TOWARDS A STRONGER, MORE EFFECTIVE IMF

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BASIC CONSIDERATIONS

- The IMF is a unique and essential institution.

- It is probably the most effective multinational institution.
  - Best staff in its field.
  - Has contributed towards improving policy design and management, including by setting standards, through surveillance and technical assistance (TA).
  - Provider oftentimes of effective policy recommendations.
  - Through its lending facilities, it has contributed to the resolution of several crises.
  - It has helped many Low Income Countries (LIC) build institutions.

- But the Fund is NOT ALL IT COULD BE.

IMF´S FOUR MAIN CHALLENGES

- The Fund´s institutional development has been lagging behind in several dimensions:

1. Governance
2. Ability to perform appropriate surveillance (both at the national and multilateral levels) and prevent crises
3. Ability to effectively support crisis resolution
4. Capacity to induce policy coordination at the global level

- If these issues are not addressed, the IMF will cease to be relevant for all its members- advanced, emerging, and low income countries.

1. GOVERNANCE

- The main "deliverables" of the IMF as an institution are:
  - Policy recommendations, derived from surveillance and TA;
  - Lending programs, usually tied to conditionality on macroeconomic policies. Use of taxpayers´ money.
- At the end of the day, the main mission of the Fund is to help countries take the tough policy decisions.

1. GOVERNANCE

- For all these policy recommendations to be heard, accepted, implemented, and from them continuity of good policymaking to be built at the country level, it is vital that the Fund be perceived as:
  – An apolitical institution, in a political environment.
  – Legitimate in the sense that evenhandedness among members prevails, there are no regional biases, and country representation and voice is well-balanced.

- Even though there has been some recent progress in this regard, only baby-steps have been taken. FUND EFFECTIVENESS IS AT RISK.

1. GOVERNANCE

- Many aspects on this issue need to be addressed , but particular attention should be paid to:

A. Voice and Representation of Emerging-Market and Developing Economies
   - Chairs;
   - Representation in staff, in particular at the higher levels, all through merit-based processes;
   - Policy advice. Emerging Markets have been reliable partners during the last decade. We have vast experience in policymaking that can benefit the global community.

B. Quota redistribution in favor of Emerging and Developing Countries
   - Objective criteria should be followed;
   - Periodic automatic adjustment;
   - European overrepresentation should be addressed.

1. <u>GOVERNANCE</u>

C. <u>Election of M.D., plus top officials of IFIs</u>.

- Process:
  - Transparent;
  - Fair;
  - Merit-based, independent of nationality.

  Consensus at the G-20 and IMFC for several years (at least since 2005), but Europe has decided <u>not</u> to act accordingly this time around.

- Is Europe's crisis a good enough reason to have an European?
  - <u>No</u>.
    - Historical precedents. Effectiveness of the Fund in Asia and Latin America with a European MD.
    - Conflict of interest: borrowers dominating creditor institution?
    - Europe as a whole did not prevent the crisis: European nations did not address in time fundamental issues resulting from the design of the European Union and known for at least a decade.

1. GOVERNANCE

- Europe needs help with crisis resolution: LET´S CALL THE EXPERTS!

- Why Mexico´s Central Bank Governor?

  – Emerging Markets have to act in congruence with what they have been advocating for.

  – Merits, ability, and experience to effectively lead the institution:
    - Academic credentials;
    - Policymaking experience;
      – Governor, Banco de México
      – Minister of Finance
    - Experience in crisis resolution;
    - Knowledge of the Fund as Executive Director, DMD, and authority;
    - Political and Diplomatic Skills;
    - Capacity to provide intellectual leadership to the institution.

2. <u>HOW TO ENHANCE SURVEILLANCE AND ULTIMATELY PREVENT CRISES</u>?

- The recent financial crises were not anticipated. This resulted from:
  - Light surveillance in advanced economies.
    - Insufficient resources devoted to surveillance.
    - Lack of motivation at the institutional level, given lack of interest at the country level.
    - “Conventional wisdom” was not challenged by staff.
  - Insufficient attention at the regional level:
    - Underpinnings of the European Union not sufficiently tested.
  - Insufficient surveillance and understanding of financial sector issues.
- What is required?
  - More staff dedicated to surveillance. More experts.
  - More intense and inquisitive surveillance. Fund should second-guess conventional wisdom and authorities.

<u>2. HOW TO ENHANCE SURVEILLANCE AND ULTIMATELY PREVENT CRISES</u>?

- Staff and management should take more "risks" in their assessments; Board should be open to this.
- Combat the emerging markets bias: such economies are not the "weaker link" any longer.
- In financial sector issues it is clear that regulation and supervision by authorities (including surveillance by the Fund) lagged behind innovation in financial markets. Rebalancing needs to take place.
  - Resources.
  - Coordination with other instances: BIS, FSB, IOSCO.
  - Be aware of the "silent killer" syndrome.
- In the end, <u>surveillance is useless if authorities do not take it seriously</u>.
- FUND should be perceived by authorities as a TRUSTED ADVISOR AND PARTNER, although it should not end up being hostage to the membership.

3. <u>CRISIS RESOLUTION</u>

A. <u>Lending Facilities and Quota Amounts</u>

- Even though financial resources available to the Fund to support member countries have been increased recently, more needs to be done.
  - <u>Adjustments of quota size</u> is of the essence. Quota sizes have been lagging with respect to the rate of growth of the world economy and world financial markets and countries´ interconnectedness.
  - Further development of <u>lending instruments</u>. Preventive facilities, like the FCL, should be encouraged.
  - Facilities oriented to LIC, for them to deal more effectively with commodity price volatility.

B. <u>Fund Programs</u>

- The Fund has to form judgments about the appropriate balances between: a) availability and scale of IMF financing; b) domestic policy adjustment; and c) support from other stakeholders.

3. CRISIS RESOLUTION

- The Fund must also consider the implications that a crisis country may have on the stability of the international system.
- Critical elements:
  - The nature of the crisis and the sustainability of debt;
  - If problem is driven by high liquidity constraints, Fund should lend, including in large amounts;
  - If debt position is unsustainable, Fund lending would only overburden the members, and would lead to the postponement of other, more effective decisions. Under these circumstances, pre-emptive restructuring agreements can help countries regain debt sustainability and Fund support;
  - Gray zone cases. Lending usually is based on judgment calls and, therefore, involves considerable risks. The institution should be mindful of the costs of <u>not</u> supporting a member in crisis.

3. CRISIS RESOLUTION

C. Complementarity of lending of last resort options.

- The IMF should complement its lending capacity with other options:
  - Regional arrangements.
  - Central bank swap arrangements (although the Fund should not have a coordinating role).

4. THE IMF AS A CATALYZER OF POLICY COORDINATION

- International policy coordination is essential, but extremely difficult to engineer.
  - In the end, all politics are local.
- Main challenges today:
  - Global imbalances;
  - Spillover effects of major economies´ policy decisions:
    - Capital flows to emerging market economies;
    - Macroprudential measures, including reserve accumulation and capital controls;
    - Commodity price increases.
  - European Union

4. THE IMF AS A CATALYZER OF POLICY COORDINATION

How to enhance "cooperative solutions"?

- Strong coordination with G-20, FSB processes;
- Transform the IMFC from a "quasi-ceremonial" event to a more substantive policy discussion meeting;
- Fund technical work should provide useful guidelines to frame debate.
- Receptivity of countries would increase, if legitimacy of the institution is enhanced.

CONCLUSIONS

- The IMF is a unique institution that can provide the capacity and credibility to avert crises and resolve them when they occur.
- But for this it needs a legitimate governing structure.
- For this reason it is crucial that the IMF´s next Managing Director be selected transparently and on the basis of ability and experience.