REFORM of the INTERNATIONAL MONETARY FUND
About the Authors

The views expressed in this paper are those of the Working Group on the Reform of the International Monetary Fund and do not necessarily represent the views of all of the individual members of the Group of Thirty.

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# ACRONYMS AND ABBREVIATIONS

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<th>Acronym</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>EU</td>
<td>European Union</td>
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<td>FSAP</td>
<td>Financial Sector Assessment Program</td>
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<td>FSB</td>
<td>Financial Stability Board</td>
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<td>FSF</td>
<td>Financial Stability Forum</td>
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<td>FSSA</td>
<td>Financial Sector Stability Assessment</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>IEO</td>
<td>Independent Evaluation Office</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IMFC</td>
<td>International Monetary and Financial Committee</td>
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<td>MoU</td>
<td>Memorandum of Understanding</td>
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<tr>
<td>NAB</td>
<td>New Arrangements to Borrow</td>
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<td>NGO</td>
<td>Nongovernmental organization</td>
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<tr>
<td>PPP</td>
<td>Purchasing Power Parity</td>
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<tr>
<td>ROSC</td>
<td>Report on the Observance of Standards and Codes</td>
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<td>SDRs</td>
<td>Special Drawing Rights</td>
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The Group of Thirty’s (G30’s) mission is to deepen understanding of international economic and financial issues, to explore the international repercussions of decisions made in the public and private sectors, and to examine the choices available to market participants and policymakers. This report continues the G30’s long history of responding to challenges faced by the supervisory, central banking, and financial communities with recommendations that can be adopted by policymakers across the globe.

The Group decided in May 2009 to commence a rapid analysis of the underlying justifications for further reform of the International Monetary Fund (IMF) in response to a concern felt by many in the G30 that, as the immediate severe effects of the financial crisis began to wane, the impetus for real, substantive, and long-lasting reform of this key international financial institution would diminish and begin to stall. This report, the culmination of that effort, is a natural complement to the G30’s recent study reports on financial supervision (The Structure of Financial Supervision: Challenges and Opportunities in a Global Marketplace, 2008) and on a framework for financial stability (Financial Reform: A Framework for Financial Stability, 2009). The report draws on the work of others, most notably on the recommendations of the Committee on IMF Governance Reform, appointed by the Managing Director of the Fund and chaired by Trevor Manuel of South Africa, the work of the Fund’s own Independent Evaluation Office, and the High Level Group on Financial Supervision of the EU, chaired by Jacques de Larosière.

This report underscores the continued need for reform of the IMF. To that end, it identifies a number of key recommendations for reforms that we believe are necessary as regards governance, resources and, most important, surveillance, both bilateral and multilateral in nature. It is only with effective governance reform that enhances the legitimacy of the Fund that it can achieve the necessary changes in surveillance to make the process more effective not only for the smaller member countries but also, and most important, as applied to the largest and most systemically significant countries that have tended to pay too little attention to this central monitoring function of the Fund.

The Working Group feels strongly that the reforms we have identified would help ensure that the IMF can strengthen its surveillance role, build its early-warning facilities, and, importantly, enhance its legitimacy among member governments, the broader public, and the international community at large.

The Working Group urges the leadership of the G-20, the member countries of the IMF and its management, and other actors to work
collaboratively and move forward with dispatch to create a strengthened organization. The new IMF should be better prepared to perform multilateral surveillance in the future in a manner that will assist policymakers in identifying developing risks and in responding to them before they mutate into severe regional or global financial crises such as the extremely severe one we have all just lived through.
On behalf of the entire Group of Thirty (G30), I would like to express appreciation to those whose time, talent, and energy have driven this project to successful fruition.

In particular, I would like to acknowledge the leadership and work of the members of the Steering Committee, including Stanley Fischer, Arminio Fraga Neto, and Guillermo Ortiz, who worked consistently on the project and provided invaluable input. The Steering Committee’s collective understanding of what it takes to lead the International Monetary Fund (IMF) and of the urgent need for substantive and fundamental reform of this key international institution is much appreciated and is reflected in the final product.

Special recognition must also go to those members of the G30 who actively participated in the Working Group’s project deliberations and discussions.

Crafting a thoughtful, precise report that addresses the fundamental reforms necessary for the IMF to work most effectively in the future requires considerable knowledge of the issues and an ability to synthesize the views of numerous individuals. We particularly appreciate the work of the Steering Committee members and our G30 colleague Peter Kenen, who served on the Steering Committee and as the principal draftsman of the report, and who brought extraordinary experience and accomplishment to that task.

Thanks also go to the editor, Diane Stamm, and the designers, Sarah McPhie and Katie Burgess, for their dedicated efforts and flexibility working on this project.

Finally, the coordination of this project and the many aspects of report production had their logistical center at the offices of the Group of Thirty. This project could not have been completed without the efforts of the Executive Director, Stuart Mackintosh, and the Associate Director, Sviatlana Francis, of the Group of Thirty.

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# Observers.
EXECUTIVE SUMMARY

The Group of Thirty Working Group on the Reform of the International Monetary Fund was established in May 2009 to address the need for further reforms in this key international financial institution. The working group included individuals who served in leadership positions in the Fund and in countries that have used Fund resources. All of the Working Group’s members are familiar with the challenges faced by the Fund and the difficulties in achieving meaningful reform.

The Working Group is strongly of the view that the financial crisis exposed not only major institutional failures on the part of financial institutions, regulators, and international financial institutions, including the International Monetary Fund (IMF)—though the Fund’s Global Financial Stability Reports certainly issued some of the most prescient warnings about global financial instability in the period before the crisis broke. The crisis also revealed the interconnectedness of national economies around the globe. As governments, finance ministries, and central banks continue to work on the reform of the international financial architecture, to address and correct these failures individually and holistically, they are urged to reform the Fund to better reflect global realities.

The Working Group believes that the mission of a reformed IMF must be clearly stated and understood by all the stakeholders. That mission should include the following:

- Delivering unbiased, respected analysis and macroeconomic advice, both confidential and public, via an enhanced bilateral and multilateral surveillance process;
- Monitoring of emerging systemic risks and the provision of timely early warnings;
- Performing macroeconomic and prudential analyses that provides members with a considered view of future risks to global financial stability, with a focus on the largest, most systemically significant economies;
- Addressing balance-of-payments crises in member countries and, where needed, providing financing to member countries, coupled to necessary conditionality;
- Acting as a global reserve, via its liquidity facilities; and
- Reviving the original purpose of the Fund as set out in the Articles of Agreement, Article I(i), “To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.”

The Fund is unique, and has a unique legitimacy in that it is a near-universal institution, established by treaty, with a highly professional
staff, in which typically both finance ministries and central banks represent their countries.

Yet significant reforms are necessary in two areas for the Fund to better serve its member countries and to enhance its legitimacy. First, the governance system of the Fund must be reformed. Second, and equally important, the Fund’s system of bilateral and multilateral surveillance must be reinforced, buttressed, and made more effective. Indeed, bolstering the multilateral and cross-country perspectives in its bilateral surveillance and placing greater focus on international economic and financial linkages and spillovers are key. Cross-checking between multilateral and bilateral surveillance will help to promote both policies at the national level that are consistent with other domestic policies and global adjustment within the international monetary and financial system. Moreover, the Working Group members note that the Fund does not operate in a vacuum and must collaborate with many institutions, including with the Financial Stability Board and the World Bank, and that, in particular, the former linkage should be further clarified and strengthened. To achieve these goals, this report recommends the following major changes in the governance and functioning of the Fund.

GOVERNANCE

The members of the G30 Working Group on the reform of the IMF believe that a number of key governance reforms must be undertaken to strengthen the Fund and to ensure that its institutional structure better reflects changing global economic realities and relationships. The report recommends that:

- **The revision of IMF quotas should be accelerated to realign existing shares with members’ economic weights in the global economy.** In the future, quota adjustments would be better achieved through a regularized automatic process. Under such a system, quota review would occur every four years, using the existing formula, with a review and if necessary changes to the quota formula every eight years. Further, no single country should retain a veto over Fund decisions.

- **The IMF Council envisioned at the time of the Fund’s creation should be activated.** The Council should replace the International Monetary and Financial Committee (IMFC), and would provide strategic direction to the Fund and discuss policy coordination needs. It would exercise oversight of the Fund’s Executive Board and management. It would also initiate multilateral consultations aimed at reaching agreement among the participating governments on policy responses to major economic problems.

- **The size of the Executive Board should be reduced from 24 to 20 by consolidating European representation.** In the future, the Board should focus more on strategic matters and leave day-to-day operational matters to the Managing Director and staff.

- **We believe the Fund should conduct an open, merit-based, and transparent process in the selection of the Managing Director, with the final decision taken by the Council.** In particular, this position should not be allocated on the basis of nationality.
RESOURCES AND FACILITIES

- We believe that, at present, the total availability of financing for the Fund’s lending facilities is sufficient, provided that the recent commitments are honored. Recent commitments include the creation of the Flexible Credit Line, the significant enhancements to potential financing through the issue of Special Drawing Rights (SDRs), the expansion of the New Arrangements to Borrow (NAB), and the development of Fund borrowing agreements with individual member countries.

- We believe that for the IMF to be truly regarded as the central institution of the international monetary system, it requires a permanent strengthening of its resource base to equip it to perform that role. Therefore, it is essential that Fund quotas increase significantly in the 14th quota review.

SURVEILLANCE

The members of the G30 Working Group underscore that the current financial crisis exposed failings in the Fund’s system of bilateral and multilateral surveillance. These weaknesses are linked to the reluctance of certain member countries to accept surveillance advice; in some important cases member countries ignore it entirely. The proposed reforms would strengthen and buttress the Fund’s surveillance function. The report recommends that:

- Article IV surveillance reports should be more sharply focused on current and impending problems and should include specific policy recommendations to deal with those problems. Governments should be obliged to respond promptly to those recommendations. Their responses and any subsequent failure to act should be brought to the attention of the Executive Board.

- Member countries of the Fund should participate in the Financial Sector Assessment Program (FSAP). The Fund should monitor their progress in complying with the recommendations made by the FSAP. Members whose FSAP reports were completed several years ago should invite new reviews of their financial systems.

- To be more effective, the Fund must conduct assessments to detect vulnerabilities and the build-up of risk on a near-continuous basis in the financial sector or elsewhere. The next crisis may take place in the core of the financial system, but it could just as well be a fiscal or debt crisis or an “old-fashioned” balance-of-payments and inflation crisis. Whatever the cause, the Fund must enhance its ability to do whatever it takes to get ahead of the curve on a real-time basis.

- The Fund must equip itself to issue confidential warnings to systemically important countries whenever developments in their economies or financial sectors give cause for concern. The Managing Director, advised by his or her staff, should be authorized to issue such warnings when deemed necessary. The Fund must be able to act as a trusted adviser in private. However, in the interest of transparency, the Fund must balance this role with the need to ultimately make its recommendations public.
INTERNATIONAL COORDINATION

The members of the G30 Working Group on the Reform of the International Monetary Fund believe that the relationship between the Fund and the newly empowered Financial Stability Board (FSB) must be formalized to enhance coordination and cooperation between the two institutions.

- The Fund and the Financial Stability Board are urged to negotiate a Memorandum of Understanding (MoU) that delineates their respective responsibilities and roles as regards financial stability, monitoring the global economy, and giving early warning of impending systemic risks. Care should be taken to avoid duplication of tasks or responsibilities. The surveillance of financial risks in member countries and globally must be part of the Fund’s surveillance responsibilities.

- While FSAPs tend to examine the structure of the financial system and its supervision and regulation, there is also a need for continuing surveillance of financial developments, particularly including potential financial strains in member countries. Joint missions of the Fund and members of the Financial Stability Board could well be very useful in this context.

The members of the G30 Working Group believe the above reforms are necessary to the restoration of confidence in the supervision of the global financial system and its stability, and urge their prompt adoption.
PART I
INTRODUCTION
This report addresses a vital aspect of the international policy response to the global financial crisis, namely the steps necessary to ensure that the International Monetary Fund (IMF) is able to play an enhanced role in promoting the future stability of national economies and of the global economy.

The global financial crisis reflected major institutional failures on the part of financial institutions, regulators, rating agencies, and international financial institutions, including the IMF, and other more informal mechanisms for international cooperation. Notwithstanding pre-crisis G-8 rhetoric in support of international coordination aimed at the resolution of these problems, there was little political commitment to deal seriously with the problems as they emerged.

The crisis had numerous linked causes. It was a product of a combination of both macro- and microeconomic failures. The crisis had its origins in a prolonged period of excess liquidity and credit expansion leading to growing global imbalances (facilitated by the ample availability of current account deficit financing and the willingness to accumulate large foreign exchange reserves in surplus countries) and the mispricing of risk. In this sense, the current crisis has many of the elements of previous financial crises. What makes this crisis unprecedented are its size, scope, and severity. These characteristics, in turn, are the result of the crisis generated in the world’s most important financial center, the massive amount of leverage and maturity mismatches involved, extremely lax lending standards, excessive risk taking, and the global interconnectedness of the financial system.

The prevailing paradigm prior to the eruption of the crisis was that lightly regulated financial markets were not only able to allocate resources efficiently but also to manage complex risks. The view was that these systems were supported by strong elements (or pillars) of market discipline: financial institutions with sophisticated risk management systems, regulators, rating agencies, and the different mechanisms for international cooperation. The financial crisis shattered this paradigm. Weak regulatory and supervisory frameworks, excessive reliance on self-regulated markets, distorted incentives that converged to extreme risk taking in search of short-term profits, and lax lending standards made the financial sector extremely vulnerable. Many of these issues have been addressed by previous G30 reports.2

We believe that global leaders must recognize that, while the IMF’s *Global Financial Stability Report* accurately warned about some of the key risks facing the international financial system, the Fund failed in one of its principal missions—to convince its member governments of the risks to the world economy posed by the emerging financial crisis in the United States and by other imbalances that were evident elsewhere prior to the crisis. The Fund urged them to take appropriate action, individually and collectively, to limit the threat posed by the crisis to the stability of the global economy. The Fund was not complacent, but it was not forceful enough in calling for concerted action to minimize the damage to global stability and prosperity.

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1 Members of the G8 are Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States.

stemming from developments in the world’s largest economy and in other member countries.3

One of the clearest pieces of evidence that surveillance has been ineffective relates to the decisions adopted in 2006 to complement IMF surveillance arrangements with multilateral consultations. The first consultation focused on global imbalances. The objective was to provide a forum for improving understanding and sharing views on global imbalances and on how best to reduce them in a context of sustaining robust global growth. The recommendations included the following: steps to boost domestic saving in the United States, including fiscal consolidation; further progress in growth-enhancing reforms in Europe; further structural reforms in Japan, including fiscal consolidation; reforms to boost domestic demand in emerging Asia; greater exchange rate flexibility in a number of current account surplus countries; and increased spending consistent with absorptive capacity and macroeconomic stability in oil-producing countries. These recommendations were in large part ignored.

A successful multilateral consultation process—that is, a process that leads to action to carry out the key recommendations—would have contributed to avoiding the current crisis or at least ameliorating the harshness of the adjustment process. The Fund itself can hardly be blamed that its recommendations were not implemented. That was the responsibility of the member countries. However, there is always an issue about how strongly the Fund issues warnings, and—most important—how much the member countries recognize the need for the Fund to speak out, even when they are the subjects of its criticisms.

We are convinced that national governments must now exploit the opportunity created by the economic and financial crisis and the apparent G-204 consensus concerning the need to enhance the role of the IMF.

The first step in that reform process is to implement as a matter of urgency a series of governance reforms, many of which have been debated a number of times in the past and have received widespread support from diverse constituencies. These reforms concern: strengthening the political leadership of the Fund through the activation of the IMF Council; a further realignment of IMF quotas to enhance the influence of emerging and developing economies; and changes in the size, makeup, and functioning of the Executive Board.

All of these reforms are absolute prerequisites for the Fund and its management to deliver for member countries on multiple fronts. Just as important, governance reforms are required to uphold the legitimacy of the Fund and to modernize its operation. A Fund that was designed at the Bretton Woods Conference before the end of World War II must today be reformed to reflect new geopolitical and economic realities. We are not, however, naïve, and we understand that governance reforms will require strong leadership and support from member countries, particularly those that currently possess the key

3 Some institutions, such as the Bank for International Settlements, warned of the dangers posed by developments in the global financial system, but their advice to some extent was ignored by policymakers. See www.bis.org for details. The annual reports leading up to the crisis provide evidence of the warnings delivered to but not heard by policymakers.

4 The members of the G-20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States, and the European Union, which is represented by the rotating Council presidency and the European Central Bank. To ensure global economic forums and institutions work together, the Managing Director of the IMF and the President of the World Bank, plus the chairs of the International Monetary and Financial Committee and Development Committee of the IMF and World Bank, also participate in G-20 meetings on an ex officio basis.
influence in the decision-making processes of the Fund.

Urgent reforms are also required to enhance the legitimacy and effectiveness of the Fund’s surveillance mission. With the necessary support and tools at its disposal in the future, the Fund’s surveillance, diagnoses, and policy prescriptions should command respect, serve as a source of international expertise and best practice, and provide sound and credible policy advice. The Fund’s understanding of economic phenomena should be ahead of the curve, with its recommendations independent and unbiased. The Fund’s recommendations cannot languish on a shelf in Washington, D.C., and instead should be acted upon by the appropriate parties.

This report identifies reforms necessary to prepare the Fund for this enhanced surveillance role post-crisis. We address the coverage and quality of IMF surveillance, with particular attention to financial sector matters; the redesign of multilateral surveillance to elicit the policy changes that governments are unlikely to adopt unilaterally, and the need for close and mutually beneficial coordination between the Fund and the Financial Stability Board (FSB).

These reforms are required for the Fund to play the larger role that the G-20 leaders, and the member countries that are not part of the G-20, expect of it in the future. They cannot be implemented, however, unless the Fund’s members are prepared to act on major changes in the Fund’s governance arrangements, in order to refashion the Fund to meet the challenges posed by a rapidly changing world economy.

Reform of the IMF has been addressed by other bodies and commissions. The G30 Working Group has drawn freely on their work, especially the report of the Committee on IMF Governance Reform, appointed by the Managing Director of the Fund and chaired by Trevor Manuel of South Africa, the work of the Fund’s Independent Evaluation Office and the High Level Group on Financial Supervision of the EU, chaired by Jacques de Larosière. It has also drawn on the knowledge and experience of members of the Group of Thirty who have been directly involved in leadership positions in the Fund and in member countries.

It is particularly important that the reforms proposed in this report secure the wholehearted support of the Fund’s largest members, which dominate the Fund’s decision-making process. Without their active involvement and support, the necessary reforms are not likely to materialize. Members of this Working Group urge those countries’ governments to play a strong, constructive role in the reform effort. Only with such commitments of political capital by the leaders in whose countries the financial crisis was born, and with the leadership of the wider membership of the Fund, can we implement real and lasting reform that enhances the Fund’s legitimacy, effectiveness, and relevance.
PART II
IMF GOVERNANCE
We believe that the International Monetary Fund’s (IMF’s) governance and surveillance functions are closely interconnected.

When created, the IMF largely reflected the economic power structure of the world. In recent years, however, a small group of countries, generally identified as the G7, has exercised a controlling influence on the institution. Yet the economic balance has shifted and evolved, and demands for better governance have emerged, particularly from the key minority shareholders, who express the view that the Fund’s current decision-making process lacks appropriate political and economic legitimacy. Of course, it is difficult to demand attention to the recommendations of an institution that lacks legitimacy in the eyes of its own members. Even when the Fund’s analysis is on point and ahead of the curve, it runs the risk of being dismissed by both constituencies. The controlling member countries may disregard its advice, as they have in the past. The emerging creditor nations of the world with burgeoning surpluses may continue to believe that their voices are not heard clearly enough in the International Monetary and Financial Committee (IMFC) and in the Executive Board.

To address the matter of legitimacy and to build political support behind the decisions and advice of the Fund, we believe that the relevant emerging countries must be given a greater sense of responsibility for the functioning of the international economic system. To achieve this purpose, the emerging countries must be given a larger role in the governance of the system.

This has been increasingly recognized by the international community. In fact, during their April 2009 meeting, G-20 leaders committed to reform the mandates, scope, and governance of the IMF and other international financial institutions, to reflect changes in the world economy and the new challenges of globalization. Greater voice and representation of emerging and developing countries, and increased credibility and accountability of the institutions, were considered to be an essential component of these efforts. G-20 leaders proposed, among other things, to move forward with the reform of IMF quotas and representation agreed since April 2008 and to complete the 14th general review of quotas by January 2011. The G-20 also called for consideration of greater involvement of officials at the ministerial level in providing strategic direction to the IMF. Finally, the group supported the view that the leadership of the IMF (and in general of international financial institutions) should be elected through a more open, merit-based, and transparent process.

These are, indeed, steps in the right direction. However, we are concerned by the fact that governance reform at the IMF is lagging behind efforts in other areas. Furthermore, we believe that reform of IMF governance should go beyond the measures considered by the G-20 leaders and that these changes should be implemented as soon as possible. Consequently, this Report formulates a series of recommendations aimed at correcting imbalances in quotas, improving decision making at the IMF, empowering the Fund at the political level, and achieving a more efficient division of labor between the Executive Board and Management.

5 The members of the G7 are Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.
6 The G-20 communiqué is available at: http://www.g20.org/pub_communicates.aspx.
QUOTA AND VOICE REFORM

We believe that the process of quota review is too slow and the resulting adjustments in voting power are marginal, given the increased economic significance of emerging countries in recent years.\(^7\) It is therefore fundamental to accelerate the 14th general quota review and to complete it in early 2011. We also believe that from this point forward a mechanism of automatic quota adjustments every four years should be introduced, so that any changes in the global economy are reflected rapidly in quota shares. Similarly, the quota formula should be reviewed if necessary every eight years.\(^8\)

To have an adequate impact on decision making at the Fund, the review of quota shares must be complemented with efforts in other areas.

First, the authors support the view that the Articles of Agreement of the Fund should be amended to achieve a new and more balanced composition of the Executive Board. At present, European countries have eight of the 24 seats available on the Fund’s Executive Board. We call for the reduction of this share and suggest that European countries have four seats at most.\(^9\) A salutary side effect of any sensible solution would be a reduction in the size of the Executive Board, although some of the seats vacated could be transferred to emerging and developing countries. In addition to the reduction of the number of seats on the Board, the combined quota share of the European Union (EU) countries must be adjusted. Moreover, a consolidation of the EU/euro-area seats on the Fund’s Board would be useful and in the interest of European countries because such a step would help strengthen their voice.

Second, the authors believe that in the future, decision making in the reformed Fund should not be blocked by the veto vote of a single country.\(^10\) This should be a fundamental part of the wider reform designed to make the Fund better reflect the global political and economic realities of the 21st century.

ACTIVATION OF THE IMF COUNCIL

Recently, two documents—the Manuel Report\(^11\) (see Box 1) and the report of the Fund’s Independent Evaluation Office on Governance of the IMF\(^12\)—have called for the creation of a ministerial-level governing body, a “Council,” with a formal role within the IMF structure. We fully agree that a strong case can be made in support of the creation of such a Council.

\(^7\) For instance, even after considering approval of the April 2008 quota adjustments, Belgium would have a larger quota share than Brazil and Mexico. In the same vein, France, Germany, and the United Kingdom would have larger quota shares than China, despite the fact that China’s share in world gross domestic product (GDP) on a purchasing power parity (PPP) basis is equivalent to two and a half times that of Germany and over three times those of France and the United Kingdom.


\(^9\) The High Level Group on Financial Supervision in the European Union, chaired by Jacques de Larosière, also provides its own bold ideas for reform.

\(^10\) The authors recognize that this would require amending the Articles of Agreement to reduce the voting threshold for critical decisions, eliminating veto power by any single country. Currently, the United States has about 16 percent of the total voting power in the Executive Board and can thus block any decision requiring an 85 percent majority. We recognize that a reduction of the U.S. share is difficult since it would require the assent of the U.S. Congress, because the United States’ participation in the IMF is governed by the Bretton Woods Agreement Act, not by a treaty, and would therefore require action by both houses of the U.S. Congress.

\(^11\) These recommendations draw heavily on the Report by the Committee on IMF Governance Reform chaired by Trevor Manuel and which included Guillermo Ortiz, a member of the Steering Committee for this report. The report is available at: http://www.imf.org/external/np/omd/2009/govref/032409.pdf.

\(^12\) For the text of the IEO report, see: http://www.icao-imf.org/eval/complete/eval_05212008.html.
The IMFC is an advisory body of the Board of Governors and has no legal weight. This undermines its legitimacy and adversely affects Fund Management’s accountability. Furthermore, the participation of Fund Governors in the institution’s affairs is generally modest, except in times of systemic crisis or on issues considered of interest for particular reasons. As a result, the twice-a-year meetings of the IMFC do not live up to their potential, and therefore their role in promoting international cooperation and international financial stability is modest. Not surprisingly then, it has been in the G-20 and not in the IMFC where the most relevant recent decisions on confronting the current crisis have taken place.

The IMF Articles of Agreement already provide for the establishment of a Council composed of ministers, governors, or persons of comparable rank. The Council would provide strategic and policy direction to the Fund, discuss macroeconomic and financial policy coordination needs, and exercise powers conferred upon it by the Board of Governors. Each Councilor would be entitled to cast votes equal in number to those of the corresponding member of the Executive Board. However, a Councilor representing a multi-country constituency would be free to cast separate votes for each country of the constituency—something that cannot be done in the Board.

The Council would establish a continuous dialogue with both Fund Management and the Board. Management and the Board would assist the Council in the definition of the agenda, while the Board could support the definition of priorities derived from research and frame policy discussions into an actionable format for the Council’s deliberations.

We strongly believe that for the Council to be effective and legitimate, its membership should reflect global economic realities from the moment of its inception. Thus, we fully agree with the view expressed in the Trevor Manuel Report that “…we are calling for a fundamental reform of the IMF’s governance structure, not a mere relabeling of existing ones. Changing the name of the IMFC to the IMF Council and giving it de jure decision making authority is unlikely to accomplish much.”

According to the Fund’s Articles of Agreement, the size and composition of the Council and Board need to mirror each other. Therefore, the activation of the Council can be effective only after steps have been taken to allow an adequate representation of emerging and developing economies on the Board. We also believe that representation in the Council should be adjustable over time in order to adapt to shifts in the relative economic significance of the Fund’s members.

Some concern has been expressed regarding the extent to which Ministers and Governors will be able and/or willing to participate in Council meetings and involve themselves in Fund matters. In our view the logic is totally different. The creation of the Council would strengthen the commitment of high-level authorities to international cooperation. This would banish the inertia dominating current IMFC meetings, and which engenders, as a result, only a marginal involvement at the ministerial level.

Activation of the IMF Council would engage a wider constituency at the highest level, involving a larger number of the Fund’s key members in the decision-making process and in the identification of emerging risks in a timely manner. It would strengthen the Fund’s legitimacy,}

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13 See footnote 11.
BOX 1 THE MANUEL REPORT ON IMF GOVERNANCE

Principal Recommendations

Following are the principal recommendations of the Manuel Report on IMF governance:

- A Council of ministers and governors should be activated to provide a forum for coordination and to take strategic decisions critical to global stability, as provided for in the Articles of Agreement. The report recommends:
  - The adoption of a troika leadership model (former chair, current chair, and following chair) for the Council, with regular rotation, and agenda-setting by the leadership, with input from the Executive Board and management;
  - That the Council would meet at least twice a year, with ad hoc meetings when needed, allowing it to act rapidly and effectively;
  - That steps be taken in the near term to allow for greater representation of emerging and developing countries at the Board, so that the Council is established with as much legitimacy as possible right from the beginning;
  - The Council’s task would include: discussing policy coordination; establishing new financing facilities; building consensus on norms and standards; initiating and concluding rounds of multilateral consultations; reviewing global economic developments, identifying emerging risks, and providing a forum for discussing and coordinating macroeconomic and financial policies; reviewing key management and board decisions, particularly surveillance of systemically important issues or countries, and increased accountability; and appointing the Managing Director.

- The expansion of the Fund’s surveillance mandate beyond exchange rates to provide appropriate coverage of macroeconomic policies, prudential issues, and financial spillovers. The capital account would fall within the mandate.

- A devolution of decision making to management from the Board in the areas of surveillance and resource allocation shortly after the creation of the Council, together with strengthened accountability for that role.

- An accelerated quota revision process, to be concluded by April 2010, and an amendment to the Articles of Agreement that would eliminate appointed chairs, thereby allowing for the needed consolidation of chairs, including those of EU countries.

- A change in the role of the Executive Board to remove it from oversight of day-to-day operational decisions. Instead, the Board would give advice on strategic issues to the Council and deliver a critical supervisory function, including oversight and review of surveillance. The Board would retain responsibility over lending and financial decisions, and with greater accountability.

- The lowering of the voting threshold on critical decisions from 85 percent to 70 to 75 percent, and consideration given to extending double majorities to a wider range of decisions, thus ensuring that decisions affecting key aspects of the institution command the support of the majority of members.

- The introduction of an open, transparent, and merit-based system for the appointment of the Managing Director and Deputy Managing Directors.
broaden support for the Fund’s mission among its member countries, and deliver political capital to the Fund, enhancing its capacity to take tough positions in its dealings with member countries when their actions or failure to act pose risks for the global economy. Indeed, this would be a major contribution to the objective of placing the Fund at the center of the international financial system.

DELINEATION OF RESPONSIBILITIES: THE EXECUTIVE BOARD AND IMF MANAGEMENT

We are convinced that a reform of IMF governance should include a review of the roles and responsibilities of the Board and Management. The existing framework, based on a resident Board that is heavily involved in the day-to-day running of the institution, gives rise to overlaps in functions and procedures, high costs linked to the need to maintain a large support staff for the Board, political constraints on staff’s technical analysis, reduced accountability, and a slower decision-making process.

We share the view that Management’s decision-making responsibilities in the areas of surveillance and resource allocation should be strengthened. This implies, in essence, providing Management with the authority to conduct surveillance under Article IV of the Articles of Agreement, and to develop and execute the annual budgets that allow for the achievement of the surveillance mandate, within a medium-term framework established by the Board. Other activities, such as the appointment, organization, and dismissal of staff, would remain with Fund’s Management.

Under this arrangement—which should be implemented only after quotas have been realigned to reflect current economic realities and the composition of the Board modified as suggested above—the Board would serve as advisor to the Council and formulate proposals that could be transformed into decisions by the latter. Taking advantage of the findings from Article IV consultations, the Board could deliver regular reports to the Council on issues deemed important while retaining the right to ask for discussions of country economies whenever requested under a pre-agreed procedure. The Board would continue to decide on financing arrangements and deal with noncritical activities, such as ordinary reviews of Fund policies and lending instruments.

These adjustments would allow a reduction in the size of Board offices, with the consequent savings, and even more important, they would improve accountability at the Fund. As the Independent Evaluation Office (IEO) report has noted, there is a need for greater accountability at the IMF:

Accountability is probably the weakest aspect of IMF governance. There are no agreed standards against which to assess the actions of the IMF and no adequate mechanisms for the organization to be held accountable by the membership or by appropriate stakeholders.14

Indeed, under a more rational division of responsibilities between Management and the Board, the latter could devote more energy to supervise Management’s performance without the conflict of interest that emanates from the current delineation of functions. In turn, the Board would be held accountable by the Council.

The authors of this report are clear that the interface between the Fund and the private sector, in particular the financial sector, is an important part of the drive to enhance the accountability of the Fund. We urge the Managing Director to ensure that a dialogue between the Fund leadership and the financial sector takes place on a semi-regular basis to complement the existing process involving non-governmental organizations (NGOs). Such dialogues are additive and help increase the general level of understanding of the Fund’s goals and operations, while also providing forums for a frank exchange of views.

It is also important for the Fund to strengthen its outreach to NGOs. We welcome the Managing Director’s invitation to NGOs to present submissions on the work and reform of the IMF at the Fund’s Istanbul meeting in October 2009 and trust that this will mark the beginning of closer engagement with those organizations.

APPOINTMENT OF THE MANAGING DIRECTOR

We believe the Fund should conduct an open, merit-based, and transparent process for the selection of the Managing Director, with the final decision taken by the Council. This requires a change in the Articles of Agreement, since this selection is currently the responsibility of the Executive Board. The Managing Director would continue to chair the Board and would maintain the prerogative to appoint the three Deputy Managing Directors. However, this process should be based on the above-mentioned general principles for the selection of the Managing Director. In particular, none of these positions should be allocated on the basis of nationality.

RESOURCES AND FACILITIES

The Fund must have the financial resources necessary to achieve its short-, medium-, and long-term goals. We note that much has already been done to address previously identified shortcomings in the level of resources and types of facilities available to member countries when faced with capital flight, balance-of-payment, or other financial crises.

The authors acknowledge the timely emergence of close cooperation among the central banks of the major industrial countries during the recent financial crisis, and we welcome the support for the Fund displayed by the G-20 countries at the April 2009 London Summit, and the steps they took thereafter to increase the Fund’s financial resources. At that time, G-20 leaders committed to increase Fund lending resources by approximately US$750 billion. This comprised US$250 billion in contributions from some member countries that were to be added to the New Arrangements to Borrow (NAB), further additions of US$250 billion to the NAB in due course, a general allocation increase of Special Drawing Rights (SDRs) by US$250 billion, and US$6 billion in gold sales by the Fund. Many, but not all, of the G-20 countries have delivered on the pledges they made in April 2009.15

It is hard to imagine a financial crisis worse than the one through which the world economy is passing, but it could have been worse without the cooperative response of the major central banks. The Fund has also made a significant contribution to the resolution of the global financial crisis by overhauling its lending framework, including the creation of the Flexible Credit Line, which provides unconditional short-term financing to countries with well-managed economies that have suffered sharp reductions in the

availability of foreign currency financing from other sources, such as banks that have sought to reduce their external exposure. The Fund has also doubled the normal access limits for drawings on its nonconcessional facilities, modernized conditionality for all borrowers, enhanced the flexibility of its traditional stand-by arrangements, and eliminated certain seldom-used facilities. It is clear that the Fund has shown considerable flexibility in responding to the crisis.

Thus, member countries and the Fund have dealt with the resources and facilities issues quite effectively in response to the recent crisis and should be commended for their action. Policymakers will recall that prior to the autumn of 2007, the relevance of the Fund and its very existence were being called into question, on the spurious grounds that risk was so well contained, was so well managed by private sector actors, and was so well underpinned by central bank reserves that there was no longer a relevant mission for the Fund. Recent events have proved how wrongheaded such assessments turned out to be.

Given the above actions, the authors do not believe there is currently a need to increase the availability of financing for the Fund’s lending facilities, provided that the recent commitments are honored. Nonetheless, we believe these temporary measures introduced to boost the Fund’s lending capacity should not undermine the much-needed increase in IMF quota resources. For the IMF to be truly regarded as the central institution of the international monetary system, it needs a permanent strengthening of its resource base. Therefore, it is fundamental to ensure a very significant increase of Fund quotas is agreed to at the 14th quota review.

Looking still further ahead, an assessment by an appropriate group of the future, perhaps broader, role of SDRs could also prove useful.16

16 Leaders of a number of Fund member countries have raised the matter of the future role of SDRs. Today, SDRs perform only a limited role in global reserves. Their present use is confined chiefly to transactions between the central banks of member countries. The early attempts to create functioning markets for SDR-denominated claims were not successful. Their future role, however, is a matter of considerable interest among economists and some countries’ officials, and it may be time to consider the regular resumption of SDR allocations. Clearly, many steps would have to be taken for SDRs to become a widely accepted medium of exchange and store of value in the official and private sectors. This subject, however, can be considered only in the context of a comprehensive study concerned with the long-term evolution of the international monetary system, a matter that lies beyond the scope of this report.
PART III
IMF SURVEILLANCE
The financial crisis and deep recession that gripped the global economy in 2009 testify to the need for changes in macroeconomic policies and financial sector supervision in individual countries and for the intensification of surveillance by the IMF.

**BILATERAL SURVEILLANCE**

Put simply, it is not enough for effective surveillance by the Fund to identify potential risks, as it has done in some cases, either in its *Global Financial Stability Reports* or its *World Economic Outlook*, its two flagship publications. The Fund must be able to move from surveillance to action whenever economic or financial stability are deemed to be at risk.

The authors believe that more support of Fund management by its membership is required, both to exert peer pressure whenever a country’s policies begin to follow a risky path, and to foster the conduct of national economic policies with greater awareness of the need for international cooperation. If these conditions were met, use of existing supplementary procedures that open the door for informal and confidential discussions, or even for ad hoc Article IV Consultations, would become more feasible.

In the past, IMF staff teams have visited each member country periodically and issued a detailed report to be examined by the Fund’s Executive Board. This process is perhaps sufficient to identify weaknesses in the conduct of national economic policies, including those pertaining to the supervision of the financial sector. At a recent G30 meeting, one member familiar with his country’s surveillance report said that it was “undoubtedly the best external report we get on our economy.” Yet the quality of the reports, by themselves, does not tell the whole story.

There are three serious weaknesses in the surveillance process that must be addressed. First, the huge membership of the Fund prevents the staff from visiting individual countries often enough to detect emerging economic problems or weaknesses in the financial sector.

Second, the Fund’s Executive Board cannot review the staff reports with adequate knowledge of the country under consideration—knowledge sufficient to judge the quality of the staff report. For this reason, the attendance at Board meetings devoted to the discussion of the staff reports has been abysmally low. A recent review of IMF Surveillance by the Fund’s Independent Evaluation Office notes that, on average, only nine of the 24 Executive Directors or their Alternates attend Board discussions of individual surveillance reports; the rest are represented by members of the Executive Director’s staff. This contrasts with an average attendance of 15 Directors or Alternates at meetings devoted to broad policy issues.

Third, the Fund’s bilateral surveillance, as conducted through the Financial Sector Assessment Program (FSAP) process, has focused on the architectural structure of supervision and oversight and not on current developments in the financial markets that may pose major systemic risks and threaten economic stability in the future. This weakness must be addressed.

While the FSAP process should continue, regular surveillance reports should devote less attention to the structure of supervision and a review of past problems and policies. Instead, they should focus sharply on current and prospective problems and on the policies adopted or proposed to deal with them, including financial sector issues. These matters should receive close attention by the Fund’s committee charged
with reviewing surveillance reports and by the management.

A thorough and timely form of oversight is required for systemically important countries, including, most importantly, surveillance of their financial sectors, and their institutional arrangements for the conduct of financial supervision. To this end, the Fund’s Managing Director proposed a streamlined approach to country surveillance, and the proposal was adopted by the Executive Board. The Fund no longer undertakes annual surveillance of many member countries, especially small, stable countries; it has moved instead to biennial surveillance over those countries’ economies and policies. Furthermore, it has reduced the coverage of surveillance to focus on matters of central concern to the Fund and pays closer attention to financial and balance-sheet vulnerabilities, which have played a major role in most emerging-market crises, and in the current global crisis, which originated in the United States, an advanced industrial country.

Most important, the Managing Director has proposed that more emphasis be given to the original aim of surveillance—assessing the consistency of a country’s exchange rate and macroeconomic policies with national and international stability. We would add that the Fund should pay closer attention to the consistency between its members’ exchange rate regimes and their observable exchange rate policies. Under Article IV of the Fund’s Articles of Agreement, each member country has the right to choose its own exchange rate regime, but the Fund is required to exercise firm surveillance over its members’ exchange rate policies. This is the legal basis for the Fund’s surveillance of its member countries.17

At this juncture, moreover, when many governments are running very large fiscal deficits and incurring huge amounts of debt, including, in some cases, foreign currency debt, the Fund’s surveillance of those members must assess the sustainability of their fiscal situations and, where appropriate, their medium-term plans to maintain or restore debt sustainability. The Fund should provide reassurance where appropriate but offer frank expressions of concern whenever a country’s fiscal situation raises doubts about debt sustainability. If Fund surveillance is not forward looking, it is of little use to the government of the country involved or to the Fund itself.

**THE FINANCIAL SECTOR ASSESSMENT PROGRAM (FSAP)**

In addition to exercising regular surveillance of its members’ economies and economic policies, the Fund, together with the World Bank, administers an FSAP, in which Fund and Bank staffs, joined by outside experts, undertake a comprehensive review of a member country’s financial system. The results are conveyed to the country’s government, along with a report on the country’s observance of the relevant financial-sector standards and codes (Report on the Observance of Standards and Codes, ROSC), and a Financial Sector Stability Assessment (FSSA), in which Fund staff address issues of particular relevance to IMF surveillance, including risks to macroeconomic stability stemming from a member’s financial sector, and the sector’s capacity to absorb macroeconomic shocks.

We underscore the general usefulness of the FSAP program, the ROSC review, and the

17 The actual exchange rate policies of some members, including systemically important countries, can differ substantially from those one would associate with their declared exchange rate regimes. The Managing Director and staff must be prepared to address cases in which a country’s stated exchange rate regime differs substantially from its actual practice. The Fund’s staff and its member countries should be willing to discuss these matters frankly and address the problems they raise rather than engage in circuitous debates that avoid the fundamental issues.
FSSAs, but we also recognize certain areas for improvement. Given the tumultuous events that have gripped national and international financial markets during the last two years, it has become clear that the FSAP, ROSC, and FSSA reviews must endeavor to identify weaknesses in the oversight of national financial sectors, and the Fund should strengthen the reviews, and member countries should pay close attention to their conclusions and act on their recommendations.

More than half of the Fund’s members have participated in the FSAP program. We note with concern, however, that as of the end of August 2009, a number of significant G-20 countries have yet to complete an FSAP (including Argentina, China, Indonesia, and the United States). The failure of countries to participate fully in the FSAP process is perhaps symptomatic of a tendency by major stakeholders to avoid Fund surveillance. In the case of the United States’ historic refusal to submit to an FSAP, observers long suspected that this was in part because they knew what the FSAP report would say: that the American system of financial supervision was not coherent and had to be fixed. For instance, there are at least 54 different supervisors of banks, 50 of them at the state level, four at the federal level. Each state has its own insurance regulator and there is no national regulator. The supervisory overlaps, gaps, and failings have been recognized for some time and are addressed directly by a G30 report.18 We therefore welcome the decision to participate in the FSAP program and the U.S. government’s plan to reform the U.S. system of prudential supervision.

We note that many financial sector assessments were made several years ago. Since there may have been significant changes in the financial sectors of the countries concerned, in the way they are supervised, and in the regulatory frameworks, those countries should be the object of new assessments. The Fund is urged to conduct new FSAPs and FSSAs where necessary and appropriate.

The authors believe that the bilateral surveillance undertaken as Article IV reviews and via the FSAP are essential tools, but they are not sufficient to get the surveillance job done. As we have noted, FSAPs address structural and institutional matters and take place very infrequently. The Article IV missions are in general more focused on vulnerabilities and, therefore, on what may go wrong, but these missions take place at most once a year. When appropriate, the two processes of financial system review and analysis should be linked. If an FSAP identifies weaknesses in the application or maintenance of international standards and codes, these should be tackled in a subsequent Article IV review and addressed via corrective actions undertaken by the member country’s authorities.

To be more effective, the Fund must equip itself to conduct assessments to detect vulnerabilities and the build-up of risk on a near-continuous basis, in the financial sector or elsewhere. At this juncture no one knows just where the next crisis will develop or what might trigger it. We cannot judge whether the crisis will emerge from the core of the financial system, from a fiscal or debt crisis, from an old-fashioned balance-of-payments and inflation crisis, or from some other source.

The authors are clear that the Fund must be constantly vigilant in performing this surveillance role. Part of the Fund’s real analytical value should be measured by its ability

to identify future systemic risks in financial markets, nationally, regionally, and globally. Having shed light on the risks, the Fund ought to be supported in the crucial task of warning member countries of the dangers ahead and in the equally important but very difficult task of pressing members to pay attention to the message and act on the considered advice offered in good faith.

Whatever the case may be for each individual member country or group of countries, the Fund must enhance its capability and do whatever it takes to get ahead of the curve on a real-time basis, including retaining additional staff with the desired mix of skills and abilities specific to the complex task of real-time analyses of emerging risks.

To that end, the authors believe it is important for the Fund to strengthen the capacity of its staff to address aspects of surveillance related to the functioning of complex and rapidly evolving financial markets and instruments. Such work is in some degree separate from and complementary to other surveillance roles and may require a focused risk assessment process, using different methods and approaches and necessitating the development of a financial intelligence network that can deal with rapidly changing information on a continuous basis. Too few members of its staff may be thoroughly competent to monitor the functioning of countries’ financial systems or their institutional arrangements for financial supervision. Many of the Fund’s staff are macroeconomists whose training may not fully equip them to assess the quality of financial supervision in member countries. Those who have the required skills, moreover, typically seek employment in the financial sector itself, not in institutions such as the Fund, concerned with oversight of the sector. Given the centrality of surveillance for the functioning of the Fund, the necessary resources and effort must be devoted to the recruitment of staff that can address any such lack in the Fund’s institutional capacity to continuously assess financial markets and the systemic risks that may germinate from within major economies and financial markets.

**MULTILATERAL SURVEILLANCE**

In 2006, the Fund expanded its surveillance instruments and launched a new supplementary consultation procedure in a multilateral format. This so-called multilateral consultation would bring together representatives of key countries’ governments to agree on common or differentiated actions aimed at resolving a major international economic problem. There is much need for a process of this sort, exemplified by the problem of global imbalances, which required—and still requires—mutual adjustments in the economic policies of the systemically important countries directly involved.

The first round of these new consultations, however, disappointed those who held high hopes for the process. After the IMF’s recommendations described on page 19 of this report were made, each participating country listed the policy changes it was prepared to make in order to reduce global imbalances, but most of those changes reflected decisions the countries had already taken unilaterally or were committed to take, rather than new commitments to one another. Thus we again see the tendency of member countries to avoid frank exchanges and instead to provide formulaic answers to pressing issues requiring new policy measures.

This experience suggests that multilateral consultation is unlikely to be productive unless the Fund takes the initiative. The Fund should propose specific policy recommendations to
each participating country in advance of the actual consultations. This would compel them to focus on a package of mutually consistent policy adjustments that they might be reluctant to propose on their own. Furthermore, the Fund’s subsequent report on the consultations, including the participants’ responses to the Fund’s proposals, should be discussed by the Executive Board and the International Monetary and Financial Committee (IMFC), and a summary should be published thereafter.\textsuperscript{19}

It must be noted, moreover, that the problem of global imbalances has not yet been resolved and is apt to reemerge as the world economy recovers from the current economic crisis. There will then be need for a new round of multilateral consultation involving the United States, China, and other major countries. That new round of consultations should be conducted in the manner described above, with the Fund making explicit recommendations to the participating governments. The particular recommendations, whether they concern, for example, the appreciation of the renminbi\textsuperscript{20} or a reduction in the U.S. fiscal deficit as economic recovery takes hold, are a matter for the Fund. The authors are clear that to be credible and command more respect and legitimacy, the multilateral surveillance recommendations must be direct and focused squarely on the matters of greatest concern.

Finally, we take this opportunity to praise the work of the Fund’s staff and the publications for which it is responsible, especially the \textit{Global Financial Stability Report} and the semiannual \textit{World Economic Outlook}, which are surely among the best sources for authoritative commentary on the state of the world economy.

\textsuperscript{19} If another recommendation made above is adopted (activation of the Council for which provision is made in the Fund’s Articles of Agreement), the Fund’s report on each multilateral consultation should be transmitted to the Council, since the IMFC would have ceased to exist.

\textsuperscript{20} The issue of the value of the renminbi is already being addressed bilaterally via the U.S.-China Dialogue, but this dialogue does not preclude the Fund taking a robust stance on the matter.
PART IV
THE IMF AND INTERNATIONAL COORDINATION
The Fund must coordinate and collaborate with other institutions engaged in matters of financial supervision in a close and productive manner. Many observers have stressed the need for the Fund to work closely with other diverse forums and institutions, including the G-20, the World Bank, the Bank for International Settlements, national governments, and central banks. We strongly encourage linkages that enhance information flow and collective endeavors. We note the distinction between fora (such as the FSB), which meet periodically and draw generally upon national authorities and outside resources in their work, and those international institutions (such as the Fund), with a distinct separate mandate, legal personality, and permanent resource base. We believe that there is a need for a careful balance in the respective roles of the two types of organizations as each has relative strengths and weaknesses.

Going forward, the Fund must equip itself to conduct global financial surveillance aimed at detecting unsustainable developments in the financial markets of major economies and issuing confidential warnings to financial supervisors in those countries. Within the G-20 framework, as laid out in the April 2009 work program, it is hoped that forthright early warnings by the Fund may help to raise concern among supervisors regarding financial developments, especially in systemically important member countries, such as the United States and China. This can only be achieved if policymakers ensure that the mechanisms for collaboration and coordination are effective and, insofar as workable, inclusive.

The authors of this report believe the Fund must ensure a particularly close collaboration between itself and the Financial Stability Board (FSB), a process that was begun under its previous name, the Financial Stability Forum (FSF).21 On April 2, 2009, the G-20 leaders Declaration replaced the FSB with the FSB, which, in addition to an expanded membership, was provided with a much broader mandate.22 We welcome the G-20’s decision to enhance the role of the FSB. It is tasked to perform a key function as regards the rebuilding and redesign

21 Joint letter from the Managing Director of the IMF and the Chairman of the FSB to Finance Ministers and Central Bank Governor members of the G-20, November 13, 2008. The letter sets out the proposed division of labor and the roles and responsibilities between the FSF and the IMF. However, the division of responsibilities in the joint letter is different from that suggested by the G-20 Declaration of April 2, 2009 (see footnote 22). The G-20 gives the major role in financial sector surveillance to the FSB, while the joint letter agrees that financial sector surveillance should be undertaken by the Fund.

22 G-20, Declaration on Strengthening the Financial System, London, April 2, 2009. The FSB mandate includes the following roles: to assess vulnerabilities affecting the financial system; to identify and oversee action needed to address them; to promote coordination and information exchange among authorities responsible for financial stability; to monitor and advise on market developments and their implications for regulatory policy; to advise on and monitor best practice in meeting regulatory standards; to undertake joint strategic reviews of the policy development work of the international Standard Setting Bodies to ensure their work is timely, coordinated, focused on priorities, and addressing gaps; to set guidelines for, and support the establishment, functioning of and participation in, supervisory colleges, including through ongoing identification of the most systemically important cross-border firms; to support contingency planning for cross-border crisis management, particularly with respect to systemically important firms; and to collaborate with the IMF to conduct Early Warning Exercises to identify and report to the IMFC and the G-20 Finance Ministers and Central Bank Governors on the build-up of macroeconomic and financial risks and the actions needed to address them.
of the global system of financial standards and the related modes of cooperation among national central banks, supervisors, and ministries of finance. The authors hope that an enlarged FSB will continue to provide a forum in which frank discussions and exchanges of views are possible. Ultimate responsibility for financial stability must, of course, reside with the financial supervisors of individual countries, but we expect that the enlarged Board will facilitate communication in normal times and develop the channels to speed communication in times of crisis.

The roles of the Fund and FSB should be complementary and enhance each institution’s ability to achieve its respective mandate. With its universal membership, the Fund has a capacity to draw synergies from its multilateral, regional, and bilateral surveillance activities; integrate financial sector assessments with macroeconomic stability analyses; adapt its policy advice to the needs and circumstances of each country; and closely monitor and evaluate policy implementation. The FSB, in turn, brings together senior national policymakers and key international supervisory and regulatory institutions and central banks, as well as international standard setters, giving it a unique capacity to give impetus to and facilitate coordination among these bodies, especially in the area of financial sector regulation.

We stress that the Fund’s member countries and G-20 policymakers must strive to avoid institutional overlap and duplication of responsibilities when undertaking the redesign of the architecture of international coordination and related standard-setting roles. It is of note that the IMF and FSB mandates pose overlaps of responsibilities that could give rise to problems. First are the high costs of operations not only for the institutions themselves, but also for the national financial authorities that provide their inputs to both organizations. Second, having two institutions charged with the same functions could lead to different diagnoses (and possibly policy recommendations), with the associated problem of making it harder to converge to common proposals.

These risks imply the need for a clear delineation of work between the Fund and the FSB given the need for the effective implementation of financial surveillance, both currently and in the future. The authors of this report believe that, in particular, the IMF as an international financial organization would be best placed to make an objective assessment of countries’ financial vulnerabilities, through its surveillance of financial conditions in member countries and globally. Such surveillance could be conducted in joint missions with FSB members (that is to say, supervisors of different types), under Fund leadership.

To ensure comity as to respective competencies and responsibilities, the authors of this report urge the leadership of the G-20, the FSB, and the IMF to negotiate a detailed Memorandum of Understanding (MoU) that would draw on earlier agreements between the two institutions and lay out each institution’s role, their respective responsibilities, and the type of coordination mechanism proposed for normal times and during crises. If this is not done, ambiguity over the ways in which the Fund and the FSB coordinate and collaborate may weaken rather than strengthen the international system.

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23 In Europe, the call for effective coordination between the IMF and the FSB and the need for the careful division of responsibilities as regards surveillance and the monitoring of systemic risk has been led by the High Level Group on Financial Supervision in the EU, chaired by Jacques de Larosière. See “Chapter IV: On Global Repair,” pages 59–68, at: http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf.

PART V
RECOMMENDATIONS
GOVERNANCE

Quota and Voice Reform

- The revision of IMF quotas should be accelerated to realign existing shares with members’ economic weights in the global economy. The revision should enhance the influence of emerging and developing countries.

  In the future, a mechanism of automatic quota adjustments every four years should be introduced, so that any changes in the global economy are reflected rapidly in quota shares. Similarly, the quota formula should be reviewed and if necessary adjusted every eight years.

  Further, no single country should retain a veto over Fund decisions.

The Activation of the IMF Council

- The IMF Council should be activated and replace the International Monetary and Financial Committee (IMFC).

  The Council must be empowered to take strategic policy decisions and to take the necessary steps to foster policy coordination.

  The Council must also be empowered to foster and monitor the implementation of Fund recommendations aimed at maintaining economic and financial stability.

  The Council should exercise oversight of the Fund’s Executive Board and Management.

  The Council should initiate multilateral consultations aimed at reaching agreement among the participating governments on policy responses to major economic problems.

Delineation of Responsibilities:
The Executive Board and the Fund’s Management

- The size of the Executive Board should be reduced from 24 to 20 by consolidating European representation.

  In the future, the Board should focus more on strategic matters and leave day-to-day operational matters to the Managing Director and staff.

  The respective responsibilities of the Executive Board and Management should be reviewed with the aim of limiting the Board’s involvement in routine matters, reducing the frequency of Board meetings, and improving attendance at those meetings.

Appointment of the Managing Director

- We believe the Fund should conduct an open, merit-based, and transparent process in the selection of the Managing Director, with the final decision taken by the Council. In particular, none of these positions should be allocated on the basis of nationality.

Resources and Facilities

- We believe that at present the total availability of financing for the Fund’s lending facilities is sufficient, provided that the recent commitments are honored. Recent commitments include the creation of the Flexible Credit Line, the significant enhancements to potential financing through the issue of Special
Drawing Rights (SDRs), the expansion of the New Arrangements to Borrow (NAB), and the development of Fund borrowing agreements with individual member countries.

- We believe that for the IMF to be truly regarded as the central institution of the international monetary system, it requires a permanent strengthening of its resource base so as to equip it to perform that role. Therefore, it is essential that Fund quotas increase significantly in the 14th quota review.

SURVEILLANCE

- Article IV surveillance reports should be more sharply focused on current and impending problems and should include specific policy recommendations to deal with those problems.

  In its regular surveillance of its members, the Fund should give close attention to the sustainability of their fiscal policies and risks to economic and financial stability arising from them. The Fund must give candid advice to a member country when it detects serious risks to economic and financial stability.

  Governments should be obliged to respond promptly to those recommendations. Their responses and any failure to act should be considered by the Executive Board when it reviews their surveillance reports.

- Member countries of the Fund should participate in the Financial Sector Assessment Program (FSAP). The Fund should monitor their progress in complying with the recommendations made in the FSAP, and related ROSC and FSSA reports, noting the progress made in their implementation but identifying remaining weaknesses.

  The FSAP report should be made public soon after its completion. Members whose FSAP reports were completed several years ago should invite new review of their financial systems. Lack of adherence to accepted international financial standards should be identified and subsequent recommendations included in Article IV reports.

- To be more effective, the Fund must also conduct assessments to detect vulnerabilities and the build-up of risk on a near-continuous basis in the financial sector or elsewhere. The next crisis may take place in the core of the financial system, but it could just as well be a fiscal or debt crisis, or a balance-of-payments and inflation crisis. Whatever the cause, the Fund must enhance its ability to do whatever it takes to get ahead of the curve on a real-time basis.

- The Fund must equip itself to issue timely confidential warnings to systemically important countries whenever developments in their economies or financial sectors give cause for concern. The Managing Director, advised by his or her staff, should be authorized to issue such warnings when deemed necessary. The Fund must be able to act as a trusted confidential adviser. However, in the interests of transparency, the Fund must balance this role with the need to ultimately make its recommendations public.

  To deal with its increased responsibilities relating to surveillance and the identification of systemic risks to the global economy, the Fund should recruit additional staff with expertise in the functioning of complex financial markets and products.
INTERNATIONAL COORDINATION

- The Fund and the Financial Stability Board are urged to negotiate a Memorandum of Understanding (MoU).

  The MoU should delineate respective responsibilities and roles as regards financial stability, monitoring the global economy, and early warning of future systemic risks. Care should be taken to avoid duplication of tasks or responsibilities, and to ensure that the surveillance of financial risks in member countries and globally is part of the Fund’s surveillance responsibilities.

- While FSAPs tend to examine the structure of the financial system and its supervision and regulation, there is also a need for continuing surveillance of financial developments, particularly including potential financial strains in member countries.

  Joint missions of the Fund and members of the FSB could well be very useful in this context.
PART VI
CONCLUSION
Policymakers throughout the world have recognized the need to strengthen international coordination and the policy responses and mechanisms designed to underpin financial stability. The extensive G-20 work program adopted in April 2009 makes the degree of consensus abundantly clear. Governments have underscored the key role that must be played by the International Monetary Fund (IMF) in resolving financial crises and helping to ensure the maintenance of a more durable degree of financial stability in the future. To achieve that goal, the IMF requires robust reform, especially with regard to the level of political leadership, its system of governance, and the conduct of bilateral and multilateral surveillance.

The need for governance reforms in the Fund is well established. The governance reforms we identify must be undertaken to strengthen the legitimacy of the institution and to ensure it better reflects evolving political and economic realities. Action to activate the Council, adjust quotas, change the makeup of the Executive Board, and strengthen the Fund’s resource base all require the leadership of the G-20 and other member countries to desist from a defense of entrenched positions and a recognition of the benefits to all that would accrue from a reinvigorated Fund with enhanced political and institutional credibility.

The authors are also clear in the belief that the Fund must continue to play a central role in a system of enhanced bilateral and multilateral surveillance of member countries’ policies and actions that is designed to identify trends, risks, weaknesses, and strains in the national and global financial system. The Fund must be supported by member countries in these surveillance and early warning tasks. When required, countries should be pressed by the Council and leadership
of the Fund to take remedial measures to correct problems that have been identified.

Finally, the Fund must coordinate closely and effectively with other international institutions, in particular with the Financial Stability Board. This key relationship must be formalized and clarified through the negotiation of a Memorandum of Understanding. Roles must be clear and respective responsibilities must be appropriate to each actor’s capabilities and historic strengths.

The Group of Thirty’s recommendations for reform of the IMF are being conveyed to the members of the Fund, the leadership of the G-20, and other interested parties. We call upon them to implement the recommendations as a matter of urgency and urge that the recommendations be considered by the Fund’s membership and underpin a renewed commitment to act. We call on members of the Fund to adopt a timetable for the implementation of the necessary reforms at its 2010 spring meeting in Washington, D.C.

A final word: the Fund is not an organization separate from its members. If the members, especially the leading countries in the global economy, are not willing to take the Fund’s surveillance seriously, no amount of improvement in the quality of surveillance will make a major difference to the functioning of the global economy. It is up to the membership of the Fund to ensure that the Fund can play the role in the global economy that it has repeatedly been asked to play—a role that this report strongly supports.
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