THE INTERNATIONAL MONETARY FUND: TIME FOR REFORM

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Introduction

The International Monetary Fund (IMF) was set up in 1944 to promote international cooperation on monetary and exchange rate matters. The purposes of the IMF –stated in Article I of its Articles of Agreement– include the promotion of exchange stability, assistance in establishing a multilateral system of payments for current international transactions and, where necessary, providing temporary financing to IMF members to help them address their balance of payment problems without resorting to measures destructive of national or international prosperity.

Since its establishment the IMF has developed into a global financial institution with a nearly universal membership comprising 185 countries. For over seventy years the IMF has served its member countries by providing financial and technical assistance, and policy advice on the issues within its competence. During all that time, the IMF has continuously adapted itself to handle new challenges: the breakdown of the Bretton Woods system of fixed exchange rates and the oil crisis in the 1970s; the debt crisis of the 1980s; and the emerging-market crises of the 1990s. The collapse of the state-run economies of Eastern Europe in 1990s and the challenges facing low income countries have also prompted new directions for IMF assistance. In contrast, the last several years have witnessed an unprecedented growth fueled by globalization of trade and financial flows, innovations in the financial markets and ample liquidity. As a result, the world economy has gone through a relatively calm period. Ironically, however, the very stability and resilience of the international economy, which may be at least partially attributed to the IMF, have become the major cause of the “identity crisis” that the IMF is now facing. Although adapting to changes is not new to the IMF, the current situation is unusually challenging: in the globalized economy where private capital flows dwarf official financing, and where financial and economic power is getting rebalanced from the developed countries to countries who used to come to the IMF for financial assistance and advice, the IMF has to redefine its place in the international financial architecture if it were to remain relevant for its membership.

The IMF itself has recognized the need for reform better than any one else. This self critical approach is reflected in the IMF’s Medium Term Strategy (MTS) that was proposed by the former Managing Director Rodrigo de Rato in 2005[1] and was subsequently endorsed by the Executive Board and the International

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[1] The Managing Director’s report on the MTS drew on the work of the Committee on the Strategic Review of the IMF, chaired by the then First Deputy Managing Director Ms. Krueger. The full text of the MTS is available at: http://www.imf.org/external/np/exr/ib/2006/041806.htm.

Monetary and Financing Committee (IMFC).[2] The MTS summarized the challenges faced by the IMF as follows:

> "Last year, on the 60th anniversary of the founding of this institution, a consensus emerged on the need to reflect on the future direction of the IMF. Despite a generally positive assessment of the organization's work and adaptability, at least three factors prompted a desire for critical self-reflection:
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> - First, there is a sense that the challenges of the past decade have pulled the IMF in too many new directions—further straining the original vision of an institution devoted to international monetary stability and the financing of temporary balance of payments problems.
> - Second, the accretion of new mandates, without eliminating old ones, has made it difficult to allocate resources effectively and to stay ahead of emerging challenges.
> - Third, there is the question of whether the IMF is fully prepared to meet the great macroeconomic challenges that lie ahead. Among other things, these include tackling unprecedented global payments imbalances, responding to capital account crises caused by abrupt shifts in global asset allocation, and helping all members, especially low-income countries, to grow by integrating into the world economy."

Acknowledging that, in order to meet these challenges, the IMF had to change, the MTS outlined the key areas of reform: more effective surveillance, enhancing the role of IMF's advice in developed countries, enhancing the IMF's crisis prevention and crisis resolution tools, better understanding capital account liberalization, clarifying IMF's involvement in low-income countries, addressing budgetary issues and the issues of the legitimacy of the IMF through quotas and voice reform. The MTS also suggested that helping members to meet the challenge of globalization should be the key objective of the IMF's work.

The reforms on which the IMF embarked following the adoption of the MTS are unprecedented in the history of the Fund. The rest of the article discusses in more detail the ongoing reforms in three major areas: IMF governance (Section II), surveillance (Section III) and IMF's income model (Section IV).

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[2] The IMFC is a 24-member advisory committee of the IMF's Board of Governors which is comprised of finance ministers and central bank governors. The IMFC is currently chaired by Mr. Tommaso Padoa-Schioppa of Italy. Views expressed in the IMFC *communiqués* are considered to be implicitly endorsed by the IMF membership and serve as guidance for IMF management and staff. More information about the IMFC is available at: http://www.imf.org/external/np/exr/facts/groups.htm.

II. Reforming IMF Governance

Reforming IMF governance is a corner stone of the ongoing reforms. It has been recognized by the IMF and its members that the outdated voice and the distribution of quotas system poses a significant risk to the legitimacy and effectiveness of the IMF, and that the failure to rebalance the existing system to give countries a voice in the IMF commensurate with their weight in the world economy would further weaken the IMF. While the current voice and quota distribution has long been perceived by some countries as "unfair", the ongoing major rebalancing of the international economic power adds urgency to the reform. Many developing countries that traditionally borrowed from the IMF have repaid their loans, often ahead of time, and their economies continue to grow rapidly. These countries are no longer satisfied with the *status quo* and are demanding a bigger say in IMF's policy making. Delays in reforming the IMF's voice and quota system would further weaken the legitimacy of the IMF in the eyes of these countries as well as low income countries who are now the most frequent users of IMF concessional resources, and increase the risk of further alienating them from the IMF.

A quick overview of the quota distribution system may be useful to understand the governance structure of the IMF and why changes are needed. Under the IMF's Articles, each country joining the IMF is assigned a share ("quota") determined in accordance with a formula designed to reflect the size of its economy relative to other similarly situated economies. In determining quotas various economic factors are taken into consideration, including GDP, the size of the country's official reserves, and current account transactions. Quotas are important, as they determine the member's contribution to the IMF, its voting rights, and have a bearing on the member's access to IMF financial resources. In particular, the size of the member's quota determines the member's voting rights: under Article XII, Section 5 of the Articles of Agreement each member regardless of the size of its economy is entitled to 250 votes (called "basic votes") with one additional vote allocated per each one hundred thousand Special Drawing Rights ("SDRs")[3] of the member's quota. So the larger the member's quota, the more significant its vote in the IMF.[4]

The Articles of Agreement provide a mechanism for periodic reviews of quotas: quotas must be reviewed every five years by the Board of Governors, the

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[3] The SDR is an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their IMF quotas. The SDR also serves as the unit of account of the IMF and some other international organizations. Its value is based on a basket of key international currencies. Additional information about the SDR is available at: http://www.imf.org/external/np/exr/facts/sdr.HTM.

[4] Five members with the largest quotas currently are: the United States, Japan, Germany, France, and United Kingdom.

IMF's highest governing body.[5] One-time changes in quotas are also possible under the Articles.[6] However, the existing mechanisms do not guarantee that quotas, once assigned, will remain generally in line with the relative sizes of the members' economies. As the weight of developing countries such as China, India, and Brazil, in the world economy has increased over time, the distribution of quotas and voice in the IMF has become more and more out of line with the economic realities.

The objective of the ongoing voice and quota reform is thus three-fold: *first,* to make significant progress in realigning quota shares with economic weight in the global economy; *second,* to make quota and voting shares in the IMF more responsive to changes in global economic realities in the future, and *third*, to enhance participation and voice for low-income countries, whose weight in global economy may be small, but for which the IMF plays an important advisory and financing role. The timetable for the reform is ambitious – the major elements are expected to be completed by the IMF 2008 Annual Meetings.

Due to the complexity of issues involved in reforming IMF governance, the voice and quota reform is implemented in several stages. As the first step, in 2006, the Board of Governors increased the quotas of four most underrepresented members -China, Korea, Mexico and Turkey- whose quotas were considered to be most out of line with the size of their economies.[7] At the second stage, members should reach an agreement on a new quota formula, to be used, at the third stage, as the basis for further *ad hoc* quota increases. In addition to adjusting the existing quotas, another important element of the reform is increasing the number of basic votes in order to give the smallest members a greater voice in the IMF.[8]

The reform is currently at its second stage – developing a new quota formula. Designing a new formula is very challenging because it is complex conceptually, technically, and politically. For a few formula to be approved and implemented, a very broad consensus will have to be reached among the IMF membership.

In addition to voice and quota issues, the reform of the IMF governance will also need to address other aspects, for example, the process for the selection of management. On this issue good progress has been made. There is a consensus now among IMF membership that the selection of the Managing Director -who has traditionally been an European, while the President of the IMF sister

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5 Article III, Section 1 of the Articles of Agreement.

6 Under Article III, Section 2(e) of the Articles of Agreement, any change in quotas must be approved by an eighty five percent majority of the total voting power in the IMF.

7 The Resolution on Quota and Voice Reform in the IMF was adopted by the Board of Governors on September 18, 2006.

8 Any increase in the number of basic votes would require an amendment of the Articles of Agreement. Such an amendment will also include a mechanism for safeguarding the proportion of basic votes in the total voting power.

institution, the World Bank, has been an American- should be open and transparent and should be based on merit, rather than on the nationality. The selection of Dominique Strauss-Khan as the new Managing Director in 2007 provides some assurances that reaching agreement on the Managing Director's selection process will be less contentious that on other elements of the reform.[9]

III. Enhancing IMF Surveillance

Moving from the IMF governance to its operations, this section discusses developments in IMF surveillance. Surveillance, i.e., an oversight by the IMF over the economic and financial policies of its members (bilateral surveillance) and over the international monetary system (multilateral surveillance), is a core function of the IMF.[10] Through surveillance the IMF promotes global financial stability and advises members on risks to economic stability and growth and on the necessary policy adjustments.

Surveillance in its present form was established in late 1970s by a new Article IV of the IMF's Articles adopted as part of the Second Amendments to the Articles of Agreement following the collapse of the system of fixed exchange rates.[11] Under the new framework, members were given broad discretion to adopt exchange arrangements of their choice (subject to few limitations specified in Article IV) in exchange for the undertaking to conduct their economic and exchange rate policies in accordance with the established "code of conduct" and to cooperate with the IMF and with one another to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member undertook the following obligations set forth in Section 1 of Article IV:

i) to endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;

ii) to seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;

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9 Additional information about the reform of the IMF governance is available at: http://www.imf.org/external/np/exr/key/quotav.htm.

10 The two other main functions of the IMF are the provision of financial and technical assistance.

11 The Second Amendment became effective in 1978. Prior to the Second Amendment, the exchange rates of all currencies were linked to U.S. dollar and the value of the U.S. dollar was linked to gold. After the break-up of that system, exchange rates of currencies got decoupled from the U.S. dollar and started fluctuating against one another.

iii) to avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and

iv) to follow exchange policies compatible with the undertakings under this Section.

Members also undertook an obligation to provide the IMF with the information necessary for surveillance and, when requested by the IMF, to consult with it on their exchange rate policies.[12] The IMF, on the other hand, was given the mandate to oversee compliance of members with their obligations, to exercise firm surveillance over the members' exchange rate policies and to adopt specific principles to guide members with respect to those policies.[13] The IMF provided such guidance by adopting the Decision on Surveillance over Exchange Rate Policies (the "1977 Surveillance Decision")[14] in April 1977, even before the new Article IV entered into force. The 1977 Surveillance Decision established specific principles to guide members' exchange rate policies, principles for the IMF's conduct of surveillance, and surveillance procedures.

While the 1977 Surveillance Decision has been the basis for the IMF's bilateral surveillance for 30 years, surveillance has constantly evolved and adapted to the changing world economy. The Executive Board which, under the Articles, is responsible for conducting surveillance, reviewed the 1977 Decision on a biennial basis. These reviews provided additional guidance to IMF management and staff on the coverage and priorities of surveillance.[15]

Several developments in the evolution of surveillance are worth noting in the context of this discussion. First, with regard to the coverage, the intent of Article IV was clearly to focus bilateral surveillance on members' exchange rate policies, including a prohibition of exchange rate manipulation to achieve certain objectives, and to a lesser extent - on members' other economic and financial policies.[16] Over time, however, the focus of exchange rate issues became less pronounced and the coverage of surveillance assessments extended to many other

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[12] Obligations set forth in Article IV of the Articles of Agreement are sometimes collectively referred in this article as members' "policy obligations."

[13] Article IV, Section 3(b) of the Articles of Agreement.

[14] Decision No. 5392-(77/63), April 29, 1977 available at: http://www.imf.org/external/pubs/ft/sd/index.asp.

[15] Such guidance was included in the Chairman's Summings-Up of the Board meetings on the review of the 1977 Surveillance Decisions. The legal effect of the summings-up is similar to formal Board decisions.

[16] Obligations with respect to policies other than exchange rate policies are of a "soft" nature and require that members only "endeavor" or "seek" a certain result. This contrasts with much stronger language on the obligations on exchange rate policies, which require that members "avoid" manipulating exchange rates and "follow" exchange rate policies compatible with the rest of the Article IV.

areas. This change could be partly explained by the fact that Article IV itself provides little guidance on the meaning of members' obligations on exchange rate policies, but also resulted from the sensitive nature of exchange rate issues and the resistance from many IMF members to involve the IMF in discussions of these policies.

Second, the particular modalities of surveillance that evolved over the years have important implications for the effectiveness of this exercise. While the legal basis for surveillance is the provision of Article IV, Section 3(a) that requires the IMF to assess compliance of members with their obligations under Article IV, Section 1, bilateral surveillance has always been seen by the IMF more as a policy dialogue with the members than a compliance exercise. This dialogue is conducted on a continuing basis and includes regular missions by IMF staff to member countries (known as "Article IV consultation missions"). During such a mission staff discusses with the member's policy makers the member's current and forward looking economic and financial policies, their impact on the member's economic stability and growth, and advises on the desired policy changes. Upon the mission's return to the headquarters, a report is prepared and presented to the Executive Board, which discusses it and formally concludes the Article IV consultation. While the IMF can publish surveillance reports only with the consent of the member,[17] members are increasingly consenting to making these reports public. In fact, in bilateral surveillance the IMF plays a dual role: the assessor and a trusted advisor to members' governments on economic policies. It is partly due to the general nature of the members' obligations as set forth in Article IV, and partly to an inherent conflict between these two roles of the IMF, that no member country has ever been found in violation of its obligations under Article IV. The conflict between these two roles presents a serious challenge for the effectiveness of IMF's surveillance.

In addition to bilateral assessments of members' policies, the IMF conducts regional and multilateral surveillance through monitoring developments in regional and global economy. As part of regional surveillance the IMF conducts discussions with the policy making institutions of monetary unions (e.g., the EURO area, CEMAC (the Central African Economic and Monetary Union), ECCU (Eastern Caribbean Currency Union), WAEMU (West African Economic and Monetary Union)) and prepares reports on such discussions that are considered in the context of bilateral consultations with countries members of these unions. The IMF also prepares reports on regional economic developments. Key instruments of multilateral surveillance are two semi-annual publications, *World Economic Outlook* and *Global Financial Stability Report*,[18] the former

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[17] The IMF can generally publish documents pertaining to a member if such documents do not contain confidential information or view of the Executive Board with respect to the member. As reports on Article IV consultations do contain views of the Executive Board, these reports cannot be published without that member's consent.

[18] These publications are available at the IMF's website: http://www.imf.org/external/pubind.htm.

focused on the world economy as a whole and the latter on the financial sector and capital markets. The multilateral aspect of surveillance has become increasingly important with the globalization of world economy and financial markets.

Although surveillance has always been considered a core function of the IMF, it was overshadowed by the economic developments of the 1980s and 1990s, as the IMF focused on providing financial assistance to countries hit by a crisis or reforming their economies after the break down of central planning systems. However, in early 2000, the growth of global economic imbalances, perceived to be fueled in part by the exchange rate policies of some of the Asian countries, put exchange rate issues back on the international economic agenda. Renewed attention to exchange policies revived interest in IMF surveillance as a tool for addressing these issues and more generally in the role of the IMF on exchange rate matters.

Around the same time several studies were conducted within and outside the IMF focusing on IMF's surveillance activities.[19] These studies, while acknowledging the challenge faced by the IMF in conducting surveillance, expressed serious misgivings about the effectiveness of surveillance. For example, the main finding of a study conducted by the IMF's Independent Evaluation Office (IEO)[20] was that "the IMF was simply not as effective as it needs to be in both its analysis and advice, and in its dialogue with member countries."[21] According to the IEO report, the reasons for the IMF's failing to fully meet its core responsibility were many and complex, including a lack of understanding of the role of the IMF in exchange rate surveillance; a failure by member countries to understand and commit to their obligations to exchange rate surveillance; a strong sense among some member countries of a lack of evenhandedness in surveillance; a failure by management and the Executive Board to provide adequate direction and incentives for high-quality analysis and

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[19] See, e.g., IEO Report on "Evaluation of the IMF's Multilateral Surveillance" (April 7, 2006); IEO Report on "The IMF's Exchange Rate Policy Advice, 1999-2005" (May 17, 2007); Report of the Meltzer Commission (http://www.house.gov/jec/imf/meltzer.htm). IEO Reports are available at the IEO's website at: http://www.ieo-imf.org. The Meltzer Commission's report touches on IMF surveillance in a broader context of reviewing the activities of the IMF and several other IFIs.

[20] The Independent Evaluation Office (IEO) was established in 2001 to conduct independent evaluations on issues relevant to the mandate of the IMF. It is fully independent from the Management of the IMF and operates at arm's length from the Board of Executive Directors. More information about the IEO is available at: http://www.ieo-imf.org.

[21] Report of the IMF's Independent Evaluation Office on "the IMF's Exchange Rate Policy Advice, 1999-2005", p. 3. The report is available at: http://www.ieo-imf.org/eval/complete/eval_05172007.html.

advice on exchange rate issues; and the absence of an effective dialogue between the IMF and many -though certainly not all- of its member countries.

Facing the growing criticism of surveillance from inside and outside the institution, the IMF started to address these real and perceived deficiencies. While this work is currently ongoing, some improvements are already visible. For example, the analysis of exchange rate issues now features much more prominently in IMF surveillance reports. Also, reports strive to incorporate better the analysis of financial sector issues and potential spillovers from a member's policies to other members' economies. Another important noteworthy development is an update by the Fund in 2007 of the legal foundation for bilateral surveillance by replacing the 1977 Surveillance Decision with a new decision on bilateral surveillance.[22] The new decision has the objective to codify the best practices on surveillance and to provide better guidance to both IMF members and the IMF on the scope and modalities of surveillance. The key features of the 2007 Surveillance Decision are that it:

- refocuses IMF's bilateral surveillance on members' promoting domestic and external economic stability on the rationale that by promoting stability on the national level each member is promoting international stability;

- confirms that the IMF's assessment and advice in the context of bilateral surveillance will be informed by, and be consistent with, a multilateral framework that incorporates relevant aspects of the global and regional economic environment;

- provides better guidance on the acceptable exchange rate policies by clarifying the concept of "exchange rate manipulation" and by establishing new principle for the guidance of members' exchange rate policies that prohibits exchange rate policies that result in external instability;

- streamlines surveillance procedures and clarifies that surveillance is a collaborative, candid, and evenhanded process between the IMF and its members.

The new surveillance decision is a positive development, although its impact on IMF's bilateral surveillance remains to be seen. The decision is now in the early stages of implementation and its application to all IMF members in a consistent and evenhanded manner is key.

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[22] Decision No. 13919-(07/51), adopted on June 15, 2007, on Bilateral Surveillance Over Members' Policies (the "2007 Surveillance Decision"). The Decision is available at: http://www.imf.org/external/np/sec/pn/2007/pn0769.htm#decision.

In addition to updating the legal framework for bilateral surveillance, the IMF is in the process of implementing other measures that should improve surveillance, such as better incorporation into surveillance of financial sector issues, enhancing assistance to members on improving the quality of economic data, streamlining procedures and documentation requirements for Article IV consultations, and improving its communication strategy.

Beside the work on improving bilateral surveillance, the IMF is also exploring ways to step up its oversight over the global economy. To this end, in 2007 multilateral consultations were introduced as a new tool to supplement IMF multilateral and bilateral surveillance. The first multilateral consultation, focusing on reducing global imbalances, while maintaining robust global growth, involved six major economies (China, the Euro Area, Japan, Saudi Arabia and the United States) and was completed in July 2007. The consultation helped to identify measures that: should gradually reduce imbalances over time while also supporting global growth; are beneficial from a regional and international perspective; and have strong ownership. Each participant prepared and published a statement of policy intentions that would help address the global imbalances and committed to implementing those policies. Although the first multilateral consultation has been criticized by some commentators as not having achieved concrete results, its conduct and conclusion showed that this is a potentially valuable innovation.

The reforms of IMF surveillance discussed above are only starting to bear fruit but it is already clear that further action by the IMF and its members will be necessary if surveillance is to become more effective. First, more work is needed on a number of technical and methodological aspects relevant to the application of the new 2007 Surveillance Decision, as there is currently no consensus within the economic profession on some of the key issues that lie at the heart of IMF surveillance (e.g., the concept of "fundamental misalignment" of an exchange rate, the appropriate levels of official reserves, ways to better incorporate financial sector issues into surveillance). Second, the issue of how to make IMF member countries, who are ultimately responsible for conducting prudent economic policies, more responsive to IMF's surveillance advice warrants further consideration. This issue becomes especially important, as the leverage that the IMF once exercised over the countries that used its financial assistance is quickly disappearing, and the ability of the Fund to enforce compliance of members with their policy obligations without such leverage is generally untested. Relying on sanctions set forth in the Articles of Agreement alone is unlikely to achieve the desired results, as these sanctions are too severe[23] and the IMF has so far been

[23] Sanctions set forth in the IMF's Articles of Agreement include: a declaration of ineligibility to use IMF resources, suspension of voting rights, and compulsory withdrawal from the IMF (Article XXVI). The imposition of formal sanctions by the IMF has serious implications for a member, as it affects its relationships with the rest of the international community and may also interfere with the member's other international obligations. For example, many sovereign external bonds include a covenant requiring

reluctant to use them to punish members for breaching their policy obligations. Besides, as mentioned above, the dual role of the IMF as a compliance monitor and a trusted advisor to the members' authorities creates additional challenges. Therefore, the Fund should continue to look for ways to increase "traction" of its advice, balancing incentives with potential sanctions. In this regard, the increasing transparency of IMF assessments is an important tool. Third, the effectiveness of surveillance is linked to broader governance issues that the IMF is now addressing: members are more likely to listen to, and implement, IMF's advice if they perceive the IMF to be truly representative of their interests, not just seeking to impose policies, in the development of which the member has no voice. It is thus crucial that the reform of the IMF governance structure is implemented without delay.

Finally, the IMF and its membership may have to consider a broader issue of whether the IMF should assume a greater regulatory role in assessing and enforcing compliance of its member countries with their policy obligations under the Articles, and in particular compliance with the obligations on exchange rate policy. Some commentators[24] argue that the IMF is uniquely positioned to act as a referee on exchange rate matters and that its failure to do so would result in the proliferation of bilateral action, affecting the stability of international monetary system and international trade. They also argue that the IMF risks loosing its relevance as an institution if it does not assume a greater role on the issue that lies at the heart of its mandate. While these arguments are not without merit, there is currently little appetite on the part of the IMF membership to make radical changes in the manner in which the Fund conducts surveillance. Giving the IMF a greater role on exchange rate matters would be a significant shift in how the IMF does its business and would have significant implications for the international financial architecture that go beyond the discussion in this article.

IV. Reforming the IMF's Income Model

In 2004 the IMF initiated an internal review of its finances and financial structure, which became the first step in the process that culminated in the proposals for most significant changes in how the IMF is financed in decades. In 2005, concerns over the IMF's medium-term budget were acknowledged in the MTS which stated that the accumulation of mandates by the IMF over the years had greatly reduced the flexibility in its budget to respond to new challenges and predicted that this pressure would increase in the coming years, as earnings from large IMF arrangements receded. However, by early 2006 it had become clear that the budget issue had become more urgent. The report on the implementation

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the issuer to retain membership in the IMF and to remain eligible to use the IMF's general resources. A breach of such a covenant may have serious economic implications for the debtor.

[24] See, e.g., Morris Goldstein "Global Imbalances: Time for Action", available at: http://petersoninstitute.org/publications/interstitial.cfm?ResearchID=720.

of the MTS made by the former Managing Director Rodrigo de Rato to the Executive Board in April 2006 stated that "although the strategy paper had flagged a decline in income from lending as important issue for the medium term, the future has arrived sooner than anticipated."[25] The report estimated that the IMF was facing the SDR 150-200 million fall in annual income -equivalent to a third of the IMF's current level of annual spending- in the coming years. It was recognized that the IMF's current business financing model, of paying for surveillance and capacity building with margins on adjustment lending, was no longer viable.

Against that background, Mr. de Rato established, in May 2006, the Committee of Eminent Persons to Study Long-Term Financing of IMF Running Costs. The Committee, which comprised several central bank governors and was chaired by Andrew Crockett, former Director General of the Bank for International Settlements and then president of JP Morgan Chase International, prepared a report that identified major shortcoming in the IMF income model and recommended changes. The Crockett Committee report was presented to the IMF Executive Board on January 31, 2007.[26] The key problem identified in the report was that the IMF income model relied chiefly on the income derived from its lending operations to meet the costs of running its operations. The report also pointed out to other weaknesses of the existing model: for example, that it was inequitable because the margin on lending has funded by IMF's other activities, and also that, ironically, the IMF's financial well-being depended on being unsuccessful in its primary functions, i.e., the prevention of financial crises. Although the current model served the IMF well and generated sufficient income as long as member countries made active use of the IMF financial resources, its shortcomings have become increasingly obvious as the volume of IMF credit has drastically declined, as more countries were able to access capital markets and repaid their obligations to the IMF. From the perspective of the IMF as a multilateral institution set up to promote global financial stability, these developments were welcome. At the same time, however, they also prompted the IMF to identify predictable and stable sources of income to finance its operations.

The report recommended a comprehensive package of measures to reform the IMF's current financing model. The key recommendations included: (i) expanding the IMF's investment operations by broadening its investment mandate and investing part of the quota resources; and (ii) the limited sale of IMF gold and creating an endowment for investing the proceeds and using investment income to help cover administrative expenses. The report also recommended other measures, including charges for services provided by the IMF to its members,

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[25] The Managing Director's Report on Implementing the IMF's Medium-Term Strategy, April 5, 2006, paragraph 47.

[26] The report is available at the IMF's external website at: http://www.imf.org/external/np/oth/2007/013107.pdf.

reimbursing the IMF for administrative expenses of the PRGF-ESF Trust,[27] breaking the link between the rate of charge[28] and the IMF's administrative expenses, and establishing a formal dividend policy.

Expanding the IMF's investment operations is an important part of the reform, as it should allow the IMF to receive additional income from investing an increased portion of its resources. While the IMF is authorized under the Articles of Agreement to invest part of its resources,[29] the provisions of the Articles governing the IMF's investment authority are very restrictive compared, for example, to those of the World Bank and most other key IFIs. In particular, investment by the IMF of a member's currency held in the Investment Account requires consent of the member, and the permitted investments are limited to marketable obligations issued by IMF members or international financial organizations.[30]

To address these shortcomings, proposals to reform the framework for investing the IMF's resources seek to increase the share of resources that the IMF may invest to include an equal percentage of each member's quota; to eliminate the consent requirement for a member's currency to be invested; to require members whose currencies cannot be used for investment to convert balances of their currencies transferred to the Investment Account into SDRs or a freely usable currency, to expand the list of permissible investments, and to make the new framework both equitable to all members and flexible by giving the Executive Board the authority to adopt the required policies on some issues, while making decisions on other issues subject to a qualified majority vote. The implementation of the above mentioned measures will require amending the Articles of Agreement and therefore broad consensus among the IMF membership.

Another measure recommended by the Crockett Committee was creating an endowment which would be funded by the sale of a limited portion of the gold reserves that the IMF holds, and using income generated from investing these funds toward the running costs of the IMF. The IMF currently holds an equivalent of 3,217 metric tons of gold, which it acquired in various ways over

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27 The IMF acts as a Trustee of the PRGF-ESF Trust by mobilizing, managing and dispensing the resources of the Trust contributed by the IMF membership and the IMF itself to low-income countries.

28 The rate of charge is the interest payable by a member on its outstanding use of IMF credit.

29 The relevant provisions were adopted in late 1970s and include separate but identical clauses for the investment of resources held in the Investment Account (IA) and Special Disbursement Account (SDA), respectively. (Article XII, Section 6(f)(iii), and Article V, Section 12(h) (SDA)). Article XII, Section6(f) provides that the IMF may establish an Investment Account for investing a share of its resources, as specified in the Articles.

30 Article XII, Section 6(f)(iii) of the Articles of Agreement.

the years, making it one of the largest official holders of gold. A sale by the IMF of a share of its gold would convert non-income generating assets into a source of income, as the resources of the endowment would be invested in line with the IMF's expanded investment mandate.

The sale of gold is a very complex issue both legally and politically. From the legal perspective, the Articles impose limitations on the IMF's transactions with gold.[31] Moreover, any decision to sell gold will require an eighty-give percent majority of the total voting power, giving the United States, the IMF member with the largest quota, a veto over such a transaction.[32] Recognizing that any sale of gold raises difficult issues, the Crockett Committee emphasized in its recommendations that the amount of gold to be sold should be limited so as to ensure that (a) the role of gold as a source of strength to the IMF's balance sheet is not undermined, and (b) the sale does not cause disturbances to the functioning of the gold market. It therefore proposed to limit gold sales to 403 tons of gold the IMF has accumulated since the Second Amendment, which are derived primarily from the off-market gold transactions that were conducted in 1999-2000.[33]

In April 2007, the recommendations of the Crockett Committee were broadly endorsed by the IMFC as a sound basis for further work on the development of a new income model for the IMF. Over the last year staff and management of the IMF have been working on developing the Committee's recommendations into concrete proposals, and this work continues at the time of this writing. What has become clear, however, is that, for a broad consensus to be achieved on reforming the IMF's income model, the reform of IMF expenditure and income must be tackled simultaneously. Recognizing this, the Managing Director Strauss-Kahn has launched a program to come up with significant expenditure cuts, including reducing the number of staff employed by the IMF. It is expected that a final set

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31 The Articles strictly limit the transactions the IMF can undertake with gold. In particular, the IMF may sell gold, it can accept gold from members making repurchases, and it can "restitute" the gold that members generally provided in payment of quota subscriptions before the Second Amendment. The IMF may not purchase gold, nor is it able to engage in other transactions open to central banks such as lending, leasing, or swapping gold, nor may it post gold a collateral. For more information see: Financial Organization and Operations of the IMF, No. 45 Sixth Edition, International Monetary IMF 2001, pp. 49-54, available at:
http://www.imf.org/external/pubs/ft/pam/pam45/contents.htm.

32 The U.S. authorities have also informed IMF staff that, in light of existing U.S. legislation and the purpose of the proposed sale of gold, U.S. Congressional authorization by law would be required before the Executive Director appointed by the United States could support a decision on the sale of gold.

33 Under the Articles of Agreement, gold acquired by the IMF prior to the Second Amendment is treated differently from gold acquired after the Second Amendment. Due to the more restrictive treatment for the former, including for purposes of the IMF's financial statements, the sale of the post-Second Amendment gold is considered to be more acceptable by IMF membership.

of proposals will be discussed by the Executive Board in the first part of 2008 and that specific proposals on a new income model and expenditure framework will be presented to the Board of Governors at the time of the IMF Spring meetings in April 2008.

Conclusion

The IMF is currently undergoing unprecedented reforms. These reforms, if implemented successfully, would make the Fund a more effective institution that can better respond to the evolving needs of its members. Whatever the outcome of these reforms, it will shape the future of the IMF as the key authority on international monetary and financial matters. And while it is way too early to predict what the outcome would be, it is safe to say that the success of the reforms is in the best interest of the IMF itself, its members and the international community as a whole.