gradually being replaced by OPs, BPs and GPs..
5. *Operational Memoranda (Op. Memos)*: These are interim instructions designed to elaborate on issues raised in OPs/BPs or ODs. Once the instructions in Op. Memos are incorporated into revisions of the pertinent OPs/BPs, the Op. Memos are retired.

OPs, BPs and ODs, which are contained in the Operational Manual, are mandatory and staff are expected to comply with their terms in all their operational activity. GPs and Op. Memos are not mandatory and may not be in the Operational Manual.

The Bank has established a number of independent mechanisms for monitoring and ensuring staff compliance with these operational policies and procedures³⁵. They are:

1. *Operations Evaluation Department(OED)*³⁶: The OED is responsible for evaluating completed Bank projects and for offering the management insights into the strengths and weaknesses in Bank operations. Its activities may lead it to recommend changes in Bank operating policies and procedures.
2. *Inspection Panel(Panel)*³⁷: The Panel, whose jurisdiction is limited to IBRD and IDA operations, is authorized to receive requests from any groups of two or more persons who claim that they have been or are threatened with harm by the Bank's failure to act in compliance with its operational policies and procedures. The Panel is authorized to investigate these complaints and make recommendations to the Bank's Executive Board on how to correct the problems caused by Bank non-compliance with these policies and procedures.
3. *The Compliance Advisor Ombudsman (CAO)*³⁸: The CAO's jurisdiction is limited to the social and environmental aspects of IFC and MIGA operations. It is authorized to deal with complaints received from persons who claim they have been or are threatened with harm caused by IFC or MIGA funded operations, to monitor compliance with IFC and MIGA social and environmental standards and operational procedures and to give the management of these institutions advice on the social and environmental aspect of its operations.

The Bank's personnel policies and procedures have a similar structure to the IMF. It has a staff manual that informs staff about their rights and responsibilities. In addition, the Bank, like the IMF, has an Administrative Tribunal, an Ombudsman, and an Ethics Officer. Their powers and procedures are similar to those of the corresponding bodies in the IMF.

³⁵ In the case of the IBRD and IDA these independent mechanisms are in addition to the Operations Policy and Country Services Vice Presidency, which is responsible for strengthening management systems for monitoring compliance. See World Bank, *Quality Assurance Group*, available at <http://web.worldbank.org/WBSITE/EXTERNAL/PROJECTS/QAG/0,,pagePK:109619~theSitePK:109609,00.html>.

³⁶ World Bank, *Operations Evaluation Department*, available at <http://www.worldbank.org/oed/>.

³⁷ World Bank, *The Inspection Panel*, available at <http://wbln0018.worldbank.org/ipn/ipnweb.nsf>.

³⁸ *Compliance Advisor Ombudsman*, available at <http://www.cao-ombudsman.org/ev.php>

C. *Situation in Regional Development Banks*³⁹

The African, Asian and Inter-American Development Banks and the European Bank for Reconstruction and Development follow similar approaches to the World Bank. This means that they each have operational policies and procedures to guide their staff in the conduct of their operations. All four have an evaluation department that helps monitor the implementation of these operational policies and procedures. In addition, the Asian, and Inter-American Development Banks and the European Bank for Reconstruction and Development have inspection mechanisms to monitor compliance with these policies and procedures and to deal with the harm that they cause⁴⁰. Finally, each of the regional development banks has personnel policies and mechanisms for dealing with grievances that may arise under them.

III. Designing a Formal and Comprehensive Set of Operational Policies and Procedures for the IMF

The previous section makes clear that the IMF is an unusual international financial institution (IFI) because it does not have a set of formal and comprehensive operational policies and procedures. There are two possible explanations for this difference. The first is that the IMF's lack of such procedures is attributable to the significant operational differences that follow from the macroeconomic focus of the IMF's responsibilities and the MDBs' emphasis on project lending. However, this is not an adequate justification for the IMF's lack of a formal set of operational procedures. The scope of the IMF's interactions in those member state's that use its services tends to be no less diverse or complex than the interactions of the MDBs in these societies. In addition, the impact of an IMF operation on a particular state tends to be stronger than the impact of most MDB operations on the same state. Consequently, it has the same need for transparent and predictable procedures to guide the conduct of staff and management as the MDBs.

The second possible explanation is that the costs to the IMF of having formal operational procedures are too high. In order to adequately assess this explanation, it is necessary to determine both the costs and benefits that such procedures would create for the IMF.

A. *The Benefits*

There are five significant benefits that would accrue to the IMF from having a set of formal operational procedures. They are:

1. *Effective Guidance for Staff*: Formal operational procedures would provide staff and management with a clearer understanding of what is expected from them during IMF

³⁹ For information on the operational policies and procedures of these banks, see <http://www.iadb.org/exr/english/POLICIES/policies.htm> for the Inter-American Development Bank; see <http://www.adb.org/Development/policies.asp> and <http://www.adb.org/Documents/Manuals/Operations/default.asp?p=policies> for the Asian Development Bank; see http://www.afdb.org/projects/policies_and_procedures.htm?n1=3&n2=1&n3=0 for the African Development Bank; see <http://www.ebrd.org/about/index.htm> for the European Bank for Reconstruction and Development.

⁴⁰ Asian Development Bank, *Inspection Function*, available at <http://www.adb.org/Inspection/default.asp>; European Bank for Reconstruction and Development, *Independent Recourse Mechanism*, available at <http://www.ebrd.org/about/policies/irm/irm.pdf> The Inter-American Development Bank does not mention its Investigation Review Mechanism on its website.

- operations. This should facilitate staff accountability and provide a basis for improving staff performance. It should educate those with whom they interact on the limits of staff's decision-making authority. This, in turn, could help promote member state "ownership" of IMF-funded programs. Finally, these procedures may positively affect staff willingness to be innovative by giving them clear guidance on where there is scope for innovation.
2. *Predictability in the Conduct of IMF Operations*: Formal operational procedures would provide greater predictability to IMF operations than informal procedures which can relatively easily be changed. This will enhance both stakeholder confidence in dealing with the IMF and IMF staff confidence in their interactions with outside stakeholders.
 3. *Transparency in IMF Decision-making and Action*: Formal procedures would make it easier for outsiders to understand how the IMF does its work and the factors that it considers in making its decisions. This should help clarify the scope of IMF responsibilities and differentiate them from the responsibilities of member governments in their dealings with the IMF. Increased transparency may also reduce suspicion that the IMF management is unaccountable and has too much discretion. It may also clarify the ways in which the IMF is susceptible to pressure from powerful member states.
 4. *Accountability*: Formal operational procedures will promote accountability in two ways. First, they will give outside stakeholders—member states and non-state actors—a principled basis on which to hold IMF staff and management accountable. This should help depoliticize the issue of IMF operational accountability for specific operations and decisions. Second, formal procedures will help the Board members to hold IMF staff and management accountable.
 5. *Lessons Learned*: Formal operational procedures will also make it easier for the IMF to learn about the actual impact of its operational practices and the strengths and weaknesses of its operational policies and procedures and to improve them over time.

B. *The Costs*

The IMF would incur the following costs from having formal operational procedures:

1. *Increased Bureaucratization*: Formal operational procedures can result in IMF staff developing a cautious approach to their work in which they seek to do everything "by the book". There is also a danger that the rules result in an increase in reporting and paperwork requirements that reduce staff productivity.
2. *Loss of Flexibility*: It is impossible for the drafters of the procedures to anticipate all the situations in which they need to be applied. Thus, the procedures can result in a certain loss of operational flexibility because they cannot be easily adapted to specific conditions in which they actually must function. This in turn may cause the IMF, once again, to be seen as imposing a "one size fits all" approach on its member states.
3. *Disincentives for Innovation*: Formal procedures can increase the risk that staff and management will be sanctioned for being innovative in ways that do not strictly comply with strict interpretations of the procedures. Since the issues with which the IMF deals do not have clear answers and their resolution requires creativity, any disincentive to innovation is a potentially significant cost for the IMF. The cost however is mitigated by the fact that it is not in the IMF's interest for the staff and management to have too much scope for uncontrolled innovation and the procedures can establish the limits on their scope for permissible ingenuity.

C. *Balancing Costs and Benefits*

There are four reasons why the benefits of having formal operational policies and procedures outweigh the costs for the IMF. First, such procedures help outside stakeholders particularly those in developing countries, engage more effectively with the IMF. This is particularly relevant useful given that the IMF advocates increased participation in the PRSP process, increased country ownership of IMF supported programs and transparency, participation and accountability as key elements in good governance for its member states. Second, transparent and predictable operational procedures will increase public understanding of the IMF's operations, including of the costs associated with more transparent operating procedures. In fact, it is the stakeholders in those member states that are most directly affected by the operations of the IMF who currently have the least ability to learn about and understand the operating policies and procedures of the IMF and who would benefit most from having formal operational policies and procedures. Third, the procedures will promote IMF accountability. Fourth, the policies and procedures will improve internal IMF governance at a time when IMF operations are growing more complex. All these benefits would be earned in areas where the IMF is particularly weak: public confidence and trust in the IMF and the efficacy of its operations is declining and there is a growing mismatch between the IMF's rhetoric on good governance and its own governance practices.

Given these significant gains, the question of whether or not the IMF should adopt a set of formal operational rules and procedures seems to boil down to two questions:

1. Can the IMF draft operational policies and procedures that maximize the benefits while minimizing the costs associated with such policies and procedures?
2. What should the scope of the policies and procedures be?

Each of these questions is answered below.

C.1: Drafting Operational Policies and Procedures

The primary drafting challenge is to strike the appropriate balance between the rigidity needed to provide stakeholders with the desired predictability and transparency in IMF operations and the flexibility needed for management and staff to adapt the policies and procedures to the variety of situations in which they must operate. There is no theoretical reason that this cannot be done. In fact, it is the type of drafting challenge that government draftspeople confront all the time.

In the IMF's case the goal is to draft operational policies that are sufficiently detailed that they provide all stakeholders with enough predictability and information to understand the policies of the IMF and their operational goals when they implement the policies. Thus, the operational procedures must identify the categories of information staff need to gather in order to perform their operational responsibilities; the factors they should consider, the people they should consult and the steps they should follow in making operational decisions. In addition, the procedures should clearly explain how staff can seek exceptions to the policies and procedures. There are two good models that the IMF could use in this drafting exercise. The first is the IMF's own New Conditionality Guidelines and its Operational Guidance on the New Conditionality Guidelines⁴¹.

⁴¹ *Guidelines on Conditionality, supra note 4, Operational Guidance on the New Conditionality Guidelines, supra note 6.*

The second is the Bank's three related operational documents --OPs, BPs and GPs. These examples clearly demonstrate that it is possible for the IMF to develop operational policies and procedures that combine predictability and transparency in IMF operations with operational flexibility.

C.2: The Scope of the Operational Rules and Procedures

There are two aspects to this issue. First, the operational policies and procedures should address how the IMF conducts its operations and makes decisions relating to all aspects of its work. This means that they should cover all aspects of IMF surveillance, the design, negotiation and implementation of IMF financial programs, IMF technical assistance, policy and analytical work and its relations with other organizations.

Second, the IMF needs to establish a transparent and predictable rule-making procedure that will govern how the IMF develops all its operational policies and procedures. The extensive consultations that preceded the adoption of the current guidelines on conditionality and of the work plan of the Independent Evaluation Office are important precedents in this regard. However, in both cases this impressive process was "revealed" to all interested parties, thereby leaving interested parties uncertain as to whether these were harbingers of new operating procedures or exceptions to the normal procedures granted at the IMF management's discretion. The IMF could enhance confidence in its own governance by establishing a predictable rule-making procedure that it will always follow when developing new operational policies and procedures.

IV. The Need for an Ombudsman in the IMF

In order for operational policies and procedures to be effective they need to be supported by a mechanism capable of monitoring and promoting compliance with them. One indication of the importance of such mechanisms is that the MDBs either have or are considering establishing an inspection mechanism that is empowered to investigate charges of non-compliance with their operational policies and procedures⁴².

There are a number of benefits that such mechanisms offer to IFIs. First, the mechanisms can help raise the profile of the operational policies and procedures within the institution. In this regard the experience of the World Bank's Inspection Panel, is instructive. The risk that Bank projects may become the object of Panel investigations has increased staff sensitivity to the Bank's operational policies and procedures and their interest in acting in complying with them. In fact, it has led to a phenomenon known as "Panel-proofing" a project, which means making sure that the project is sufficiently in compliance with the policies and procedures that it will survive any challenge in the Inspection Panel.

⁴² See World Bank, *The Inspection Panel*, available at <http://wbln0018.worldbank.org/ipn/ipnweb.nsf>; International Finance Corporation (IFC) / Multilateral Investment Guarantee Agency (MIGA), *Office of Compliance Advisor/Ombudsman*, available at <http://www.cao-ombudsman.org/ev.php>; Asian Development Bank, *Inspection Function*, available at <http://www.adb.org/Inspection/default.asp>; European Bank for Reconstruction and Development, *Independent Recourse Mechanism*, available at <http://www.ebrd.org/about/policies/irm/irm.pdf>; Inter-American Development Bank, *Independent Investigation Mechanism*, available at <http://www.iadb.org/cont/poli/mecanism.pdf>; The African Development Bank is expected to establish such a mechanism.

Second, the mechanism can become a vehicle for solving problems that have arisen in IFI operations. Such problem-solving capability offers obvious advantages in terms of the quality of the operations of the institution and in term of public relations. The IFC and MIGA's Compliance Advisor Ombudsman (CAO) offers the best example of an effective problem-solving mechanism.

Third, the mechanism offers the institution an opportunity for learning lessons about the actual impact of its operations. Since these mechanisms are triggered by complaints from those who have been most directly affected by the operation, they have a unique perspective on the operations of the institution. Consequently, its findings and the expertise it develops over time can offer the institution some important insights into the strengths and weaknesses of its operations and into what feasible improvements can be made to both the policies with which its operations must comply and the procedures that it should follow in designing and implementing these operations.

Fourth, the mechanism is helpful in differentiating the responsibilities of the international financial institution from those of other actors in its operations. This is a particularly useful benefit for an institution like the IMF which has to be careful to avoid unduly interfering with the sovereignty of its member states. The mechanism, whose mandate is limited to monitoring issues arising under the institution's operational policies and procedures, can focus just on the operations of the institution without having to investigate the activities and decisions of its member states. The evolution in the functioning of the World Bank's Inspection Panel shows both the sensitivity and importance of this issue and the ability of such mechanisms to enhance institutional accountability without unduly interfering with the sovereignty of its member states⁴³.

The above suggests that the efficacy of the IMF's operational policies and procedures would be enhanced if it established a mechanism that was empowered to monitor their implementation. There are a number of forms such a mechanism could take. For example, the IMF could follow the examples of the IBRD and IDA, and the regional development banks and establish an inspection mechanism⁴⁴. Alternatively, it could follow the example of the IFC and MIGA and establish a compliance advisor and ombudsman arrangement. A third possibility is to follow the example of many national governments and the European Union and appoint an ombudsman⁴⁵.

Based on the experience of all these examples, it is possible to deduce certain general principles that should be observed by any IFI interested in establishing a mechanism to monitor the implementation of its operational policies and procedures. Any mechanism that fails to incorporate these principles is likely to be viewed as deficient by at least one of the IFI's stakeholders – member states; the Executive Directors, management

⁴³ See Ibrahim F.I. Shihata, *The World Bank Inspection Panel: In Practice* (2d ed. 2000); Daniel D. Bradlow, *Lessons From the NGO Campaign Against the Second Review of the World Bank Inspection Panel: A Participant's Perspective*, 7 ILSA J. INT'L & COMP. L. 247 (2001).

⁴⁴ See, *supra*, note 40. The United Nations also has an inspection mechanism, although this is not triggered by outside complaints. See, United Nations, *Joint Inspection Unit (JIU)*, available at <http://www.unsystem.org/jiu/>.

⁴⁵ European Ombudsman, available at <http://www.euro-ombudsman.eu.int/home/en/default.htm>.

and staff of the IFI; and non-state actors directly affected by the operations of the IFI and their representatives.

These principles are:

1. *Role of Non-State Actors*: It is absolutely essential that the mechanism be triggered directly by non-state actors who claim that they have been harmed or threatened with harm by the failure of the IMF to comply with its operational rules and procedures.
2. *Clarity of Purpose*: The mechanism can be designed to serve one or more of three different functions. These functions are:
 - a. **Compliance Review**: This involves determining if the IFI staff and management are satisfying the requirements of all the applicable operating policies and procedures in a particular IFI operation. The World Bank's Inspection is a good example of an inspection mechanism whose primary focus is compliance review.
 - b. **Problem Solving**: This involves resolving problems that arise in the course of an IFI operation and that have been identified by affected people as causing them or threatening them with harm. The IFC and MIGA's CAO is a good example of a problem solving mechanism.
 - c. **Lessons Learned**: This refers to the ability of the mechanism to contribute to the lessons that the IFI can learn about the efficacy of its operational rules and procedures. Given its unique perspective, the mechanism is in a position to identify trends within the implementation of operational policies and procedures that are unlikely to be obvious to other IFI actors. This function is not well developed in most of the mechanisms in the MDBs. The European Union's ombudsman is an example of a mechanism that performs a "lessons learned" role.

These three purposes are not necessarily mutually exclusive and it is possible for one inspection mechanism to perform more than one of these functions. In the case of the IMF, the two most relevant functions will be the compliance review and lessons learned function. It is more difficult for the mechanism to perform a problem solving function because of the complexities and multi-faceted nature of IMF operations. However, this does not mean that it should not be given the ability to solve problems when it can appropriately do so.
3. *Limited Jurisdiction*: The mechanism's jurisdiction must be limited to any case arising out of an allegation of non-compliance by the IFI staff and management with the IFI's operational policies and procedures. This helps ensure that the mechanism does not encroach onto the sovereignty of the institution's member states.
4. *User Friendliness*: Since the mechanism is intended to be available to those who have been adversely affected by the operations of the IFI, its procedures for receiving and handling complaints should be as easy for the affected people to understand and utilize as possible. One way to make the mechanism user

friendly is to limit the number of requirements that a complaint must satisfy before the mechanism begins to address the substance of the matters raised in the complaint. The Ombudsman part of the CAO is a good example of a user friendly mechanism. An example of a mechanism that is not particularly user friendly is the World Bank Inspection Panel⁴⁶. One consequence of its formal procedures is that the management of the World Bank has been able to use the Panel procedures to challenge the eligibility of complainants and the suitability of complaints for investigation. This has forced affected people to rely on relatively sophisticated advisors in preparing their complaints. In some cases, it has also contributed to an unnecessary politicization of the complaint.

5. *Independence*: The mechanism should be independent of the management of the IFI and should report directly to its Executive Board. In addition, the terms and conditions of employment of the mechanism's personnel should be designed to promote and protect its independence. Finally, the budget of the mechanism should support its independence.
6. *Powers of Investigation*: The mechanism must have access to all the persons, documents, records, and locations that it deems necessary to conduct a complete investigation.
7. *Impartiality and Competence*: This means that the mechanism's recommendations, findings, and conclusions must be supported by facts and, well reasoned arguments. In addition, the mechanism's investigations should be sufficiently comprehensive to demonstrate that it has gathered all the relevant information and has used this information in its reports.
8. *Efficiency and Cost Effectiveness*: This means the mechanism should be able to deal with complaints relatively quickly and at a cost that does not impose an undue burden on the IFI.
9. *Effective Management of Issues Presented*: This means that the mechanism must be able to demonstrate to all stakeholders that its findings and recommendations are taken seriously by the IFI and that the IFI will either implement the mechanism's recommendations or explain its failure to do so. One important consequence of this principle is that the mechanism should be given the power to monitor the implementation of the results of an inspection process.
10. *Transparency*: This means that the mechanism must publish the results of its investigations and must publish an annual report.

Application of the Principles to the IMF

Given the complexity of the IMF's operations, it needs a mechanism that is flexible, efficient, effective and easy to use. It also needs a mechanism that can both monitor staff and management compliance with its operational policies and procedures and can provide the IMF with a lessons learned capability. The mechanism should also, where appropriate, be able to help those directly

⁴⁶ See, *supra*, note 41.

affected by the IMF's decisions and operations either resolve their problems with the staff and management, or explain to them why a resolution is not possible.

The model that is most suited to the IMF's needs is an ombudsman. Historically an ombudsman was created for the purpose of receiving complaints from people who believed that they had been harmed by the failure of an institution to comply with its own policies and procedures⁴⁷. It was also expected to report to higher authorities on how well the institution was performing its responsibilities and complying with its policies and procedures. An ombudsman was designed to be flexible and relatively informal in its approach to the issues brought to it. This means that it can perform its function with minimal procedural requirements. The ombudsman is also well suited to help educate the institution and the authorities to which it reports on the problems that are arising in its operations and on identifying ways in which it can improve its operations.

The following are the essential characteristics that should be exhibited by an IMF ombudsman charged with monitoring its operational policies and procedures:

1. The ombudsman must be appointed by and report directly to the IMF's Executive Board. He/she should have the status of a senior official of the IMF.
2. The ombudsman must be given all the indicia of independence. This means he/she should not have to report to IMF management or to receive any authorization from management regarding its budget or personnel decisions, He/she must be appointed to a single non-renewable term of office from which he/she can only be removed by the Executive Board for cause. The ombudsman should also have full control over all staff appointments in the ombudsman's office, and assured budgetary support.
3. The ombudsman must be able to receive any complaint relating to the IMF's operations from any person who believes they have been or are threatened with harm caused by the failure of IMF staff or management to comply with the IMF's operational policies and procedures.
4. The ombudsman must have the exclusive power to review the complaint and to decide whether to investigate the complaint or to reject it.
5. If the ombudsman decides to accept the complaint for investigation, he/she must have complete powers of investigation, which includes access to all the IMF staff and records that he/she deems relevant to the investigation.
6. The ombudsman must be required to make a report, which is publicly available, to the Executive Board for each case for which he/she conducts a full investigation.
7. The ombudsman must publish an annual report in which he/she must report on all the complaints he/she received and on how they were handled. In addition, the ombudsman, in the annual report, must comment on the lessons he/she believes can be learned about the IMF's operational policies and procedures from the cases he/she has received and, if appropriate, make suggestions on how to improve these rules and procedures.
8. The ombudsman must have the authority to monitor the implementation of the outcome of any investigations he/she conducts.

Example of Operation of IMF Ombudsman

⁴⁷ For information on ombudsmen generally, see Ibrahim al-Wahab, *The Swedish Institution of Ombudsman* (1979); World Bank, PREM Notes, No. 19, April 1999, *Using an Ombudsman to Oversee Public Officials*, available at <http://www1.worldbank.org/prem/PREMNotes/premnote19.pdf>.

The following example may help clarify the benefits that an ombudsman could provide to the IMF: Assume that the IMF has proposed that a country seeking its financial support cut its budget deficit as a condition for this support. Under the current situation, groups opposing the government's proposed cuts to government expenditures or proposed increased taxes could not easily establish whether the government alone shares responsibility for this action or if the IMF staff share some of the responsibility because, for example, they failed to consult all relevant parties or failed to take certain pertinent information into account in establishing the challenged condition. This is because these groups could not easily determine if the IMF staff have complied with IMF operational policies and procedures in establishing this condition (which would set out with whom the staff should consult and the variables that the IMF should consider in making its conditions) and would have no formal channels through which to address their concerns about the IMF staff. The result may be that the groups will either politicize their concerns so as to get the attention of the IMF Board of Director or that they will work to undermine the government's policy, thereby, also undermining the potential success of the IMF's operation.

If there were formal IMF operational policies and procedures and an IMF ombudsman, the affected groups could determine whether or not the IMF staff had complied with the applicable policies and procedures and could bring their concerns to the ombudsman. This person could then review the record to determine if the IMF complied with its operational policies and procedures. If he/she determined that there was compliance, he/she could provide the complainant and the IMF Board and management with a reasoned explanation for his/her finding. Alternatively, if the ombudsman found there was non-compliance, he/she would provide the IMF Board, the management and the complainants with a reasoned explanation for this finding. This would allow the Board, based on a well reasoned record and finding and the management's response to this record, to decide, based on the merits of the case, how they wish to address the situation. In either case, the findings of the ombudsman would assure the complainants that their concerns had been addressed on their merits at a high level in the IMF. While this may not bring them their desired outcome, it should satisfy them that their concerns have been taken seriously and that they have been treated fairly by the IMF.

This example highlights a number of important points. First, the ombudsman's mandate is limited to reviewing the IMF staff and management's compliance with the IMF's formal operating policies and procedures. He/she cannot comment on the actions of the government concerned. Second, the ombudsman's authority rests only on his/her persuasive powers, as he/she has no independent powers of enforcement. Thus, the efficacy of the ombudsman depends on maintaining the confidence of all relevant stakeholders—both those inside and outside the IMF. It is for this reason that the independence of the ombudsman from all stakeholders is of such critical importance. Third, the ombudsman's findings and decisions will help provide all interested persons with empirical data on the actual implementation of its operational policies and procedures. These lessons can help contribute to both their improvement over time and to better understanding among all interested parties about the challenges the IMF faces in its operations. Fourth, there is no part of the current IMF structure that can readily play the role of the ombudsman, even though there are two existing units that play a role in policy review and evaluation. The Policy Development and Review Department, both because it reports to management and because of its role in developing policies is not a credible independent monitor of the implementation of the policies it develops and helps review. The Independent Evaluation Office, under its current mandate has the requisite independence but is limited to reviewing

completed operations. Consequently, without an expansion of its mandate, it cannot deal with cases arising from ongoing operations, which would be the normal source of cases for an IMF ombudsman.

V. Conclusion

The complexity and range of IMF operations has grown to the point where it is no longer feasible for it to limit its interactions in its member states to officials in the Central Bank and the Ministry of Finance in those countries. It now regularly consults with a broad range of government officials, legislatures and actors in civil society in those member states that utilize its services. This means that the number and range of actors with which the IMF is engaged as grown beyond the point where its operating practices can be kept informal and known only to a relatively small number of experts. Consequently, it needs to develop a set of operational policies and procedures to guide its interactions with all these actors and to guide its decision making. The lack of a comprehensive set of such policies and procedures renders IMF operations unduly opaque and undermines stakeholder confidence in its fairness and impartiality.

While the creation of such operational policies and procedures do impose some costs on the IMF, they can be minimized through the policy and procedures design and drafting process. In addition, these costs are more than compensated for by the benefits that they will bring to the institution.

It is not sufficient for the IMF to merely promulgate such policies and procedures. It must support the implementation of these operational policies and procedures by establishing an independent ombudsman with the authority to investigate complaints from directly affected people and groups about staff and management non-compliance with the policies and procedures.

Both of these steps are required if the IMF is to demonstrate that it practices what it preaches about good governance.