Global Economic Governance and the IMF:
From Bretton-Woods to the Crisis of 2008-2009[1]

Introduction

Many of the 730 delegates from 44 countries who met in July of 1944 at Bretton Woods in New Hampshire, while the most terrible war in human history was still raging, were convinced that the lack of economic policy cooperation that had characterized the two decades preceding World War II had been a key factor in leading the world to the tragedy of the Great Depression and another great war. In the early 1920s, John Maynard Keynes had already been campaigning against some of the destructive behavior of the interwar years. He was, in 1943 and 1944, along with Henry Dexter White, the intellectual driving force of the preparations for a post-war economic order and argued for a central role for what was to become, in a somewhat more modest form, the International Monetary Fund (IMF):

"We need a central institution, of a purely technical and non-political character, to aid and support other international institutions concerned with planning and regulation of the world's economic life."[2] *J.M. Keynes*

More than six decades later, the great economic crisis of 2008-2009 has led to renewed debate on global economic governance, and in particular, on the international monetary system. Of course it can be argued that the origin of the crisis was very much rooted in national governance failures and, more specifically, in regulation and supervision failures regarding the US and also European financial sectors. However, most observers also agree that there was a global governance dimension to these failures, linked to the large current account imbalances that were allowed to develop. There is an even stronger agreement that international policy coordination can strengthen the prospects for a lasting global recovery. The April 2nd G-20 meeting in London, held at leaders-level, catapulted the IMF to center stage again and, with it, the debate on global economic and financial governance. Global governance is not, of course, just about economics. It is also about peacekeeping, nuclear proliferation, human rights or the control of infectious disease. In today's lecture I will focus on the future of the IMF, which is at the center of the global *economic* governance debate. After a brief overview of the broad historical background, I will present my perspective on the core issues that have surrounded the IMF for decades and that will undoubtedly be on the agenda of the enlarged G-20 meeting that is taking place, again at leaders-level, in Pittsburgh on September 24th. The London meeting of April 2009 has already proposed a much enlarged role and size for the IMF. The discussions of the future governance role of the IMF will surely continue after Pittsburgh during the annual World Bank and IMF meetings in Istanbul in October.

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[2] John Maynard Keynes, "Proposal for an International Clearing Union", April 1943.

At the original Bretton Woods meeting, the founding fathers wanted to design a system with three pillars: an *International Clearing Union* to secure financial and exchange rate stability, a *Global Bank* to finance reconstruction and development and an *International Trade Organization* to promote freer trade and stabilize commodity prices. These three pillars became the IMF, the World Bank and the GATT, the latter being more a treaty with a small secretariat than an actual organization as Keynes had wished. It became the WTO much later, in 1995.[3] This three pillar system has had many ups and downs, but it has withstood the test of time in a remarkable way. It is still functioning today, admittedly with much controversy surrounding it, but, if anything, revitalized by the economic crisis of 2008-2009. I will focus on the first of these three pillars, the IMF, looking at the key issues affecting the Fund as it has evolved over the last decades as well as those affecting its future.

The IMF in historical perspective

When the first twelve Executive Directors of the IMF met in Washington on May 6, 1946, five of them appointed by their countries and 7 elected by their multi-country constituencies, the objective of the new institution was to oversee a system of fixed exchange rates and to provide countries experiencing temporary balance of payments shocks with financing to close temporary gaps while they implemented policies to deal with the problem. Exchange rate adjustments were not entirely ruled out, but they were to be exceptional events, connected to irreversible changes in circumstances. Countries were to cooperate with the IMF in implementing exchange rate changes. The specter of the competitive devaluations of the 1930s and the damage they had done to the world economy was still on everyone's mind. The very existence of the institution was seen as linked to a system in which exchange rates – or par values as they were referred to – would be generally fixed, with the IMF providing the oversight. It is true that the rules and system adopted at the time did not go as far as Keynes himself had wanted. His "Clearing Union" plan, referred to in the quote above, would have had the IMF become much more of a true global Central Bank. Keynes envisioned a Central Bank that would manage worldwide effective demand by issuing "Bancor", to be accepted as international money.

As Keynes himself described it: "The *essence* of the scheme is…the extension to the international field of the essential principles of *banking* by which, when one chap wants to leave his resources idle, those resources are not therefore withdrawn from circulation but are made available to another chap who is prepared to use them—and to make this possible without the former losing his liquidity and his right to employ his own resources as soon as he chooses to do so."[4] In other words, the new entity would keep banking accounts for central banks along the same lines as central banks keep accounts for commercial accounts. The accounts would be denominated in an international currency (bancor) of (adjustable) value in terms of gold. But Keynes's plan differed from regular

[3] See Kemal Dervis (2005)
[4] John Maynard Keynes to Montagu Norman, Governor of the Bank of England, 19 December 1941, Collected Writings, Cambridge University Press, Vol. XXV, pp. 98-99.

banking in that this new institution would charge an interest rate on both debit and credit balances, thereby stimulating adjustment in surplus and deficit countries alike.

Instead, a much more modest American proposal was adopted, which relied on the dollar, linked to gold by a fixed exchange rate, to serve as the anchor of this system that the IMF was to validate and to oversee. The hope was to recreate a kind of gold standard, with positive memories of the pre-World War I age of globalization, when the world had enjoyed a period of relatively rapid growth, aided by the expansion of trade and major international capital flows from Europe to the colonies and to the Americas.

The idea was to set up a system that could offer a reasonable anchor of stability as the gold standard did a few decades earlier without, however, incurring the heavy shortcomings that the gold standard had. It was very alive in Keynes's mind the painful cost in terms of deflationary pressures faced by his country in the 20s. White had a lot of appreciation for gold as a medium of exchange but was wary to rely on it as the international monetary anchor. Moreover, White was well aware that for an open international trade system to materialize after the end of the war, gold would need to be redistributed from the US to the rest of the global economy---hence, the gold exchange standard of Bretton Woods as a pragmatic alternative to the gold standard.

This first Bretton Woods system actually worked quite well until the early 1970s. World growth had never been more rapid and international trade expanded to reach and surpass the share of world GDP it had reached at the beginning of the 20th century. Between 1950 and 1973, referred to by some as the "golden age", world per capita income grew nearly 3 percent a year, world GDP 5 percent and world trade almost 8 percent.[5] Moreover, starting in the 1950s, the process of decolonization changed the nature of the world economy from one largely consisting of the United States and a few dominant colonial powers with their vast colonies, to one with a much larger number of post-colonial independent nation states in the developing world alongside the group of rich countries (the "West" and Japan) and the Soviet led bloc of centrally planned economies. Each part of this three-tiered world grew rapidly between 1950 and 1973. In the "West" there was rapid technical progress in the frontier economy of the US and impressive reconstruction and catch-up growth in Europe and Japan. In the Soviet Bloc, including China, there was reconstruction and a huge investment effort leading to rapid growth, although measurement and product quality problems led one to overestimate the exact pace of progress. In the post-colonial developing countries there was also rapid early growth, as nations recaptured their own resources and destinies, and started to expand human and physical infrastructure.

The IMF's dominant concern during these two decades was the advanced industrial world. It was essentially excluded from the centrally planned economies that had almost all walked out of the IMF in the post-war years and it did not have a substantial role in the developing countries, where the aid agencies of the old colonial powers or of the communist countries, as well as the World Bank, were in the lead in terms of financing

[5] Angus Maddison defines the period from 1950-1973 "a golden age of unparalleled prosperity" in his book "Contours of the World Economy, I – 2030 AD" Oxford University Press: 2007

and policy advice. This first Bretton Woods system changed substantially in the early 1970s. Rapid worldwide growth of income and trade, increased capital mobility and large public expenditures in the US, linked in part to the Vietnam War, combined to put strong pressures on fixed exchange rates and eventually broke the link between gold and the dollar. On August 15, 1971, the US informed the IMF that it was no longer going to freely sell gold to settle international transactions. On March 19, 1973, the majority of European Community countries decided that they would jointly let their currencies float against the dollar. By that time, Milton Friedman and the Chicago economists had developed the theoretical case for floating rates that would allow both independent monetary policy and capital mobility.[6] After 1973, the advanced economies adopted a regime of floating exchange rates, effectively ending the exchange rate oriented global surveillance role of the IMF.

After the 1970s transformation of the international monetary system, the IMF became much more focused on the developing countries. In most of these countries, exchange rates remained fixed or actively managed. This in itself, however, was not the reason for the strengthened role of the IMF in developing countries, because fixed exchange rates were no longer considered an "internationally required" feature of macroeconomic policy regimes. In fact, after the early 1970s the IMF did not defend or uniformly impose a particular exchange rate regime and, in 1978, the second amendment to the Articles of Agreement went into force, establishing the right of members to adopt exchange rate arrangements of their choice. If anything, IMF economists found increasing merit in flexible exchange rates, in keeping with the general shift in academic opinion, although fixed rates were considered a useful tool to fight high inflation. Fixed exchange rates often came under pressure, and attempts to defend them brought about many financial crises which in turn led to requests for IMF support in the form of various short-term stand-by (SB) or longer-term extended fund facility (EFF) arrangements.[7] In the decades following the collapse of the par-value system, the IMF was transformed into a provider of crisis finance, policy advice and conditionality for developing countries. In so doing, it lost, however, the original credit union character, whereby all members were deemed equally likely to borrow from the Fund. A segmentation between advanced economies and developing countries would gradually become entrenched. The former would not seek any financial assistance from the Fund until just recently, due to the current financial crisis. However, they would hold the decision-making power to determine the rules of conduct that the latter would need to follow to access Fund resources. That same decision-making power, moreover, would exempt the advanced economies from adhering to those same rules imposed on the other members. This role of the IMF, with various shifts in emphasis in the exact conditions governing the extension of IMF financial support, but with no real fundamental change, lasted from the 1970s to the great crisis of 2008-2009. During this long period, the IMF played a particularly visible and important

[6] The concept that it is impossible for a country to have at the same time a stable exchange rate, independent monetary policy and free capital mobility is referred to as the "trilemma", see for example Durringer Fabien "The Trilemma: an Empirical Assessment over 35 years since the 1970s", Global COE Hi-Stat Discussion Paper Series 069, Hitotsubashi University: May 2009.

[7] Other IMF financial facilities included compensatory financing for sudden shifts in the terms of trade, such as those experienced during the two great oil price surges of the 1970s.

role throughout the first great Latin American debt crisis of the 1980s and at the time of the Asian crisis of 1997-1998. From the mid-1970s onward, the IMF was also allowed to develop subsidized lending programs for the very poor countries, which would become a permanent feature of the Fund's policy toolkit.[8]

There are a three important points that I would like to emphasize about the role of the IMF and global macro-economic governance from the 1970s to the great crisis of 2008. First, the IMF became the "de facto" overseer and provider of crisis finance to the developing countries *only*. It is true that regular consultations (required by Article IV of the IMF Articles of Agreement) continued with the developed countries, but they were not accorded much importance by these countries. The so-called IMF missions were low-key and met only with relatively junior officials from the rich countries. For decades there were no financial IMF programs for any of the advanced countries. Contrary to initial design, the IMF was no longer involved in global macroeconomic governance, but only governance of the system of crisis finance, official policy advice and conditionality *affecting the developing countries*. The Board of Governors of the IMF, the Executive Board and the Interim Committee, renamed International Monetary and Financial Committee in 1999, consisting of the Ministerial or Central Bank leaders of the IMF's 24 constituency chairs,[9] could have played a much stronger role in global policy coordination and economic governance. But the strongest shareholders preferred, on the whole, to give this role more informally to the G-7 meetings that started in the mid-1970s and, later, on matters of banking standards and supervision, to the Basel Committee (founded in 1974) and the Financial Stability Forum which was launched at the time of the Asian crisis in the late 1990s.[10]

None of these parallel mechanisms of more informal governance included the developing countries, although the standards and codes that were discussed and agreed on would also affect the developing countries. In 2006 Rodrigo de Rato, then Managing Director of the IMF, did obtain a revision of the 1977 decision on surveillance from the IMF Board, providing for IMF coordinated global consultations on the growing global current account imbalances and consultations that would include the advanced countries in a major way. This multilateral surveillance attempt did not, however, lead to substantive actions and did not change the fact that the IMF, after 1973, had become an institution overseeing and financing the developing countries rather than an instrument of *global* governance that also included the advanced countries in a substantive manner in its domain.

Second, the *formal governance* of the IMF itself did not change significantly over these decades, despite major changes in the economic and financial weight of many countries

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[8] Boughton, James and Domenico Lombardi, *Development, Finance, and the IMF*, Oxford University Press, June 2009.

[9] There are, as of the summer of 2009, 24 constituencies - 8 single members and 16 multi-member chairs. This includes 5 appointed executive directors (G5 countries), 3 directors elected by the single-country constituencies of China, Russia, and Saudi Arabia, respectively, and 16 directors elected by multi-country constituencies.

[10] The Financial Stability Board was established in April 2009 and replaced the Financial Stability Forum (FSF) that was launched in 1997.

in the world economy. The voting weight of countries at the IMF Board, reflecting their quotas, was determined by a formula involving “basic votes”, which countries get in equal amounts as sovereign nation states, and voting shares reflecting a country’s GDP, indicators of openness and variability of foreign exchange receipts as well as foreign exchange reserves. The ratio of basic votes to total votes was 11.3% in 1946 and had declined to 2.1% by the end of 2007, resulting in a loss of voting power for countries with lower quotas, most of whom are developing countries. This combination of the modest and declining share of basic votes and the indicator based voting shares has always resulted in developed countries holding the majority of voting power.

Weighted voting actually has advantages over the one-country one-vote formula, used by other organizations such as the UN General Assembly or the WTO. Most would agree that while each sovereign nation state is a legitimate constituent of the international community of nations, there is little legitimacy or “democracy” involved in having a tiny country with, say, one hundred thousand inhabitants, have the same formal “governing weight” in an international organization than a country with a billion inhabitants. Weighted voting and a system of constituencies allows universal participation in governance and yet a small number of “chairs”, 24 in the case of the IMF; a number more conducive to real debate and decision making than very large, unwieldy bodies.

Most would also agree that there should be some relationship between “economic weight”, the resources made available to an organization by a country and the “share” of governance of that country; at least when it comes to *economic* governance. That said, it is now abundantly clear that the particular weighting formulas and constituency groupings used at the IMF have biased the system of governance against the developing countries in favor of the European countries. As of the end of 2007, the EU-15 alone had 29 percent of the voting strength at the IMF Board compared to 33.5 percent for 142 developing countries.[11] This compares to the developing country share in global population of 84 percent, and their share of global GDP of 26.2 percent at market prices and 42.3 percent at PPP (purchasing power parity) prices. Belgium had a share of 2.1 percent compared to Brazil’s 1.4 percent. Denmark’s share was 0.8 percent compared to 1.9 percent for India and 1.0 percent for Indonesia. Switzerland had a share of 1.6 percent compared to 1.4 percent for Mexico. Moreover, depending on the particular year, European countries, excluding Russia, hold 7 or 8 of the 24 Executive Directorships. The problem is essentially between Europe and the developing countries. The US has a 16.7 percent share and only one Executive Director. It is hard to argue that this constitutes too big of a share for a country with about 22 percent of world GDP and about 5 percent of the world’s population, unless one wanted to make population the dominant determinant of voting strength, which most would not advocate in the economic and financial domain.[12] Finally, when discussing governance, many have argued that the actual *users* of IMF resources should collectively have a larger say, because they are the most affected by IMF policies and, in the case of the middle income countries, they provide the IMF

[11] Calculations based on World Bank country classifications.

[12] For the most important decisions requiring an 85% majority the US share gives it a veto. The EU countries, of course, collectively have the same. Some argue that the US should agree to give up the veto, not by a lowering of its voting share, but by lowering the percent majority required to, say, 80% or 75%.

with income when they pay interest while using IMF resources. Be that as it may, it is clear that the governance structure that was in place for the IMF at the beginning of this century no longer reflected the realities of the 21st century and, if perpetuated, would make it impossible for the IMF to become an effective and legitimate instrument of global governance. It should be noted that some changes to quota and voice were endorsed at the Annual Meeting in Singapore in 2006, leading to ad hoc targeted quota increases for China, Korea, Mexico and Turkey. This quota increase resulted in approximately a 1.8 percent increase in total quotas to the four countries. A second round of reform proposals entails a number of amendments to the Articles of Agreement, thus requiring a more lengthy procedure and is currently awaiting final approval.[13] This package of reforms include, among others, a new quota formula, additional quota increases, the tripling of basic votes and additional Alternate Executive Directors for large constituencies.[14] If these reforms receive the majority vote needed for implementation,[15] it would indeed be significant; however it would still not be sufficient to reach a structure of governance that reflects the realities of today's global economic circumstances.

The third point worth stressing is that it is not only formal governance arrangements or the scope of IMF surveillance that determine the perception and the reality of the IMF as an instrument of global governance. The *actual policies advocated and often demanded* by the IMF for and from developing countries were, and still do remain, very important in defining the institution. Going back to the quote from Keynes, what IMF staff should provide is best practice advice based on evolving professional opinion and experience, and that is what the IMF has always said it provides. When it is called to help in a payments crisis, for example, the IMF has maintained that it provides resources conditioned on policies that have a good chance of correcting the causes of the imbalance. Since a balance of payments crisis is always, by definition, linked to an excess of domestic absorption over domestic production that can no longer be financed by "normal" external resources, correcting the problem requires a reduction in the gap between domestic absorption and domestic production. To this end the argument is unassailable, unless one argues that the international community "must" finance the gap, whatever it is; an extreme argument sometimes made implicitly by some critics. There may be particular cases of post-war or post-natural disaster situations where one can argue that the international community, on ethical and humanitarian grounds, has to finance the resource needs of a particular country. Bosnia or Liberia, after their wars, comes to mind. There is also the general and routine flow of foreign assistance that the rich countries have pledged to provide to the poor countries in many declarations and summits. These should be ongoing receipts for the least developed countries. But it is reasonable to argue that countries with balance of payments shortfalls that cannot be

[13] On June 18, 2009 Congress authorized the U.S. Governor of the Fund to agree to the amendments to the Articles of Agreement relating to reform in voice and quota; specifically a to a tripling of basic votes and an additional Alternate Executive Director for large constituencies.
[14] International Monetary Fund, "Reform of Quota and Voice in the International Monetary Fund—Report of the Executive Board to the Board of Governors", March 28, 2008.
[15] Amendments to the Articles of Agreement require at least three-fifths of IMF members representing 85 percent of the total voting power in order to become effective. Most member countries will need the approval of domestic legislatures to accept the proposed amendment(s).

financed by ongoing receipts should adjust internally in exchange for extraordinary international resources provided or orchestrated by the IMF.

The real issue is not whether there should or should not be an adjustment, but the nature of the adjustment. Implicitly or explicitly the IMF has generally assumed that over the period under consideration, domestic supply is fixed, so that adjustment must come entirely from a reduction in absorption. Therefore, tighter fiscal and monetary policy has almost always been part of the prescription. But the gap between absorption and production could conceivably also be reduced by a surge in domestic production, something IMF analysis has generally not emphasized. If there are large amounts of unused capacity and unemployment, a "Keynesian" expansionary fiscal policy or a reduction in interest rates could perhaps stimulate domestic production by more than it increases total absorption, contributing to help solve the foreign payments problem by augmenting supply rather than reducing demand. Such an outcome would be more likely if the policy package included expenditure switching devaluation as well as supply augmenting structural reforms.[16] Recent events have demonstrated how the advanced countries practice massive fiscal expansion in the face of recession and economic crisis. The context, admittedly, has been different, as the crisis has been one of collapsing internal demand rather than a balance of payments problem. Nonetheless, there is a stark contrast between the restrictive macroeconomic policies the developing countries have been asked to pursue at moments of crisis and the massive fiscal expansion and monetary easing one has witnessed in the advanced countries in 2008 and 2009.

To be complete, the argument must of course include consideration of public debt sustainability and the solvency of the government. In situations where public debt has reached a very large proportion of GDP, where this debt is short-term, and where there are roll-over problems, fiscal expansion is likely to have immediate and potentially devastating effects on expectations, due to fears of public default. These negative expectation effects of fiscal expansion are then likely to dominate the positive effects of supply stimulus and make a bad situation worse. Assuming a country does not consider involuntary debt restructuring or outright default, the key trade off is that between the potentially positive supply augmenting effects of fiscal expansion and the negative effects of larger budget deficits on expectations, debt sustainability and market determined interest rates. A trade-off may also exist between the presumed helpful effects of tighter monetary policy generally advocated by the IMF on net capital outflows and the destructive effects those same interest rates can have on the balance sheets of the corporate sector, and therefore on aggregate supply. This was very much at the center of the debate between the IMF and its critics, such as Joseph Stiglitz, during the Asian crisis.

There can also be debate about involuntary debt restructuring. There may be situations where the domestic pain for an individual country involved in cutting domestic absorption is larger than the costs it would incur by forcing a restructuring of its public debt. It is natural that a country should consider the alternatives from a national point of

[16] Devaluation reduces expenditures by reducing real income, but it also increases the relative price of tradables, attracting resources into the tradable sectors.

view. It is also natural for the IMF to look at this issue from a systemic global point of view. One should not expect any international institution having to oversee the international monetary and payments system to encourage involuntary debt restructuring as a routine way to solve payments imbalances. Nonetheless, even in a systemic perspective, it should be recognized that sovereign (as well as other debt) problems are not always just due to the irresponsibility of the borrower. For example, many would argue that before the Latin American debt crisis of the 1980s or before the Asian crisis of the late 1990s, imprudent aggressive lending by the international banks greatly contributed to the problem. History keeps repeating itself: aggressive lending to the subprime borrowers certainly was one of the key causes of the great crisis of 2008. This is why the IMF's attitude, which has tended to put the whole burden of adjustment on the borrowing countries, has been criticized. The IMF has often been perceived as siding unabashedly with creditors. At times, particularly in the 1980s, it insisted that countries have an agreement with commercial banks before they could have access to resources from multilateral institutions, contributing to an unfair distribution of the costs of adjustment. To be fair, the IMF did, later, start to make efforts to encourage the international banks not to withdraw their funds and there was much talk in the 1990s of "concerted lending", with some attempts to make IMF programs conditional on the participation of private lenders in the overall funding effort. Then Deputy Managing Director Stanley Fischer was particularly active in encouraging such concerted efforts. Somewhat later there was also the proposal by former Deputy Managing Director Anne Krueger for an orderly sovereign debt restructuring framework, which was never adopted. On the whole, the pressure the IMF was able to put on the private lenders was always minimal when compared to the pressure it was able to put on the borrowing countries in dire need of rescue finance.

Finally, there are the systemic, worldwide policy recommendations made by the IMF which have not always been balanced and at times reflected a particular school of thought that did not give enough consideration to other views. This was particularly obvious when the IMF recommended free mobility of capital in the early 1990s. In April of 1997, months before the full onslaught of the Asian crisis and the huge private capital flow reversals associated with it, the Interim Committee "agreed that the Fund's Articles of Agreement should be amended to make the promotion of capital account liberalization a specific purpose of the Fund and to give the Fund jurisdiction over capital movements".[17] The disaster of the Asian crisis, in part rooted in excessive capital mobility, quickly led to the discarding of this recommendation, but it was telling that the IMF would take such a policy position when even such strongly free market oriented economists as Jagdish Bhagwati, for example, had warned of premature and excessive capital account liberalization.[18]

To recapitulate: after the early 1970s the IMF became an overseer and funder of developing countries only, with no real role in the richer countries; its weighted

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[17] IMF, Communiqué of the Interim Committee of the Board of Governors of the International Monetary Fund, Press Release Number 97/22, April 28, 1997

[18] For an overview of this debate see, for example, Bhagwati (2004) In Defense of Globalization, Oxford University Press.

governance structure became increasingly outdated when compared to the rise in actual economic weight of many emerging market economies and the relative decline in the actual economic weight of European countries; and the policies pursued by the IMF in the form of conditionality were often giving undue priority to the reduction in domestic absorption, compared to possible supply side stimulation or debt restructuring that would have assigned a larger share of adjustment to foreign lenders. One highly important exception to this last habit has been the concerted debt reduction for the highly indebted poor countries (HIPCs) that was finally launched in the late 1990s, with much greater early leadership from the World Bank than from the IMF. However, there was nothing similar for lower-middle income countries in crisis. In the mid-1990s the IMF also imprudently advocated excessive capital account liberalization, without showing sufficient sensitivity to or understanding of the herd behavior often underpinning the excessive volatility of financial markets and private capital flows.

These factors responsible for the "debt collector" image of the IMF in much of the developing world and among civil society worldwide were not, of course, independent of each other. The policies pursued obviously had something to do with governance, and the fact that the rich countries did not need IMF resources and did not agree to any real IMF surveillance of *their* policies reinforced the one-sided perception of the institution. It is not fair to blame the IMF leadership or staff for the nature of the institution's governance or for the fact that the rich countries did not agree to real surveillance, although, at times, greater sensitivity to developing country concerns and greater resistance to rich country pressures might have been possible. As a result, most middle-income developing countries turned their back on the IMF after the turn of the century. Those countries that could pay back their debt did so early, particularly in Asia. They accumulated huge foreign exchange reserves to serve as self-insurance, with the often firmly expressed intention of never again returning to the IMF for help.

An IMF for the 21st century

It is with this 20th century history that the IMF entered the great crisis of 2008-2009. The proposals of the London G-20 meeting, which have largely been endorsed by the IMF governing bodies, almost triple the financial size of the IMF and could be interpreted as moving it to a more central role in international economic governance; not into the central role Keynes had envisioned, but into a much greater role than the future seemed to have in store two years ago. There have been previous such attempts, however, and it is not clear whether the momentum created at the London meeting will persist into the next decade, particularly as the financial crisis loses the degree of urgency it had in the Spring of 2009. The summer of 2009 witnessed a slow bottoming out of the crisis in the advanced industrial countries, a resumption of rapid growth in much of Asia and a tentative recovery throughout the emerging market economies, with some exceptions particularly in Eastern Europe. The sense of urgency may no doubt decline. Nonetheless, the financial size of the IMF has increased and the potential for a much stronger IMF seems to be there.

The realization of this potential and the emergence of the IMF as a truly central global governance institution would require a substantial change in all of the three areas discussed above. These reforms and changes are integrated and should be considered as a whole. They are unlikely to be achieved in parts and need to be realized *together* to allow the institution to play a role closer to what Keynes had envisioned.

First, the IMF's surveillance (its policy review function) should be accepted by all countries, including the richest. The great crisis of 2008-2009 has demonstrated that no country can claim not to need impartial, arms-length, reasonably non-political and professional review. The Unites States, and with it the world as a whole, would no doubt have benefitted from an IMF, or IMF-WB financial sector assessment some time around 2005-2006. Moreover, the multilateral surveillance initiative should be pursued and the IMF should indeed be given the role to facilitate meetings and discussions on the coordination of macroeconomic policies. If all countries can see that the most advanced countries take their policy dialogue with the IMF seriously, the credibility and legitimacy of the institution would be greatly strengthened and developing countries would engage with less misgivings and domestic political constraints. This does not necessarily mean that the IMF would become a global financial sector supervisor and regulator. That function should no doubt be left to cooperation between national supervisors. The enlarged Financial Stability Board, now to include the major emerging market economies, can play a strong role in that context as standard setter; but, the IMF should be at the *center* of the policy coordination process, as proposed by Keynes and White (although in somewhat different forms) with strong convening power and a mandatory universal policy review function.

On governance, the logjam created by the excessive European voting shares and representation will have to be broken. While a single European chair is unlikely to be feasible in the near future, some kind of "troika" arrangement whereby there would be three European chairs at any one time, rotating in a manner that the EU would decide on,[19] should not be beyond reach and would be equitable given Europe's size and the large amount of resources it provides to global institutions and to the funding of global public goods. The renewed formula to re-calculate quotas, and thereby voting shares to be agreed on, should no longer include intra-EU trade. After all, Europe is a single trading bloc. Europe's collective share would thereby become smaller, but still remain large, larger than the share of the US, which is in line with their larger collective GDP and population.[20] The combination of a significantly reduced number of Executive Directors, with a somewhat reduced voting share, would offer enough movement on Europe's part while allowing it to retain a lot of influence. The big emerging market economies should benefit from a significant increase in their voting shares. The US would remain more or less as it is. The poorest and smallest countries should gain a small amount of voting share; something they will achieve largely through an increase in basic

[19] The EU uses has one troika consisting of the countries that hold the Presidency and their immediate predecessors and successors. That particular formula would not work well for the IMF, but other formulas could be designed.
[20] Population is not a determinant of voting shares at the Bretton Woods institutions. Time may have come to introduce it as one of the variables entering the formulas.

votes. More importantly for them, they should gain additional Executive Directors seats, and thereby strengthen their voice at the Board. If the EU agrees to a troika, this can be achieved without increasing the total number of chairs. All of the above could be accompanied by a lowering of the veto threshold in place for major decisions, from 85% to, perhaps, 75%. The US would thereby lose its individual veto, a symbolic move that may be helpful. At the same time, it is highly likely that the US could find a sufficient number of supporters to get to the additional 8.3% to reach the 25% threshold, if it really does not agree with some fundamental proposals. This combination of a significant but not radical change in voting shares, a substantial change in the composition of Directors seats and a modest lowering of the veto threshold, if implemented as a package, would constitute fundamental governance reform and would be recognized as such by the developing countries and civil society worldwide. A final powerful addition to this package would be the selection of the Managing Director and of his deputies by a truly competitive worldwide process, open to all nationalities. It seems that this has in fact finally been agreed on informally and in principle. Next time around it needs to be implemented.

The final ingredient of overall far reaching reform has to do with the nature of policy advice and conditions for access to IMF resources. With the recent adoption of the Flexible Credit Line (FCL) as well as the High Access Precautionary Arrangements (HAPA), the IMF has already, under the pressure of events linked to the great crisis of 2008-2009, moved a long away from the practices of the 1980s and 1990s. In terms of financing instruments, no doubt there will continue to be the need for a "firefighting" part of the IMF to provide emergency finance linked to adjustment and "work-outs" for some countries in acute crisis. However, the larger post-crisis financial role of the IMF should become much more one of providing precautionary finance to many countries that "pre-qualify" for access to such finance by having pursued responsible and broadly successful macroeconomic policies. A more generalized FCL would become more like an insurance fund, allowing the world economy to economize on the hoarding of foreign exchange reserves by individual countries, which would also have the benefit of allowing better management of global payments imbalances. For this to work, two things are needed: the size of the resources potentially available has to be sufficiently large, and the governance of access to these resources has to be widely perceived as fair and responsive to the developing countries. Generally, and in the conditions specified for a country to qualify for ongoing access to precautionary finance from the Fund, the IMF has to accord greater policy space to member states. History shows that greater modesty is in order and some diversity in policies reflecting different political preferences should be totally acceptable. The recognition of policy space does not, of course, mean that any policy would be acceptable. There will have to be standards and there will have to be professional judgment. That judgment should not be driven, however, as strongly as in the past, by the needs of creditors and it should not be informed by a narrow school of thought. The fact that a country's growth record is not at all mentioned in the criteria for access to the FCL shows that the old model, purely relying on demand restrictions to correct imbalances, may still be alive and too well! As proposed by some critics, such as Nicolas Stern and others, it would be highly desirable for the Fund to systematically access outside advice from a broad spectrum of opinion, that would test and, at times, contest, the internal analysis. This could be done by formally setting up an external advisory board, not as a governance organ, but to ensure systematic input from expert and diverse external opinion. It is interesting to recall that Keynes, in the quote referred to at the beginning of this paper, wanted his Clearing Union to be of a “technical and non-political nature”. That would seem very hard to achieve for an intergovernmental organization. It is true, however, that an outside advisory board with long tenure could reduce the purely political pressures on policy advice. Such advice, combined with the reformed governance giving developing countries greater weight, could result in IMF policies and standards of access to finance that would be more balanced and carry greater legitimacy than in the past.

Conclusion

Whether or not the world will really enter the second decade of the 21st century with renewed and stronger global economic governance remains to be seen. The great economic crisis of 2008-2009 spurred leaders into action and major steps were taken to augment the financial capacity of the IMF. Successful cooperation and reform at the IMF, important in its own right, could facilitate cooperative action on other institutions and domains, such as the developments banks and in the areas of climate protection and trade. A renewed and more effective IMF will require more than increased capacity to lend. It has to become a truly global institution with the developed countries agreeing to give it a strong role in policy coordination. The reform of governance must be implemented with Europe finding a formula to have itself represented by a smaller group of Executive Directors, controlling a somewhat smaller share of the vote. Perhaps most importantly, the policies advocated and access criteria practiced by the IMF must better balance the need for diversity and policy space, including the need to consider more fully the responsibilities of creditors, with the need to set behavior standards encouraging financial stability and sustainable public finances.

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