Beyond the IMF

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Paper for G-24 Technical Meetings, March 2006

A. INTRODUCTION

The purpose of this paper is to examine the governmental and market mechanisms that are being developed in the world financial community as ways to complement and substitute for the gap created by IMF deficiencies. This review has two objectives in mind. The first amounts to a stock-taking: an assessment of what defenses, in addition to a weakened IMF, are in place to prevent and to deal with financial turbulence. The second objective is more pro-active; the discovery of non-IMF, alternative defenses against instability would provide a basis for measures and policies that could reduce the risk and costs of instability, independently of IMF reform.

The paper reviews the core IMF functions - crisis resolution, exchange rate management, financial policy coordination and surveillance - and finds examples of non-IMF organizational arrangements in all cases. However, the paper focuses in particular on the insurance role of the Fund and argues that developing countries are developing alternative insurance mechanisms, from a higher level of reserves to regional co-insurance facilities to remittances as a counter-cyclical source of foreign exchange. The de facto exit of its clientele, driven by the combination of high political costs associated with Fund borrowing and growing availability of alternatives, now poses an unprecedented challenge for the Fund, in particular pressures on its income. Given the close link between exit and the Fund's high borrowing costs, linked in turn to its high administrative expenses, the paper also examines the options available to the Fund if it is to reverse its loss of clientele. In particular, in addition to governance reform, the Fund's future seems to require significant cuts in its administrative budget, using budget savings to lower borrower interest rates. We conclude with an assessment of the systemic implications – stability and possible deflationary bias – of a continuing non-reformed IMF accompanied by a continuing move towards non-IMF arrangements.

B. IMF PERFORMANCE AND LEGITIMACY AND ITS DECLINING RELEVANCE

The IMF is rudderless and ineffective.[1] It is suffering from an identity crisis[2], waning influence[3] and a reduced role. It is on the brink of irrelevance.[4] As a result, the world economy, basically, isn't managed at all.[5] The IMF has long since lost its role as the world's central banker,[6] has lost sight of where it wants to go,[7] and suffers from a mismatch between aspirations and authority and instruments. No single step will restore the Fund to its prior respected position.[8] Each of the preceding statements was made publicly over the last two years by a respected international financial analyst. Each statement was followed by a call for IMF reform, in many cases, by specific proposals. For several years, the reform debate has concentrated the attention of senior international finance specialists. Meanwhile, however, markets and governments and civil associations have been developing alternative solutions to the various functional deficits that result from the lack of an effective IMF.

In the late 1990s, the Fund appeared to be at the zenith of its influence. Its attempt in 1997 to change the Articles of Agreement to make capital account liberalization a formal goal, and its subsequent role in the financial crisis that began in Asia in 1997-98 and spread to Russia and Brazil in 1998-99 gave the Fund an unprecedented global role. New forays such as the Poverty Reduction and Growth Facility (PRGF) drew the institution into core development issues hitherto the preserve of the multilateral development banks. But these initiatives did not reverse the underlying trend to irrelevance of the institution, while the PRGF may have turned out to be a Pyrrhic victory.

Today, just a few years later, the Fund's future appears much bleaker. Not only is demand for its resources at a historic low, but borrowers are rushing to prepay the institution. In 2003, Thailand finished paying off its obligations two years ahead of schedule while in 2004 Russia prepaid its $3.3 billion debt to the IMF. Then in December 2005 and January 2006,

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[2] Ted Truman, interview in Finance and Development. October 31, 2005, p. 321.

[3] Ted Truman, op. cit., p. 321.

[4] Martin Wolf, Financial Times, February 22, 2006.

[5] John Williamson, "Reforms to the International Monetary System to prevent Unsustainable Global Imbalances," in World Economic Forum, The International Monetary Fund in the 21st Century: Interim report of the International Monetary Convention Project, p.22.

[6] Rawi Abdelal, comment at IIE Conference on IMF Reform, September 23, 2005.

[7] Ted Truman, op. cit., p. 321.

[8] Ted Truman, Background paper prepared for the IIE Conference on IMF Reform, September 23, 2005, p. 1.

Argentina and Brazil announced their decision to repay their entire debt to the Fund ($15.5 billion in the case of Brazil and $9.8 billion in the case of Argentina). Pakistan, which owes $1.5 billion and is currently the third-largest debtor, has said that it is seeking to cut its dependence on the Fund; Ukraine, the fourth largest debtor, has declined any further assistance; and Serbia has announced that it would not increase its borrowings. In fiscal year 2005 just six countries had Stand-by Arrangements – the lowest number since 1975. The volume of lending rebounded in the current fiscal year, but almost entirely due to one country – a $10 billion loan package to Turkey).

A charitable interpretation is that the current decline in the demand for Fund resources is part of cyclical process. The Fund, to quote Barry Eichengreen, is "a rudderless ship in a sea of liquidity." If that were the case, the *raison d'etre* of the Fund would be justified. After all, the importance of insurance is not diminished if insurance agencies are called in only occasionally. However, it is worth contrasting the global payment systems in the aftermath of the oil price shocks of 1973-74 and 1979-80 with 2005-06. In stark contrast to the earlier two shocks which created major global disequilibria and led many developing countries to avail of the Fund's facilities, there is little demand this time around. To be sure, this reflects structural and epistemic changes in developing countries, in which the Fund played an important role. And greater liquidity in capital markets has given many middle-income developing countries alternatives, while low interest rates have made new financial emergencies less likely.

But there is more to the story. The Fund no longer has the mystique and its imprimatur no longer carries the weight previously associated with the institution, despite the continuing appearance of an all-powerful and non-accountable institution.

For some time there has been a broad consensus on the need to reform the IMF. Ideas for reform cover virtually every aspect of the Fund, from its surveillance role to its role in debt management and emergency lending, to the nature of its advice and the roles it needs to add or discard to its governance (for a recent elaboration see Akyüz (2005), Buira (2004), Woods (2005). However, there is little agreement when it comes to the details of the reforms. In the past quarter century, developing countries have been periodically afflicted by financial crisis. Each flurry of activity has resulted in an expansion in the scale and scope of Fund itself. Consequently the institution has been blasé with the reality that its principal shareholders will

ensure that the institution will "evolve through a series of ever more bland communiqués and meaningless statements."[9]

But today the Fund faces perhaps its gravest crisis, the result not of opprobrium but of irrelevance. The realization that if the Fund is not "kept up-to-date… [it] risk[s] suffering a lengthy senescence,"[10] may well prompt real reforms. However, as this paper argues, while developing countries should continue to press for reforms, they should take heed of just how little past calls for reforms have advanced. Consequently, they must complement the focus on reform with exploring alternatives outside the IMF which hold the potential to not only give developing countries greater bargaining leverage with the Fund but also, by increasing competition, spur the institution to better performance.

C. ALTERNATIVES TO THE FUND

Several factors have contributed to the development of alternative mechanisms to carry out particular IMF functions. Perhaps the most important has been the rapid growth of financial markets, and especially bond markets, which in turn has driven the expansion of institutions that monitor and carry out continuous market surveillance, notably rating agencies and other private and governmental institutions that track financial conditions. A second factor has been an equally impressive expansion in networking and local or regional cooperation and integration. Bryant [2004] has pointed to the "Multiplicity of institutional venues – consultative groups and international organizations – [that are] involved in surveillance of financial standards and prudential oversight. Similarly heterogeneous and complex institutions are involved in the nascent supranational surveillance of all other types of economic policies." [11] Cerny [2002] makes a similar point, speaking of the "privatization of transnational regulation" through the expansion of "webs of governance," of "epistemic communities," and "multi-level governance" involving government and private sectors and civil associations. The third development, closely related to the above, has been modern communications technology which has brought about a

[9] Mervyn King, Governor, Bank of England, quoted in *Financial Times* February 21, 2006.
[10] Martin Wolf, "The world needs a tough and independent monetary Fund," *Financial Times,* February 22, 2006.
[11] Bryant, pp. 10-11.

multiplication in the volume, access and speed of information, enormously facilitating surveillance by non-official actors. These contextual trends help to explain the specific mechanisms, discussed below, that are being used to complement or substitute for particular IMF functions.

Global Financial Stability

Crisis Resolution

Although the Fund has been a pivotal player in many debt and financial crises during the 1980s and the 1990s, it began to be seen by developing countries less as an impartial referee than as a debt collector for private creditors. In the late 1990s, the Fund proposed sovereign debt restructuring mechanisms (SDRM). Even if the Fund had been successful, the SDRM would have had limited utility since debt flows were becoming a much smaller part of total financial flows. In any event the SDRM did not go anywhere as the international community chose to pursue a more market-driven approach through the use of collective active clauses (CAC) in bond contracts. Neither debtors nor creditors appear enthusiastic about the Fund's role in restructuring under CACs. As the Argentinean and Russian defaults have shown, countries have realized that rather than perennial rounds of debt restructuring with the IMF playing a central role, countries may be better off simply ignoring the Fund. The results (at least till now) don't seem to indicate that these countries are any worse off than if they had elected to use the offices of the IMF.

Managing the International Monetary System

The primary role of the Fund on exchange rate management had vanished with the collapse of the Bretton Woods system. Consequently, its original mandate notwithstanding, the Fund has been much more voluble on its member countries' fiscal policies than their exchange rate policies. Although recent G-7 communiqués have emphasized the importance of flexibility in exchange rate systems, countries continue to peg their exchange rates and there is not much that the Fund has been able to do about it.

Williamson (2005) has emphasized the need for the Fund to act as a referee on disputes over exchange rates and called for the institution to develop a

system of reference exchange rates to prevent unsustainable global imbalances. He argues that such a system would help secure global policy consistency. The main problem with these arguments is that the risks to global financial stability are from the systemically important countries and regions, such as global imbalances caused by the huge U.S. current account deficit, China's managed currency system, or Europe's rigid labor and product markets. But these are the very actors on whom the Fund has little influence and who are least likely to allow the Fund to constrain their autonomy. It is unclear why moving from the current ambiguous guidelines to more well-defined rules (through a system of reference exchange rates) would resolve the enforcement problem. That depends critically on the confidence of players in the institution itself, which in turn is singularly dependent on a perception of presumed neutrality and a referee role of the institution that few emerging markets are willing to accept given the current governance structure of the IMF.

Indeed even the SDR as a notional unit of exchange now faces competition. In spring 2006, the ADB is planning to launch a notional unit of exchange, called the Asian Currency Unit (ACU), which would help track the relative values of Asian currencies. Modeled on the Ecu (the forerunner of the Euro), the ACU would be calculated using a basket of 13 regional currencies, weighted according to the size of each economy. The ACU would allow monitoring of both the collective movement of Asian currencies against major external currencies, such as the US dollar and the Euro, as well as the individual movement of each Asian currency against the regional average. Small borrowers are also expected to issue bonds denominated in ACUs (rather than the SDR).

Coordination Role

An important role of the Fund has been to function as "a trusted, independent and expert secretariat" for policy makers around the globe. A very evident sign of its failure (on perhaps all three attributes) has been the proliferation of alternatives. A variety of institutional mechanisms are setting, interpreting, diffusing and enforcing rules on affecting global financial stability, ranging from purely governmental to purely private, with complex public-private hybrids added in. Ad hoc non-treaty intergovernmental groupings like the G-7, G-10, and G-20 are agenda setting and rule ratification institutions. Intergovernmental organizations like the IMF, World Bank, IFC, and BIS make some rules, but more importantly,

serve as transmission and enforcement mechanisms for rules developed elsewhere. Increasingly the rules underpinning global financial governance are being set by private actors (IFAC, IASC) and groupings of national regulatory institutions (IOSCO, IAIS). Appendix I lays out the goals, representation, decision rules, and agenda setting capacity of the principal institutional underpinnings of global financial governance.

Two features of this institutional mix are worth highlighting. One, there is considerable variation in forms of representation, goals, and authority. Two, there are overlapping jurisdictions in several areas, which is leading to the formation of "second generation" emanation institutions (the Joint Forum on Supervision of financial conglomerates run jointly with the Basle Committee on Banking Supervision, IOSCO and IASC, is an example). Developing countries should give greater emphasis to participating in these multiple fora, rather than wringing their hands about their marginalization in the Fund.

Surveillance Function

Besides its insurance function (emergency lending), surveillance has long been seen as the Fund's other critical function. Compared to its early years, the very success of the Fund in ensuring greater transparency in countries' macro accounts has meant that a variety of institutions (both private and public) play a role through their reports and analysis, which are similar to those of the Fund. Moreover, a key weakness of the Fund's surveillance is that issues in Article IV consultations are negotiated ex ante with the systemically important countries, implying that the latter exercise agenda control. The coverage of private rating agencies has grown enormously, extending to both sovereign and private debt, to most middle income countries and even to many Sub-Saharan nations. In addition to wide coverage and freedom from the political inhibitions that limit the Fund, surveillance carried out by the private sector is a source of frequent and up-to-date information, in contrast to the relative infrequency of Article IV consultations which occur only every 12-18 months and, in some cases, less frequently.

Proposals to rescue Fund surveillance stress the need to separate its surveillance and lending functions so as to avoid any perception of conflict of interest. The separation would apparently enhance the independence and credibility of the Fund's technical judgment. However, enhanced

surveillance of the global economy and a legal foundation for the international financial system require a tougher and more independent role for the Fund, a delegation of authority that is not likely to be accepted by the newly systemically important countries unless it is tied to a fairer quota allocation.

Better surveillance could result if the Fund were reorganized to reflect the fact that much of what is called globalization is really regionalization. Trade and exchange rate policies are taking on an increasingly regional character, reflecting in part the fact that international trade has grown faster within regions than between regions. The Fund should adopt an organizational structure akin to that of the U.S. Federal Reserve System, with regional branches acting as the principal regional institutional mechanisms for coordination and surveillance, leaving a smaller central core to focus on global systemic issues.

Insurance Role

For most developing countries, the Fund's insurance role – short-term BOP support during times of crisis, when countries cannot avail of any other sources of external finance – has been its most important function. That is when the Fund has most power, and where controversy over its use has been most manifest. Thus, finding alternatives to the Fund's monopoly in this area will do more to change the relationship between the IMF and developing countries than any other issue.

Developing countries have several external financing options in the event of a balance of payments crisis. First, they could draw up credit lines on an ongoing basis to preempt crises of illiquidity. But the volume depends on internal economic fundamentals, confidence in international markets, and the predisposition of the G-7.[12]

A second option would be to seek self-insurance. There are two main possibilities here. The most obvious is the buildup of reserves. Indeed the most significant sign of dissatisfaction with the Fund is the very conscious

[12] In 1995, in the aftermath of Mexico's crash Argentina faced a liquidity crisis and entered into US$6.7 billion worth of "reverse repo" arrangements with 14 international banks that gave it access to liquidity in the event of a sudden large capital flight. The banks charged Argentina a fee together with Argentine bonds as collateral.

choice of developing countries to sharply increase their foreign exchange reserves in recent years (Table 1). What is driving this? The demand for reserves is usually modeled on the lines of a buffer stock model, whereby the macroeconomic adjustment costs without reserves are balanced with the cost of holding reserves. Another way of looking at a reserve buildup is analogous to the precautionary motive for savings traditionally put forward for explaining individual consumption (and savings) behavior (Aizenman and Lee Marion (2005)). Kapur and Patel (2003), extend this line of thinking by stressing two additional factors: strategic considerations arising from prevailing and likely geo-political realities, and the high prospective political price that the government of the day will have to pay if the country faces an external payments crisis (i.e. if the country runs out of foreign exchange reserves).

[Table 1 here]

While in some cases (most notably in East Asia), countries have been building up their reserves to prevent appreciation of their currency, in the vast majority of cases the primary motive has been "self-insurance." To guard themselves against external shocks, developing countries can either seek some sort of joint insurance or attempt to obtain self-insurance. The institutional mechanism for the former has been the IMF, and for the latter foreign exchange reserves. The trade off between the two has been between political and financial costs. While borrowing from the Fund has lower financial costs, the political costs have been high. As conditionalities mounted so did the political costs. In retrospect, the Asian financial crisis was the turning point. Policy makers are well aware of the humiliation heaped on East Asian economies in the course of their Fund programs during the East Asian crisis from 1997-99. Although the Fund has changed tack since then, its perceived lack of independence means that policy makers would be understandably risk-averse. Developing countries appear to be prepared to pay a high financial cost (estimated to be about one percent of GDP of developing countries taken as a whole) to preempt the prospect of a ruinous political cost (Rodrik, 2006).[13]

[13] Generally these costs are calculated as the difference between short term borrowing abroad and yield of liquid foreign assets (e.g. US Treasuries) in which reserves are usually invested. One puzzle (highlighted by Rodrik) is why countries in their quest to insulate themselves from financial crises choose to increase their foreign reserves rather than reduce their short term liabilities. Rodrik notes that developing countries have resorted to the former but the optimal solution is in fact a combination of the two measures. This

Thus, the high costs of holding reserves notwithstanding, they are still a more attractive option relative to availing of any contingent credit line, either from markets or the IMF. For one, the very act of securing contingent credit facilities may trigger a downward spiral of confidence that a government would want to avoid in the first place. Moreover, once a crisis builds up it is exceedingly difficult to either predict or control its momentum. High levels of uncertainty enhance the case for the *status quo* option (i.e. hold high reserves and pay a financial premium). This is even more the case given current geopolitical realities where economic pressure, whether through international financial institutions or on trade policies or even something as seemingly mundane as travel advisories, means a high level of reserves is essential for a country to maintain policy autonomy. Large reserves also help to reassure foreign investors that the likelihood of default on foreign currency denominated liabilities is extremely small.

Another source of self-insurance, especially for poorer developing countries whose exports are insufficient to build reserves, is from their citizens abroad. Remittances have emerged as an important (in some cases, critical) source of financial flows for many developing countries. These flows come without a plethora of conditionalities, are unrequited transfers (and therefore do not require repayment), and increase in times of shocks. They are allowing many developing countries to cover their trade deficits and therefore avoid the cycle of unsustainable external borrowings to cover high current account deficits, thereby necessitating an IMF program.

But a country's diaspora can be a source of self-insurance not just through accretion in the current account (in the form of remittances) but in the capital account as well. For instance in 1998, when India faced sanctions and global financial markets were in turmoil, the country raised US$4.2 billion through India Resurgent Bonds (IRBs) and again in 2000, apprehensive about its balance of payments prospects, India raised another US$5.5 billion through the India Millennium Deposit (IMD) scheme. While both issues (especially the latter) were expensive, they were much less costly than any other alternative. And the experience underscored a new possibility: a country with a large overseas diaspora could raise significant resources at relatively

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would not only decrease this social cost of holding excess foreign reserves, but also increase liquidity to respond to external shocks.

short notice, without having to go to the Fund. Nonetheless there are clear limits as to the amount of money that can be raised through this route.

Political motivations have also led to emergency financing between countries, as illustrated by Venezuela's recent offer to Argentina to buy $3.4 billion of Argentinean government bonds, of which $1.1 billion has been disbursed thus far. Similar financing has been a long established practice between oil rich and needy Muslim nations in the Middle East and Africa.

Developed countries had already developed self- and joint-insurance systems. It was the establishment of the General Agreements to Borrow (the GAB) among the G-10 in 1964 that undermined the Fund's *raison d'etre* for the industrialized countries. Following the onset of the Asian crisis, the U.S. shot down the idea of an Asian Monetary Authority and severely criticized the Asian Development Bank when it attempted to adopt a position different from the prescriptions of the IMF. In the last few years Asian countries have renewed efforts at establishing swap facilities between the region's central banks to pool resources against a speculative attack (under the so-called Chiang Mai Initiative), and efforts to develop a region-wide market for local currency bonds. In the medium-term the swap arrangements (now around $70 billion) pose a singular challenge to the Fund. If growing cooperation among central banks in the region (exemplified by central bank swap facilities) leads to an Asian equivalent of a GAB, the Fund's importance to the region will diminish for the same reason that it has all but disappeared in the industrialized countries.

The strong development of regional monetary and financial arrangements has been pointed out by Henning [2005] and Cohen [2003]. "Cohen counts four full-fledged monetary unions, involving 37 countries, thirteen fully dollarized countries, five near-dollarized countries, and ten bimonetary countries." [14] Henning also notes that the Exchange Stabilization Fund of the United States has entered into nearly 120 agreements since its introduction in 1934.

Some developing counties are seeking insurance by coming under the umbrella of a major power. The EU will effectively provide insurance for new Central and East European members through the ERM2. The liquidity

[14] Henning, [2005] p. 1.

provided to these countries will come from the European Central Bank rather than the IMF.

The Cold War powerfully shaped the lending of the Bretton Woods Institutions in two distinct ways. First, the prospect of a country turning to the Soviet Bloc made the market for lending contestable. Second, allies of major shareholders could always expect their economic transgressions to face less opprobrium. For a while the collapse of the Soviet Union seemed to remove any political competition, but the war on terrorism and the rise of China has changed that. In Asia, Africa, and Latin America, China has mounted a charm offensive, with economic deals that eschew advice and hectoring. China's demand for raw materials from the latter two regions in particular has fuelled a new commodity boom and led China to stake strategic partnerships – and much needed investment. China's volume of trade with Africa has quadrupled in the past five years (to reach about $37 billion).[15] And the pragmatic Chinese policies are a much less constraining philosophy than that of the Fund's major shareholders. Thus, even as Zimbabwe defaulted on its obligations to the Fund, Beijing rolled out the red carpet for President Mugabe.

Table 2. Alternate Insurance Mechanisms for LDCs

Region	Insurance Mechanism
Central America (incl. Mexico)	Remittances
East Asia	Reserves, Swap Facilities
East Europe	ECB (through EU membership)
Latin America	Reserves
Mid-East and North Africa	Remittances
Russia	Reserves
South Asia	Remittances, Reserves
Sub-Saharan Africa	Assistance from Asia

[15] Details of official Chinese policy can be found in "China's African Policy". The so-called "Five Principles of Peaceful Co-existence" enshrine mutual territorial respect, non-aggression and non-interference in each other's internal affairs The white paper promises that the Chinese government will now "vigorously encourage" Chinese enterprises to take part in building African infrastructure and help Africa to build its own capacity.

D. ORGANIZATIONAL CHANGES

The recent decision of Argentina and Brazil to prepay their IMF debts has meant that the Fund income will decline by $116 million in 2006. Apart from a short period in 1990, the IMF's loan book is at its lowest in the past quarter century. One option that the Fund is considering to augment its shrinking income is a proposal to invest some of its reserves in higher yielding longer-term securities, while another option would find a way to generate income from its gold holdings.

One alternative that does not seem to be on the cards is to cut the Fund's administrative expenses. The Fund (like the IBRD) is cost-plus lender and therefore has had little incentive to make the sorts of hard choices that are forced on its clients. In recent years, the cost of borrowing has increased and along with high administrative expenditures, the financial costs of IMF loans are high. When added to the political costs, it is hardly surprising, therefore, that countries are prepaying loans.

Unlike the Bank, which has undergone several major and wrenching organizational changes, the Fund has enjoyed a charmed existence. The only fundamental reform occurred in the aftermath of the collapse of the Bretton Woods system in the early 1970s, but even that had very modest organizational effects. However, as discussion above has sought to demonstrate, the Fund's current financial situation is not the result of temporary circumstances, but is being driven instead by longer-term structural factors. The income pressures facing the Fund will not be resolved by tinkering with the budget. The underlying cause of this predicament is that the Fund is losing rents that it enjoyed as a monopolist, but which are dissipating as alternative sources of insurance and counter-cyclical flows become available to developing countries. Consequently, the revenue shortfalls facing the Fund are of a more permanent nature than the management appears willing to acknowledge. We believe that the Fund has little alternative but to swallow some if its own medicine, tightening its belt and reducing administrative expenditures. We believe there is considerable scope for doing that, though the Fund's recent strategic review avoided any serious consideration of the matter. The standard cost-cutting steps required are to overhaul compensation policies, develop more flexible (internal) labor markets, greater decentralization and outsourcing to lower cost locations.

The biggest anomaly in the Fund's compensation is its pensions. The anomaly is both in terms of level and structure. On level, a comparison of the pension of the median Fund staffer with other comparable places (e.g. universities) is revealing of the extent to which the Fund has gone overboard. It is simply over the top. The present value of the pension due to a Fund staffer who retires at B3-B4 level after about 25 years at the Fund is about $5-6 million.

Even as the Fund's advice recommends that countries move from defined benefits to defined contributions, its own compensation policy remains wedded to a defined benefit pension system, one of its last bastions in the world. Even worse, the defined benefits are linked to a staffer's last three years salary, a perverse incentive from the point of view of another favorite Fund recommendation, labor market flexibility. Its pension system actually encourages immobility because pensions increase disproportionately with years of service: in fact there are two major career kinks, when the pension jumps discontinuously, so a staffer within sight of these kinks simply drops anchor. The Fund's justifies this policy with references to the importance of factors such as experience and institutional memory. The Fund, however, stands out from other organizations that require similar skills.

A second problem with the Fund's compensation policies is wage compression. The Fund's standard prescription is to argue for wage decompression to allow more flexibility to hire staff with special skills, especially at senior levels. Sadly, here too the Fund has failed to follow its own advice. Unlike most of its member states, senior Fund staff is well compensated. The wage compression arises from the fact that junior staff is compensated much too handsomely, especially when one adds in munificent expatriate benefits (home leave, education, the G-5 (ability to "import" domestic help) and pensions. These high salaries do not compensate for greater risk, since it is virtually impossible to be downsized from the Fund.

A third issue is the need for greater transparency in salary structure. IMF staff receives a range of benefits in non-monetized form from education for children to home leave travel allowances. The Fund's message to its civil service clients around the world has been a consistent one – monetize all benefits so that they are clear and transparent. A comparison of lower level total emoluments (including the present value of pension liabilities), with his/her counterpart in comparable private/public institutions would be telling.

Developing countries have a strong interest in pushing for organizational changes in the Fund, and in particular a major overhaul of the Fund's personnel and compensation policies, in line with what the institution advocates everyone else. Since personnel expenses amount for about 70 percent of the Fund's budget (which is approaching nearly $900 million), there is simply no alternative but to address the size of staff and the structure of compensation. Attempts to reform the Fund's pension plan (as recent as a few months ago) were scuttled when Executive Directors from some industrialized countries bowed to pressure from staff.[16] These countries feel that few nationals from their countries would be willing to join the Fund if the compensation package were less attractive. Current policy, however, means that developing countries are subsidizing the ability of rich countries to have nationals on the staff.

E. IMPLICATIONS

The lack of voice in the IMF has been a perennial complaint of developing countries. Currently Europe (including Russia) accounts for 40% of the IMF's voting share and up to 10 of the 24 seats on the Executive Board. Japan, China and India and other East Asian countries account for only 16% of the vote share and 5 chairs. Current discussions indicate that Europe might be willing to give up 2% of its vote share (and perhaps one seat), which will do little to address the structural imbalance.

However, as Hirschman has pointed out, "voice" is not the sole source of legitimacy for an organization. If membership is voluntary, and "exit" does not impose onerous costs, then governance by voice is not necessary for legitimacy. Private firms are not democratic but nonetheless enjoy societal legitimacy when factor and product markets are competitive, since competition gives both input suppliers and output buyers exit options. Even where factor and product markets are not competitive, legitimacy can exist if markets are "contestable" (that is, entry costs are low), or where viable anti-trust and regulatory institutions exist.

[16] The IMF can learn a little from its sister institution, the World Bank, which moved toward defined contribution pension schemes and more transparent, monetized benefits since 1997.

Consequently the possibility of exit even in the absence of voice could give the Fund greater legitimacy. Unfortunately, for virtually all developing countries exit was not a viable option. The "market" for international organizations is, for the most part, not contestable except in the few areas where both regional and global institutions exist. Thus in development projects borrowers had some choice between a regional development bank, the World Bank, and (to varying degrees) the private sector. In some cases countries can engage in forum-shopping – for instance Canada, Mexico, and the US can chose between NAFTA and the WTO dispute settlement mechanisms in cases of trade dispute resolution. But in many important areas this has not been true, especially in the case of functions and services supplies by the IMF – until now.

Among the public goods that the Fund provides, including information, analysis, advice to individual governments, advice on co-ordination of policies, management of defaults and emergency lending, viable alternatives now exist for many more developing countries than ever before.

F. CONCLUSION

We find a variety of initiatives and developments outside the Fund that complement or substitute for the IMF's financial coordination, insurance and surveillance functions. It seems highly likely that the cumulative effect of those initiatives has been, in some degree, to reduce the risk and potential costs of financial instability, in short, to make the world safer, though it is difficult to arrive at a more precise assessment due to the lack of systematic data, to the heterogeneous nature of the initiatives, and to the fact that many have an informal character. However, the evidence suggests a growing trend that is driven both by the growth and diversification of financial markets, and by the increasing complexity of global and national governance. A September 2004 report to the IMF Board, *The Fund's Strategic Direction*, opens with a reference to the "tectonic shifts in the ground the IMF is directed to tend," and acknowledging that "in some important measures, the Fund has lagged rather than led."[17] Those lags are part of the explanation for the surge in non-Fund initiatives aimed at reducing financial vulnerability,

[17] The Fund's Strategic Direction – Preliminary Considerations, a report by The Secretary to the International Monetary Committee on the Fund's Strategic Direction, September 30, 2004, p. 2.

whether as a direct intent, as in the case of regional insurance arrangements, higher reserve holdings, and increased market-based surveillance, or as an indirect effect of other governance objectives, especially the rapid growth of bilateral and regional trade agreements. However, this paper has argued that the resort to non-Fund alternatives is also driven in part by the increasing cost of Fund resources, largely explained by its very high administrative budget.

Further analysis is needed to explore the extent to which these developments can be integrated into a new model for the management of financial instability in the world, a model that will complement the centralized decision and rule-making capacities of an IMF with the more flexible, and more participatory, decentralized governance that is being generated through the combined action of national governments, regional arrangements, market institutions, and civil associations.

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Table 1. Developing Country Reserves (SDR bn)

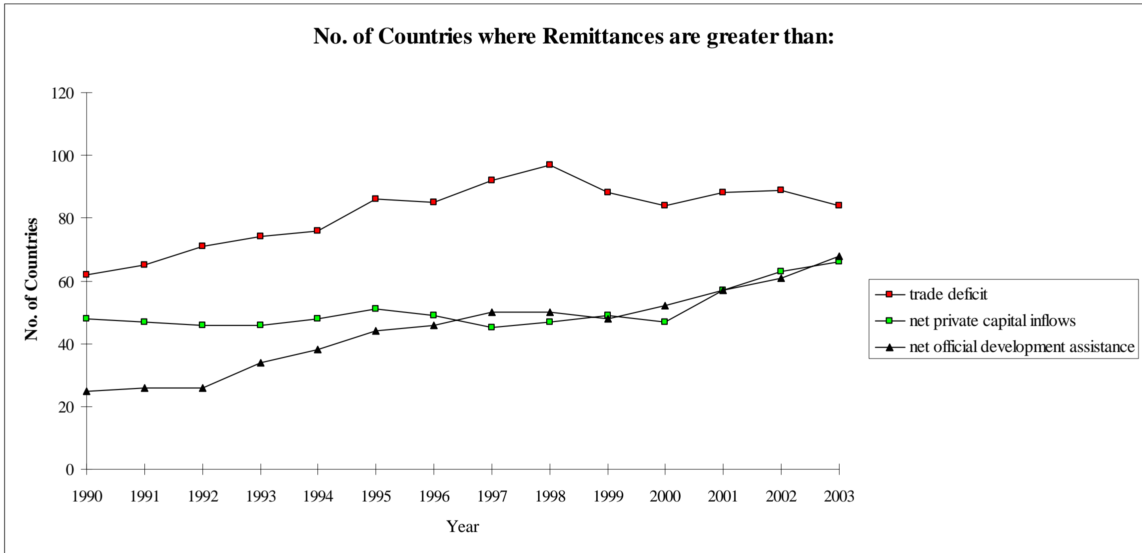
Region	1991	1998	2004
Asia	174.4	408.6	1,033.3
Asia ex China	75.9	240.3	580.3
Africa	13.9	28.9	81.4
South and Central America	44.7	112.5	139.2
Developing Europe	15.4	71.7	211.9
Middle East	38.4	69.5	101.9

Region	1991	1998	2005
Asia	5.0	24.2	7.6
Asia ex China	4.7	24.2	7.6
Africa	5.9	6.8	4.4
South and Central America	12.1	15.6	9.2
Developing Europe	3.5	19.7	13.2
Middle East	0.2	0.7	0.7

IMF Loans Outstanding (SDR bn)

Ratio of Developing Country Reserves to IMF Loans

Region	1991	1998	2004
Asia	34.7	16.9	119.9
Asia ex China	16.2	9.9	67.3
Africa	2.4	4.3	16
South and Central America	3.7	7.2	5
Developing Europe	4.4	3.7	10.7
Middle East	247.3	121.6	134.7


No. of Countries where Remittances are greater than:
120
100
80
60
40
20
0
No. of Countries
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
Year
trade deficit
net private capital inflows
net official development assistance