House of Commons

Treasury Committee

Globalisation: the role of the IMF

Ninth Report of Session 2005–06

HC 875

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The Treasury Committee

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Contacts

All correspondence should be addressed to the Clerk of the Treasury Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5769; the Committee's email address is treascom@parliament.uk. Media inquiries should be addressed to Luke Robinson on 020 7219 5693.

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Summary

The International Monetary Fund stands at the centre of the international financial system. It has the potential to play a key role in managing the risks to both the United Kingdom and world economies, including potential problems arising from the disorderly unwinding of global economic imbalances. At present, the IMF is not optimally organised to meet the challenges it faces.

The IMF is cognisant of these short-comings and has instituted its own reform agenda. We strongly support the idea of a focussed Fund, with a greater role in crisis prevention than crisis resolution. As part of this, we await with interest the review of the relationship between the World Bank and the Fund, and recommend that the Fund ensures concentration upon its core remit of crisis prevention. But we also recommend reforms to strengthen governance in order to ensure that the Fund is more representative of its stakeholders and accountable to them, including a more open selection process for the next Managing Director and greater representation for low-income countries and emerging market economies via a reform of the quota allocations. At the next autumn meeting of the IMF, in Singapore this September, we would encourage the United Kingdom Government to ensure there is no two-stage process for governance reform. Low-income and emerging market economies should both be included in the reforms. We consider the scope of the US veto, noting that any outcome must ensure that the USA remains engaged with the Fund. We also recommend that the Fund moves towards a more transparent decision-making process, especially around the workings of the Executive Board, to ensure the Fund remains accountable to its stakeholders. However, such transparency must not detract from the operational effectiveness of the Fund.

The IMF is seeking to ensure that its surveillance activities concentrate more on the effects of member states on the world economy as a whole, and we agree that balance sheet analysis should lie at the heart of its surveillance work. However, we note that the IMF needs to ensure that it appears independent in its analysis, both independent from the views of individual member states, and free from any potential bias based on its own lending programmes. The attainment of such independence in analysis is the best way to ensure that the IMF's analysis leads to effective and appropriate action by individual member states and the world economic community.

Although the IMF should not be seen first and foremost as a lender of last resort, the Fund will always have to retain some ability to lend to prevent crises or to promote crisis resolution. We therefore support the notion of the Exogenous Shocks Facility, which will provide assistance to countries suffering from events such as natural disasters. As part of its lending remit, the Fund will have to maintain some form of conditionality on its lending, but this must be both appropriate to the circumstances of the borrowing member state, and allow for a suitable input through local democratic processes.

The Fund's finances are also in need of reform. In promoting such reforms, the United Kingdom Government should seek to ensure that the Fund maintains both its independence in surveillance and its ability to support low-income countries.

1 Introduction

1. On 13 December 2005, we announced the start of an inquiry into the International Monetary Fund (IMF), and its role in globalisation. After requesting written evidence, we held three oral evidence sessions. The first, in January 2006, was with non-governmental organisations (NGOs) and selected academic experts; the second, in April 2006, with the Governor of the Bank of England, Mervyn King; and the final session in May 2006 was with the Chancellor of the Exchequer, the Rt Hon. Gordon Brown. We also undertook a visit to the United States in February 2006, in the course of which we met both representatives of the World Bank, including President Wolfowitz of the World Bank, and representatives of the IMF, including Ms Anne Krueger, first deputy Managing Director of the IMF. We are grateful to all those who gave evidence or otherwise assisted with our inquiry, especially those we met on our visit to the United States.

2. This is a time of change for the International Monetary Fund (IMF). Since its foundation as one of the 1940s Bretton Woods institutions, the Fund has seen enormous growth in the world economy. The organisation of the world economy has also changed, from an era of almost global fixed exchange rates, to one where most major industrialised countries now float their exchange rates. Changes in technology and communications have given rise to a perceived increase in 'globalising' trends. The IMF sits as the central institution of the international financial system, and therefore at the heart of the world economy.

3. In the light of this, our inquiry has proved to be extremely timely. After our evidence session with experts and NGOs, the Spring meetings of the IMF occurred. Afterwards, in our next evidence session, the Governor of the Bank of England remarked to the Committee that he thought "the events last weekend [at the Spring meetings] were a very significant departure from earlier versions of the strategic review and the energy which the Fund was demonstrating".[1] They also marked a change in the outlined position of the Fund, as it begins its own process of reform to make itself more relevant to the environment in which it finds itself. The IMF published 'The Managing Director's Report on Implementing the Fund's Medium-Term Strategy' in April 2006, which superseded the original document on which the inquiry had been taking evidence, 'The Managing Director's report on the Fund's medium-term strategy'. As well as this, the International Monetary and Financial Committee (IMFC) produced a communiqué which also aimed to address policy recommendations for the IMF going forward. At the conclusion of the IMFC meeting, the Chancellor of the Exchequer referred to the upcoming annual meeting of the IMF in Singapore as a "reform summit".[2] Our report therefore comes at a time when the UK Government has an excellent opportunity in which to mould the debate on the IMF's future.

4. Our report deals first with defining a purpose for the Fund and, with this purpose in mind, we deal in turn with the governance of the Fund, its surveillance and analysis functions, its lending, its finances and the UK Government report on its dealings with the IMF. We conclude with the overall findings of our work.

1 Q 90

2 Transcript of a Press Conference by the Chancellor of the Exchequer and others, International Monetary Fund, Washington, D.C., 22 April 2006, www.imf.org

2 A role for the IMF

A clear role for the IMF

5. In the popular mind, the IMF is mainly linked with the lending it undertakes to bailout member countries with balance of payments problems. However, the Fund undertakes a wide range of other activities of which lending is, in fact, a diminishing part. We discussed with witnesses the main role for the IMF in the future. Any organisation needs a clear role by which to determine how to allocate its resources, and by which to measure its success, and the IMF is no different to other organisations in this regard. The Governor of the Bank of England told us that he thought that "the main mission of the Fund is to focus on its role as guardian of the international monetary system. Its job is to ensure the smooth workings of the international economy…"[3]. The Chancellor of the Exchequer told us that, at the Spring Meeting, "faced with the changes that are taking place in the global economy and with protectionist sentiment rising as well as the problem of oil prices, we [the IMFC] resolved to make the IMF more fit-for-purpose and more able to address the challenges that are quite different from those of the 1940s when the IMF was created. We agreed that the IMF should focus more on crisis prevention as well as on crisis resolution, and we agreed also that there should be a new focus on surveillance."[4] This idea of the IMF focussing on crisis prevention rather than crisis resolution was also endorsed by the Governor of the Bank of England.[5] In line with his thoughts on UK monetary policy, he thought the IMF should be a "boring" institution: "It is very important to have an institution like the IMF which does not benefit from financial crises, either financially or in terms of the culture and excitement of the work".[6] **The Committee supports the move to focus the IMF's work on crisis prevention, rather than crisis resolution, as well as the decision to make sure the Fund can fulfil its new role.**

Global economic imbalances

6. One feature of the evidence we received was the focus on a particular danger presented to the smooth functioning of the international financial system by global economic imbalances. The United States has maintained a strong dollar, despite a 7% current account deficit.[7] This has been achieved by other countries, especially in Asia, buying dollar-denominated assets. The risk is that this may unwind extremely quickly, with a rapid fall in the value of the dollar, causing import prices in the US to rise. This increase in inflationary pressure may lead to US interest rates rising. This would lead to slower growth in the world's largest economy, which would then have knock-on effects for the global economy. Professor Portes told us "I believe that in a better world the IMF would be coordinating those efforts [to tackle global imbalances]." However, he warned that the IMF "does not

3 Q 81

4 Q 161

5 Q 88

6 Q 88

7 Treasury Committee, minutes of evidence (May 2006 Inflation Report), 6 June 2006, Q 8

now have the status, or stature if you like, to do so".[8] He described himself as "very worried" about this issue.[9]

7. We took evidence about whether a lack of trust in the IMF has resulted, in part, in the build up of global imbalances. We heard that Asian countries have built up huge foreign currency reserves to ensure that, in the case of a domestic crisis, they would not have to turn to the Fund for emergency financing, and the conditions on policy that would entail. Professor Miller told us that "there has been a lot of do-it-yourself insurance by countries, especially in east Asia. To that extent, they are finding a substitute for the IMF."[10] David Woodward also regarded the failure of IMF policies as a reason for the build-up of Asian reserves.[11] The Governor of the Bank of England agreed, and said that he thought that "the decision by countries in Asia to build up large foreign exchange reserves undoubtedly, in part, is a result of the experience of the Asian crisis in the late 1990s, when they got into difficulty partly because they did not have large dollar reserves of their own". In part, he felt this was due to Asian countries experience of dealing with the Fund. [12]

8. More recently, we have again received warnings as to the potential disruption from a disorderly unwinding of global imbalances. In evidence we took on the May 2006 Inflation Report, Professor Quah, London School of Economics, referred to the risk from a disorderly unwinding of the imbalances as "huge"[13], while Professor Muscatelli, University of Glasgow, regarded it as his "biggest risk"[14] to the UK economy.

9. The Spring meetings saw some welcome signs of movement on the issue of global imbalances. A multi-lateral consultation procedure has been recommended by the IMFC, and the IMF has recently announced that the first one will be on global economic imbalances.[15] We discuss multi-lateral surveillance and consultations in Chapter 4. **A disorderly unwinding of global imbalances poses a real risk to the UK economy. It is therefore important that the IMF take an active part in providing both independent analysis of, and potentially a solution to, the risks posed by a disorderly unwinding of global imbalances.**

Reducing the number of extraneous roles of the IMF

10. With a clear remit, there may come the realisation that some roles currently undertaken by IMF may no longer be appropriate. Professor Portes was quite firm in his conviction that the IMF had incorrectly widened its scope. He told the Committee: "It has been a mistake to widen the range of activities of the Fund, both in terms of poverty-reduction programmes in various countries and, to the extent that we have seen with its

8 Q 4

9 Q 52

10 Q 30

11 Q 39

12 Q 85

13 Treasury Committee, minutes of evidence (May 2006 Inflation Report), 6 June 2006, Q 8

14 *Ibid.*, Q 47

15 *IMF to Begin Multilateral Consultations with Focus on Global Imbalances*, Press Release No. 06/118, 5 June 2006

involvement over a huge range of ROSCs (Reports on Standards and Codes)”.[16] He went on to say: “I do not think the Fund should be a money laundering policeman. I do not think the Fund should be a ratings agency.”[17] His views on the inappropriateness of the IMF’s role in money laundering was also supported by Professor Miller.[18] Echoing this criticism the Governor of the Bank of England told us: “I think that if you want to have policemen it makes sense to hire professional policemen. They are not in the IMF, they are in national capitals; it is a question of political will.”[19] He then also went on to criticise any further widening of the IMF’s role, saying “I think one of the big mistakes is to try to ask the Fund to do too many things; in recent years the Fund has been asked to be a fireman, a policeman”.[20] **The IMF has, in recent times, taken on too many roles. As part of the need to create an IMF able to meet its responsibilities, we recommend that the UK Government support a greater focussing of the IMF’s work, which may entail identifying another organisation or body better suited to carry out certain activities, including work on terrorist financing and money laundering.**

The World Bank and the IMF

11. The World Bank was set up in 1944 and, like the IMF, is a Bretton Woods institution. Its role is to promote “global poverty reduction and the improvement of living standards”.[21] The division of responsibilities between the World Bank and the Fund is a key issue, because it determines both the future role of the IMF and its relationship with low-income countries.

12. The Treasury Committee has previously looked at this issue. In 2000, the Committee recommended that the IMF should pull back from debt relief programmes in developing countries as this would “help clarify the roles of the IMF and the World Bank. If it is not done, the level of overlap increases the argument for a merger.”[22]

13. We received evidence, both written and oral, suggesting that the IMF has not dealt particularly well with low-income countries and emerging market economies, exemplified in the build-up of reserves by the Asian economies, as insurance against future IMF intervention.[23] Some of our witnesses criticised the IMF’s role in these countries, with Dr Tembo, of World Vision, calling for “the IMF to stand back from putting too much weight on lower income countries”.[24] While the staff of the IMF were considered excellent, Ms Greenhill, of Action Aid, told us “I think that is the real problem with IMF economists, that they see things very much in purely economic terms and they do not have any basis to think more broadly”.[25] However, she did not necessarily agree with merging the IMF and

16 Q 2

17 Q 12

18 Q 14

19 Q 87

20 Q 87

21 World Bank Website, www.worldbank.org

22 Third Report from the Treasury Committee (1999–2000), *The International Monetary Fund* (HC 72)

23 See para. 7

24 Q 72

25 Q 78

the World Bank.[26] Dr Tembo also told us that World Vision had found that social impact analysis, with its wider scope than purely economics, achieved more changes in favour of poor people.[27]

14. In his evidence to us, the Chancellor of the Exchequer stated that "there is a new sense … that it [the IMF] has got to work far more closely with the World Bank, and … the United Nations agencies that are operating in some of these countries as well".[28] He said that "there have been quite difficult examples of the World Bank giving with the one hand, the IMF taking with the other".[29] However, the Chancellor was also adamant that the IMF should not move away from working with low-income countries. He told us that, as the "IMF becomes a very specialist organisation that is dealing with surveillance … it is not necessary then to say that the IMF should be out of developing countries; it should be involved in surveillance of developing countries".[30]

15. The Managing Director's Report on Implementing the Fund's Medium-Term Strategy announced a review into the concordat that defines the working relationship between the World Bank and the Fund.[31] The Governor of the Bank of England referred to this review as a "welcome development" to make sure there were no "unnecessary overlaps" between the IMF and the World Bank.[32] Tom Scholar, UK Executive Director to the IMF and World Bank, thought it would be a "a very important and welcome review" that would be "looking precisely at [the] collaboration between the two institutions, ensuring that there is complete coverage of all issues but without duplication".[33] On our visit to Washington D.C., President Wolfowitz told us that in the past there had been supposed tension between the IMF and the World Bank. But, he said, to counter this there was currently a high level of engagement with the present review of the relationship between the two institutions. **We welcome the IMF Managing Director's announcement of a review to examine the relationship between the World Bank and the Fund. Given the concerns expressed to us by NGOs, we recommend that the UK Government ensure that the Fund utilises the expertise of the World Bank in social and poverty issues, to augment the Fund's more macro-economics based analysis. The IMF should remain within its remit of crisis prevention, not extend its activities into areas of social policy and development it does not appear to be equipped to deal with.**

26 Q 78

27 Q 77

28 Q 198

29 Q 198

30 Q 205

31 *The Managing Director's Report on Implementing the Fund's Medium-Term Strategy*, 5 April 2006, IMF, para 31

32 Q 113

33 Q 205

3 Governance

Introduction

16. We examined the governance of the IMF. A clear, focussed role for the IMF in the world economy would enable it to deal more effectively with some of the major issues currently facing it, such as global economic imbalances. However, along with clear objectives must come a more inclusive governance structure, so that all countries feel that the IMF is a representative institution.

Quotas

17. Quotas lie at the heart of the governance structure of the Fund. An increase in the quota allocation to an individual country increases that country's voting power and 'voice' within the organisation. However, votes are taken rarely. According to HM Treasury's report on its dealings with the IMF:

> The IMF's Articles of Agreement and by-laws specify the issues which require a vote by the Board of Governors. These are relatively few and include subjects such as changes to quotas, remuneration of Executive Directors and the Managing Director, decisions on the allocation and cancellation of Special Drawing Rights, amendments to the Articles of Agreement, election and changing the number of Executive Directors, forcing the withdrawal of a Fund member and liquidation of the Fund.[34]

The report also notes that most of the IMF's decisions are taken in the IMF Executive Board, "which usually works on the convention of consensus, without recourse to formal voting".[35]

18. Mr David Woodward pointed out that "the weighted voting system of the IMF, coupled with the shift in its role since 1944, means that the votes that each country has in the IMF are inversely proportional to the impact the IMF has on them".[36] He cited as an example "countries in Africa, in particular, [where] the IMF plays a major role in all of their economic and social policies and yet, for example, Mozambique, with 16 million people, has fewer votes [in the IMF] than Iceland, which has about a quarter of a million".[37] Ms Greenhill told us that "you have got the IMF which at the international level is very undemocratic and it lacks basic accountability. We think you really need quite fundamental reform. You cannot really tinker at the edges."[38] However, Professor Portes highlighted the basic conundrum at the heart of voting in the IMF: "There is the problem here of saying that those that tend to need borrowing facilities should have tremendous control over the way in which those borrowing facilities are used, especially when it is, for the most part, the taxpayers' funds of the big and rich countries".[39] However, the NGOs

34 *Meeting the challenges of globalisation for all: The UK and the IMF 2005*, HM Treasury, March 2006, para A.2

35 *Ibid.*, para A.1

36 Q 49

37 Q 49

38 Q 56

39 Q 49

preferred a different system of voting, and Ms McDonald, of Christian Aid, suggested to us that "ideally [we] want one member, one vote because rather than being seen as a shareholder institution, it should be seen as a part of global governance and that should be based on much more egalitarian principles".[40] However, they were conscious of the political reality, and Ms McDonald suggested as an interim: "There are ways of readjusting the voting formula within the institution to get a much better balance of power, to have a 50:50 say with lower income countries having a much greater input".[41]

19. The Governor of the Bank of England told us:

> If there really is to be an institution where people have trust in the neutrality of the management and the fact that it will be objective in its analysis, it must be willing to change the quotas in line with the changing importance of countries in the world economy. It is important in terms of establishing the overall trust and confidence of members in the Fund, but if we had made quite significant changes in quotas I doubt that you would see that reflected in changes in decisions or attitudes, and so on.[42]

He went on to cast doubt on how much changes in quotas would alter the actual workings and debate within the IMF, saying "The fact that China has a small quota now relative to its calculated quota does not mean to say that people take China less seriously now than they would 12 months from now if the quota were increased".[43] The Chancellor of the Exchequer, in his opening statement to the Committee, said "We also agree that, to reflect changing times, a country's voice, votes and quotas should reflect the changing international economic weight of these countries in the global economy. The IMF's effectiveness and credibility should be safeguarded and its governance further enhanced to ensure a fair voice and representation for all its members."[44] He went on to say "We have got to bind in and give representation and voice to large numbers of countries who are increasingly a big block in the world economy who are certainly under-represented" but also highlighted that "It is quite difficult for African countries, with the structure of governance at the moment in the IMF, to see their views fully represented, and so I think we have got to show that we can deal with these issues".[45]

20. **The Committee regards it as important that the governance of the Fund is made more accountable and transparent if it is to be able to meet the challenges of the changes in the world's economy. While we note that changing the quotas may have no discernible effect on how the Fund operates, there is a good case for reforming the quotas to improve the Fund's governance by increasing the accountability to its members and the wider international community. There is a balance to be struck between the rights of those that provide the Fund's resources, and the needs of those that utilise those same resources. We recommend that the UK Government should look**

40 Q 76

41 Q 76

42 Q 136

43 Q 135

44 Q 161

45 Q 163

at whether any more innovative solutions, beyond reform of the quota system, are possible to try ensure the competing needs are met.

The US veto

21. For all key votes in the IMF, such as those on quota allocations, changing the number of executive directors or forcing a member to withdraw from the Fund, a majority of 85% is required for the vote to pass.[46] The United States currently has a quota of 17.4% which means that it has an effective veto where the 85% majority is required.[47] David Woodward explained the problem as he saw it to the Committee. "The biggest potential financial crisis is a collapse of the dollar. The IMF is not in a position to do anything about that because the US has a vested interest and has a veto. That raises fundamental issues."[48] Professor Portes told us: "The US is not going to give up its blocking veto and that is clear. That is just not on the table. We cannot expect that."[49] The Governor of the Bank of England also suggested that the US would always have a unique position with the IMF, and that there may be other changes to be made first, such as the selection process of the Managing Director.[50] The Chancellor of the Exchequer appeared not to accept the case for reform, saying "It is never normally a case of the US with a huge vote against the rest".[51] **We note the political difficulties in achieving reform of the voting structure, bearing in mind the need to maintain a close US involvement with the IMF, but the current voting arrangements do not sit well with an international organisation that sees itself providing impartial worldwide economic advice in the future. We recommend that the UK government seek a reduction in the scope of the veto so that surveillance matters are no longer included.**

The European dimension

22. One area of governance reform discussed was that of the position of European countries. Nevertheless, as the Governor of the Bank of England pointed out, "it is important to distinguish between the European Union, on the one hand, and the euro area, on the other".[52] He went on to say that "There is quite a good argument for suggesting that the euro area has to think quite hard and deeply in the years to come about how it is represented at the IMF".[53] He described the present arrangement whereby European countries in the euro area continue to be well represented despite not having separate currencies, as causing "significant friction" in international organisations, such as the IMF.[54] Professor Portes also described Europe as "hugely overweighted", but said this particularly applied to the euro area, with its single currency and monetary policy.[55] He

46 IMF articles of agreement, IMF website, www.imf.org/external/pubs/ft/aa/aa.pdf

47 IMF Members' Quotas and Voting Power, and IMF Board of Governors, IMF website, www.imf.org

48 Q 49

49 Q 33

50 Qq 136, 137

51 Q 180

52 Q 125

53 Q 126

54 Q 127

55 Q 33

went on to say "The countries in the eurozone cannot have it both ways. They cannot say the euro is this wonderfully important international currency and then not behave as if it were a single currency and have a single monetary policy and a single presence in the international foreign exchange markets and so on and so forth."[56] However, the Chancellor of the Exchequer appeared to suggest that the chance of reform was limited, telling us: "I think there is a general view still that the individual countries—Germany, France, Italy—will retain the separate seats in the IMF".[57]

23. On the European Union side, the Governor of the Bank of England felt that there was significant cooperation and, when it coincides with UK interests, then a "harmonised" view is presented.[58] However, since the UK is not part of the euro area, he felt that the UK could not, and would not, merge its position in the IMF with other European countries.[59] This position was also strongly endorsed by the Chancellor of the Exchequer.[60] **There are two issues involved in European representation at the IMF. Although not a matter directly for the UK government, it appears sensible that the UK should encourage its euro area partners to combine their representation at the IMF. More importantly for the UK, the UK government should actively seek to try and ensure there is a harmonised EU view when dealing with IMF matters, where this is possible.**

The quota reform process

24. The Managing Director's Report on Implementing the Fund's Medium-Term Strategy outlined a two-stage process for reforming the quota structure, to try and achieve some progress by the Singapore meetings in September 2006.[61] The Chancellor of the Exchequer told us that "It may be that this will be a two-stage process rather than a one-stage process, but I believe now we will make significant progress at Singapore and there is a will that I found in April, when I was chairing the meeting of the IMFC, to make progress very quickly; so that will happen, in my view, over the summer."[62] However, in a press conference of African Finance Ministers, Mr Mulongo, Governor of the Central Bank of Congo, said of the two stage process:

> "The African countries don't like that strategy, that two-step procedures. We prefer that the re-structuring of the shares be done in one, single time instead of first solving the problem of the underrepresented countries, the Asian countries, and then a change, an amendment, to the statutes to allow the African countries to increase their share. We think that the whole thing should be done one, single time, so that, since we are the ones that contribute the most to the IMF's income and use most of

56 Q 44

57 Q 169

58 Q 130

59 Q 126

60 Qq 170–172

61 *The Managing Director's Report on Implementing the Fund's Medium-Term Strategy*, 5 April 2006, IMF, para 34

62 Q 163

the Fund's lending, we believe that we need to have broader representation within the IMF."[63]

25. **The Committee is encouraged by the view of the Chancellor of the Exchequer that there may well be quick progress in the reform of the quota system. However, we note the concerns expressed by African representatives about being left behind in a two-stage process, and call on the UK Government to ensure that all countries are better represented in the governance structure of the IMF after the Singapore meetings.**

Appointment of the Managing Director of the IMF

26. The Managing Director of the IMF is generally selected by the western European governments, while the World Bank President is selected by the United States of America. The current Managing Director, Mr Rodrigo de Rato, previously Spain's Minister of Finance, began his five-year term on 7 June, 2004. In the course of his evidence to us, the Governor of the Bank of England described Mr de Rato as a major driving force for reform at the Spring meetings.[64] However, the Governor highlighted the process of selecting the replacement for the Managing Director of the IMF as an area of potential reform.[65] He told us that "I think that what is most important is to put in place a process which is acceptable to the membership overall. It is not at all clear what the present process is. The most important thing is to write down what that process is before there is a vacancy…"[66] The Chancellor of the Exchequer, however, felt that the selection of the current Managing Director had been more open. "I do not think what was done in the process of selecting Mr Rato has been fully recorded, and this was not a European cabal, as you suggest. It is true that he emerged from Europe as a candidate, but it is also true that there was consultation with every continent."[67] While he noted that there would be a desire to move towards a meritocracy for appointments, the Chancellor of the Exchequer suggested that perhaps the IMF ought not to be dealt with in isolation, telling us, "I think you have got to take into account all the international institutions that have an impact on the world economy and not just one".[68] **The Committee notes the Chancellor of the Exchequer's view that the selection of the current managing director was more open. However, even the Chancellor stated that not all that was done in selecting Mr Rato was recorded, suggesting the process in future could be less opaque. We therefore support the Governor's request for an open selection process for the IMF's managing director, and recommend that the UK Government prepare, publish, consult on (including with its European partners) and then support at the Singapore meeting a transparent process for selecting the next IMF managing director. While this may mean that the IMF has a more transparent procedure than other international organisations, we believe that it is right that the Fund, with its new focus, should be the first in achieving reform in this area.**

63 Transcript of a press conference of African Finance Ministers, Washington D.C., 22 April 2006,

64 Q 86

65 Q 137

66 Q 138

67 Q 167

68 Q 168

The Executive Board

27. The issue of representation on the Executive Board is similar to that of the quota allocations. Part of this has to do with the level of European representation, which has been dealt with above. The Governor of the Bank of England told us: “I think that we need to make the Board, which represents all 184 member countries, an effective Board which is capable of holding the management accountable”.[69] As part of this, the Governor in a recent speech in India had suggested that the Board should become non-resident, with part-time Executive Board members providing “an essential link between the Managing Director and the national treasuries and central banks from which they were drawn”.[70] In his oral evidence to us, he went on to say “This general problem of a very expensive, very time-consuming, full-time Executive Board, staffed at middle level … not by senior officials from capitals, has made it, in my view, in many organisations, more difficult to hold the senior management accountable, as well as embroiling the senior management in a massively expensive bureaucratic exercise”.[71] The Chancellor of the Exchequer disagreed with this position when he gave evidence to us: “I would not suggest that the Executive Board should be removed at all, I think it does an important piece of work, and while diplomacy can be carried out by telephone and by video conferencing, I think the detailed work of having an executive for this organisation probably does still need resident directors”.[72]

28. Another of the Governor of the Bank of England’s concerns had arisen from the amount of information passing in front of the Executive Board. He told us that the Board receives over 300 pages of text every single working day.[73] However the Chancellor reminded us that “the Board has a responsibility for the allocation of what are essentially public funds, and while one wants the reports to be precise and as concise as possible, I do not think when you are allocating public funds you should fail to go into detail of some of the issues which are raised by country investigations”.[74] Tom Scholar added that “there are other areas, such as surveillance, which are essentially technical areas, and I think that could be an area where there could be quite significant economies in the use of Board time”.[75]

29. **On the representation of the IMF’s members on the Board, the Committee stands with its earlier conclusions on quotas, in that there should be movement to allow a fairer representation of the newly emerging economies, as well as the main recipients of the Fund’s expertise and resources. We support the Chancellor’s view that there needs to be a resident board, to allow effective oversight of the Fund’s activities. This underlines the need to ensure proper representation of all the Fund’s members. We also note the Governor’s concern as to excessive information flow through the Board, and**

69 Q 133

70 Speech by Mervyn King, Governor of the Bank of England, *Reform of the International Monetary Fund,* at the Indian Council for Research on International Economic Relations (ICRIER) in New Delhi, India on Monday, 20 February 2006

71 Q 84

72 Q 180

73 Q 84

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therefore recommend that the UK Government try and ensure that there is reform of the processes of the Fund, which would then allow the Executive Board members to properly discharge their duties in overseeing the Fund. In the area of surveillance, and given the need for independence, we would not expect there to be heavy influence from the Board in this area.

The International Monetary and Financial Committee (IMFC)

30. We also sought evidence as to the effectiveness of the IMFC, which the Chancellor of the Exchequer currently chairs. According to the IMF, the "the IMFC has the responsibility of advising, and reporting to, the Board of Governors on matters relating to the Board of Governors' functions in supervising the management and adaptation of the international monetary and financial system, including the operation of the adjustment process, and in this connection reviewing developments in global liquidity and the transfer of resources to developing countries; considering proposals by the Executive Board to amend the Articles of Agreement; and dealing with disturbances that might threaten the system."[76]

31. Mr Woodward raised the issue of representation on the IMFC, telling us "I think there are issues about the composition of that body [the IMFC] which reflects the composition of the Executive Board".[77] When asked about the effectiveness of the IMFC in providing oversight of the Fund, Ms McDonald told us "I am not clear how something that meets so infrequently and is more an opportunity to state our policy preferences can be an oversight body".[78] When we asked the Governor of the Bank of England, the current UK representative on the IMFC, about how effective he thought the IMFC was, he told us that "Up until now I would have said it is one of those meetings where you have got a Saturday afternoon, you would be sitting there in this windowless room in Washington, thinking … 'Is anybody else outside the room taking any notice of this?'"[79] However, he considered that the last meeting had been very useful, and he said the reason for this was a combination of the work of the current Managing Director, the US Treasury Secretary John Snow, and the Chancellor of the Exchequer.[80] The Chancellor of the Exchequer himself said that the meetings had in the past been unduly long, but, he told the Committee: "Now I think we operate to a fairly tight procedure where the meetings last, I think, five or six hours and, by the time the meeting is finished, you have agreed the communiqué, which, if I may say so, is having an increasing influence on the way the debate is focused in the world economy".[81] **We welcome the moves to make the IMFC more effective. It is important that, as a high level body of the IMF, it is particularly cognisant of its role in providing guidance and oversight of the work of the Fund. We therefore recommend that the UK Government do it all it can to ensure that the procedures of the IMFC are effective in helping the IMF develop its role in the global economy, and in ensuring that it provides significant**

76 An [IMF] Factsheet—March 2006, *A Guide To Committees, Groups, And Clubs*, www.imf.org

77 Q 51

78 Q 74

79 Q 139

80 Q 141

81 Q 179

oversight of the work of the Fund, especially considering the IMFC's new remit in setting the surveillance objectives for the year.

Transparency within the IMF

32. One repeated theme in the written evidence submitted to us was the need for greater transparency in the workings of the IMF. The Bretton Woods Project felt there was a "long way to go" on transparency. They suggested the current IMF policy of not allowing access to IMF board minutes made "a mockery of the public's right to access information in a timely fashion".[82] This call for greater transparency was also seconded by Action Aid.[83] David Woodward, of the New Economics Foundation, told us that he thought "a major step forward would be, at the very least, the release of the UK Director's statements in the Executive Board and preferably the full minutes of all meetings, unless there is a specific reason for confidentiality".[84] Professor Portes also agreed that it would be useful to have a less opaque decision-making process.[85]

33. The Governor of the Bank of England, while supporting the need for transparency, noted that there would be always be issues of the timing of such transparency. He told us that "There have to be opportunities for having meetings where you are not committed to a communiqué at each and every meeting but where the Fund, at the end of this process, has to make a clear public statement of its analysis and its views on where the consultation has got to".[86] He used the example of closed MPC meetings, but a timetable for publishing the minutes, to show how you "get transparency, but it has to be designed carefully".[87]

34. **Transparency is a necessary part of any public institution's maintenance of accountability to its stakeholders. We recommend that the UK Government work with other member countries to persuade the Fund to release more material, including Executive Board minutes. We would like to see the IMF publish the Board's minutes as soon as is advisable. In doing so, the UK Government should bear in mind the view of the Governor of the Bank of England that transparency, has to be 'designed carefully' if it is not to prevent free and frank discussion.**

82 Ev 54

83 Ev 52

84 Q 45

85 Q 38

86 Q 120

87 Q 120

4 Surveillance and analysis

Introduction

35. The IMF refers to the process of monitoring and consulting on the effects of individual member countries' economic and financial policies as 'surveillance'.[88] Article IV of the IMF's articles of agreement sets a mandate for the IMF to engage in exchange rate surveillance. In 1977, the Executive Board decided that, in order to meet this mandate, the IMF would require "a comprehensive analysis of the general economic situation and policy strategy of each member country".[89] To achieve this, the IMF sends a team, normally once a year, to each individual country — a process known as an article IV consultation. Member states have to agree to publication of the IMF team's report, which in general they do. As well as these consultations, the IMF also produces two reports, the W*orld Economic Outlook* and the *Global Financial Stability Report*, which cover the outlook for the world economy and financial markets respectively, on a cross-country basis.[90]

36. The most recent IMFC communiqué set out four principles for future IMF surveillance:

- First, a new focus of surveillance on multilateral issues, including global financial issues, and especially the spillovers from one economy on to others.
- Second, a restatement of the commitments which member countries and their institutions make to each other under Article IV on which surveillance can focus on monetary, financial, fiscal and exchange rate policies.
- Third, the Managing Director should implement his proposal for a new procedure, which will involve the IMFC and the Executive Board, for multilateral surveillance.
- Fourth, the IMFC should set a new annual remit for both bilateral and multilateral surveillance through which the Managing Director, the Executive Board and the staff are accountable for the quality of surveillance. This should involve the independence of Fund surveillance, greater transparency and the Independent Evaluation Office.[91]

37. The importance of surveillance as the new primary role of the IMF was emphasised in evidence. The Governor of the Bank of England told us "I think that, from now on, my own view is that the main role and functions of the Fund will be primarily in surveillance".[92] The Chancellor expressed hope that the move towards surveillance will assuage the fears of countries as they deal with the IMF, placing the IMF very much towards the crisis prevention rather than crisis resolution role. He told us "The idea that all the IMF did was deal with fiscal crises has developed over a period of years but once you

88 An [IMF] Factsheet—September 2005, *IMF Surveillance*, www.imf.org

89 *Ibid.*

90 *Ibid.*

91 Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, 22 April 2006, IMF, para 10

92 Q 81

see the emphasis on surveillance and that it is about crisis prevention the IMF then seems less of a threat than people had seen it to be when it came into the country with its programmes and more of a service to prevent there being a crisis in the first place."[93]

Multilateral surveillance

38. Before the 2006 Spring meetings of the IMF, multilateral surveillance, especially of exchange rates, became an increasingly discussed topic. Tim Adams, US Under Secretary for International Affairs, said in a speech that there was a requirement for "an IMF capable of demonstrating strong leadership on multilateral exchange rate surveillance. The IMF membership should endorse such an enhanced role for the IMF, restoring its central role on exchange rates. There are four areas where our experience [of the United States] clearly points to the need for concrete improvements: clarifying exchange rate surveillance principles; Article IV reviews; the special consultation mechanism; and multilateral surveillance reforms."[94] The Governor of the Bank of England, in a speech in India in February 2006, made similar comments, though he raised the need for multilateral surveillance to focus on more than just exchange rates, saying "The Fund has been in the forefront of the analysis of balance sheets for emerging market economies, and it needs to extend this approach to its surveillance of the industrialised world. In conducting this analysis, the Fund must look at countries' exchange rate choices. But no one price is a sufficient statistic for the effect of one country's policies on the rest of the world—even one as important as the exchange rate. Balance sheet analysis should be at the heart of the surveillance process. That analysis should lead to an assessment of the risks to the world economy as a whole."[95]

39. The Managing Director's Report on Implementing the Fund's Medium-Term Strategy also discussed the move towards multilateral surveillance, with the IMF aiming to "doing more to identify—and promote effective responses to—risks to economic stability, including from payments imbalances, currency misalignments, and financial market disturbances."[96] The Committee heard strong support for the Fund undertaking more effective multilateral surveillance. Professor Portes told us that "multilateral surveillance in accordance with some fairly basic economic principles is one of the core functions of the Fund, which it has not effectively pursued".[97] Dr Fletcher Tembo, of World Vision, when asked what the IMF did well, said "The dimension the IMF brings is that, when they look at the global issues, the regional issues we have in Africa and the way the economy has changed at the regional level and at a country level, they bring that kind of analysis together".[98] The Governor of the Bank of England also outlined the importance to the IMF of the new focus on multilateral surveillance. He thought that "the new approach to multilateral surveillance which was launched last weekend [at the Spring meetings] is one

93 Q 219

94 Remarks by Tim Adams, Under Secretary for International Affairs, 2 February, 2006, *Working with the IMF to Strengthen Exchange Rate Surveillance*

95 Speech by Mervyn King, Governor of the Bank of England, *Reform of the International Monetary Fund* At the Indian Council for Research on International Economic Relations (ICRIER) in New Delhi, India on Monday, 20 February 2006

96 *The Managing Director's Report on Implementing the Fund's Medium-Term Strategy*, 5 April 2006, IMF, para 4

97 Q 23

98 Q 57

which the Managing Director will run with and he is very conscious of that being one of his main tasks in the year ahead".[99] The Governor saw the IMF's concentration on multilateral surveillance as a chance to "to make sure that countries realise that they did have responsibilities to each other and that there needed to be a restatement of their policy frameworks not just in the area of exchange rates but also in the area of monetary policy and fiscal policy".[100]

40. The Chancellor, in his opening statement to the Committee, outlined the new role as agreed at the Spring meetings by the IMFC, reflected in the four principles for surveillance: "The IMF should not only now assess risk to individual countries but also focus on the spill-over effects and the linkages between individual countries' policies and the global economy. Member States should reaffirm the commitments on which IMF surveillance is based and this should include that there be surveillance of monetary, fiscal and exchange rate policy."[101] The Chancellor also told us how this new role would impact on individual country assessments undertaken by the IMF: "I think, as regards the individual studies, the emphasis will be not only on what is happening within the borders of an individual country but the spill-over effects of what is happening in the biggest economies as well as the categories of economies, like developing country economies and emerging market economies".[102]

41. **We welcome the renewed commitment of the IMF to multilateral surveillance, and to surveillance overall. Given that a major risk to the UK economy at the moment stems from global imbalances, it seems entirely appropriate that the IMF, as the guardian of the global financial system, should seek to redouble its efforts in assessing the effects of the interplay between the world's economies. In doing so, the Fund should utilise the overall "balance sheet analysis" called for by the Governor. We recommend that the UK Government supports these moves, while seeking to ensure that there is broad consensus for this change in focus of the surveillance across all members of the Fund.**

Multilateral consultations

42. The IMF, in a recent press release, announced the first multilateral consultation on global economic imbalances. The overall purpose of these new procedures was outlined in the following terms:

> Multilateral consultations, which form part of the Fund's multilateral surveillance responsibilities, will provide a forum for debate among parties to a common economic issue. The consultations are intended to strengthen the Fund's analysis of the potential benefits of collective action. They will aim to enable the Fund and its members to agree upon policy actions to address vulnerabilities that affect individual members and the global financial system, and they will help policy makers to show that the measures they propose will be matched by measures taken by others, with benefits to all. Each multilateral consultation will focus on a specific international

99 Q 90

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101 Q 161

102 Q 190

> economic or financial issue and directly involve the countries that are party to that issue.[103]

43. The Governor of the Bank of England told us why he felt that the IMF was the correct institution for this new role:

> I think it is not just intellectual leadership, it is also the moral authority that comes from having, as happened last weekend, 184 countries around the world, through their elected members of the IMFC, agreeing to ask the Fund to carry out this function. That gives it a moral authority to call in multilateral consultations, to report objectively and give its view.[104]

44. We questioned how the conclusions of a multilateral consultation can be enforced, considering that the IMF has no policy instruments, such as an interest rate setting mandate, or an ability to levy fines, to ensure compliance. The Governor told us that the lack of such an instrument did not mean that the IMF should go out and find one. He accepted that a lack of such an instrument meant that sometimes larger countries may pursue their own agendas, but he felt that the Fund could try "to demonstrate to them that when it comes to the major issues of imbalances and exchange rates it is in the interests of countries to work together; it is not in their own interest to diverge".[105] The analogy he used was that of a cricket umpire, and he felt that while the Fund does not have an instrument, it would always be a forum for discussion when there is a major economic problem. "When the world economy is fairly quiescent and there are not any significant risks out there then I suspect this will not be perceived as being a very important or major role, but that is not bad, in my view, let us let things just carry on. When the imbalances look as if they may start to unwind, I am completely confident that the major players will want to talk to each other."[106] We also asked the Chancellor of the Exchequer how agreements from multi-lateral consultations could be enforced. He told us: "Basically you are going to have to persuade countries. There are certain sanctions you have, there are certain incentives you have. Part of the power of this comes from the power of information, people seeing the consequences of their actions, but in the end you are going to have a far more cohesive international community so that they recognise that what affects one continent also affects another and therefore reciprocal actions or sometimes joint actions are totally necessary."[107]

45. **We welcome the IMF's new approach to multilateral consultation, given the Fund's new focus on crisis prevention. However, we note that in order for the findings of such consultations to be effective, member states must feel that the actions that may be required from the conclusion of this process will be broadly beneficial. We therefore recommend that the UK Government encourage the Fund's development in a manner which reinforces its neutrality and authoritativeness and that the UK Government support measures to strengthen the Fund's governance.**

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103 *IMF to Begin Multilateral Consultations with Focus on Global Imbalances*, Press Release No. 06/118, 5 June, 2006

104 Q 116

105 Qq 116–117

106 Q 92

107 Q 229

The role of the Independent Evaluation Office (IEO)

Background

46. The Independent Evaluation Office of the IMF began operations in 2001, after its institution was proposed by the UK.[108] It was set up "as a means to enhance the learning culture within the Fund, help build the Fund's external credibility, promote a greater understanding of the work of the Fund, and support the Executive Board's institutional governance and oversight responsibilities".[109]

47. The IMFC has recently suggested that the Independent Evaluation Office should take a greater role in accounting for the surveillance output of the IMF.[110] However, Professor Miller had suggested to the Committee that the OECD could be used to provide "counter-assessments" of IMF surveillance.[111] This idea was firmly rejected by the Governor of the Bank of England, who said "The OECD should not be asked to comment on the IMF, they have got their own remit and role".[112] The Governor of the Bank of England felt that the IEO was the "right body" to provide an objective analysis on the IMF's work, and that it had shown "a willingness to be very frank and blunt about the failures or shortcomings of Fund programmes".[113] The aid agencies also praised the analysis of the IEO, but expressed concern as to the how well it was then followed up by the IMF. Ms Greenhill told the Committee that "At the moment it seems a bit like the IEO produces reports and all the NGOs say 'What a great report' and then nothing happens".[114]

The statutory basis for the IEO

48. An important aspect of the IEO's work that arose in evidence was the protection afforded the Office in the articles of agreement. The IEO on its own website says it "will be independent of Fund management and staff and will operate at arm's length from the Fund's Executive Board. Its structure and modalities of operation must protect its operational independence—both actual and perceived".[115] Mr Scholar explained to us the degree of separation provided to the IEO. Mr Scholar described the IEO as "a separate and independent body reporting to the board", and that while all other staffing decisions are made by the Managing Director, the head of the IEO is appointed by the Board.[116] **The Independent Evaluation Office (IEO) has been a significant success. However, it still has scope for further development, especially given the International Monetary and Financial Committee's recommendation to include the IEO within the oversight of the**

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108 Q 197

109 IMF Executive Board Report to the IMFC on the Establishment of the Independent Evaluation Office (IEO) and its Terms of Reference, 12 September 2000, IMF website, www.imf.org/ieo

110 Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, IMF, 22 April 2006

111 Q 36

112 Q 107

113 Q 107

114 Q 73

115 IEO website, http://www.imf.org/external/np/ieo/index.htm, 'terms of reference'

116 Q 218

surveillance remit. We recommend that the UK Government set out in its reply to this report whether the IEO's remit should be set out clearly within the articles of agreement or by-laws of the IMF, allowing for its independence of governance and financing. The IEO's remit may be about to widen should it also take on a role within the oversight of the surveillance work undertaken at the IMF. We recommend that the UK Government consider whether the IEO will require further resources to fulfil its extra responsibilities.

The IMF as a ratings agency

49. The Committee heard suggestions that the IMF, with its significant surveillance capability, was in danger of assuming the role of a ratings agency. Professor Portes was adamant that this was not a role for the IMF, telling us "I do not think the Fund should be a ratings agency".[117] The Governor of the Bank of England also suggested that this was not a role for the IMF, telling us "Certainly it should not be seen as a ratings agency, it is not there to take responsibility; otherwise, if it does take on that responsibility, it will come under great pressure to continue to lend to countries when they get into trouble."[118] In its follow-up evidence to the Committee, the Bank of England gave additional reasons for rejecting the IMF taking on this role, saying: "In a situation where an over-optimistic rating was produced by the IMF itself, the institution would be placed under considerable pressure to remedy the situation by providing a large 'bail-out' package. There is a clear risk that this dynamic would prevent the Fund from focussing on its core surveillance mandate, undermine the credibility of IMF access policies, and distort the international financial system."[119]

The IMF as 'gatekeeper'

50. However, while the IMF may not take on the role of a ratings agency, it has played a role in deciding whether other agencies and donors will provide grants for, or lend to, low-income countries. Ms Greenhill told us that the IMF's role was "increasingly about that seal of approval which will allow the bilateral donors to come in and very often that is in the form of grants".[120] The Bank of England refers to this as a 'gatekeeper' role.[121] Christian Aid highlighted the importance of this role, telling us "if the IMF labels a poor country 'off-track' on its macroeconomic and structural policy performance, then most donors are unwilling to offer debt relief or will cut the amount of aid they give it. In some cases, this sudden drying up of aid can actually trigger a macroeconomic crisis—the very thing the IMF is meant to guard against."[122]

51. One aspect of the IMF's gatekeeper role is the introduction of the Policy Support Instrument (PSI). The IMF describes the PSI in the following terms:

117 Q 12

118 Q 152

119 Ev 53

120 Q 67

121 Ev 53

122 Ev 63

> The Policy Support Instrument (PSI), introduced in October 2005, enables the IMF to support low-income countries that do not want—or need—Fund financial assistance. The PSI will help countries design effective economic programs, and, once approved by the IMF's Executive Board, will signal to donors, multilateral development banks, and markets the Fund's endorsement of a member's policies.[123]

Effectively the PSI widens the Fund's 'seal of approval' to countries to which the Fund is not currently lending. The Policy Support Instrument has been presented to us both as an opportunity and as a risk to developing countries. Christian Aid, in its written submission, told us that the PSI "will significantly increase the IMF's influence over all developing country governments, who will need to be on track with the PSI if they want donors to provide them with funds."[124]

52. However, the Bank of England in its supplementary evidence to the Committee provided a more positive assessment, and said that the PSI provided three advantages to low-income countries. First, low-income countries could utilise the expertise of Fund staff. Second, the PSI acts as a marker to other agencies (the gatekeeper role), and third, undertaking a PSI may allow access to Fund resources in a crisis.[125] The Governor alluded to the PSI, telling us he supported "a non-borrowing programme, in which the Fund and the country work together to discuss the economic policy of that country in a context which does not involve borrowing from the Fund. I think that is one way of making the advice more available without getting into any detailed conditionality, or indeed lending".[126] According to the latest HM Treasury annual report on its dealings with the IMF, the "UK welcomes the proposed new PSI, which will create a more effective means of support for low-income countries with sound policies that neither need nor want IMF financing, but are seeking policy advice, monitoring and signalling support from the Fund".[127] However, the report also noted that "financing decisions are the responsibility of donors, not the Fund. The UK does not require an on-track Fund programme as a condition of budget support: decisions are taken on the basis of a more graduated, multidimensional assessment of macroeconomic performance, rather than relying on on/off signals."[128]

53. **We agree with the view that the IMF should not become a ratings agency, especially considering the potential distortion of the financial system. However, we also recognise that the IMF has a significant role as a gatekeeper for low-income countries. With IMF approval, low-income countries are far more easily able to access development aid and lending, both from international institutions and individual donor countries. The Policy Support Instrument (PSI) extends this role. We therefore recommend that in its response to this report, the UK Government sets out its views on whether the existence of this instrument will penalise countries that do not wish to be involved with the IMF by preventing them accessing aid. As well as this, the UK Government should also**

123 An [IMF] Factsheet—December 2005 *The Policy Support Instrument*, http://www.imf.org/external/np/exr/facts/psi.htm

124 Ev 64

125 Ev 53

126 Q 110

127 *Meeting the challenges of globalisation for all: The UK and the IMF 2005*, HM Treasury, March 2006, para 2.43

128 *Ibid*, para 2.43

consider whether the conditions attached to the PSI are consistent with its own policy paper on conditionality, and how the instrument will interact with the UK Government's own development policies, including the meeting of the Millennium Development Goals. The Committee notes the increase in development assistance provided by donors other than traditional donors.

The independence of surveillance

54. We gave particular attention to the independence of the IMF's surveillance, given the renewed focus on that role in the IMF. Independence ensures that the surveillance analysis undertaken by the Fund will be both respected and, potentially, acted upon. If member countries feel that surveillance is in any way biased, they will be less inclined to base policy upon it. We heard evidence in two areas where independence of surveillance will be important. One was over the need to maintain a separation of the surveillance and lending functions of the Fund. The Chancellor of the Exchequer told the Committee of his own support for such a separation. "You must find a way of separating the advice that is necessary to be given, which can be public in most cases, from the allocation of money and, if you had an authoritative set of advice being given about what should be done, then I think markets, citizens within countries, would look at this advice and see whether it was relevant and it would form a subject of debate and then, quite independently, you would decide is there a case for giving money rather than merging the two processes so closely together. I think there are real advantages in the separation."[129]

55. The second area related to maintaining the independence of the analysis in the face of pressure from the individual member countries. The Governor of the Bank of England, in a recent speech in India, declared that the IMF should become "independent of governments".[130] David Woodward expressed concern as to the influences on the IMF's surveillance more forcefully: "The biggest potential financial crisis is a collapse of the dollar. The IMF is not in a position to do anything about that because the US has a vested interest and has a veto. That raises fundamental issues."[131]

56. **The IMF must be seen to be provide independent surveillance analysis, especially where it has lent to a country. There is an obvious moral hazard in that the IMF may wish to use its surveillance analysis to support a country it has lent to, purely to protect its own investment. This is especially important given the IMF's 'gate keeper' role. The other element of independence is that no single member country, or group of member countries, should hold sway over the surveillance analysis of the IMF. While the IMF must, of course, remain accountable, it should also be encouraged to provide an independent voice on the interactions of the world economy. We therefore recommend that the UK Government do it all it can to arrange that there is a separation of the surveillance analysis from the analysis undertaken for the purpose of the Fund's lending activities. We further recommend that the UK Government seek to ensure that a framework develops in which the IMF, while ensuring adherence to the principles of**

129 Q 194

130 Speech by Mervyn King, Governor of the Bank of England, *Reform of the International Monetary Fund* At the Indian Council for Research on International Economic Relations (ICRIER) in New Delhi, India on Monday, 20 February 2006

131 Q 49

accountability, provides an independent voice, able to offer unbiased advice on the world economy.

5 Lending

Conditionality of IMF lending

57. There has been a significant amount of past controversy over the conditions the IMF places on borrower countries to receive loans, and it was a significant part of our discussions with the non-governmental organisations. In March 2005, the UK Government published a policy paper on aid conditionality, entitled *Partnerships for poverty reduction: rethinking conditionality*, which was intended to move UK policy from one where aid was conditional on specific policies, to one where poverty reduction was the key criterion in assessing aid requirements. The document set out five principles for the UK Government's aid relationships: developing country ownership, participatory and evidence-based policy making, predictability, harmonisation (including working more effectively with the IMF), and transparency and accountability.[132] There were to be three objectives to UK aid policy:

a) reducing poverty and achieving the Millennium Development Goals;

b) respecting human rights and other international obligations; and

c) strengthening financial management and accountability, and reducing the risk of funds being misused through weak administration or corruption.

58. One initial concern the NGOs suggested to us was that an economic ideology operated at the IMF, based around economic liberalisation. Ms Olivia McDonald, of Christian Aid, reiterated a point made in their written submission, that the "IMF has a very pro-liberalization stance".[133] They felt that this alleged bias was then being expressed in the conditions on IMF lending. However, when the Committee put to the Governor of the Bank of England the idea that the IMF lectured on free markets, he responded, "I do not think the Fund is going to get very far just by lecturing people. It should be in the business of explaining things and letting people draw their own conclusions and I think that is where the Fund will have its biggest influence".[134] He went on to say "Whether there are tariffs on particular items or not is not a matter for the IMF, it is a matter for WTO, the country itself; the big, macro picture is what the Fund is concerned about".[135]

59. One particular area of concern about IMF conditionality in the past has been the micro-management of countries' policies. However, Professor Portes thought that the IMF had changed in its outlook, and believed that there had been "some substantial adaptation in the Fund and in the nature of conditionality. It is not as detailed as it used to be, for example."[136] On our visit to the United States, we heard from the IMF staff who told us that they had taken on board criticisms of excessive conditionality, and were taking steps to

132 *Partnerships for poverty reduction: rethinking conditionality*, March 2005, Department for International Development, p 2

133 Q 60

134 Q 109

135 Q 110

136 Q 17

increase country ownership. However, the NGOs suggested to us that the reality was somewhat different. Ms McDonald informed us that:

> One reason that we think the IMF is accounting for that supposed reduction in conditionality is by saying that they are reducing the overall number of conditions, but what we found when we analyzed it is you might have one single condition that says liberalized trade in a variety of sectors and that would be down to one condition, but that is actually quite a few different conditions because it could implicate at least three or four or five different sectors.[137]

Ms Greenhill described this to us as a "broadening of conditions", so that "even though there are fewer conditions, sometimes those conditions have greater weight".[138] The Governor of the Bank of England pointed out to the Committee that the conditionality imposed by the IMF on Asian countries "was much greater in detail than was imposed on Latin American countries which borrowed from the Fund. I do think that the Asian countries have a genuine cause for complaint about the way that was carried out."[139] However, the Governor also thought that "as far as the IMF is concerned, we have won the argument, because they themselves have acknowledged that certainly in the 1990s some of the conditionality was too detailed".[140] Mr Chris Salmon, Head of the International Finance Division at the Bank of England, also said that the IMF had debated this issue, and that the "conclusion [was] that it is much more important to demonstrate that conditions were on things which were macro-relevant, particularly on the structural side".[141]

60. Another key concern about conditionality has been that it appears to undermine the sovereignty of the countries receiving IMF support, a point raised by Mr Woodward, who told us that "the policy of conditionality raises a lot of issues around sovereignty and democracy".[142] Professor Miller however, pointed out that there occasionally had been beneficial results from the IMF's lending conditions, such as in Brazil.[143] Professor Miller also highlighted to us that conditions can be useful in trying to strengthen the governance structures of countries, especially around the spending of the IMF's loan, concluding "I think there are cases, particularly in Africa, where some of these issues [around elites pocketing money] can be addressed in terms of conditionality, and should be".[144] The NGOs also agreed that there would always have to be some form of conditionality. Ms Greenhill said that "I think you do need to have some conditions to ensure that money is well spent. We are not advocating writing blank cheques to the Mobutus and Mugabes of this world."[145] However, Ms Greenhill also said that "We have a particular concern that …

137 Q 55

138 Q 55

139 Q 85

140 Q 112

141 Q 112

142 Q 10

143 Q 11

144 Q 11

145 Q 62

what the IMF is doing in the countries is very often using anti-democratic processes; it is undermining the systems of local democratic accountability."[146]

61. The Governor of the Bank of England also felt that the IMF needed to do more to engage borrower nations. He told us: "The lessons I think we saw with IMF programmes are that it is no good just 'Here's a piece of paper; sign it,' because if people at home are not convinced that these policies are the right policies to be pursued in these circumstances they will find ways round it and the conditionality will not be met. It is a question of winning hearts and minds, not a question of telling people what to do."[147] The Chancellor of the Exchequer told the Committee that in the Government's own policy paper, "the emphasis is on less conditionality from the IMF and more accountability of governments to their own people so that they have to answer to their own people for how they are spending the money".[148]

62. **The Fund will have to maintain some form of conditionality on its lending. We support the Government's policy paper, and its focus on poverty reduction, human rights and stronger financial management. We recommend that the UK Government lend its support to reforms to the Fund that ensure that democracy is protected, conditionality is appropriately designed for each individual country and solutions are not driven by a single economic philosophy.**

The reduction in lending by the IMF

63. The Governor of the Bank of England told us: "I think actually one of the good news stories of the past five years is that the Fund is no longer a major lender, and far from being a problem this is actually very good news, that … countries do not wish to borrow and do not need to borrow and we ought to encourage that".[149] The Chancellor of the Exchequer said that the IMF should have "as little as possible" role in lending.[150] However, he dismissed the idea of the IMF not lending at all, saying "You cannot exclude the possibility that crisis resolution will have to happen in relation to economies in the future, but you wish to minimise both the crises and the liabilities or the loans you have to make to deal with them".[151]

New facilities

Introduction

64. The Governor of the Bank of England expressed concern about the creation of new facilities, telling us "my own personal view is I have reservations about encouraging the Fund to develop yet more facilities. If we go on like this, soon we will have more facilities

146 Q 56

147 Q 109

148 Q 221

149 Q 81

150 Q 206

151 Q 207

than borrowers."[152] However, two new facilities have been suggested and have been, or soon will be, implemented.

Exogenous Shocks Facility (ESF)

65. One of the new facilities welcomed in the IMFC communiqué was the exogenous shocks facility. The communiqué stated that the IMFC "underlines the importance of further contributions to enable the IMF to provide timely concessional shock financing".[153] The facility is described by the IMF as "policy support and financial assistance to low-income countries facing exogenous shocks", where exogenous shocks are described as including "commodity price changes (including oil), natural disasters, and conflicts and crises in neighbouring countries that disrupt trade".[154] The Governor of the Bank of England, after being questioned as to whether the ESF was not just another facility, told the Committee: "This is very specific, where it needs a facility, this is designed to help particularly poor countries which suffer from the consequences of big changes in oil prices, basically; that is why some of the producers have contributed to it. That is very much, I see, part of the development nexus and I think those involved in the development side welcome this; it is a question of trying to help countries which have suffered from the big changes in relative prices in the world economy".[155] The Chancellor of the Exchequer also saw the facility as being of service to the low-income countries.[156] He went on to say: "It was a tragedy that we could not act instantly in certain recent natural disasters, so we realise we have to do more on that, more on reconstruction and more on the economic effects of a natural or physical crisis".[157] **We note the Governor's remarks on the need to limit new facilities, and therefore recommend that the UK Government exercise caution before recommending any new facilities at the Fund. However, we support the notion of the Exogenous Shocks Facility, though we recommend that it be designed so as to ensure that all member states that require it are not dissuaded by onerous conditionality.**

Contingent financing for crisis prevention

66. The Managing Director's Report on Implementing the Fund's Medium-term Strategy suggested establishing a framework to enable the IMF to provide funds prior to a crisis in a member state taking place.[158] The proposed facility would be available to member states "with strong macroeconomic policies, sustainable debt, transparent reporting, but which still face balance-sheet weaknesses and vulnerabilities".[159]

152 Q 104

153 Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, 22 April 2006, IMF, para 12

154 An [IMF] Factsheet—December 2005 *The Exogenous Shocks Facility (ESF)*, www.imf.org

155 Q 114

156 Q 198

157 Q 208

158 *The Managing Director's Report on Implementing the Fund's Medium-Term Strategy*, 5 April 2006, IMF, para 18

159 *Ibid.*,

67. One concern is that a previous facility of the IMF with a similar purpose, called the Contingent Credit Line facility, was never drawn upon, and lapsed in November 2003.[160] When we questioned him on the reasons for its failure, Mr Salmon, Head of the International Finance Division at the Bank of England, told us “the failure of CCL, in a sense, to attract any customers shows a problem, because you have to balance, on the one hand, safeguards for the Fund, how you make it sufficiently tight so that only countries which are really good go in there, versus benefits to the countries in the first place, and they could not get the balance between those two things right.”[161] Jon Cunliffe agreed with this, telling the Committee that the Contingent Credit Lines “had some design problems because you had to find a way of designing an assurance for countries that the Fund would step in with potentially large amounts in the event of a crisis while maintaining the Fund's ability to set some conditions on the use of its funds, and that is quite a difficult problem to solve”.[162] However, he went on to say to the Committee that “there is a lot of pressure from emerging market countries for a facility of that sort and it would give the Fund a relationship with countries before a crisis because they would have this facility and they would have to discuss with the Fund their programme in order to maintain it, and I think there is going to be quite an effort over the next year to try and solve some of those design problems to see if it can be made to happen”. The Chancellor of the Exchequer, while telling the Committee that it was “very important that it is done right because the signal that is sent out by your application for help from this fund has got to be one that is stabilising rather than destabilising, and it is also important that the terms on which it is available are not too onerous, so there are difficult issues but I would not say that the lack of use of the contingent credit facility proved that there was no need for it.” He went on to say: “If we are in the business of crisis prevention then we ought to be in the business of making it possible to draw on the support of the IMF to avoid a crisis”.[163]

68. The Governor of the Bank of England expressed reservations to us about the proposed facility, although he did not disagree with the overall concept. Essentially, the Governor was concerned that, once the IMF had committed to lend funds under this new facility, should a crisis then occur in that country the Fund might face considerable political pressure to continue to lend despite likely assurances at the beginning of the process that it would not. He told us:

> Taken at face value, there is a perfectly good case for that facility. The argument against it is not an argument against it on grounds of substance in those circumstances, it is a political, economy concern, that in the past the Fund has not shown itself to be as disciplined and rigorous as it might be in implementing what it said *ex ante* were the rules of the game.[164]

69. **We note the lack of take-up by member states of the contingent credit lines facility. We understand that a balance has to be struck given the need to protect taxpayers' money. We recommend that the UK Government continues to take an active part in**

160 An [IMF] Factsheet—March 2004, *The IMF's Contingent Credit Lines (CCL)*

161 Q 99

162 Q 209

163 Q 209

164 Q 98

ensuring that the facility for contingent financing for crisis prevention is capable of ensuring that the Fund can fulfil its remit to prevent crises developing.

Debt restructuring

70. When a country defaults on its loans, there has occasionally been difficulty in organising the debt restructuring, because the bonds and loans of the defaulting country may be held by many different investors in different jurisdictions. Given the IMF's role in crisis resolution, it has put forward some ideas in this area. However, as the Bretton Woods Project pointed out in its written evidence to the Committee, there is a danger in placing "the IMF in a hypocritical position as both creditor and arbiter of debt work-outs".[165] Professor Miller, however, pointed out that the IMF should be involved in generating "promoting efficient *ex poste* [debt restructuring] negotiations …. I think the Argentine ones were quite successful at the end but it took about four years."[166]

71. The Governor of the Bank of England confirmed that a Chapter 11-style system, where day-to-day business continues while a restructuring of ownership occurs under a bankruptcy court, may be better for working out sovereign debt restructuring cases, and that the Bank of England and the Bank of Canada had done joint work that "proposed that it was necessary to take seriously the development of mechanisms in which the Fund would sanction debt restructuring".[167] However, the Governor also made the important point that, using the example of Argentina, it is sometimes necessary to admit to the overall scale of the problem and arrange a restructuring, rather than keep lending money, as "In the end, as in Argentina, it was inevitable that default occurred, and it did".[168] The Governor went on to explain that continued lending meant that while the residents of the country would have to repay the IMF from any bail out, the IMF would essentially have bailed out the "large western financial institutions".[169] The Chancellor of the Exchequer told us that this was going to have to involve both the private sector and the international institutions. While the UK government was supportive of the potential reforms, including those akin to Chapter 11 procedures in the US, he also warned that "this is a long-running issue and progress is going to be gradual rather than dramatic".[170] As evidence of this, in its supplementary evidence to us, HM Treasury noted that at the 2003 Spring meetings, the "IMFC decided not to pursue a statutory framework [for sovereign debt restructuring] further".[171]

72. The Governor of the Bank of England also felt that, as in the case of Korea, sometimes a standstill arrangement might be necessary because the repayment problems were an issue of liquidity rather than long-term ability to repay. He felt the best way to allow for such measures was "to go right back to when the contracts were signed, and that is the purpose of the Collective Action Clause in bond issues, and it is something which bond issues in

165 Ev 55

166 Q 40

167 Q 101

168 Q 101

169 Q 101

170 Q 226

171 Ev 88

London have recognised for a long time and the ones in Wall Street now have come more into line with that”.[172] Mr Cunliffe told us that “The IMF is supporting collecting collective action clauses, particularly in the US markets. It is also supporting the private sector and emerging market governments' voluntary code on debt restructuring.”[173] In its written evidence to us, HM Treasury stated that “market practice has converged toward broad acceptance of the use of Collective Action Clauses in international sovereign bonds”.[174]

73. **While the Fund has a desire to move towards a greater focus on crisis prevention, there will always remain a need for crisis resolution. Debt restructuring will sometimes be an integral part of this. The Fund, as a potential creditor in these situations, seems inappropriate as the organisation to oversee such restructuring. However, this does not preclude the IMF from taking an active part in the discussions over the design of the framework. We acknowledge the political difficulties of creating a final consensus, but we recommend that the UK Government continue to promote collective action clauses. We further recommend that the UK Government consider what role the IMF should play in any future debt restructuring mechanism. Though previously not followed up by the Fund, a statutory system may be appropriate, and may be similar to a Chapter 11-style system where the day-to-day business continues while a restructuring of ownership occurs under a bankruptcy court.**

172 Q 103

173 Q 228

174 Ev 88

6 Financing the IMF

Statement of position

74. The Fund's primary source of income derives from the difference between the interest received on its lending activities and the interest it has to pay out to the member states that hold money with the Fund. The Managing Director's Report on Implementing the Fund's Medium Term Strategy, states that the Fund has significant reserves (SDR 6 billion[175]): "Although the strategy paper had flagged a decline in income from lending as an important issue for the medium term, the future has arrived sooner than anticipated." The report went on to say: "The current business-financing model, of paying for surveillance and capacity building with margins on adjustment lending, is no longer tenable".[176] Table 1 highlights the funding problem:

Table 1: IMF Projected Income Shortfall: FY06–09 (millions of SDRs)

	Medium-term projections			
	FY06 Est	FY07	FY08	FY09
Sources (with establishment of investment account)*	754	616	548	502
Administrative and Capital Expenses	646	673	690	708
real change, admin budget (in percent)		0.0	-1.0	-1.0
Shortfall	-107	57	142	206
*Projected income sources also include surcharges				

Source: Office of Budget and Planning: Finance Department, The Managing Director's Report on Implementing the Fund's Medium-Term Strategy, *2006, IMF, para 47*

75. Given these problems, the report went on to say: "Although it is true that the current level of reserves could finance budgetary gaps well into the next decade, and it is possible, if by no means certain, that income will pick up with lending, it is incumbent on an institution devoted to financial prudence to aim for a more credible and durable solution … It is therefore proposed to catalyze this process [of financial reform] by establishing an external committee, headed by an eminent personality, to make recommendations."[177]

The funding of regular IMF activities

76. In addition to discussing the need for a clearer separation of lending and surveillance activities. However, we also heard evidence about the need to separate funding and lending decisions. Witnesses called for such separation on the basis that the IMF earns its income from the difference between the interest rates charged in its lending activities and money paid out to those who hold shares in it. This means that the IMF relies on its lending

175 Special Drawing Right, the unit of account at the IMF. As at 23 June 2006, 1 SDR = 1.4691 US Dollars

176 *The Managing Director's Report on Implementing the Fund's Medium-Term Strategy*, 5 April 2006, IMF, para 47

177 *Ibid*, para 49

activities to fund its operations, and therefore lending decisions may be, or at least appear to be, skewed by the desire to maintain a steady stream of income for the Fund's operations. The Governor of the Bank of England told us that "It is very important to have an institution like the IMF which does not benefit from financial crises, either financially or in terms of the culture and excitement of the work".[178]

77. The Committee heard that several possible solutions to the future financial difficulties at the IMF are being discussed. The Managing Director's Report on Implementing the Fund's Medium Term Strategy also suggested different possibilities were under consideration "be it conversion of gold into earning assets or an annual fee linked to quota or anything else".[179] Professor Miller suggested to us that in some degree there should be reform of the Fund's processes, such as on debt restructuring, before it tries to find further finance. He told us "I feel it is about improving the financial mechanisms rather than suddenly finding a pot of gold".[180] However, Professor Portes indicated that he could not see any reason why the IMF, much like central banks across the world, may not wish to divest part of its gold holdings.[181] Rachel Lomax, Deputy Governor at the Bank of England, suggested that there were several options under consideration, but that there were many different variables to consider: "You can move towards something which involves annual subscriptions or contributions of some sort; lots of disadvantages in doing that, in terms of assuring the Fund a steady flow of income which is not too dependent on political pressure. Or you could give the Fund a kind of endowment, which would generate an income over a period of time."[182] In its supplementary written evidence to us, HM Treasury discussed further the possibility of either an annual contribution or an endowment to fund the IMF's operations. Its evidence also outlines some potential methods of funding such an endowment, such as by gold sales or voluntary contributions.[183]

78. **The search for a solution to the long-term financing of IMF operations should be considered against two criteria. The first is that poorer nations should not have to pay to gain access to the range of services the IMF can provide. The second is that funding for surveillance should be seen to be as independent as the actual analysis, especially where the IMF may also be a lender to a specific country. We therefore recommend that the UK Government further consider and report on the feasibility of the different options for the funding of an endowment for the financing of surveillance activities, as an endowment would ensure both the actuality and perception of the independence of surveillance.**

178 Q 88

179 *The Managing Director's Report on Implementing the Fund's Medium-Term Strategy*, 5 April 2006, IMF, para 49

180 Q 40

181 Q 40

182 Q 155

183 Ev 88

7 The UK's relationship with the IMF

Introduction

79. We now turn from the UK Government's policies in relation to the IMF to the way in which the Government informs both Parliament and the people as to its dealings with, and policies in relation to, the Fund. HM Treasury produces an annual report on its dealings with the IMF, following a recommendation made by the Treasury Committee in the 1998–99 session.[184]

Transparency of the UK Government's position towards the IMF

80. We asked witnesses for their views of the annual Report produced by HM Treasury on its dealings with the IMF. Professor Portes was dismissive, saying "I did look, in preparation for coming here, at the latest one and I did not find it something that I should occupy myself with every year".[185] Professor Miller was more conciliatory, and told us that he thought "it is an important part of transparency. Before what the Executive Directors did or did not do was a matter of mystery. Now we do have much more transparency. Whether it is a matter of profound interest is another question".[186] Mr Woodward however, felt there was room for improvement. He told us that "it is a useful contribution to transparency but it is a very, very small step. We have statements being made on our behalf in the Executive Board at every meeting pretty much and we have no idea what is being said. We cannot get hold of those even under the Freedom of Information Act and I think that raises real issues."[187]

81. The Governor of the Bank of England told the Committee that HM Treasury report also carried the work conducted by the Bank at the IMF.[188] Asked by us if there was anything further the Bank might do to be more transparent in its dealings, he replied "We are here today, in front of the cameras, as the Chairman has reminded us. I think we could not be more transparent than that."[189]

82. **To enhance transparency, we recommend that the UK Government disclose further information on the Executive Director's dealing with the Executive Board, and its views of recently published IEO reports. We further recommend that the UK Government report on its view of the surveillance remit of the IMF, prior to this being set by the IMFC, to allow discussion of this view before it is put forward at the IMFC.**

184 Second Report, Session 1998–99, *The World Economy and the Pre-Budget Report*, HC 91-I, recommendation d.

185 Q 41

186 Q 42

187 Q 43

188 Q 123

189 Q 124

8 Conclusions

83. The forthcoming Autumn meeting of the IMF in Singapore, in September 2006, provides an ideal opportunity for the UK Government to play a leading role in promoting and securing the most significant reforms of the role and governance of the IMF in over a generation. This Report sets out many key areas in which the success or failure of the Singapore "reform summit" will be judged. We expect the Government's response to report to this Committee and to Parliament on the progress made in Singapore. After the Singapore meeting, it should be clearer whether the IMF is being successfully reformed to become an even more effective and focussed organisation.

Conclusions and recommendations

A clear role for the IMF

1. **The Committee supports the move to focus the IMF's work on crisis prevention, rather than crisis resolution, as well as the decision to make sure the Fund can fulfil its new role.** (Paragraph 5)

Global economic imbalances

2. **A disorderly unwinding of global imbalances poses a real risk to the UK economy. It is therefore important that the IMF take an active part in providing both independent analysis of, and potentially a solution to, the risks posed by a disorderly unwinding of global imbalances.** (Paragraph 9)

Reducing the number of extraneous roles of the IMF

3. **The IMF has, in recent times, taken on too many roles. As part of the need to create an IMF able to meet its responsibilities, we recommend that the UK Government support a greater focussing of the IMF's work, which may entail identifying another organisation or body better suited to carry out certain activities, including work on terrorist financing and money laundering.** (Paragraph 10)

The World Bank and the IMF

4. **We welcome the IMF Managing Director's announcement of a review to examine the relationship between the World Bank and the Fund. Given the concerns expressed to us by NGOs, we recommend that the UK Government ensure that the Fund utilises the expertise of the World Bank in social and poverty issues, to augment the Fund's more macro-economics based analysis. The IMF should remain within its remit of crisis prevention, not extend its activities into areas of social policy and development it does not appear to be equipped to deal with.** (Paragraph 15)

Quotas

5. **The Committee regards it as important that the governance of the Fund is made more accountable and transparent if it is to be able to meet the challenges of the changes in the world's economy. While we note that changing the quotas may have no discernible effect on how the Fund operates, there is a good case for reforming the quotas to improve the Fund's governance by increasing the accountability to its members and the wider international community. There is a balance to be struck between the rights of those that provide the Fund's resources, and the needs of those that utilise those same resources. We recommend that the UK Government should look at whether any more innovative solutions, beyond reform of the quota system, are possible to try ensure the competing needs are met.** (Paragraph 20)

6. **We note the political difficulties in achieving reform of the voting structure, bearing in mind the need to maintain a close US involvement with the IMF, but the current voting arrangements do not sit well with an international organisation that sees itself providing impartial worldwide economic advice in the future. We recommend that**

the UK government seek a reduction in the scope of the veto so that surveillance matters are no longer included. (Paragraph 21)

7. There are two issues involved in European representation at the IMF. Although not a matter directly for the UK government, it appears sensible that the UK should encourage its euro area partners to combine their representation at the IMF. More importantly for the UK, the UK government should actively seek to try and ensure there is a harmonised EU view when dealing with IMF matters, where this is possible. (Paragraph 23)

8. The Committee is encouraged by the view of the Chancellor of the Exchequer that there may well be quick progress in the reform of the quota system. However, we note the concerns expressed by African representatives about being left behind in a two-stage process, and call on the UK Government to ensure that all countries are better represented in the governance structure of the IMF after the Singapore meetings. (Paragraph 25)

Appointment of the Managing Director of the IMF

9. The Committee notes the Chancellor of the Exchequer's view that the selection of the current managing director was more open. However, even the Chancellor stated that not all that was done in selecting Mr Rato was recorded, suggesting the process in future could be less opaque. We therefore support the Governor's request for an open selection process for the IMF's managing director, and recommend that the UK Government prepare, publish, consult on (including with its European partners) and then support at the Singapore meeting a transparent process for selecting the next IMF managing director. While this may mean that the IMF has a more transparent procedure than other international organisations, we believe that it is right that the Fund, with its new focus, should be the first in achieving reform in this area. (Paragraph 26)

The Executive Board

10. On the representation of the IMF's members on the Board, the Committee stands with its earlier conclusions on quotas, in that there should be movement to allow a fairer representation of the newly emerging economies, as well as the main recipients of the Fund's expertise and resources. We support the Chancellor's view that there needs to be a resident board, to allow effective oversight of the Fund's activities. This underlines the need to ensure proper representation of all the Fund's members. We also note the Governor's concern as to excessive information flow through the Board, and therefore recommend that the UK Government try and ensure that there is reform of the processes of the Fund, which would then allow the Executive Board members to properly discharge their duties in overseeing the Fund. In the area of surveillance, and given the need for independence, we would not expect there to be heavy influence from the Board in this area. (Paragraph 29)

The International Monetary and Financial Committee (IMFC)

11. We welcome the moves to make the IMFC more effective. It is important that, as a high level body of the IMF, it is particularly cognisant of its role in providing

guidance and oversight of the work of the Fund. We therefore recommend that the UK Government do it all it can to ensure that the procedures of the IMFC are effective in helping the IMF develop its role in the global economy, and in ensuring that it provides significant oversight of the work of the Fund, especially considering the IMFC's new remit in setting the surveillance objectives for the year. (Paragraph 31)

Transparency within the IMF

12. Transparency is a necessary part of any public institution's maintenance of accountability to its stakeholders. We recommend that the UK Government work with other member countries to persuade the Fund to release more material, including Executive Board minutes. We would like to see the IMF publish the Board's minutes as soon as is advisable. In doing so, the UK Government should bear in mind the view of the Governor of the Bank of England that transparency, has to be 'designed carefully' if it is not to prevent free and frank discussion. (Paragraph 34)

Multilateral surveillance

13. We welcome the renewed commitment of the IMF to multilateral surveillance, and to surveillance overall. Given that a major risk to the UK economy at the moment stems from global imbalances, it seems entirely appropriate that the IMF, as the guardian of the global financial system, should seek to redouble its efforts in assessing the effects of the interplay between the world's economies. In doing so, the Fund should utilise the overall "balance sheet analysis" called for by the Governor. We recommend that the UK Government supports these moves, while seeking to ensure that there is broad consensus for this change in focus of the surveillance across all members of the Fund. (Paragraph 41)

14. We welcome the IMF's new approach to multilateral consultation, given the Fund's new focus on crisis prevention. However, we note that in order for the findings of such consultations to be effective, member states must feel that the actions that may be required from the conclusion of this process will be broadly beneficial. We therefore recommend that the UK Government encourage the Fund's development in a manner which reinforces its neutrality and authoritativeness and that the UK Government support measures to strengthen the Fund's governance. (Paragraph 45)

The role of the Independent Evaluation Office (IEO)

15. The Independent Evaluation Office (IEO) has been a significant success. However, it still has scope for further development, especially given the International Monetary and Financial Committee's recommendation to include the IEO within the oversight of the surveillance remit. We recommend that the UK Government set out in its reply to this report whether the IEO's remit should be set out clearly within the articles of agreement or by-laws of the IMF, allowing for its independence of governance and financing. The IEO's remit may be about to widen should it also take on a role within the oversight of the surveillance work undertaken at the IMF. We recommend that the UK Government consider whether the IEO will require further resources to fulfil its extra responsibilities. (Paragraph 48)

The IMF as a ratings agency

16. We agree with the view that the IMF should not become a ratings agency, especially considering the potential distortion of the financial system. However, we also recognise that the IMF has a significant role as a gatekeeper for low-income countries. With IMF approval, low-income countries are far more easily able to access development aid and lending, both from international institutions and individual donor countries. The Policy Support Instrument (PSI) extends this role. We therefore recommend that in its response to this report, the UK Government sets out its views on whether the existence of this instrument will penalise countries that do not wish to be involved with the IMF by preventing them accessing aid. As well as this, the UK Government should also consider whether the conditions attached to the PSI are consistent with its own policy paper on conditionality, and how the instrument will interact with the UK Government's own development policies, including the meeting of the Millennium Development Goals. The Committee notes the increase in development assistance provided by donors other than traditional donors. (Paragraph 53)

The independence of surveillance

17. The IMF must be seen to be provide independent surveillance analysis, especially where it has lent to a country. There is an obvious moral hazard in that the IMF may wish to use its surveillance analysis to support a country it has lent to, purely to protect its own investment. This is especially important given the IMF's 'gate keeper' role. The other element of independence is that no single member country, or group of member countries, should hold sway over the surveillance analysis of the IMF. While the IMF must, of course, remain accountable, it should also be encouraged to provide an independent voice on the interactions of the world economy. We therefore recommend that the UK Government do it all it can to arrange that there is a separation of the surveillance analysis from the analysis undertaken for the purpose of the Fund's lending activities. We further recommend that the UK Government seek to ensure that a framework develops in which the IMF, while ensuring adherence to the principles of accountability, provides an independent voice, able to offer unbiased advice on the world economy. (Paragraph 56)

Conditionality of IMF lending

18. The Fund will have to maintain some form of conditionality on its lending. We support the Government's policy paper, and its focus on poverty reduction, human rights and stronger financial management. We recommend that the UK Government lend its support to reforms to the Fund that ensure that democracy is protected, conditionality is appropriately designed for each individual country and solutions are not driven by a single economic philosophy. (Paragraph 62)

New facilities

19. We note the Governor's remarks on the need to limit new facilities, and therefore recommend that the UK Government exercise caution before recommending any new facilities at the Fund. However, we support the notion of the Exogenous Shocks

Facility, though we recommend that it be designed so as to ensure that all member states that require it are not dissuaded by onerous conditionality. (Paragraph 65)

20. We note the lack of take-up by member states of the contingent credit lines facility. We understand that a balance has to be struck given the need to protect taxpayers' money. We recommend that the UK Government continues to take an active part in ensuring that the facility for contingent financing for crisis prevention is capable of ensuring that the Fund can fulfil its remit to prevent crises developing. (Paragraph 69)

Debt restructuring

21. While the Fund has a desire to move towards a greater focus on crisis prevention, there will always remain a need for crisis resolution. Debt restructuring will sometimes be an integral part of this. The Fund, as a potential creditor in these situations, seems inappropriate as the organisation to oversee such restructuring. However, this does not preclude the IMF from taking an active part in the discussions over the design of the framework. We acknowledge the political difficulties of creating a final consensus, but we recommend that the UK Government continue to promote collective action clauses. We further recommend that the UK Government consider what role the IMF should play in any future debt restructuring mechanism. Though previously not followed up by the Fund, a statutory system may be appropriate, and may be similar to a Chapter 11-style system where the day-to-day business continues while a restructuring of ownership occurs under a bankruptcy court. (Paragraph 73)

The funding of regular IMF activities

22. The search for a solution to the long-term financing of IMF operations should be considered against two criteria. The first is that poorer nations should not have to pay to gain access to the range of services the IMF can provide. The second is that funding for surveillance should be seen to be as independent as the actual analysis, especially where the IMF may also be a lender to a specific country. We therefore recommend that the UK Government further consider and report on the feasibility of the different options for the funding of an endowment for the financing of surveillance activities, as an endowment would ensure both the actuality and perception of the independence of surveillance. (Paragraph 78)

Transparency of the UK Government's position towards the IMF

23. To enhance transparency, we recommend that the UK Government disclose further information on the Executive Director's dealing with the Executive Board, and its views of recently published IEO reports. We further recommend that the UK Government report on its view of the surveillance remit of the IMF, prior to this being set by the IMFC, to allow discussion of this view before it is put forward at the IMFC. (Paragraph 82)

Formal minutes

Wednesday 5 July 2006

Members present

Mr John McFall, in the Chair

Mr Michael Fallon
Mr David Gauke
Ms Sally Keeble
Mr Andrew Love
Kerry McCarthy
Mr Brooks Newmark
Mr Mark Todd

Globalisation: the role of the IMF

The Committee considered this matter.

Draft Report (Globalisation: the role of the IMF), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 19 read and agreed to.

Paragraph 20 and 21 read, amended and agreed to.

Paragraphs 22 to 44 read and agreed to.

Paragraph 45 read, amended and agreed to.

Paragraphs 46 to 52 read and agreed to.

Paragraph 53 read, amended and agreed to.

Paragraphs 54 to 61 read and agreed to.

Paragraph 62 read, amended and agreed to.

Paragraphs 63 to 70 read and agreed to.

Paragraphs 71 to 73 read, amended and agreed to.

Paragraphs 74 to 76 read and agreed to.

Paragraphs 77 and 78 read, amended and agreed to.

Paragraphs 79 to 82 read and agreed to.

A paragraph—(*The Chairman*)—brought up, read the first and second time, and added (now paragraph 83).

Summary read, amended and agreed to.

Resolved, That the Report, as amended, be the Ninth Report of the Committee to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134 (Select committee (reports)).

Ordered, That the Chairman make the Report to the House.

Several papers were ordered to be appended to the Minutes of Evidence.

Ordered, That the Appendices to the Minutes of Evidence taken before the Committee be reported to the House.

[Adjourned till Tuesday 11 July at 9.45 am

List of witnesses

List of written evidence

List of Reports from the Treasury Committee during the current Parliament

Session 2005–06

		Report
First Report	The Monetary Policy Committee of the Bank of England: appointment hearing	HC 525
Second Report	The 2005 Pre-Budget Report	HC 739
Third Report	The Monetary Policy Committee of the Bank of England: appointment hearing for Sir John Gieve	HC 861
Fourth Report	The 2006 Budget	HC 994
Fifth Report	The design of a National Pension Saving Scheme	HC 1074
Sixth Report	The administration of tax credits	HC 811
Seventh Report	European financial services regulation	HC 778
Eighth Report	Bank of England Monetary Policy Committee: appointment hearing for Professor David Blanchflower	HC 1121

Oral evidence

Taken before the Treasury Committee

on Tuesday 31 January 2006

Members present:

Mr John McFall, in the Chair

Lorely Burt	Kerry McCarthy
Jim Cousins	Mr George Mudie
Angela Eagle	Mr Brooks Newmark
Mr Michael Fallon	Mr Mark Todd
Susan Kramer	Peter Viggers
Mr Andrew Love	

Witnesses: **Professor Marcus Miller**, Associate Director, Centre for the Study of Globalisation and Regionalisation, **Mr David Woodward**, Head, New Global Economy Programme, New Economics Foundation, and **Professor Richard Portes**, London Business School and President, Centre for Economic Policy Research, gave evidence.

Q1 Chairman: Good morning and welcome to this our first inquiry into globalisation and the role of the IMF. Could you introduce yourselves, please?
Professor Portes: I am Richard Portes, Professor of Economics at the London Business School and President of the Centre for Economic Policy Research.
Mr Woodward: I am David Woodward, Head of the New Global Economy Programme at the New Economics Foundation.
Professor Miller: I am Marcus Miller, Professor of Economics at the University of Warwick and Associate Director of the Centre for the Study of Globalisation and Regionalisation.

Q2 Chairman: Thank you for giving us this opportunity to question you on the IMF. The Fund itself acknowledges that its scope has widened in recent years. For example, the Managing Director's Report on the Fund's Medium Term Strategy of 15 September 2005, made that point. Do you believe that this widening has been a positive development, or has it detracted from the Fund's original goals? If it were starting from scratch and the Fund did not exist, would there be strong arguments for creating it in its current form?
Professor Portes: Chairman, I believe that that has been a mistake. It is quite understandable. The Fund historically has gone through cycles. It loses a role and then it finds another. It lost a role when the Bretton Woods exchange rate system broke up; it found one in dealing with recycling of petro-dollars and then the 1980s debt crisis. That was resolved and the IMF got into the economics of transition in eastern Europe and the former Soviet Union. That was sorted out and of course they had to get into something else, and that was poverty. I think that was a mistake. It has been a mistake to widen the range of activities of the Fund, both in terms of poverty-reduction programmes in various countries and, to the extent that we have seen with its involvement over a huge range of ROSCs (Reports on Standards and Codes).

Q3 Chairman: The IMF Managing Director suggested also that globalisation can be thought of, as he says, as an "organising principle" of the IMF's work. One central tenet of this work will be to help countries meet the challenge of globalisation. How well equipped is the IMF to perform this role?
Professor Miller: It has an extremely well trained staff. They pride themselves on the kind of talent they attract from all over the world; and they have a very good database. I think the idea of looking at global imbalances and things like debt sustainability is something the IMF could push further than it does—that is its role as a source of information, not just of money.
Mr Woodward: If I may return to the first question, I would like to agree with Professor Portes. I think the widening of the Fund's role has been very unhelpful, both in terms of being a distraction from its core role but also in terms of its failure to adapt effectively to a global environment which has changed quite fundamentally since it was established in 1944. In particular, the Fund has, for me, been quite spectacularly unsuccessful in its core role of dealing with debt and financial crises, and we are still looking at the effects of the crisis in low income countries, particularly in sub-Saharan Africa, which started nearly a quarter of a century ago. That can only be regarded as a spectacular failure. It prioritised the crisis in the middle income countries over that in the low income countries in the 1980s, which was largely a reflection not of the values of its membership as a whole but of the priorities of the developed country governments which constitute a majority of its membership. I think those failures are fundamentally linked to the issue of the Fund's governance structure, which was established in the 1940s during the colonial era when perhaps it seemed acceptable to give a single country a blocking minority and a majority to the developed countries. In answer to your question "would we establish the IMF in its present form if we were starting from scratch?" the answer is very clearly "no".

Q4 Ms Keeble: The Governor of the Bank of England has called for an international meeting to help agree a co-operative response to global economic imbalances. To what extent do you think that the IMF should be helping to co-ordinate this work? Professor Portes, would you like to start with that?
Professor Portes: That is part of its core function. Its core function is international financial stability. We see out there, with those major global imbalances, serious threats to international financial stability. Yes, I believe that in a better world the IMF would be co-ordinating those efforts. It does not now have the status, or stature if you like, to do so.

Q5 Ms Keeble: From the description which you and David Woodward gave, and you talked about the core function which was largely defined in a completely different era, was it not, the circumstances around it have changed since then. Do you think that it would still be capable of recasting itself and meeting the new challenges and re-defining perhaps its role?
Professor Portes: I rather differ: I do not think the big issues have changed, but I think, in terms of your overall inquiry, globalisation is not such a new thing that we need to change the major orientations and objectives of the Fund as it was set up at Bretton Woods. The big issues of financial crises, sovereign debt and exchange rate misalignments are longstanding; they go back a long way. I do not think that in those respects the Fund's mandate need be changed.

Q6 Ms Keeble: To what extent do you think the IMF's recent review of its strategy addressed concerns that it is not doing enough to address the global economic imbalances?
Professor Portes: The Strategic Review seemed to me to be fairly much motherhood and apple pie—all very well; nothing terribly controversial there; and, although talk at the beginning, no serious effort to limit the Fund's activities to focus them on those core functions. I do not think that the Strategic Review has taken us very much further.

Q7 Ms Keeble: David Woodward, would you agree with the comments that Professor Portes has made? In particular, your analysis seems to suggest that the current circumstances are very much different from those that gave rise originally to the establishment of the IMF.
Mr Woodward: I think I would make a distinction between the core objectives of the Fund and the context in which it is having to fulfil those objectives. The objective of international financial stability clearly is a continuing one. Where I might perhaps differ with Professor Portes is that the context and the nature of international financial flows are very different. That gives rise to forms of financial crisis which would have been unthinkable at the time when the Fund was established. I am thinking particularly of the crises in Asia and Latin America and elsewhere during the 1990s. Those arose from types of financial transactions which just did not happen and were pretty much unthinkable in the mid-1940s. I think that is perhaps where the difference between us lies.
Professor Portes: I think that is dead wrong. If you look at the international lending of the 1920s, it was very similar to the international lending of the 1990s. If you look at the financial crises, crashes and contagion that occurred in the period 1930–33, it looks in some ways, several ways, very similar to what we saw in 1997–98. I just think that is wrong.

Q8 Ms Keeble: It is an analysis about a different interpretation of globalisation. Professor, you are saying it is the same and David Woodward is saying it is qualitatively different.
Professor Miller: As mentioned in my submitted paper, the big change has been the liberalisation of capital that has taken place since the early 1970s, which led to the breakdown of Bretton Woods. So there has been, as Richard Portes earlier pointed out, a shift in what the IMF has been doing. It has largely been coping with capital account crises of middle income countries. I think it is getting much better at doing that. There is a political problem of handling the really big global imbalances, things like telling the United States what it should do with the dollar. I think this is a big political problem, given the weight of the United States in the organisation. Nevertheless, in analysing the situation and saying that there has to be a shift of demand—reduction in America and expansion in Asia—and that there has to be an adjustment of exchange rates, say 20% or 30%, I think in that kind of analysis, which actually is in their World Economic Outlook, they do look at these things and talk about them. I think they should be getting more into this game; but it is politically much more difficult.

Q9 Ms Keeble: You mentioned Asia in particular. What do you think the IMF should be doing to encourage Asian countries, in particular obviously China, to promote more balanced trade flows?
Professor Miller: Asia may discover that it has inflation if it keeps the exchange rate down. It may learn that it should change the exchange rate. If it does raise the exchange rate, it may find it has to expand demand to keep the jobs coming forward; so there is a sort of learning by doing that one would hope would operate. It has also been argued that China wants secure property rights. The Chinese people may be going into the international market to get assets which are secure, in which case the generation of property stability and ownership rights in China may help solve that problem.

Q10 Kerry McCarthy: There has been, I think it is fair to say, considerable criticism of some of the conditions that have been attached to IMF lending. How well do you think the current conditions work, and do you think there is any room for improvement?
Mr Woodward: There have been fundamental problems with the whole process of conditionality right through from the 1980s. Again, I think the governance issue is a key one here. What we have is

an institution which is being run by the developed countries, through their majority of the votes, to impose economic policies exclusively in the last 20 years on developing countries. I think there is a fundamental issue there. The policy of conditionality raises a lot of issues around sovereignty and democracy. In the case of Korea, for example, ahead of an election when the Korean crisis happened, the IMF and the World Bank went in and required not only the government to sign up to conditions but also the opposition. Similarly, fairly fundamental issues are raised in Latin America where governments have been elected on a clearly anti-structural adjustment programme in the 1980s and early Nineties and they have then been required to change that position, having been elected on that mandate, in Argentina and Ecuador for example.

Q11 Kerry McCarthy: Generally speaking, the conditions are focused on achieving targets of restricting inflation and fiscal deficit. How does that square with what you were saying about the role of the IMF and it being a mistake for it to focus on tackling poverty? Obviously the critics of those conditions would say that the countries ought to be allowed maybe to have higher inflation rates so that they can look for greater economic growth rates. How does that square with your saying that the role of the IMF should not be able to look at those and then give development goals or goals on poverty reduction?

Mr Woodward: I would not say that the IMF should be given responsibility for poverty reduction, but I think it is clearly something it must take into account and take into account much, much better than it has done in recent years. In terms of inflation, I think they have been unduly obsessed with inflation in terms of the policies they have recommended. Personally, I think there would be a very strong argument for incorporating into the Articles of Agreement an obligation to respect and promote the economic and social rights which are established under international conventions, which would include the right to health, the right to an adequate standard of living, the right to education, and so on.

Professor Portes: You might as well give up the IMF then. It is not going to happen and any effort to amend the Articles of Agreement now would threaten having the United States simply not continue to play ball. Whatever one may say about the dominance or excessive importance of the US in the governance of the Fund, with which I would strongly agree, nevertheless, if the US Congress were to decide that the United States should pull out of the Fund, it could not function properly. Amending the Articles is just not the way forward; really it is not.

Professor Miller: If I may add something on governance issues, the IMF has been criticised for intervening in the sovereignty of the state but this can, on occasions, be beneficial. In the case of Brazil, for example, the fact that the presidential candidates signed up to the IMF's plan was very helpful for Brazil in the crisis of 2002, and so there can be occasions when it calms the markets down. More particularly, I would like to mention that there are often governance problems in the countries themselves. In many less developed countries, there is an elite that runs the country and the poor suffer. The problem with just giving money to the country is that the elite will collect the money. One need in such circumstances, as argued in the paper I submitted, is for conditionality on the money to try to make sure that it is not just the elite that pocket the money but that the poor benefit. This might mean, for example, putting a limit on taxes on the poor; promoting spending on health and education; and limiting the borrowing by the existing government. I think there are cases, particularly in Africa, where some of these issues can be addressed in terms of conditionality, and should be.

Q12 Jim Cousins: The British Government has encouraged the International Monetary Fund to become involved in issues like the countering of terrorist finance and opposition to money laundering. Was that a suitable role for the IMF?

Professor Miller: In one sense, I think it is a really good move because it means there is a lot more information coming forward about the economic system. One of the problems in Africa and in Latin America, for example, is the rich, the elite, moving their funds overseas. It is notorious that in many poor African countries the rich people have moved the money out of the country. One of the side-effects or one of the good aspects of the terrorism investigation will be more knowledge about where the money is going and the capacity of sovereign states to tax their own citizens. I look for something positive from this. I guess you have to have some global institution doing the investigation.

Mr Woodward: Again, this comes to the core of the issue that the developed countries are setting the priorities for what should be an international global institution. The US has now found a major concern with terrorist finance and therefore the IMF, even in the Medium Term Strategy, names that as the priority for recruitment. We are hoping that dealing with issues of capital flight will come about as a side-effect of that. I think that demonstrates the point that the Fund's governance structure is preventing it from doing what it should be doing.

Professor Portes: I do not think the Fund should be a money laundering policeman. I do not think the Fund should be a ratings agency. There are all sorts of things—we can think of *n* different possibilities and the Fund has thought of most of them—for Fund activities. I reiterate that I think it should be concentrating on its core functions. There are plenty of other international agencies, some of them better governed, if you like, that could deal with money laundering. Professor Miller is absolutely right that the one big lacuna in the whole private dealing with global financial issues is the inadequacy of our data on international capital flows. Part of that, especially for a certain subset of countries, is exactly due to the sorts of movements that we are talking about—money laundering or simply illegal capital flight or hidden capital flight—and should the Fund be involved in that? I just do not see it. It is another way of employing people, but they could be employed elsewhere with a little structural adjustment!

Q13 Jim Cousins: Without going on about football with you, and we would all like to know where Chelsea got their money from, I would like to declare my interest, Chairman, as a season ticket holder in Newcastle United! I would not necessarily stop anyone from having access to Russian gold. Professor Miller, do you not think there is a distinction to be drawn between the IMF's work on codes and standards, on which people perhaps should report or in some sense be tested, and the IMF being a regulatory or surveillance or investigatory agency? Do you not think there is an important distinction there?
Professor Miller: As a regulatory agency of what sort—in terms of preventing people moving money?

Q14 Jim Cousins: Yes?
Professor Miller: Yes, I guess that is right, that they should not be in the business of being a policeman in the way that Richard Woodward described it. I was encouraging the idea of them being a database and this becoming public knowledge. The reason for doing this was again the problem of governance inside countries. There is a lot of focus here obviously on the IMF but there are also problems inside countries. One of the problems is people moving money out of poor countries. In that context, it seems to me that the informational role of the IMF could be important, but I am not suggesting the IMF should become the world's policeman.

Q15 Jim Cousins: Professor Portes, would that distinction have any attractions for you?
Professor Portes: I think as far as it goes it is absolutely right. To the extent that the Fund can help to identify where capital movements appear to be abnormal and so forth, that seems to me perfectly reasonable, but to push it further than that and to get the Fund involved in actually investigating money laundering would be misguided.

Q16 Susan Kramer: Could I go back to conditionality, conditions attached to IMF lending and assessment? The most common criticism that I hear of the IMF is that it goes way beyond its necessary remit in order to promote and impose a particular economic philosophy. That is largely, in simple words, being Thatcherite or Reaganite. Do you agree with that and that it is in fact stepping beyond its powers if that is so, reflecting more, if you like, the governance structure of who has weight within the organisation rather than the core remit of the IMF?
Mr Woodward: Yes, I would certainly agree with that contention. There has been a very clear and particular economic model or ideology underlying the policies which have been advanced by the IMF throughout the last 25 years. I think that does clearly reflect an ideological shift and also partly the commercial interests of the developed countries. There is certainly a very strong case to be made for that.

Q17 Susan Kramer: If no one else has any comment on that, can you propose any kind of mechanism that would shift that approach?
Mr Woodward: That is something that is very difficult. Within the IMF, as with any institution, there is a very deeply ingrained institutional culture and set of values. The issue of reforming an existing institution, even if one were to change the governance structure, is quite a difficult one. The transition from the GATT (General Agreement on Tariffs and Trade) into the WTO, which again was in principle a very fundamental restructuring, demonstrates that, even if you have that sort of restructuring, that sort of inertia persists and in many respects not all that much has changed. I think the same would apply to the IMF. In terms of where we need to get to in the long term, it requires a more even-handed approach as between the developed and developing countries. If we are serious about eradicating poverty, improving health and securing the right to education, then we need to start off from what needs to be done to achieve those goals at the country level with a blank slate and then shift up from that to a system of global economic governance which would accommodate, foster and promote those policies. At the moment, we have a top-down approach where the broad policy lines are formulated at the global level and imposed on the country on the basis essentially of ideology in the hope that poverty reduction will somehow come about as a result, and that clearly has not worked.
Professor Portes: It will not surprise you to hear that I substantially disagree with that analysis. It suggests, for example, that the Fund has not changed its views and its *modus operandi* and its underlying economic models and so forth over the past 25 years. That is just not correct. All you have to do is read the output of the Fund carefully and you can observe many changes. People in the Fund have acknowledged that the Washington Consensus that was so touted in the early Nineties was not adequate and that things have changed. Yes, of course it is a strong organisation and it has a strong organisational culture and that has great virtues. You do not want to destroy organisations just because they have a strong organisational culture; quite the opposite. What you want to do is adapt them. I believe that there has been some substantial adaptation in the Fund and in the nature of conditionality. It is not as detailed as it used to be, for example. You get exactly into the trap of excessively detailed conditionality if you want to start from the bottom up and look first at what is going to promote poverty and what is going to promote this or that and then try to go to overall fiscal and financial policy. Monetary and fiscal policy is actually relatively straightforward. It is a straightforward set of issues; whether it is politically implementable or the right policy is another matter. I think is fundamentally misguided to try to base it on poverty reduction strategies or whatever.

Q18 Angela Eagle: I think the Washington Consensus clearly does not have the same hold over the IMF's approach as it used to have. Perhaps that is because it did so much damage when it was applied in an ideological way. Hopefully, even international organisations can learn from that. Going back to money laundering and offshoring, it seems to me that when the IMF was first set up, Maynard Keynes certainly wanted there to be the potential to override banking secrecy so that the issue of the offshoring and storing of vast amounts of capital could actually be in the public domain and people could be aware of it, and this was not agreed. In the meantime, according to the latest figures, there is US$ 11.5 trillion of offshore money swilling around the system somewhere, which is US$ 255 billion of tax revenue foregone. It is also increasingly financing narcotics and globalised criminality. Do you think that there is now a case for going back to the issue of banking secrecy and not necessarily having the IMF as the policing organisation but at least the transparency organisation to find out what is going on with this kind of offshoring, simply because, as a source of global imbalance and potential crises, it is obviously immense?
Professor Miller: Clearly I would support what you have just said and the point you made about the missing taxes is crucial in the context of the elite versus the non-elite. The people who are not paying these taxes are the people rich enough to have Swiss bank accounts. My feeling is that they should not be allowed to have secret bank accounts, so I would look for more transparency in this area. In general, I think the notion of information and providing advice is something of which the IMF could do more. There are challenges of ideological purity and so on. I agree with Richard Woodward on this that there are a lot of fairly straightforward points that could be made about policy as well. The IMF's role in this area of information and policy advice is one which I encourage.

Q19 Angela Eagle: Professor Portes, you said, I thought probably with absolute accuracy, that the idea of amending the articles of agreement in a way that had been suggested earlier was probably not practically on the cards. Do you think that there might be potential in trying to create more space for this kind of international transparency in capital offshoring? Whilst the IMF is not going to be allowed to run the US's economic policy for it or tell it what it ought to be doing with the dollar, is there not an argument for having a move now towards greater transparency internationally?
Professor Portes: Maybe the IMF should be telling the US what should happen to the dollar.

Q20 Angela Eagle: I doubt the US would listen.
Professor Portes: We should perhaps get into that question of how the IMF deals with its major shareholders. I would point out one thing in respect of your basic question and that is that we have made progress on some of these issues, some of that led by the United Kingdom, and that is in particular in the European Union where the negotiations, which took a long time, actually got to the point of agreeing the cross-border transfer of information about bank accounts, in particular, to avoid tax evasion. It is just a very hard slog. You cannot impose that from some international organisation. It is a matter of national negotiation and we got there on that one. Also, the OECD has been involved in identifying tax havens and so forth. There is a range of international fora for dealing with these issues. I think a major problem with the Fund is that it has been drawn into too many things. One does not want to get too deeply into this one.

Q21 Angela Eagle: The banking secrecy question did feature at its birth in terms of what Keynes wanted it to do, so it is not something new?
Professor Portes: That is a very interesting and important point but it does remind us, too, that at its birth we had a world of capital controls, which Keynes of course strongly supported. That box is open now and it is not going to be closed up.

Q22 Angela Eagle: Does not banking secrecy become even more important in a world without capital controls? That would be my view.
Professor Portes: I quite agree, yes, but I think, as I say, that there are ways of going at that that do not necessarily involve the Fund trying to act as policeman.

Q23 Mr Fallon: I want to come back to this issue of IMF reform. When the previous Managing Director, Horst Köhler, gave evidence to this committee back in July 2002, he identified as the fourth area for reform setting more of the rules for the macro-economic game, if you like, the reassessing of what can be done at the centre of our macro-economic systems. Is that reform really happening?
Professor Portes: No, not really. You are correct to identify that as a major issue. What is the Fund's role in dealing—and Marcus Miller stressed this before too—with the global imbalances? We have seen very little. You can try to take this too far. Some people have called for the Fund to establish a set of reference exchange rates that would then be a standard by which you would evaluate whether countries are over-valued or under-valued and what policies they are to take, and so forth, to deal with that. I think that is a chimera as well, but for reasons that would take me a little more time to elaborate than I think you have. On the other hand, multilateral surveillance in accordance with some fairly basic economic principles is one of the core functions of the Fund, which it has not effectively pursued.

Q24 Mr Fallon: I understand the surveillance, the kind of coastguard role and the lifeboat role. It is about whether it is possible for the Fund actually to develop and operate rules for the macroeconomic system without altering the articles. Is it possible for the IMF to do that?

Professor Portes: Yes, I think so. I do not think there is any conflict or difficulty at all with the Articles on that account.

Q25 Mr Fallon: Apart from improving surveillance, is it moving successfully in that direction in any way? Is the Medium Term Strategy taking us there?
Professor Portes: It is not obvious to me.
Professor Miller: I think your distinction between the surveillance role and the lifeboat role is very useful. The question arises: is there something in the middle? Richard Woodward I think is fairly sceptical. I think there is more they could be doing. For example, on the dollar, there is a very important paper by Obstfeld and Rogoff recently re-circulated which computes that there needs to be a 30% adjustment in the dollar and a big shift of demand from America to the Far East to correct the imbalances. These are two busy academics writing a paper. It seems to me there is a good case for the IMF to do this on a more regular basis and let us all know the numbers. What kind of exchange rates would be operative in a world of balance? Richard does not want them to do this. I would be quite interested if they did compute what are often known as fundamental equilibrium exchange rates. I think it would be a useful informational role. I differ from Richard on this and feel: why not have these expert economists they employ providing some calculations that we could all use? They do, of course, discuss these issues in their World Economic Outlook, so it is not as if they are doing nothing, but I feel they could do more on a more regular basis between surveillance and the lifeboats.
Professor Portes: This is a longstanding difference between Marcus Miller and myself, you will not perhaps be surprised to know.
Professor Miller: The person who is most keen on the fundamental equilibrium exchange rates is John Williamson. From time to time, he computes these numbers and they have often turned out to be quite useful in seeing whether countries are way out of the correct range. For example, in 1985, he was saying the dollar was far too high, and it came down. He is saying the same again now.

Q26 Chairman: In October the Governor of the Bank of England mentioned that the big currency blocks should stop passing the buck and he called for international meetings to help agree a proper response to global economic imbalances. To what extent is the IMF the appropriate body for that?
Professor Miller: I think that is exactly what we are talking about.

Q27 Chairman: Should that be another function of the IMF now?
Professor Miller: Yes, but it is largely about getting them to talk and co-operate. I do not think it is about setting rules.

Q28 Chairman: You do not need another body for that.
Mr Woodward: Again, the governance structure of the IMF raises real questions about that. If we are going to have those sorts of global discussions, can we have the terms of reference for those discussions being set by a body which is run by the developed countries which form one-sixth of the world's population and yet have 60% of the votes in the IMF?

Q29 Chairman: In its present form it is not the appropriate body. Would you agree with that, Richard?
Professor Portes: No, I would not agree. I fully accept that the current governance of the Fund is unbalanced, that the power relationships are unbalanced, and therefore that if the Fund is going to play its role properly, it has to be more equal. Given those constraints, for the time being, it has to be cognisant of that, but that does not mean that if the Fund convenes a meeting to discuss global imbalances, it should not have Brazil and China there. Obviously, it would simply not be fulfilling its role if it were to do that, and I do not believe that it would. The question is whether the major countries are willing to enter into those discussions seriously under the aegis of a relatively impartial, I think, body that also has a great deal of expertise to contribute to precisely this set of issues. May I go back for one second to the exchange rate question, because it is quite important? After all, this is one of the Fund's core defining issues. There the work that Marcus Miller was referring to is good work and it is generally right. There is a problem in trying to set up reference rates. We have FEERs, the Fundamental Equilibrium Exchange Rates; we have GS DEERs, the Goldman Sachs Dynamic Equilibrium Exchange Rates. There are all sorts of exercises like that. The issue is how fast you get to what you might define as a long-run equilibrium exchange rate. There we really have very little knowledge. We have conflicting views right now about whether the adjustment which Marcus referred to as necessary—with which I totally agree—is going to occur in the space of six months or at some point in what Paul Krugman calls "a Wile E Coyote moment". You will remember the Roadrunner cartoons: Wile E keeps running off the edge of the cliff and then suddenly he realises that there is nothing underneath him. That is one scenario, and I think that is a serious possible scenario. Another is that we have gradual adjustment, as some of our other economics models would suggest.

Q30 Mr Love: I am not clear yet whether what is being suggested by our experts is a different role for the IMF in the sense of moving away from helping countries with adjustments where they have imbalances or suggesting exchange rates but not having a direct involvement. I want to pursue that a little. I was interested in Professor Miller's contribution to the committee when he talked about the changes over the last 10 years where quota lending has gone up significantly, 10 or 15 times, and of course that led the IMF into talking about debt

restructuring and countries talking about the appropriate exchange rates. Of course what we have also seen during that period is countries like China pursuing very specifically a low exchange rate policy which has built up enormous balances for them. Some people suggest that those balances have been built up as a protection against having to go to the IMF. For all these countries building up balances so that they can, frankly, ignore what the IMF is saying to them about restructuring and their exchange rate, is there a continuing role for the IMF in that area?
Professor Miller: As you say, there has been a lot of do-it-yourself insurance by countries, especially in east Asia. To that extent, they are finding a substitute for the IMF. It is pretty expensive. They have to save and buy American dollars and give resources to America, so it does not seem a very socially efficient mechanism. One feels it is better to have all this done centrally, as the IMF initially was set up to do. Another possibility is an east Asian mechanism. One of the papers I sent in was about the emerging of these swap agreements in the Far East that may achieve the same kind of result. I think there is panoply of different things one can do to try to cope with capital account shifts. The IMF has been meeting some competition. Frankly, I think competition is good. If the conditionality is inappropriate, as you say, get your own reserves; forget the IMF. It may be expensive but at least it is a challenge to the IMF, a challenge that may mean they change their conditionality. In general, I believe it is good to have competition. But I think it is silly for the Far East to be accumulating quite as many reserves as they are doing. I feel it is a challenge to the IMF to be more attractive as a global lender than it was a few years ago. I hope that that is what they are trying to do. There are, as you probably know, moves afoot or discussion of moves for a Country Insurance Facility to provide quick money to countries that look safe to lend to quickly. That would be, in my view, an improvement on existing resources and might economise on what we see going on in the Far East.

Q31 Mr Love: I want to ask the question slightly differently to Professor Portes. If we assume, since the Chinese seem to have an inexhaustible supply of cheap labour coming from the country into the city, that therefore they can sustain this low exchange rate policy, assuming that the Americans will go along with it in the longer term—and of course we will get India coming along and they have not even started this process properly—does the IMF have any role with those countries, the larger countries that make come to dominate the world economy, or will it be with the smaller countries it has a continuing role?
Professor Portes: Of course the IMF should, in principle, have a role. Marcus is absolutely right that the kinds of self-insurance that Asian countries, including India by the way which now has 100 million plus of reserves, are building up and the moves being taken, with some discussion of an Asian Monetary Fund and so on, are good for the Fund. It is good to have potential competition out there. But the Asian countries have what a distinguished Asian economist, who was in the Japanese Ministry of Finance for a brief period, said to me the other day: they have a fear of floating exchange rates and a fear of the IMF. If you put those two together, you get a build-up of reserves. I do not think it is easy to stop that. Marcus and I were discussing some recent work before we came in here that suggests that this is cost-effective for these countries. I do not buy that work entirely, but many of the Asian countries know all too well the costs of exposing yourself to the risks of financial crisis. The Chinese observed it in 1997 and 1998, and remember at about that time everybody was calling on the Chinese not to *de*value. I do not think that they are doing things that are totally stupid.

Q32 Mr Love: Short of waiting until there is going to be an abrupt adjustment where I suspect the IMF would undoubtedly have to have a role, are we talking about the IMF softening the conditions under which it wants to stop the fear of the IMF that relates back to the Asian crisis of whatever number of years ago? Is that what we are talking about or is there a negotiation that can be carried on here to get them to recognise the need?
Professor Miller: An analogy here might be house prices. What should the Bank of England do about house prices? It does not really want to tell everyone to sell houses now because the prices are too high. It holds back and then at some stage finally Mervyn King has begun to warn people. I think house prices and the dollar are not too dissimilar. In fact, some people say that when the housing market crashes in America, the dollar will crash as well.
Professor Portes: And conversely.
Professor Miller: I think that is the sort of way to think about it. What would you do if you were the Governor of the Bank of England? Would you feel you knew enough about house prices to call the market exactly? or do you think you would wait until you thought it was really over-bought and then start dropping hints? I feel it may be the role of the IMF to orchestrate conferences in which people discuss the issues and maybe come to the conclusion that the dollar ought to adjust. I think the big issue is that it requires spending changes. America has to absorb less goods. A lot of the deficit is the counterpart of the US Government deficit. That is real politics and so there has to be some political realisation of the non-sustainability. Again, the IMF cannot tell America what to do but it can put the cards on the table. It is a very delicate issue. I do not think there is any magic solution.

Q33 Mr Love: Finally, can I put Professor Portes on the spot in the sense that we know that Mr Woodward wants fairly radical restructuring of the IMF. You have accepted that there is an imbalance, that it is all the developed countries that currently have control of the IMF. What sort of restructuring do you think would be, if I can put it crudely, acceptable to the US that will sustain all of the developed countries in the IMF but give a much greater voice to the other parts of the world? Do you think there is a sustainable change?

Professor Portes: Yes, I think the United States would be perfectly happy to accept a rebalancing of Europe as against other countries, in particular the so-called systemically important countries like Brazil, India, China and so forth. It is quite clear, if you are talking about real imbalances, that European representation is much too great in the Executive Board and very hard to justify now, especially when you have the euro and a joint monetary policy. For a number of those countries to be separately represented on the Board of the Fund does not make sense. Europe is hugely over-weighted. The US is not going to give up its blocking veto, and that is clear. That is just not on the table. We cannot expect that. I think there is a fair degree of agreement in Washington, and it goes across party lines, that a restructuring of governance along the lines I have suggested would be a good thing.

Q34 Mr Todd: One of the core functions of the IMF is surveillance work and analyses of economic risk. Do you think that that is deployed effectively? We see reports for example on the UK by the IMF. Those of us old enough can remember that there was a time when active engagement with the IMF was a real political issue in this country, but nevertheless some time back. Are the resources deployed sensibly towards areas of highest risk or do people really just cover the ground?
Professor Portes: That is a very good question. By the way, I once wrote a monograph entitled *Crisis? What Crisis?* You may remember that phrase.

Q35 Mr Todd: I am old enough to remember.
Professor Portes: Exactly, and the title was drawn directly from the 1976 remark.

Q36 Mr Todd: A misquote, apparently.
Professor Portes: I think you pose an extremely difficult question: how to rebalance, if you like, the surveillance function and where it could be focusing. I think the focus right now really does have to be on the few countries that are still at risk. Brazil is still at risk. Turkey is still at risk. These are systemically important. Those countries could be affected by the major global imbalances that we have been talking about: exchange rates and current account deficits. An adjustment of those imbalances, depending on the form it took, could have some strong impacts upon countries that are at risk. Then there are smaller countries that are also at risk. I am hesitating a bit because I am not sure about how I would go about it. That is testimony to the difficulty of the questions. Again, it is partly a matter of internal resource allocation of the Fund, but I think that the focus should be away from things that I think the Fund should not be doing and towards the issues on which you are focusing.
Professor Miller: One idea here is competition. The problem with the Fund telling its bosses what to do is precisely that bosses do not like to hear this kind of thing from their economists. Often you find someone outside the organisation may do the job, say the OECD. One could encourage counter-assessments by the OECD as a challenge because I think there is this internal problem. I should also mention that on occasions there are problems of a conflict of interests. In these risky cases like Brazil or Turkey, the IMF is often in there as a big lender; it wants to get its money out. Sometimes its judgment and its position is suspect because of a conflict of interest. I think that is one issue that has to be taken account of, that it may not be trusted by all the parties because it is a big lender. That is unfortunate but maybe for reasons like that it is important to have some other external sources of assessment as well.
Mr Woodward: Could I add that I think that raises fundamental questions about the central role that the IMF plays in the process of negotiating debt cancellation, that essentially we have a process for debt cancellation which is run not only by a creditor but by a creditor the majority of whose shareholders, the majority of the control, is in the hands of other creditors. In any national process you would not think of that as a state of affairs. In terms of debt cancellation, I think we need to move towards a process which is led by an organisation independent both of debtors and of creditors, or at least balanced between the two.
Professor Portes: In what way did the Fund actually run or in any way seriously guide the debt restructuring and debt cancellation process, as you put it, for Argentina? Not at all. It goes back to what Marcus was saying: the Fund in part had a substantial conflict of interest in that situation. That was perceived by all the parties. For the Fund to go in and say, "And this is what Argentina can afford to pay, and, by the way, we are first in line" was not acceptable; it certainly was not acceptable to the Argentines, and it would not have been implementable.

Q37 Mr Todd: What you are highlighting in this interesting little debate is that having analysed where risk lies, because the IMF is a lender as well, identifying what to do is complicated because there is an interest in it and it is complicated by the shareholder mechanism of governance of the IMF as well. Does it suggest that actually the IMF's brief of action to deal with the risk is beyond its competence or is it just that we are all adults and we all understand those complications, and then we work around them in the rather traditionally British way of doing things?
Professor Miller: There has been a suggestion that the assessment of sustainability should be done by the IDB (the Inter-American Development Bank) precisely to avoid the conflict of interest. I do not think the IDB wants to do it. They may have to get some economists over from the IMF to help them with the task, but I think it illustrates the problem. It is a delicate problem and, as I say, I think external sources of assessment may be useful.
Mr Woodward: Can I clarify, in the light of Professor Portes's comments? I was essentially referring, if you like, to the 1980s-style debt crisis led by government debts. The IMF plays a key role in recommending to the Paris Club what terms of rescheduling or debt

cancellation should be offered. There is a very clear role. The 1990-style debt crisis where the Paris Club is not involved is a somewhat different kettle of fish.

Q38 Peter Viggers: Dealing with the mechanistic point on the manner in which the IMF is run, do you think that it would be helpful if there were further clarity about the deliberations of the Board of Governors? There are no minutes made available, for instance. Would it be helpful if the method of decision making were less opaque, more open and more two-way?
Professor Portes: That is an easy question to answer: yes, sir.

Q39 Peter Viggers: Let us quit while we are ahead! Funding for the IMF has fallen and private cash flows have become more important in proportional terms. Is this a sign that the IMF is less important than it used to be or do you think there is prospectively a greater need now for the IMF and that the low level of funding actually poses a danger?
Professor Miller: As I argued in the paper submitted at the beginning, I think it reflects a substantial change in the world, namely the liberalisation of capital movements. That has just raised the game enormously. I think it has suggested that the Fund size is not really adequate. Therefore, what has happened, in fact, is that they have tried to make bigger and bigger bail-outs until they failed. In the case of Korea, it was interesting that they found they simply could not assemble a big enough package and so the answer was to get the banks to play the game as well and to get the banks to stay in Korea, and so to get creditors to take some action. Otherwise the IMF found it was simply trying to raise enough money to allow all the big banks in the world to leave Korea at Christmastime. That is a lot of money and more than the IMF could put together and so you just persuade the banks to stay in. If it is only a liquidity crisis, then the answer is to persuade people to leave their money in Korea, which is what they did. I think there has been a shift towards getting creditors to play a much bigger role and not to have the IMF playing longstop, and I would encourage that kind of role. For the last 10 years the IMF has been trying to get creditors involved and taking losses or staying in crisis countries, if it is a short-term crisis. Another possibility is floating exchange rates, to persuade countries not to stay on fixed exchange rates too long. So there is a panoply of responses to a Pandora's Box.
Mr Woodward: My perspective on it would be that the Fund is now facing a crisis which comes about pretty much as a direct result of its failure to deal either with the 1980s debt crisis or the 1990s financial crisis. Its membership is increasingly divided between one set of countries that, as a result of the failure still to deal with the 1980s debt crisis, are no longer able to borrow from the Fund on its normal terms. At the other end of the spectrum you have countries which are more prone to financial crises, but the Asian crisis and the Latin American crises of the 1990s shows that the instruments available to the Fund and the policy packages it has available are not equipped to deal with that, hence you have the build up of reserves, particularly among Asian economies, to prevent having to go to the Fund. So effectively you have countries which cannot afford to borrow from the Fund and countries which do not want to borrow from the Fund, but the Fund is dependent on its lending and the interest on its lending to cover its administrative costs and that risks getting squeezed out in between. In a sense this is something that could come about as a result of excessive success from the Fund, if it managed to maintain the international financial system so that nobody faced a crisis and nobody needed to borrow, but it is a result of its failures in that we have countries which either cannot afford to borrow or which are going to make every effort to avoid borrowing.

Q40 Peter Viggers: As the IMF examines its options for broadening its income base and has been looking at its reserves and its goal, what would be the effect of another revaluation of the gold held by the IMF both on its ability to Fund further lending and on its credibility and the managing of its own financial affairs?
Mr Woodward: For me it seems fairly strange for the IMF still to be holding so much gold now that we have moved away from gold playing a central role in the international financial system. In a sense gold is becoming a bubble asset in much the way same way as the dollar is, or in parallel with the housing crisis. To a great extent it is only worth something because people think it is worth something. We have literally tonnes of gold sitting in central banks around the world, some of it held by the IMF and the main reason for anyone to hold onto it is because they know if they start selling it on a substantial scale the market will collapse because the market will potentially be flooded with gold. It is becoming only worth something because people think it is worth it. So I think there needs to be an exit strategy both for the Fund and for central banks as to how they can translate that gold into assets which will retain their value.
Professor Miller: Let me respond on something that has not been mentioned, namely capital controls because if capital is part of the problem, what about controlling it directly? I think there is a role for in-flow controls. Letting countries not expose themselves too much to lots of short-term in-flows that may rush out in a crisis if they are converting these into long-term investments I think is something the IMF should contemplate in practice and I would encourage that. Out-flow controls are not so ideologically pure but, nevertheless, in a crisis, as in the case of Korea, one can have out-flow controls as well. My feeling is that, rather than look for another source of money like raising the price of gold, it is more creative finance, it is things like the new arrangements to borrow, it is things like getting creditors to roll-over in a crisis, having sensible capital controls on short-term flows *ex ante* and regional swaps. It is a whole set of mechanisms that it seems the world is moving into and also promoting efficient *ex post* negotiations, the debt restructuring negotiations. I think the Argentine ones were quite

successful at the end but it took about four years. I feel it is about improving the financial mechanisms rather than suddenly finding a pot of gold.

Professor Portes: I notice that Marcus did not refer to a new allocation of SDRs. We have got plenty of international liquidity out there. There one great function of gold that is very important. If any of you has ever taken a tour of the Federal Reserve vaults or the Bank of England vaults you will know it gives great pleasure, it is very enjoyable just to look at the stuff. After that, why should the Fund hold any gold at all? There is an agreement among central banks about disposing of their gold holdings. That agreement was reached some years ago and it has been going on steadily since then. They have been selling in such a way as not to disrupt the market excessively. Why should the Fund not be part of that?

Q41 Lorely Burt: I would like to ask you about your views on current UK and European policy towards the IMF. A Treasury report is produced on the IMF every year. I just wondered what your thoughts were on that report, whether you think that it has changed over the last few years and whether you think that improvements should be made.

Professor Portes: That is presupposing that one has read all those reports, and I have to say I have not. In preparation for coming here, I did look at the latest one and I did not find it something that I should occupy myself with every year. I think that is my best answer.

Q42 Lorely Burt: Would anyone like to elucidate further?

Professor Miller: I think it is an important part of transparency. Before what the Executive Directors did or did not do was a matter of mystery. Now we do have much more transparency. Whether it is a matter of profound interest is another question.

Q43 Chairman: It was a recommendation of this Committee, Professor Portes. Thank you very much. We would be delighted to invite you along again!

Mr Woodward: It is a useful contribution to transparency but it is a very, very small step. We have statements being made on our behalf in the Executive Board at every meeting pretty much and we have no idea what is being said. We cannot get hold of those even under the Freedom of Information Act and I think that raises real issues.

Q44 Lorely Burt: Let us move on to European policy. Professor Portes has already suggested the need for some sort of a joint monetary policy for Europe at the moment and made the point about the number of seats that the different European countries occupy. I just wondered if you would like to elucidate on that a bit more, please.

Professor Portes: The countries in the eurozone cannot have it both ways. They cannot say the euro is this wonderfully important international currency and then not behave as if it were a single currency with a single monetary policy and a single presence in the international foreign exchange markets and so on and so forth. It is an anachronism to have as we do now, Belgium, the Netherlands, Italy, France and Germany sitting there, it just does not make sense. At some point international pressure plus, one hopes, some seeing of sense inside the euro area will lead to a consolidation there.

Q45 Mr Newmark: Previous Treasury Select Committees have pushed for greater disclosure on the workings of the IMF. Do you feel that these calls have been heeded at all? What further work can be done to improve this?

Mr Woodward: As with the Treasury report, I think there have been a few steps in this direction but they have been very, very small steps. I think we need to look at the whole process of transparency for the IMF. I think a major step forward would be, at the very least, the release of the UK Director's statements in the Executive Board and preferably the full minutes of all meetings, unless there is a specific reason for confidentiality.

Q46 Mr Newmark: I think they are dealing with releasing the board's minutes. It is the Board's transcripts that people are pushing for. Do you think it is worth having the full transcripts released?

Mr Woodward: Absolutely.

Q47 Mr Newmark: There is also this huge time-frame of about 10 years. Should that be accelerated?

Mr Woodward: The minutes do not say very much. I worked in the British Director's office 17 years ago now. Normally the Executive Director goes into the board meeting with a fully written verbatim note which he reads out. He may make manuscript changes on the way to the meeting, but that is something that exists on a piece of paper. The World Development Movement tried to get access to that through the Freedom of Information Act and it was denied on the grounds that the Executive Director is an official of the IMF rather than being a UK public servant, even though when I was in Washington my understanding is that he was paid as a British diplomat and not by the IMF, unlike the other IMF Executive Directors. I think there are issues there that need to be looked into.

Q48 Mr Newmark: Given the thirteenth review of IMF quotas is currently upon us, what reforms of the IMF governance structure would you like to see made? I know Professor Portes has touched on one or two of these.

Mr Woodward: In a sense there are two questions. One is what would we like to see and the second is what might we possibly get out of this process?

Q49 Mr Newmark: Or what would the US agree to as opposed to what other people ideally want.

Mr Woodward: Exactly. We have a situation where the US and the US alone has a veto on all the major policy decisions of the IMF. At the moment we have an institution responsible for international financial stability. The biggest potential financial crisis is a collapse of the dollar. The IMF is not in a position to do anything about that because the US has a vested interest and has a veto. That raises fundamental issues. More generally, the weighted voting system of the IMF, coupled with the shift in its role since 1944, means that the votes that each country has in the IMF are inversely proportional to the impact the IMF has on them, so the developed countries are at the top. It really makes very little difference to people in the UK. Since the 1970s what the IMF does impacts purely indirectly. For countries in Africa, in particular, the IMF plays a major role in all of their economic and social policies and yet, for example, Mozambique, with more than 19 million people, has fewer votes than Iceland, which has less than 300,000. I think there is a fundamental problem there which has to be addressed and as long as it is addressed only through discussions within the IMF we cannot resolve it. I think what we need to do 60 years plus on is we need a new Bretton Woods conference to think what we really need in the 21st Century rather than having a governance structure and functions and *modus operandi* which were established in the 1940s during the colonial era for a fundamentally different world.

Professor Portes: I would note that the eurozone also has veto powers if you aggregate its quotas. I expect that if it were to be a shift to single representation it, too, would not be willing to give up a blocking vote and perhaps quite rightly. After all, the question is at what point you say that there are too many representatives of the borrowers and debtors on the board of a bank. There is the problem here of saying that those that tend to need borrowing facilities should have tremendous control over the way in which those borrowing facilities are used, especially when it is, for the most part, the taxpayers' funds of the big and rich countries. This is a political reality. One cannot get away from that. Any restructuring of governance will necessarily take that into account. We cannot be unrealistic about it.

Q50 Mr Newmark: It has been said that the voting arrangements of the IMF reflect the distribution of world wealth. On the other hand, there is a good reason as to why those who give the money—the gold makes the rules effectively—and those who are the borrowers both need a say and there needs to be some reconciliation on the balance between the two. How can the competing needs of both borrowers and lenders be adequately addressed?

Professor Portes: Negotiations.

Mr Woodward: By taking the decisions out of the IMF itself into a broad international body on a democratic basis.

Q51 Mr Newmark: Finally, do you believe that the International Monetary and Financial Committee, of which Gordon Brown is the current Chairman, provides sufficient oversight of the IMF's activities?

Professor Miller: I think it is a useful strategic body to look at the big issues. I guess it is still in business so let us see what comes.

Mr Woodward: It certainly provides some oversight, but again I think there are issues about the composition of that body which reflects the composition of the Executive Board.

Q52 Chairman: Next week we are off to Washington and we will be seeing both the IMF and the World Bank. If we had one question to put to them, what should it be?

Professor Portes: I would ask, "What are you doing about the current global imbalances? What is your analysis, and how do you propose to get anybody to listen to that analysis and do anything about it?" I am very worried.

Mr Woodward: I would say, "How can you justify the governance structure which not only gives the weighted voting but also allows the US to appoint the Head of the World Bank?" This was particularly controversial in the case of Paul Wolfowitz and it was far easier to do than for the US administration to appoint John Bolton as UN Ambassador and, similarly, the IMF Managing Director being appointed by the EU.

Professor Miller: I would ask, "How can you help to make the *ex post* debt restructuring procedures more efficient than they are now, as in the case of Argentina for example?"

Chairman: Your evidence has been very valuable. We will certainly be using it next week. Thank you very much for your time.

Witnesses: **Ms Olivia McDonald**, Senior Policy Officer, Christian Aid, **Ms Romilly Greenhill**, Senior Policy Officer—Aid and Accountability, Action Aid, and **Dr Fletcher Tembo**, Senior Economic Justice Policy Adviser, World Vision, gave evidence.

Q53 Chairman: Welcome. Could you introduce yourselves for the record, starting on the left?

Ms Greenhill: I am Romilly Greenhill. I am a Senior Policy Adviser with Action Aid UK.

Dr Tembo: I am Fletcher Tembo. I am a Senior Economic Justice Policy Adviser for World Vision.

Ms McDonald: I am Olivia McDonald. I am a Senior Policy Officer for Christian Aid.

Q54 Chairman: Thank you. It could be said that the IMF walks a delicate line in that the aid agencies will often ask for it to step back from taking a part in events, and yet if things go wrong it feels it has been made a "scapegoat". Can you think of instances where the IMF has been unfairly criticised, or where its policies are having a beneficial effect?

Dr Tembo: On the point about the IMF being unfairly criticised, perhaps it has to do with the kind of expertise they have on the global economics, I think that is where they genuinely have the expertise. I think, however, that largely the criticisms have largely been right because of the way the IMF has been able to stand apart with that expertise, especially when you begin to see economics coming together with the development. On the development side there has been a move towards achieving the Millennium Development Goals in a better way, with the World Bank coming up with the CDF a comprehensive development framework for instance and looking at poverty as a mutual phenomena rather than just income. The IMF has been rather slow to catch up with that reality and has used their expertise independently and has not brought it into play with what other actors know.

Ms Greenhill: I would like to second that. The IMF obviously does have technical capacity and advice and skills that are useful for poor countries, but as Fletcher says, that often manifests itself in a very narrow technical debate between the IMF and Ministry of Finance officials. Some of the research that Action Aid has done in Southern countries has shown that even officials from other ministries, for example health and education, are not able to take part in the discussions. So there are quite fundamental areas, like the macroeconomic framework, like the overall level of public expenditure and so on which are not open to public debate. The IMF does have a role to play but it must be broadened out, it must be as an adviser rather than in these very, very narrow discussions.

Ms McDonald: I would reiterate the point made there about the IMF using its weight to propose certain policies that we consider inappropriate.

Q55 Susan Kramer: I suppose we want to pick up some of the issues around the conditionality of the lending, which I assume lies behind a lot of what you are talking about. We have taken evidence which suggested that the IMF has gone a long way towards reforming its outlook, that it no longer is pursuing policies and the same ideological perspective that it once did. You are on the ground. Do you see that change in outlook feeding through?

Ms McDonald: No, we do not. We are still getting reports from our partners. We are still getting evidence of trade conditions, for example, in loans to developing countries. One reason that we think the IMF is accounting for that supposed reduction in conditionality is by saying that they are reducing the overall number, but what we found when we analyzed it is you might have one single condition that says liberalize trade in a variety of sectors and that would be down as one condition, but that is actually quite a few different conditions because it could implicate at least three or four or five different sectors. One issue we are concerned about is how the IMF measures their reduction in conditionality and, also, that second generation liberalization reforms are being pursued by the IMF, which are in areas of trade facilitation and customs, which are ways of ensuring that importers can get their goods in because of the lower tariffs, they ease their way into the country.

Ms Greenhill: On this question of whether the IMF is changing, the IMF did make a commitment in 2002 to streamline its conditionality and that was partly in response to some of the criticisms that had been made by NGOs, by Southern governments and so on. A few years down the line, as Olivia says, there has been some nominal reduction in conditions, but there are several concerns we have. Firstly, there has been a shift of some of the IMF conditions onto World Bank lending instead so that the countries are still facing the same aggregate burden of conditions. As Olivia said, there has been a broadening of conditions. Also, even though there are fewer conditions, sometimes those conditions have greater weight. From the perspective of countries on the ground and people on the ground, there does not seem to have been a very large shift in the IMF's practice.

Dr Tembo: In 2002 the IMF also came up with an analysis to help them forecast core conditions, and then there are shared conditions with the World Bank and others and then those that are not within their expertise. There is another analysis which is to do with categorisation of post-conflict countries. It is a way of looking at the different countries and categorising them as post-conflict, early stabilisers and countries that are kind of area stabilizers and mature stabilizers. What we see on the ground however is that, although there is that sort of analysis, the IMF has not changed its behaviour in the way it uses conditionality, it is not remaining within its core areas. There has been a bit of a shift again to issues of governance which can be quite tricky for the IMF to be involved in. We find that reactions on the ground suggest they are involved with the governance of countries that countries themselves are not comfortable with.

Q56 Susan Kramer: If your conclusion and experience on the ground is that while the language has changed the culture has not, do you see any mechanisms or approaches to achieve that change or would it require structural reform, who sits at the seat at the table and how the votes are weighted? Is it something as fundamental as that that has to be changed or do you see any other way to get this shift?

Ms Greenhill: I think you do require very fundamental change to the governance of the IMF. I know that the previous witnesses emphasised that point as well. We have a particular concern that, firstly, what the IMF is doing in the countries is very often using anti-democratic processes, it is undermining the systems of local democratic accountability. Very often the countries that we are dealing with do not have very advanced democratic systems, but we think that it is all the more problematic for that reason, that the IMF is undermining those systems on the ground when they are just getting up and running, they are just being developed. Meanwhile you have got the IMF which at the international level is very undemocratic and it lacks basic accountability. We think you really need quite fundamental reform. You cannot really tinker at the edges. I do not think you are going to make very much progress.

Dr Tembo: I want to add to that point based on World Vision's research in Zambia and Bolivia on IMF behaviour. Whereas the top line IMF structure will change, at the moment they do not attend the consultative group meetings even with the donors themselves. The argument has always been about reducing numbers of staff. As to the weight that the

IMF have on the process, they shift to a poverty reduction strategy approach and that has suggested cycles or processes or consultations with stakeholders and then suddenly you find the Poverty Reduction and Growth Facilities that the IMF brings that has not been factored in. Those kinds of behaviours and ways of working will have to change significantly for greater impact on poverty.

Ms McDonald: There are other approaches that could be pursued alongside structural reform, which I am very, very much in favour of, to help challenge the situation. Some of it the UK government is quite active on, which is looking at improving the domestic oversight. We have raised the point that there is a deficiency, but, for example, in Malawi there is quite a lot of support for a fledgling parliamentary committee to scrutinize the IMF and World Bank and defining their role in that process is obviously a key factor. In addition, the way that the aid system is moving towards multi-donor budget support and joint agreements between donors and recipients could provide an opportunity for donor groups to be more progressive and to say, "We're prepared to take different input on what we think the key macroeconomic and liberalization policies or trade policies necessary for this country are".

Q57 Kerry McCarthy: The experts described the IMF's role in poverty reduction earlier as "a mistake, very unhelpful, fundamentally misguided" and you have also now expressed the view that the IMF's role in developing countries does not help them bring about stable democracies, it is anti-democratic. To what extent do you think that the IMF does bring any benefits from working with low income countries? What does it bring that could not be provided by the World Bank instead and perhaps in a less anti-democratic manner?

Ms McDonald: I know the IMF does a lot of work with capacity building in ministries of finance and also with parliamentary committees and I am sure some of it is very good, but I am not entirely sure why they would have a monopoly on providing that.

Dr Tembo: The IMF are able to look at global issues, regional issues, for example in Africa and the ways in which the economy has changed at the regional and country level, and then bring this analysis together. Where we have an issue with the IMF is that analysis stands alone, it is not brought in to accountable systems domestically that have been set up through the Bank's work. Civil society organisations and other think-tanks within countries would offer alternative views on how the analysis informs the debate and conclusions.

Q58 Mr Love: Dr Tembo, in your submission to the Committee you talked about ways in which they could improve the development of poverty reduction strategies and you talked about the need for greater accountability and particularly the engagement of civil society in the countries concerned. What other ways can we make these poverty reduction strategy papers more effective in delivering the objectives that we are seeking?

Dr Tembo: There are several ways. The first one is providing more flexibility. On poverty reduction strategies, the initial bit was from HIPC arrangements, so countries were rushing to get their debts cancelled or to get debt relief. That cycle of three years went very quickly, without genuine and deep consultation with countries' strict orders. One way would be to be more flexible on timetables. We are seeing a bit of flexibility now in that countries are allowed to give in their national development plans as poverty reduction strategies. The other way is to look in terms of donors investing in domestic capacity. We have talked about members of parliament. They were not adequately involved in the initial phase, along with civil society organisations. Most of the stakeholders have failed to backtrack processes properly because they do not have the capacity. We think that is an area that needs to be developed more so that when you come up with the poverty reduction strategy it is owned by the country adequately.[1] Another area is to reduce demands for debt when they sign off by poverty to the World Bank and external influences, but that suggests more accountability to donors rather than domestically so that there is more of an organic process. I think those are some of the areas that I would raise.

Q59 Mr Love: Ms Greenhill, according to the decisions taken last year by the G8 there is going to be a significant increase in resources going to aid and development and the whole issue of effectiveness of that aid, which has been under much discussion, is going to come even more to the fore as larger resources go in. How can we assure aid effectiveness, and what role can the IMF play in that?

Ms Greenhill: I think this raises a very interesting issue because our research, as I outlined in the submission, has shown that the IMF is still quite pessimistic about the capacity of countries to absorb more aid and that is for reasons of fiscal ceilings, of their concerns about inflation and so on. We are going to see, as more of this aid starts coming on-stream, a potentially greater conflict between the IMF and other donors, but while other donors are quite keen for more money to be coming in to countries and the IMF's fiscal ceilings to be blocking the absorption of that money (and we have already seen that happening in countries like Mozambique and Uganda), in terms of the question of effectiveness of resources, it is really again a domestic process, it is a process of domestic accountability, of scrutiny by parliaments within countries, by local civil society organisations, by church groups and so on. I do not think it is really up to the IMF to be saying aid is being well used or not. They can support capacity building, they can support transparency, but it is really up to people within the country to have greater oversight over those resources.

[1] *Footnote from witness:* The negotiation of the Poverty Reduction and Growth Facility (PRGF) or the macro-economic framework in general by the IMF should be part of this process and not separate from it.

Q60 Mr Love: There are always a lot of accusations that the IMF is ideological in their approach in the sense that they talk continuously about free markets and global trade and opening countries, including Third World developing countries, to trade. Do you think that is too much of an emphasis? Are they getting it wrong there? Should they be much more pragmatic in trying to gain the objectives that are set by the international community in their Millennium Development Goals?

Ms McDonald: We take a pragmatic approach to the pros and cons of liberalization within developing countries, but we really believe that those choices should be based within developing countries themselves. The IMF has a very pro-liberalization stance, but because of its power in developing countries through its lending and its advice, the fact that they have to take the advice to get the money from other people, they are basically locked in to following those policies when countries like the UK can take that advice, pro-liberalization or not, and say, "We're not going to do that". We would also argue that these decisions should be taken through the form that is appropriate for this, which is what the WTO has been set up for. To an extent we would say the IMF is moving out of an area that it should not be working in by promoting liberalization so aggressively.

Q61 Mr Love: In the previous session with the experts we had a clear difference of views about what restructuring of the IMF would be appropriate, ranging from the fairly radical, which would be bringing a fairly substantial voice for the Third World into the internal workings of the IMF, to those that were much more conservative in the sense of recognising the power structures that already exist there. If you are to maintain the commitment of the developed nations and particularly the US, how much reform will take place at the IMF?

Ms Greenhill: The question really is not necessarily about the developed countries but I think it is more about the developing countries. You have seen some of the big Latin American borrowers, particularly middle income countries, starting to want to repay back their loans to the IMF. Increasingly, we are going to get a situation where borrower countries are saying we do not want to take the IMF's advice on these terms, we do not want to take their money or we are very concerned about the kind of policies that we are having to take. I think all of us on this panel would agree that there needs to be very, very significant governance reform to the IMF, but in terms of where that is going to come from, I would see increasingly over time it might be that poor countries are going to be standing up more to the IMF and being more assertive and that means that the IMF will have to change both in terms of its governance and in terms of its practice.

Q62 Angela Eagle: You are not against conditionality *per se* presumably because conditionality, if it is not the Washington Consensus conditionality on liberalization, might be about ensuring that the money that is lent is not completely misused. Is this an issue about what kind of conditionality is appropriate rather than about conditionality itself?

Ms Greenhill: I would say that that is exactly right. I think you do need to have some conditions to ensure that money is well spent. We are not advocating writing blank cheques to the Mobutus and Mugabes of this world. Our really big concern is around the policy of conditionality. We are concerned partly about the mix of policies that has been promoted in the Washington Consensus but we are also concerned about the way that policy conditions undermine democracy and undermine local accountability in countries. Even if they are the right policies that the IMF is demanding from the countries, we think it should be up to the country, the local people, the parliaments, *etcetera* to make those decisions. We think there should be some very minimal conditions, mainly around fiduciary accountability, rather than this very intrusive raft of policy conditions that we see at the moment.

Q63 Angela Eagle: So it is liberalization that is the problem?

Ms Greenhill: From an Action Aid perspective, even with the right policies, we do not think that it is up to outsiders to impose those policies. We have two criticisms. Firstly, we do not like the policies that are there at the moment, but, secondly, even if there were the better policies from our perspective, we would still be concerned about the impact of that on accountability within the country.

Dr Tembo: World Vision have conducted research on conditionality itself in relation to poverty reduction strategies where we think it would be more useful to go for strengthening domestic accountability which will have very positive knock-on effects on issues of fiduciary accountability and that is something which donors are concerned about. If we take conditionality in the way the IMF would put it, it would look at systems but it would not be able to handle political relations and views in the way the countries handle it. It is the domestic systems that have those powers to be able to change how things work at a more social or political level which conditionality cannot do. The way to do it is by strengthening domestic capacity and making sure the conditionality that you have strengthens those processes. Tony Illick of the Overseas Development Institute also alluded to the fact that conditionalities only work when they tilt the balance towards what citizens want. Unless citizens want something and they are well aware of what that conditionality in that country is supposed to deliver, it cannot deliver any change.

Q64 Angela Eagle: There is another issue that I asked the experts about which was off-shoring and the holding of now US$11.5 trillion of assets in tax shelters, which obviously impacts on some of the poorest countries if there is the corrupt moving of assets outside of the country in that way. When the IMF was originally set up John Maynard Keynes, it was so that bank secrecy should be dissolved and there should be much more transparency about

where assets are kept. Do you think that that would impact, if there was a change there, on this problem of off-shoring colossal amounts of monies and the consequent loss of tax revenue which apparently could achieve the Millennium Education Goals with the financing on a tax revenue from the money that currently escapes national taxation in this way?
Ms McDonald: Christian Aid has been looking at this area of taxation and offshore accounting and we definitely think that this is a vital thing that needs to be prevented, but we also think it is important to look at how that can happen and that is partly due to the taxation regimes that the countries are using themselves.

Q65 Angela Eagle: Bank secrecy?
Ms McDonald: We have not worked necessarily on bank secrecy. One of the things that we have been looking for is an international taxation authority which may be a body that could look into those things.

Q66 Mr Todd: I just wanted to explore the conditionality point a little further. This is money loaned and so a principle of the conditionality is that there should be mechanisms to give a very high chance that it will be repaid and that includes a variety of mechanisms which will improve the sustainability of the economy. Surely you accept that someone loaning money has some right to say they want to make sure their money comes back?
Ms McDonald: I think it depends on what the starting point is.

Q67 Mr Todd: You have used the word donor quite often in this discussion. There is a distinction between a loan and aid. I recognise they are tied together very often, but the principle is that this money is loaned and then repaid.
Ms McDonald: In theory, the IMF's poverty reduction growth facility is a facility to bring poverty reduction and growth. Some of the policies and income that a country might need to do might be very, very long-term policies that might take a time to start really bringing in the benefits. Having a loan with a relatively short turnaround to get it back in might encourage a recipient country to adopt different policies. Is that what the loan is for? Is it to make sure that the short-term problems are resolved and the money comes back in or is it to get long-term poverty reduction?
Ms Greenhill: Increasingly now what we are seeing with the IMF is that they are not lending large volumes of money, particularly to the low income countries, and that is because IMF monies is really quite expensive. IMF loans do not count as aid because they are so expensive. Their role is increasingly about that seal of approval which will allow the bilateral donors to come in and very often that is in the form of grants. The role that they have, the singling function, is not necessarily about their own money, it is about telling donors this country has the right mix of policies. You can then come in and bring your grant financing.

Q68 Mr Todd: So your dispute is less with the conditionality attached to a loan, which you are saying is relatively trivial, but more with the economic advice that it gives and the message that gives to others who may be wishing either to make other forms of loans or donations to a country, that this is a green light so to do?
Ms Greenhill: They go together. You have your PRGF programme which will involve you borrowing and that is generally a small amount of money, but the fact that you are borrowing that money acts as a signal, it means you are deemed eligible for budget support, for HIPC debt relief. One of our key concerns is the lack of choice that countries have. If I want to borrow money for a mortgage, for example, I might be able to go to a range of different banks and look at their conditions and see which mortgage I want to take, whereas a poor country really has no choice but to go to the IMF if it wants access from other donors, often from private sector finance as well. That is one of our key concerns around this issue.

Q69 Peter Viggers: I would like to ask about the IMF's medium-term strategic review which was produced towards the end of last year and the extent to which you are able to comment on this either direct to the IMF or through the UK government. Broadly the strategy took account of the fact that the institution was originally created to support international monetary stability and the financing of temporary balance of payments problems and then it looked at the different aspects which have come to bear on this strategy. To what extent did you study this and comment on it to the IMF or to the UK government?
Ms McDonald: Is that question about our opinions on the strategic review or what we have done about the strategic review?

Q70 Peter Viggers: What did you do in response to the strategic review? Did you consider it and did you put forward representations of your own and to whom?
Ms McDonald: We have not engaged in the strategic review apart from reading it and commenting on it within the NGO community when we received it.
Ms Greenhill: I do know that there have been some concerns from our organisations and from others that we work with that the process has been quite opaque. There have not really been opportunities for us or particularly for our counterparts in Southern countries to engage with the review, to make submissions or to make our voices heard. It seems to have been quite an untransparent process and not a very participatory one.
Dr Tembo: We still have comments on the IMF review. We do not have a process in which we can get those comments through so that the IMF includes them at the next annual meeting.

Q71 Peter Viggers: So you are really saying that it was not particularly consumer friendly in the sense that it sought responses from bodies like your own?

Dr Tembo: Yes.

Q72 Lorely Burt: I would like to ask each one of you about your views on the current UK policy towards the IMF. If there was one thing that you would like the UK government to push for in its policies towards the IMF, what would it be?
Ms McDonald: I think it would have to be taking a stand at a country level, in the multi-donor budget support framework, in how that integrates with the IMF, particularly because the UK on the one hand has got this new position on conditionality where they are saying conditions should not be used to force countries to adopt certain economic policies and on the other hand the PRGF is very central to the multi-donor budget support systems that have been spearheaded by the UK government. I think it would be helpful to have not only some form of clarity but also to see the UK government in certain countries supporting the development and use of macroeconomic frameworks by groups other than the IMF.
Dr Tembo: One issue that I would wish the government to take a stand on with regard to the review is the power that the IMF has through the instruments that they use. Even though they have embraced the issue of diversity that different countries would need, it is very much supply led rather than demand led. If you take the Policy Support Instrument that has just been introduced, for example, and if you read the clause in the UK document, it is saying that this would have an effect on what donors do with those countries. That is a position that leans towards the IMF continuing with this role with too much influence on countries. If there is an issue, it has to do with helping the IMF to stand back from putting too much weight on lower income countries, to allow for domestic processes, including that part of society to come up.
Ms Greenhill: I would agree with Olivia, the UK needs to show leadership following its position on conditionality, which is something that we very much welcomed, but it needs to be working with other donors and critiquing the IMF's approach internationally but also at a national level and particularly the IMF's approach to these fiscal ceilings and limits on public expenditure.

Q73 Mr Newmark: The UK government, in its report on relations with the IMF, strongly endorses the Independent Evaluation Office. Is the Independent Evaluation Office a great success? Do you think it is sufficiently well resourced? Do you have any idea of where it should be turning its attention to next?
Ms McDonald: The IEO has come out with some very good reviews that have been very critical of what happens in the IMF. For instance, there was one last year on the PRSP process which really condemned the IMF, so in those terms it is a success. It does seem to have quite a lot of resource in terms of capable staff to do this and investment to do field cases. The questions are: what resources does it have; what is invested in it in terms of making sure its recommendations are followed up, and what teeth does it have?
Ms Greenhill: I would agree with that point, that we have seen some very good analysis, but it is not clear what the responsibility of the IMF is then to take forward any of those recommendations. How do they feed back whether or not they have adopted the recommendations? If not, why not? At the moment it seems a bit like the IEO produces reports and all the NGOs say "What a great report" and then nothing happens.
Dr Tembo: For instance, on the IMF lack of participation on the Poverty Reduction and Growth Facility, failing to link it properly with the poverty reduction strategy papers, it was very articulate and it recommended what the IMF should do, but we have not seen any change. When the PRS review was done last year by the Bank and funded together those views were not accommodated adequately. There is no mechanism for seeing that.

Q74 Mr Newmark: Does the International Monetary and Financial Committee, of which Gordon Brown is currently the Chairman, provide enough oversight of the IMF's activities?
Ms McDonald: As far as I understand it, the IMFC meets once or twice a year and it largely seems to be an opportunity for people to give general policy statements. So Gordon Brown will make a policy statement and that will largely guide the UK Executive Director in what he then does on a day-to-day basis on the Executive Board. I am not clear how something that meets so infrequently and is more an opportunity to state our policy preferences can be an oversight body.

Q75 Mr Newmark: My sense is it does give some direction on prioritizing and so on. It is more than simply a static reporting of something that has happened. I think they do give a little bit of guidance. It been said that the voting arrangements of the IMF reflect the distribution of world wealth. On the other hand, there is a good reason why those who supply the money for the IMF to lend should have a larger say in how it is run. How do you feel the balance between lender and borrower should be struck, and how can the competing needs of both borrowers and lenders be adequately addressed?
Ms McDonald: It is not necessarily correct that the current voting structure represents world wealth when, if I remember correctly, Canada and China have the same voting share but China has a GDP that is twice the size of Canada. As it stands, there are inequalities within it and this is what is putting pressure on the next quota negotiations. There is pressure coming from middle income countries who are saying, "Our GDP is so strong, why do we not have a share of the power that recognises that?" That is not necessarily true anyway. What we would like is that, when these discussions are happening, we should look beyond a reform package that bases itself just on economic wealth and looks at something much more egalitarian, as is befitting of such a multilateral institution.

Q76 Mr Newmark: I think the concept has to do with a shareholder structure, *ie* he who is the largest shareholder, he who is lending the most money should be having a larger say than others who do not give as much. Clearly someone who is a borrower should be having some say in what is going on. I know you have been trying to address this as well. How does one adequately balance those two tensions there?
Ms McDonald: We would ideally want one member, one vote because rather than being seen as a shareholder institution, it should be seen as a part of global governance and that should be based on much more egalitarian principles. However, we recognise that that might not be something that happens. There are ways of readjusting the voting formula within the institution to get a much better balance of power, to have a 50:50 say with lower income countries having a much greater input.
Ms Greenhill: We should not see the IMF as a bank or like a private sector institution where the shareholders have voting rights depending on their shareholdings, we need to see it as part of the international organisation and so we should have a similar system to the one we have in the WTO, which is one member, one vote, or the UN. Neither of those institutions are perfect in the way they represent the views of poor countries, but in terms of the way we think about the IMF, that is the direction that we should be going in bearing in mind that some of the issues that it deals with are genuinely about the organisation global financial stability, international economic integration and so on.

Q77 Mr Newmark: Are there concerns that the skills mix of the IMF staff is not sufficiently well aligned with the work they undertake, especially in development issues? Have your institutions any particular experience of this, and what do you feel the IMF is doing to address this? It is those who have direct experience with poverty issues versus those coming in as pure economists in trying to deal with that and there is that tension between having those with economics expertise and those with real life experience in poverty economics.
Dr Tembo: There is an issue there. That is why in our submission we mentioned that within the capacity development-type of approach other than capacity building, where the IMF wants to develop the skills, should be in working with developing countries. The IMF also has to learn about the contextual issues in which it is placed. It is not as straightforward as the conclusions appear because there are underlying issues there. For instance, we pointed to the issue of the Poverty Social Impact Analysis which shows that when implemented there is a whole set of changes in favour of poor people which, by looking at it through an economic lens only, you could not achieve. I think that is something that needs to be done.

Q78 Angela Eagle: Are we not in danger of mixing up the World Bank's role with the IMF's role and ending up with one agglomerated international body here? Do you see merit, even if you do not like the Washington Consensus, as many of us do not, in having a body which is about macroeconomic stability and finance over there and then a body such as the World Bank which has different governance in things, which is really much more about development and the social issues? Do you think the system ought to be all mixed up or you ought to try to specialise in the international architecture that we have got even if it has not been perfect so far?
Ms Greenhill: There is a role for the IMF to be quite focused on macroeconomics as an institution, but in terms of the staff and the skills that they have, I do not think that one can be an economist in isolation. The sort of macroeconomic policy you have is going to have a fundamental impact on social and political dimensions. There is a lot of research showing that the Washington Consensus policies have been very detrimental to women. So you have to be able to think about all of those things and I think that is the real problem with IMF economists, that they see things very much in purely economic terms and they do not have any basis to think more broadly. It is not saying that you should merge the IMF and the World Bank, but you need to be thinking about the very particular training that IMF economists will have.
Angela Eagle: Perhaps better economic theory to apply rather than the rather narrow theory they do apply!

Q79 Chairman: We are meeting both the IMF and the World Bank next week. What is the first question we should put to them?
Ms Greenhill: I would ask them about conditionality. The track record of the Washington Consensus really is not a success.
Dr Tembo: It would be to do with how they would change their behaviour to embrace the diversity that they have pointed to, which includes development, so they do not have a one-size-fits-all kind of economic approach to development, especially in relation to low income countries.
Ms McDonald: If after having been able to ask both of those questions, I would probably want to ask a question following up on this IEO issue, which is why, when they come out with critical evaluations and recommendations, they have been so slow to implement them and what is going to change in the future.
Chairman: Thank you for your time this morning. We will be using that information next week when we go to Washington.

Thursday 27 April 2006

Members present:

Mr John McFall, in the Chair

Mr Colin Breed	Kerry McCarthy
Jim Cousins	Mr Brooks Newmark
Angela Eagle	John Thurso
Mr Michael Fallon	Mr Mark Todd
Mr David Gauke	Peter Viggers
Ms Sally Keeble	

Witnesses: **Mr Mervyn King**, Governor of the Bank of England, **Ms Rachel Lomax**, Deputy Governor of the Bank of England, and **Mr Chris Salmon**, Head of International Finance Division, Bank of England, gave evidence.

Q80 Chairman: Governor, can I start officially and welcome you to the Committee. Could you introduce your present and absent colleagues for us, please?
Mr King: I hope that Rachel Lomax, Deputy Governor for Monetary Policy, will be joining us shortly. On my left is Chris Salmon, who is head of the division in the Bank which deals with IMF matters, and both Rachel and Chris were with me in Washington last weekend for the IMF meetings.

Q81 Chairman: Thank you. We have looked at your speech, which you gave in India, in fact; that generated our interest in inviting you along this morning and I am very grateful that you have found time to come along to give us your views. In that speech you suggested that "we consider the fundamental question of what the Fund is for". The Fund itself acknowledges its scope has increased in recent times. To what extent do you believe it has gone beyond its remit and what do you think are the core remits of the Fund?
Mr King: I do not think the Fund has gone beyond its remit. I think that many of the member countries have tried to broaden out the remit of the Fund and give it a wide range of responsibilities, many of which were rather ill-defined. The Fund has faced a difficult challenge. My own personal view is that it is never good for any institution, and certainly not one in the public sector, to lose track of the clear focus on its core mission. I think it does make sense to go back to first principles and ask the question "What is the Fund for?" It was interesting that in Washington this past weekend more people than before were prepared to ask that question. I think that there are two different views. One view—the one that I would espouse—is that the main mission of the Fund is to focus on its role as guardian of the international monetary system. Its job is to ensure the smooth workings of the international economy and, to that effect, it does not have any simple instrument that it could use. Its main role has to be in terms of intellectual leadership, guidance, authority and bringing people together to discuss issues which are accepted to be of common interest. I think the other view is that if there is not a very clear instrument in the area of surveillance, in the broadest sense, then the Fund should focus on its lending activities. My own view is that we have seen over the past 30 years a very big change in the environment in which the Fund operates. It is 30 years ago this year since the UK was the last major industrial country to borrow from the IMF. It is now inconceivable that any major developed economy would ever have to or wish to borrow from the IMF. The second view—that the Fund could see its main purpose as a lending institution—is not likely to be necessary, or indeed for there to be a demand for it, from the industrialised countries. As we saw in the 1990s, the Fund became a major lender to emerging market economies. I think actually one of the good news stories of the past five years is that the Fund is no longer a major lender. Far from being a problem this is actually very good news—these countries do not wish to borrow, do not need to borrow, and we ought to encourage that. I feel somewhat uncomfortable with the idea of an international institution whose income, whose status, and whose excitement seems to depend on other countries less well off getting into serious financial difficulty. We ought to be doing everything we can to create an environment in which crises are seen as bad things, rather than good for the IMF because they raise its income and good for the staff because they give them something exciting to do. I think that my own view is that, from now on, the main role and functions of the Fund will be primarily in surveillance. I think there is one further, very important reason why, which is that we have had paper currencies for a long time, a century or more, but only in the last 20 years, even in the developed world, have we learned how to manage fiat paper currencies effectively in terms of monetary policy. One of the consequences of that is that in the new world, new for the late 20th century and 21st century, of open capital markets, capital mobility, only credible monetary policies and credible fiscal policies enable you to borrow from abroad. If you were going to borrow from abroad, it would make absolutely no sense to borrow from abroad on a big scale in foreign currency terms. You are creating an immense risk by doing that. That is exactly what led to the crises in the late 1990s. I think the major lesson that has been learned by emerging markets is that borrowing in foreign currency, leading to potentially large currency mismatches between the balance sheet of your domestic

economy and that of foreign claims on it, is very serious, it creates a big risk. What we have seen is a response of two kinds. One is that in the short run many of these emerging market countries have built up massive foreign exchange reserves to enable them, if there were to be a run on the banking system, to act as a sort of "do it yourself" lender of last resort to their own financial systems. Secondly, we have seen some emerging market economies now start to realise that they do not want to borrow in foreign currency terms. Either they are not borrowing or, where they are—as in the case of Mexico—they have gone to great lengths to ensure that they can now create a domestic debt market so they can borrow from foreigners in their own domestic currency. That is the only safe way to borrow in foreign currency terms. The only other way to borrow which is relatively safe is to encourage foreign direct investment and equity investment into your own economy. To borrow from abroad, in fixed-debt finance terms, in foreign currency, is a terrible risk.

Q82 Chairman: Welcome, Rachel. The inquiry we are having is on globalisation but the IMF is a subset of it, so we are coming on, later on, to talk about the issue of globalisation in its widest sense. As far as IMF is concerned, do you have any initial comments you would like to make on the IMF's role and its future role?
Ms Lomax: I do not think I have got anything really to add to what the Governor has said and I am happy to move on to questions.

Q83 Chairman: The Chancellor, in his Foreword to the Treasury Report, in its dealings with IMF, calls for the IMF to become independent of governments. What benefits do you think that will bring to the IMF?
Mr King: I think the main area that we focused on here—and it was something that we both discussed in Washington at the weekend—was making IMF surveillance somewhat more independent. The reason for that is that to make surveillance effective we genuinely want to know what the IMF really thinks. We do not want that somehow to be confused and concealed by lots of "behind doors" drafting of reports that they produce. What goes hand in hand with that is, if there is going to be independence of IMF surveillance and a very clear, stated view, that they must be held accountable for it. Hence the sort of twin-track approach of, on one the one hand, giving IMF surveillance more independence and, , and on the other hand, making the IMF more accountable for the quality of its surveillance and giving the Independent Evaluation Office there a bigger role, in reporting on surveillance. I think that the Independent Evaluation Office has been a big success; it produced some quite punchy reports on the lending programmes which the Fund made, particularly in the case of Argentina. The Independent Evaluation Office report certainly did not pull its punches and their reports are well worth reading. If we can encourage the same outspokenness in the IEO now, under its new leadership, as it demonstrated under its previous leadership then that would be a very, very good thing. In the lead-up to this debate, the Chancellor had been stressing also that it was very important to separate surveillance from those making decisions on the lending programmes. I think that is also very important, because there was a great temptation, if you were the part of the Fund that had been responsible for lending to a country, partly to be captured by that programme. You had an enormous amount invested in the success of that programme and you were very tempted to claim that it was being more successful than it was. The Fund was reluctant to pull the plug, and hence very often the comments that were made were not as bold and as blunt as they might have been.

Q84 Chairman: There is a view that if you make it more independent then it is less accountable to its stakeholders, and the political, the global pool of polar dissatisfaction there has been with these institutions can continue. How do you counter that?
Mr King: I think that goes to the governance of the Fund, and I think that having a very clear, straightforward, unbureaucratic method of governance of the Fund is crucial. That is why I commented on the role of the Executive Board. Any body which is the main vehicle of accountability which receives 300 pages of text to go through every single working day, every single week, is going to be snowed under with things. That is why I suggested that it was worth contemplating a non-resident Board, in order to make the accountability more effective. I do think that having senior people fly in from capitals to have regular Board meetings will be much more likely to hold the senior management accountable than the extraordinarily cumbersome method of governance that we have imposed on the Fund, and indeed many other international institutions. This general problem of a very expensive, very time-consuming, full-time Executive Board, staffed by people at middle level, not by senior officials from capitals, has made it—in my view—more difficult to hold the senior management accountable in many organisations more difficult to hold the senior management accountable as well as embroiling the senior management in a massively expensive bureaucratic exercise.
Ms Lomax: Can I comment on that as well. Looking at the context in which the Chancellor made this remark, and of course the parallel with the Bank is quite interesting and suggestive, because, in a sense, the Bank is not completely independent of Government, it is operationally independent, but it operates within a very clear framework. The great innovation in 1997 was to be extremely clear about what the respective roles were of the Bank and the political end of Government, when it came to monetary policy, and to give the Bank a very clear remit and a clear framework for accountability. I think that is the sense of independence which is important for the Fund. There needs to be a lot more clarity about exactly what it is trying to do and what

the framework of accountability is, and I think that was the point the Governor was making very strongly in his speech.

Q85 Angela Eagle: Governor, looking at your speech, you quote from the founding intellect really, John Maynard Keynes, about the desirability of the Fund's approach to every problem being absolutely objective. Do you think that happened? Trying to focus here on the imbalances which have been built up by countries in Asia really to defend themselves against intervention from the Fund, do you think that kind of approach really is based on other countries' experience of IMF bail-out?
Mr King: I think the decision by countries in Asia to build up large foreign exchange reserves is undoubtedly, in part, a result of the experience of the Asian crisis in the late 1990s. They got into difficulty then partly because they did not have large dollar reserves of their own. They had to turn to the Fund, it took sometimes both time and difficulty to organise that. The degree of conditionality that was imposed by the Fund on those countries—and I think the Fund recognised this with the benefit of hindsight—was excessive. Certainly it was much greater in detail than was imposed on Latin American countries which borrowed from the Fund. I do think that the Asian countries have a genuine cause for complaint about the way that was carried out. More fundamentally than that, in a way, I think the lesson learned was, as I said before, it is very risky to borrow from abroad in foreign currency: you might find yourselves subject to a run on your own currency and then find the burden of foreign currency debt increasing in terms of domestic resources. The lesson which was learned was: "Let's not get into the position where we find these potentially large currency mismatches on our national balance-sheet." That is the fundamental reason. I think that once you take that view the short-run answer is to make sure that, where the private sector or the banking sector does have large, foreign currency denominated loans, the country as a whole needs then to have large foreign currency reserves in order to balance that. In that way, they can ensure that they can provide those resources to the financial sector when needed without resort to borrowing from the Fund—a process which, inevitably, may exacerbate the run on the currency given the time it takes to put these things in place. I think that the experience of the 1990s was undoubtedly instrumental in persuading the countries in Asia to build up very large foreign exchange reserves. I think since then the Fund has been very clear about the consequences of doing that, namely the fact that policy is bound to exacerbate the imbalances in the world economy which existed already from trade flows and that at some point this will have to come to an end. It does not seem remotely sensible that even those countries will want to accumulate indefinitely larger foreign exchange reserves. I think that in the course of the past 12 months we have got to the point now where it is pretty clear that Asia does not want, in aggregate, to make significant further additions to its foreign exchange reserves. China has made clear that its strategy over the next 10 years is to see more growth coming from domestic demand than from net exports. That is the other side of the imbalance; over the next 10 years more of the growth in the United States will have to come from net external demand and less from very rapid, domestic demand growth.

Q86 Angela Eagle: The irony really is that, because the IMF behaved in this way and got itself caricatured, or characterised, depending on your view, as the sort of enforcer of the Washington consensus, controlled by the United States, in its interests, leaping into Asian economies and telling them how they ought to behave, in a way which was probably less generous, as you said yourself, than what happened in Latin America, now somehow the IMF has got to prove to world opinion that it is not that way. Do you think that objectivity in surveillance is the way to do that, or do you think actually they need to do something even more dramatic?
Mr King: There is a new management team at the Fund now and I think that the Managing Director gave very clear leadership; he was particularly forceful over the past weekend about being objective about the IMF analysis. Also, launching the new multilateral consultations which he has proposed will provide a way forward that will demonstrate to the major players that the IMF is completely even-handed and is objective in its analysis. The reason we need an IMF is precisely because it is possible then for all the parties to these discussions to regard the IMF as neutral. The staff analysis is very high quality; they have got some extremely good people there. I think the Fund just needs to keep playing thethe sensible game now of being objective in its multilateral consultations. That is the new exercise which it was given the authority to do at the weekend, and I think the Managing Director will run with that.

Q87 Angela Eagle: In terms of again the history of Bretton Woods and all of that, Keynes was very certain when the Fund was created that he wanted one of its duties to be dealing with offshoring, which was then a much smaller phenomenon than it is now. We have a system now where there are literally billions of pounds stored offshore, avoiding tax, causing all sorts of problems, assisting global criminal organisations and laundering their money, and terrorist organisations. Do you think there is a role now to go back to the original intent which Keynes had, which was that the IMF should have some role in attempting to police mass tax evasion of the sort that we see with offshore?
Mr King: I understand why there is a wish to do that, but I think that if you want to have policemen it makes sense to hire professional policemen. They are not in the IMF, they are in national capitals; it is a question of political will. I think one of the big mistakes is to try to ask the Fund to do too many things; in recent years the Fund has been asked to be a fireman and a policeman.

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Q88 Angela Eagle: It is all emergency services?
Mr King: I think it should not be emergency services. I think this is not the kind of support one wants to inculcate. Perhaps I am influenced too much by my experiences at home, but one of the successes, I think, of the Bank of England is that we have moved away from an institution whose main contribution is dealing with crises towards an institution which sees its main business as being boring and actually ensuring stability. I have never forgotten that in one or two of the banking crises that were seen, when people had to come in and work at the weekend and it was all terribly dramatic, the only people who ever complained were those who were not called in to work—unpaid of course—at the weekend. A crisis, far from being a real problem for a public servant in those situations, is what makes the job exciting! You do not want people to have that kind of incentive. It is very important to have an institution like the IMF which does not benefit from financial crises, either financially or in terms of the culture and excitement of the work. You want people who see their job as being to try to maintain sensible, useful, background discussions among the different economies about how, slowly and steadily, we are going to unwind these imbalances. The last thing you want is a crisis in which the Fund sees that it will be at the centre of world events, at long last, again, as it was with Argentina and Brazil. "Wasn't it fun to go to Indonesia and stand over the President and make him sign something?" You do not want an institution where people feel that way; you want people who do not want to be at the centre of events. It is on your side of the table that you want people at the centre of events, not in the official organisation.

Q89 Angela Eagle: It is the inevitability of gradualism towards complete boredom?
Mr King: Exactly; that is exactly right.

Q90 Mr Fallon: You have praised the Managing Director, but Professor Richard Portes told us that, in his view, the strategic review really had not taken us much further. Do you share that?
Mr King: I am not sure when you saw him, but I think the events last weekend were a very significant departure from earlier versions of the strategic review as was the energy which the Fund was demonstrating. I had some sympathy with the fact that the initial versions of the strategic review were not bold enough, but I think that the energy and boldness shown last weekend were quite markedly different from that which we had seen before. I do feel now that the leadership of the IMF has picked up the baton and is seriously aware of its main mission. It. It knows there is a challenge in the future, because of the reduced lending by the Fund, its income stream has fallen—everyone in the Fund is aware of that. That is a very important pressure on an institution to think about its main role and focus. I think that the new approach to multilateral surveillance which was launched last weekend is one which the Managing Director will run with and he is very conscious of that being one of his main tasks in the year ahead.

Q91 Mr Fallon: Some weekend work was effective?
Mr King: This was one of the best weekends, maybe the only one, but it was certainly a more effective weekend.

Q92 Mr Fallon: Professor Portes did make that comment on 31 January, so clearly it has moved on. In your own speech, one of the things you asked the IMF to focus on was beefing up its surveillance, but you used for that a wonderfully evocative metaphor of asking the IMF to turn into more of a cricket umpire, encouraging players not to sledge each other, and indeed encouraging players to walk. Is that realistic, is that really what you mean by making surveillance more effective; it is not the thing that umpires do any more, is it?
Mr King: I think they do and they also have quite a good relationship with the players. The IMF has no instrument to enforce its views. It can produce analysis, it can say what the consequences are likely to be of a given configuration of policies, stressing the uncertainties, but it does not have any instrument. Nevertheless, I do not think that fact should lead it to go off and find some other activity where it might have an instrument; its main purpose is to think about the global economy and the financial system. What it can do is bring people together when they want to be brought together; you cannot impose that on them. I think we have seen over the last 20 years that there are periods when there are serious imbalances in the world economy, when the various players—big players in the world economy—want to come together. We saw that in the 1980s when the G5 and G7 were set up. We saw two years ago at Boca Raton—I was there—the G7 sat round the table and said, "We're the wrong people; we need other people in this room." It is very difficult to do that when it becomes a bilateral argument between the US and China. I think that the IMF can do two things. One is that it can be the neutral chairman of a group brought together to discuss these questions. There. There is no doubt there is a demand for that. We need to know what policies other countries are likely to follow. I was very surprised at the weekend to discover that when we had a special session organised by the Fund on the imbalances, although there was nothing new to say about the imbalances in terms of analysis, we had all read it many times before, the people round the table wanted to talk to each other and they wanted to hear what other people thought about it—did they share the analysis of the Fund? So bringing people together and providing that objective analysis which people will respect as being independent of any of the parties to these imbalances I think is a very valuable role. From time to time the demand for it will be larger than at other times. When the world economy is fairly quiescent and there are not any significant risks out there, I suspect this will not be perceived as being a very important or major role. That is not bad, in my view, let us let things just carry on. When the imbalances look as if they may start to unwind, I am completely confident that the major players will want to talk to each other. We see that the US and China have a lot to say to

each other. It is better if they can say it to each other in a technical form, when the policy-makers are there, without too many cameras. With cameras. Withthe benefit of the Fund's analysis, they can try out ideas on each other and actually discover what the other's views are. That, I think, is a valuable role, even though the Fund does not have a particular instrument to use.

Q93 Mr Fallon: The Managing Director, in his Medium-Term Strategy Report, wanted more emphasis on the original goal of surveillance, which was assessing the consistency of exchange rate and macroeconomic politics with national and international stability. Should that still be the object of the surveillance?
Mr King: I think it has to be broader than that. If you look at the IMFC communiqué from the weekend, you will see that one of the four points in the four-point action plan adopted by the IMFC adopted was to make sure that countries realise that they did have responsibilities to each other and that there needed to be a restatement of their policy frameworks, not just in the area of exchange rates, but also in the area of monetary policy and fiscal policy. You cannot think about exchange rates in isolation from monetary and fiscal policy and I think one way to make more of a success of the debate between the US and China is, in fact, to see it in a broader context. I think everybody now is recognising that fact. The The issues of multilateral surveillance and consultations and the questions that the Fund will focus on are not just a question of exchange rates but go broader than that to the entire spectrum of the three main parts of macroeconomic policy.

Q94 Mr Fallon: Because they go broader than that, presumably it is more and more difficult for the Fund actually to start defining what a suitable exchange rate should be for a particular country?
Mr King: I do not think the Fund should say "The appropriate exchange rate is X." What the Fund should be saying is, for example, if a country wishes to have a fixed exchange rate it is entitled to that choice, but it cannot then turn round and claim that also, at the same time, it wants to control its domestic inflation rate; it will not be able to do that. Indeed, if it tries to intervene in the foreign exchange market to prevent the domestic price level adjusting, what it will be doing is trying to distort real exchange rates. It is very difficult to think of the world economy operating properly, in any market sense, where countries try to influence or distort real exchange rates. The Fund can just draw up the consequences of sets of policies and it can give countries choices. I do not think it makes sense for the Fund to say to a country "You should do this, that and that," in terms of very specific details. What it can point to is the consequence of its current fiscal framework or lack of commitment to a fiscal framework, its current approach to monetary policy and its exchange rate framework. Countries can then draw their own conclusions and make their own decisions. It is not sensible to repeat what happened with emerging markets in the 1990s with developed economies now. The Fund will not succeed in doing that. What it can do is really help countries, encourage them to speak to each other by debating the Fund analysis. That will bolster their determination at home, when they get back to capitals, to do something which makes sense in the medium term and they will make their decisions. Unless they are committed themselves to those decisions, just doing something because the Fund says it is a good idea will never really work.

Q95 Mr Fallon: This is talking to the team captains in the hotel after the first day's play?
Mr King: Or indeed before the play begins. And those talks can be valuable.

Q96 Mr Newmark: I would like to turn to contingent financing for crisis prevention and debt restructuring. I have a particular interest in that since I did corporate restructurings before I came in here last year. The Managing Director's Report on implementing the Fund's Medium-Term Strategy discusses a high-access, contingent financing arrangement. Do you think this is intended to replace the Contingent Credit Lines?
Mr King: Yes; but I think there are differing views in the international community about whether this is a good idea or not. On the one hand, you can see the attractions of trying to encourage countries to adopt sensible policies before they need to rush into a borrowing programme; to say to them, "If you follow the right policies now, we'll say that you will have access to a certain amount of finance and you will have to wait until a crisis to be eligible for borrowing." On the other side of this is the view that this is still harking back to an era in which we were implicitly encouraging countries to borrow foreign currency, thus running the risk of a future need of an IMF programme. I think the real uncertainty in all this, which has not been resolved, is whether it is possible to create such a contingent facility in a way which genuinely convinces people that the Fund will not then be rather lax in allowing that to slip over to an Exceptional Access programme if countries perform badly and do not meet the conditions but get into a crisis. I think there is a real worry about that. One of the big successes of recent years has been the attempt to enforce the Exceptional Access Framework. It is not ideal, there have been cases where the Fund did not comply with it completely, but in my view it is very, very important to demonstrate that the Exceptional Access Framework is taken seriously. By which I mean that if countries decide to demand a much bigger loan than three times their quota, a big loan, and cannot satisfy the Fund that their policies have a sustainable path for their debt then the Fund should not be lending. In the past, particularly in the case of Argentina, but not just Argentina, I think our view was, and we said so at the time to the Fund and to

other G7 countries, that it does not make sense to lend money in this situation because the policy framework against which we are lending is not sustainable and that, at some point, the country will not be able to repay its debts.

Q97 Mr Newmark: My understanding of this whole framework though is that you are not dealing with those, frankly, at the bottom end, you are dealing with those in the middle which have some sort of history of stable macro policies, sustainable debt, transparent reporting, and so on, that they have fallen, temporarily, sort of off a cliff and you are there to help them out?
Mr King: Certainly that is true and I do not want to dismiss that as a reasonable case for such a facility.

Q98 Mr Newmark: Effectively, you are not saying it is a junk, debt-rated country?
Mr King: No; absolutely. Taken at face value, there is a perfectly good case for that facility. The argument against it is not an argument on grounds of substance in those circumstances, it is a political economy concern that, in the past, the Fund has not shown itself to be as disciplined and rigorous as it might be in implementing what it said *ex ante* were the rules of the game. Mr Salmon is one of the experts on this.

Q99 Mr Newmark: The Contingent Credit Lines were never drawn on and why do you think this was, and what can be done to make the new proposals by the Managing Director more successful? If you could tie the two together that would be helpful.
Mr King: I will ask Mr Salmon to answer that.
Mr Salmon: Your last question anticipated what I was about to say. The issue is a design issue and the failure of CCL to attract any customers shows the problem. You have to balance, on the one hand, safeguards for the Fund, how you make the entry criteria sufficiently tight so that only countries which have adequate policy qualify, versus benefits to the countries in the first place. They could not get the balance between those two things right with the CCL. The latent demand from some of the EMEs for this type of facility has continued, and so what the MD has said is "we will have another go to see whether we can get round these design issues". I think it is an empirical issue: can you can get, on the one hand, sufficient benefits versus sufficient safeguards for the Fund on the other hand, so that actually the set of countries which will want to use the facility is bigger than the nil set The Fund will work through the summer on these issues. I think our attitude will be, very much, looking at the detail of the proposal, to assess if the Fund got the trade-off right? We will reserve judgment until we have more details.

Q100 Mr Newmark: It is still work in progress?
Mr Salmon: The strategic review sets the direction but it does not provide details, so we have to see that detail.

Q101 Mr Newmark: My next question is to do with sovereign debt reduction mechanisms. In April 2003, the IMF concluded that proposals for a Sovereign Debt Restructuring Mechanism were not feasible but that work should focus on improving orderly debt restructuring. What progress has been made in this area and what role should the IMF play?
Mr King: Let me talk about the general part of this and then I will ask Chris to comment on the more recent progress. The Bank of England was heavily involved in this because the Bank of England and the Bank of Canada did some joint work, which proposed that it was necessary to take seriously the development of mechanisms in which the Fund would sanction debt restructurings. An orderly debt restructuring was something which we had to be willing to contemplate because it was better than a completely disorderly restructuring, which is of course exactly what occurred in the case of Argentina. It goes back to the question of debt sustainability. There will be moments when a country finds itself so deeply in trouble that it is simply implausible to imagine that it can pretend that it will be able to repay its debt without some serious restructuring. At that point it is better to recognise that fact. We found it immensely difficult to persuade some other G7 countries, particularly the Americans under the Clinton administration, of that. Their strategy was to grant much bigger and larger loans to those countries so the amount of debt just escalated. In the end, as in Argentina, it was inevitable that default occurred, and it did. We feel that it is necessary to recognise that at some point such a restructuring might occur. It is not the job of the international financial institutions to bail out the country. What that means, in effect, is not bailing out the citizens of that country—they are the ones often who lose, because they are the ones who have to repay the IMF. It is bailing out the large western financial institutions which lend to the emerging market countries. They were the ones who felt they could lend, because in the end they might well end up lending not to the country concerned but to the G7 or to the IMF. If you were lending to that group of countries, that was a very different prospect. The moral hazard implied in these potentially large programmes and the unwillingness to recognise that debt restructuring might occur was very important. Anne Krueger of the Fund proposed a Sovereign Debt Restructuring Mechanism.

Q102 Mr Newmark: Based on Chapter 11 in the US bankruptcy code?
Mr King: Based on, broadly speaking, the principles of Chapter 11. The difficulty with it is not the difficulty of thinking of a mechanism but that it would require legal changes and changes to the Articles of the Fund. Those would require ratification by all member countries. It was something which clearly was years away and might never have occurred, and indeed that was the pressure of many of the Wall Street financial institutions.

Q103 Mr Newmark: Is not the concept of applying, effectively, private sector practice of Chapter 11 something which, in your view, does make sense, if one can get through the log-jam of the political process?

Mr King: It does, and in fact I think we saw one example of that in Korea. It It was not so much a debt restructuring as a debt rescheduling. When When Korea got into financial difficulty, I think we were all convinced that this was genuinely a liquidity problem; it was not an issue about Korea's ability to repay but it needed some time. In the end what happened was essentially that Korea called a temporary halt, a standstill, on payments to creditors. It brought the creditors together and within a very few months was able to start the payments again, but it needed that temporary period to call a halt. That sort of standstill is a perfectly reasonable thing to do, in certain circumstances. Lenders. Lenders must recognise that there will be circumstances when that occurs. That is part of the implicit debt contract, and I think it is important that be recognised to be part of sovereign debt as well. One way you can try to prevent that happening in practice is to go right back to when the contracts were signed. That is the purpose of the Collective Action Clause in bond issues and it is something which bond issues in London have recognised for a long time. Issues in Wall Street now have come more into line with that.

Q104 Mr Newmark: Because it deals with Qualified Majority Voting, it prevents individual countries holding out and you can get resolution quicker. It has been proposed by Daniel Cohen and Richard Portes that the IMF should act as a lender of first resort for developing countries, to prevent sort of a vicious spiral which a confidence crisis can unleash. Do you agree, and, if so, how would such a system operate?

Mr King: As I say, my own personal view is that I have reservations about encouraging the Fund to develop yet more facilities. If we go on like this, soon we will have more facilities than borrowers. I think it is more important for the Fund to focus on surveillance than borrowing. There are some technical issues that we might raise questions on. It is an idea that is worth discussing, but I am not convinced that, at this stage, it is the major need for the Fund.

Q105 Peter Viggers: The UK has commended the IMF's work in the field of money-laundering. To what extent should the IMF be involved in a fight against money-laundering or are there other institutions which will undertake the work more effectively?

Mr King: It is a very good question and I have some sympathy with IMF management when they are subject to criticisms very often that their budget keeps expanding and yet suddenly find that each time there is a meeting they are asked to take on more responsibilities. I think the main work in this area has to come from finance ministers. John Snow, the US Treasury Secretary, made that clear in an article he wrote recently. Of course, the IMF is a useful forum for bringing together finance ministers. Again, I think perhaps its real role is—and it is one it has played quite effectively—to bring together groups of finance ministers from the relevant countries involved in a wide range of activities which encompass money-laundering, on the one hand, and actions to make it more difficult to finance terrorism, on the other. These are not operations which the Fund itself can easily carry out but it is a forum within which the finance ministers can discuss joint issues, questions of communication and share information. It makes it easier for those in national capitals responsible for those questions to work with their counterparts abroad.

Q106 Peter Viggers: Turning to surveillance, do you think that the recommendation in the new Managing Director's Report, confirmed in the Communiqué, go far enough; are you satisfied with the upshot of those discussions?

Mr King: I think this was a very big step forward at the weekend. There was nothing in any previous discussions to compare with this quite clear four-point plan which the IMFC Communiqué makes clear. I think the real task now is implementation, and I think that what we saw at the weekend was a very determined Managing Director who was quite clear that he wanted to move on the multilateral consultations sooner rather than later. I think the proof of the pudding is in the eating. I think, in terms of putting in place the commitment and support to the Fund by the member countries, through its senior group, the IMFC, is very important. All member countries, through the IMFC, signed up to this four-point plan. I think that is important, and the Managing Director now has the authority to take it forward.

Q107 Peter Viggers: You have commended the Independent Evaluation Office for its work in overseeing activities. Do you think that the IEO is properly structured; does it need to be changed in any way? Just for a different point of view, would another international organisation, such as the OECD, be well placed to carry out an analysis of IMF's work?

Mr King: I think the IEO is the right body. It has got a very clear remit to comment on the Fund and it has demonstrated, so far, a willingness to be very frank and blunt about the failures or shortcomings of Fund programmes. I think that is a big question to ask; would they be frank? It is not easy for an organisation to be as open about its shortcomings in something as controversial as the programme to Argentina. I think the Independent Evaluation Office did a really first-rate job, so I think they have proved their independence and they should be encouraged. The OECD should not be asked to comment on the IMF; they have got their own remit and role. I do not think they should be trying to copy what the IMF is doing, they should be focusing on structural questions: microeconomic policies, the questions which determine the long-run development of productivity in member countries.

There is enormous benefit to be had from the peer review and exchange of ideas about those policies and experiences in each country, with different policies. That is what the OECD is for. It is not there to deal with the global macroeconomic policies and imbalances, which is the task of the IMF.

Q108 Peter Viggers: What role is the IMF playing currently, in terms of monitoring the level of financial risk within the system, and does this impact on the UK authorities' activities in this area of monitoring financial risk?

Mr King: The IMF has devoted more resources in recent years to looking at the risks in the international financial system. It is not a group of regulators or supervisors so it tends to look more generally at risks to the system as a whole. I suppose one can think of their role, in looking at risks, relative to that of the Financial Stability Forum or groups of supervisors, as analogous to the Bank of England's role in looking at financial stability generally, in contrast to the FSA's role of looking at individual institutions. I think they have done a very good job in trying to integrate the analysis of major economic shocks to the world economy and what that might do when transmitted through the financial system; does the financial system exacerbate or mitigate the risks caused by macroeconomic shocks? The Fund has, for example, contributed to the debates about about the much greater range of new financial instruments, particularly in the debt field. On the one hand, the new instruments offer opportunities for greater risk-sharing and mitigation of the risk. On the other hand, they also make it easier for people to take more risk if they wish to do so, so that might exacerbate an economic shock as it was transmitted through the financial system. I think the Fund have done quite a good job in this area. I think that its focus though has to be on the economic consequences, not the consequences for the financial sector. The IMF's role is to think about the position of economies and what is happening in the global economy; that is what it needs to focus on. From that perspective, what I suggested in the speech I gave in February was that the particular focus of the Fund should be on the balance-sheets of countries and financial sectors. It is the structure of a country's balance-sheet which really determines how these economic shocks are transmitted, not just into one country but from one country to another. That really is the focus of the Fund.

Q109 Peter Viggers: This Committee has taken two different kinds of evidence on whether the IMF should be involved in the lecturing on free markets. Do you have a view on this?

Mr King: I do not think the Fund is going to get very far just by lecturing people. It should be in the business of explaining things and letting people draw their own conclusions. That is where,I think, the Fund will have its biggest influence. I think you can see, from the demonstrations against the IMF, many of which bore no relationship at all to what the Fund has done, that the perception in many countries is that the Fund has gone in and lectured people and told them what they had to do. That of course is not true. What they have done is say, "If you would like to borrow this large amount of money then we think that, in order to be willing to lend you this money, these are the conditions that you should be prepared to meet." A lender is perfectly entitled to lay down conditions for a loan. I think the Fund needs to move away from that more. That is why I think, we should put less emphasis on lending, where conditionality is inevitable, and more emphasis on trying to explain to countries what the consequences are likely to be of the policies that are being pursued and to involve them in a discussion. When people see it laid down in a clear, analytical way they can draw their own conclusions. If you follow irresponsible monetary and fiscal policies you will get into trouble. There are occasions, I believe, when some politicians are willing to do that, because they have very short-term horizons, but most do not, most care about the future of their country and they can see what policies make sense. It does not need the Fund to lay down all this in such detail, but it can help finance ministers and central bank governors, when they come back home to national capitals, to help lay out the arguments and to persuade their own electorates. The lessons I think we saw with IMF programmes are that it is no good just to say "Here's a piece of paper; sign it," because if people at home are not convinced that these policies are the right policies to be pursued in the circumstances they will find ways round it. The conditionality will not be met. It is a question of winning hearts and minds, not a question of telling people what to do.

Q110 Kerry McCarthy: Can I just pursue the question of conditionality. In the Managing Director's recent Report, there was a suggestion that there would be maybe a two-tier approach, that for some countries with strong track records there would be fewer conditions imposed. That seems to be contradicted slightly by what you have said, of a more general approach of winning hearts and minds and talking about the consequences rather than imposing conditions. Do you see that there should be a general approach which applies to all countries, or are you saying that there are some countries where it would be easier to implement that approach?

Mr King: No. Perhaps I was not very clear, I am sorry. Where the IMF is lending to a country there will have to be conditionality. You will never get a loan without conditionality. There is a question of how detailed that conditionality should be and I think the Fund itself has recognised that in the nineties it was probably too detailed on conditionality in some cases. It has since moved away from some of the detailed conditionality. It needs really to stick to the broad macroeconomic parameters; that is what matters. Whether there are tariffs on particular items or not is not a matter for the IMF, it is a matter for WTO and the country itself. The big, macro picture is what the Fund is concerned about. In terms of lending, there will be some conditionality but, I think the Fund itself agrees, less detail. The interesting development in the Fund is to say "What can we do for countries to which we are not lending? There are lots of countries to which the Fund is not lending; what can we do?" I have talked about the multilateral surveillance and consultations in terms of the big players in the world economy. There are other economies, small players, where the Fund has said, "Well, perhaps we can do quite a lot to help that country, provide advice, without lending money." One way of doing that is to introduce something called a non-borrowing programme, in which the Fund and the country work together to discuss the economic policy of that country in a context which does not involve borrowing from the Fund. I think that is one way of making the advice more available without getting into any detailed conditionality, or indeed lending.

Q111 Kerry McCarthy: As far as lending goes, do you see that there will be a flexible approach to conditionality in terms of the countries' track records?

Mr King: I think I would put it in a less detailed way. There is always going to be conditionality in terms of the broad macroeconomic framework, and I do not think that will be flexible in the sense of saying "Because you had a good policy in the past, we won't bother to specify a macroeconomic framework." The Fund will still need to do that, but it will be less detailed and less microeconomic the more macroeconomic it is.

Q112 Kerry McCarthy: Is the UK very much behind this move? There was the DFID paper recently on reducing conditionality. In terms of both the IMF and the World Bank, the UK's approach seems to be moving away from the stringent conditionality. To what extent are other countries on board, or is it something where the UK is trying to implement it on a bilateral basis; to what extent have we actually won the arguments, as far as the super-national organisations are concerned?

Mr King: As I say, I think, as far as the IMF is concerned, we have won the argument. They themselves have acknowledged that, certainly in the 1990s, some of the conditionality was too detailed. In terms of the development aspects of Fund programmes, lending to low-income countries, where there are specific issues to do with development, that is very much for the Treasury and for DFID and not for the Bank; we would not set out a policy position on that.

Mr Salmon: On this issue about conditionality, there was a review two or three years ago at the Fund where they looked at the need to streamline conditionality in response to the lessons of the 1990s. The conclusion reached was that it was important to focus conditionality on things which were macro-relevant, particularly on the structural side. There has already been a debate and an agreement that conditionality needs to be strengthened for mainstream Fund programmes. That was a conclusion which I think had broad support within the membership, so I think that debate has happened, to an extent, for the Fund at least.

Q113 Kerry McCarthy: In terms of the relationship with the World Bank, and particularly the support for low-income countries, do you think the balance is right at the moment, or do you think there are some cases where the responsibility should be handed over to the World Bank now?

Mr King: There is certainly a need to examine again the relative responsibilities. Indeed, the Fund and the Bank themselves have said that and they set up a working party with external representatives to examine precisely that question. I do not want to say what should be the outcome of that. I think it is very encouraging that both the Managing Director of the Fund and the President of the World Bank have come to the view that together they need to look carefully at the division of responsibilities betweenbewteen them and to make sure that there are not any unnecessary overlaps. I think that is a welcome development.

Q114 Kerry McCarthy: You said earlier that you thought there were enough facilities and there was not a need for any more, but indeed one has been set up, the Exogenous Shocks Facility. I suppose I am aware it is a facility which has been established but has not yet been called upon?

Mr King: No. This was addressed very much at the weekend. This is very specific. This is designed to help particularly poor countries who suffer from the consequences of big changes in oil prices. That is why some of the producers have contributed to it. That is very much, I see, part of the development nexus and I think those involved in the development side welcome this; it is a question of trying to help countries which have suffered from the big changes in relative prices in the world economy. That is for others to comment on. From our perspective, I thought one of the interesting aspects of discussing the big change in oil prices was that it took us right back to the points which in fact Keynes made when the Fund was set up as part of a system in which the countries with surpluses were treated symmetrically with the countries which had deficits. This issue of "symmetry", which has been a bone of contention ever since 1944 when the Fund was created, came up again at the weekend in the context of oil prices, where some of the oil producers said, "Why is it that everyone takes a great interest in our policies when the oil price is high but no-one seems to take any interest when the oil price is low?" What you see, when there are big changes in oil prices, whether up or down, is that there will be quite big changes in current account surpluses and deficits. We are seeing, with the increase in the oil price, that the oil-producing countries move into a large current account surplus, which is very big even though it is after China's. The rest of the world, by the laws of arithmetic, has to move into deficit. If the oil price were to go back to where it was not so many years ago, which was around 10 dollars—it seems hard to imagine now but it did, it fell from \$20 to \$10 in the early days of the MPC—then, in fact, the deficits would swing the other way. These are examples of imbalances, which are, if you like, good imbalances. Inevitably these are the result of movements in oil prices and you do not want to prevent those imbalances emerging initially and then gradually being unwound. It goes right back to the question of symmetry. Indeed, at the IMFC, one of the representatives of Africa raised the question, "Will this new, multilateral approach to surveillance enable us now, at long last, to have a discussion of these imbalances in a symmetric way?" The answer was yes. The whole point of this multilateral consultation process is to enable us to have a symmetric discussion of the surpluses and deficits and the imbalances rather than saying "Here's a country with a deficit, it's wicked, it must do something to solve its deficit." The US deficit is not the result of measures taken solely in the United States. It is a result of savings and investments decisions taken by people all round the globe. The same is true for China's surplus. You have to look more directly at the policy instruments and the policy frameworks, not just at the surpluses and deficits. Then you can point to someone and say, "You must do something."

Q115 Mr Breed: Is it not what we have learned really from the last oil shocks back in the seventies, that, the surpluses and the deficits, it is the pace of change towards the symmetry that you are looking at? If you have very quick use of the surpluses, whatever they are going to do with it, either invest it in petrodollars or spend it on development, it is the pace at which they do that. Whereas what we are looking at, at the moment, is that there are going to be surpluses brought up, there are going to be deficits, but we address that in a timeframe much longer, therefore you do not get the shocks within the world economic system which we had back 20 or 30 years ago?

Mr King: Very much so, because when the oil price moves by a great deal it is inevitable that the surplus of the oil producers will rise very quickly. It does not make sense then to tell them to undo it very quickly; you need a more gradual adjustment. Indeed, one of the interesting comments made at the weekend was that one of the oil-producing finance ministers said, "So why is it that people talk about petrodollars? They don't talk about tee-shirt dollars or bra dollars or natural gas dollars or dollars caused by movements in other commodities that are being traded. Can we have a more symmetric way of looking at this; let's do the analysis and think about it in purely economic terms. That is the way we should do it."

Q116 Ms Keeble: I just wanted to ask some questions about the UK's perspective on the IMF's strategic review. You have referred quite a lot to the fact that you see the key role for the IMF, moving forward, as being providing intellectual leadership, you said earlier, but also you welcomed the fact the budget would be reducing because you thought it concentrated minds. You said it has not got much in the way of policy instruments and then you said it should have boring people as well. How do you see it actually providing the intellectual leadership?

Mr King: I did not say you want boring people. You want outcomes to be boring. That is the objective in it. I think it is not just intellectual leadership, it is also the moral authority that comes from having, as happened last weekend, 184 countries around the world, through their elected members of the IMFC, agreeing to ask the Fund to carry out this function. That gives it a moral authority to call multilateral consultations, to report objectively and give its view. That is something which can be achieved only through a multilateral institution. That is why I think it is important. It is not an easy role to play because it does not have an instrument that it can move up and down at the behest of the Managing Director or the staff, or even by the Executive Board. The fact that it does not have an instrument does not mean, to my mind, that you say, "Oh, it's not much fun if we haven't got an instrument; let's go and play a different game altogether, where we can find an instrument." Instead of saying, "What would it be fun for the Fund to do?" the Fund should ask the question "What would be right for the world economy?". I think the Fund is the only body which can really keep its eye on the health of the world economy as a whole and how we are going to unwind gradually these global imbalances. That is its major task.

Q117 Ms Keeble: How then does it ensure that is carried through, because having people in agreement issuing a communiqué is one thing; looking through it, actually it poses some very tough political challenges? How do you make sure that the politics catch up the imbalance?

Mr King: You cannot make sure. If countries persist in creating serious problems then those problems will be there. What I would point to is the fact that when the imbalances are big enough, the countries themselves want to talk to each other. The US has wanted to talk to China, they have had discussions and negotiations. In the 1980s, the G5 and G7, which did not exist then, were created to give a framework within which countries could talk to each other; not necessarily formally to co-ordinate their policies but to understand what each other might be likely to do. If we are setting our policy, we need to know what the major players in the world economy are likely to do. It is a limited role, in one sense, and it may be frustrating to some, but if it works it is immensely valuable and important. There is no getting away from the fact that there are big players in the world economy and they will set their national policies according to their own interests. This is a way of trying to demonstrate to them that when it comes to the major issues of imbalances and exchange rates it is in the interests of countries to work together, it is not in their own interest to diverge.

Q118 Ms Keeble: If you are saying that what the IMF has to do is have leverage in the international discussions, what role does the UK play then, and in particular in ensuring that this changing role is

carried through? I think your own speech was actually quite influential in that, because it did widen the public debate around the role of the IMF.
Mr King: I think that is all we can do. We can contribute. Gordon Brown is the Chairman of the IMFC—very important role, and he played an important role at the weekend. I think we contribute in these ways. We should not try to say "Let's force our way into these consultations or meetings" "It's vital that we have a seat at a particular table"; that is not a very sensible approach. If people want us there because we have something useful to say, they will invite us, and our job is to make sure that people find our contributions helpful if they are not, we shall keep quiet.

Q119 Ms Keeble: What do you think are the prospects for change, moving forward; in particular, what is the impact of China on that and the fact that China will have the biggest economy in about, it is 20 years, is it not?
Mr King: It is a very big economy now. The weight that people attach to Chinese contributions and interventions in discussions is already very great; it plays a big role here. I think all we can hope to do is create a forum in which countries find it helpful to come together. I think we will benefit by having fewer television cameras around in Washington for the meetings, fewer press conferences for the press back home and more opportunity to sit and talk with people facing similar challenges in other countries, because many of the problems derive from the same issues. One of the experiments which took place this last weekend was that, before the IMFC meeting took place, there was a breakfast with only the 24 representatives from the IMFC around the table. It may tell you something about the bureaucratic nature of these meetings when I tell you that a breakfast was regarded as a major innovation, but it was. The remarkable thing was that actually it was very successful and people did talk much more openly and interactively about the problems in the world economy than ever they did in a large meeting, with lots of people at the table and hundreds in the background.

Q120 Ms Keeble: Can I come back just a little on that because there are some questions we have got here on the brief, which I think to an extent have been dealt with, about transparency and about information, and obviously having the media present, whilst some people do not like it, is actually an important part of ensuring that. Part of the success of your speech was that it did get into the general media and not just the finance media and that was really important. In your model, is there not a risk that you have a very nice economic debate, very intellectually satisfying, you issue the communiqué, then you say to the Americans, "You've got to deal with the deficit," which means budget cuts, which no politician likes, and you say to the Chinese, "You've got to deal with your surpluses," which means consumer spending, which is politically explosive in China. How do you bring those two worlds together to get obviously what you are wanting?
Mr King: You have to have both. I think it is a question of timing. Some of the meetings that might take place as part of multilateral consultations should be able to take place without the participants feeling under the pressure of immediately going out and facing the cameras. At the end of the consultation, which might take several meetings and maybe many months, the IMF should be under pressure, and the Managing Director has said he would do this, to make public the IMF's views on the outcomes. I think people will know that the IMF will have to make a public statement at some point. Nevertheless, they should still be able to have meetings where they can be frank and open with each other. I think that was the original purpose of the G7. The G7 has drifted into a situation in which the purpose of the G7 meeting is to issue a communiqué. This is the wrong way round. A communiqué might report on a meeting but you do not want a meeting driven by the question "What can we think of to put in the communiqué this time?" There have to be opportunities for having meetings where you are not committed to a communiqué at each and every meeting but where the Fund, at the end of this process, has to make a clear public statement of its analysis and its views on where the consultation has got to. It is rather like our MPC meetings. We do not allow the cameras into our MPC meetings because we want to encourage frank interchange across the table, but at the end of the process we do publish detailed minutes, 13 days later, which set out the arguments and the terms of the debate. If we allowed the cameras into the meetings you would not see as open and frank a discussion at the MPC meeting as you do get now. You can get transparency but it has to be designed carefully.

Q121 Chairman: There are cameras here, Governor, and I hope you are still being frank?
Mr King: I always try to be frank, Chairman.

Q122 Mr Gauke: Governor, first of all, may I say what a splendid tie you are wearing.
Mr King: I hasten to add, this is the tie of the All-Party Parliamentary Group on Cricket.

Q123 Mr Gauke: Indeed, and your address to that Group earlier this week was very much appreciated, by all Parties, and I think Colin would confirm that. If I may ask how the Bank reports on its dealings with the IMF; the Treasury produces an Annual Report, how does the Bank of England address this matter?
Mr King: In terms of communicating, we do it through that Report. That Report summarises the contribution of the Bank. We work closely with the Treasury on all the meetings leading up to the spring and annual meetings of the Fund and our work is reported in there too.

Q124 Mr Gauke: Do you think, as a general rule, that the Bank is as transparent as it might be, with regard to international organisations such as the IMF?
Mr King: We are here today, in front of the cameras, as the Chairman has reminded us. I think we could not be more transparent than that.

Q125 Mr Gauke: Fair enough. One issue which a committee of the European Parliament has raised is greater co-ordination at a European level in the IMF, in the sense that the US has got a percentage which gives it a veto; if you combined all the various EU countries together it would be enough also to have a veto. Can I ask for your views on that issue?
Mr King: I think it is important to distinguish between the European Union, on the one hand, and the euro area, on the other. In the context of any multilateral consultation on the world economy you would expect the European Central Bank to be one of the players, yet the ECB does not have a seat at the table of the IMFC. Why? It does not correspond to a country. This is one of the challenges to the euro area in the future. It needs to develop, on the political side, the way in which it can have common and shared representation. That has not evolved anywhere as quickly on the political side as it has on the Central Bank side.

Q126 Mr Gauke: Is that in respect of countries in the eurozone alone?
Mr King: Yes; just countries in the eurozone. They have their currency and the multilateral consultations will be about issues relating to the euro and the monetary and fiscal policies in the eurozone and the consequences for the currency. There is quite a good argument for suggesting that the euro area has to think quite hard and deeply in the years to come about how it is represented at the IMF. The same does not apply to the European Union, where there are countries with national sovereignty over their monetary and fiscal policy, and obviously in our case a different currency altogether. There may be a question about exchanging views to see whether there is or is not common ground on various issues to put forward a common European position. It could not be the case that the representatives, for example, of the euro area could possibly speak for the United Kingdom on monetary or fiscal policy; we have our own currency. I think it is important to distinguish between those two aspects of it.

Q127 Mr Gauke: Presumably, you think the ECB should be there?
Mr King: Obviously they should be there, but I understand the frustrations of many non-Europeans, which are that in a process of what is described as European integration and the creation of a single currency with a single Central Bank, the result is that more Europeans end up at the table rather than fewer. This does not seem intuitively obvious and indeed it has been a source of quite significant friction and frustration at all international meetings, whether it is the IMF or even the G7, and at some point the euro area will have to face up to this.

Q128 Mr Gauke: As far as you are concerned, there is a substantial distinction between those countries that are in the eurozone and those countries that are outside, as far as organisations such as the IMF are concerned?
Mr King: Yes, because the IMF, as some of the earlier questions indicated, is, first and foremost, about currencies and exchange rates, so what distinguishes members round the table is that they have their own currency and exchange rate. This is the challenge which faces both the euro area and indeed the Fund itself, which is that there is a group of countries which have one currency. That does not make representation easy. The arguments about pooling representation have some force, but they have force because those countries share a common currency.

Q129 Mr Gauke: They do not have a force when applied to us?
Mr King: No. They would have, if we were to join the single currency, but with our own currency, no.

Q130 Mr Gauke: Given that, is there room for much scope for co-ordination with other EU countries?
Mr King: Yes, there is plenty of scope and indeed we ourselves sit on the International Committee of the European Central Bank, because we are members of the system of European Central Banks and I am a member of the General Council. It is useful to have discussions about the questions and issues in order to help all of us evolve our view. Sometimes that view is very similar, in which case we can present a harmonised view. In other cases it is not, in which case we present our own view.

Q131 Mr Gauke: It is essential, whilst we remain outside the eurozone, which looks likely for the foreseeable future, that we must have a separate voice at the IMF?
Mr King: Indeed, and I do not think anyone would suggest otherwise.

Q132 Mr Todd: Can we turn to the issue of governance and accountability. You have given your opinions on the possibility of dividing the function of lending and the representation in that part of the IMF's role from, for example, setting out the accountabilities of the leadership of the IMF, where perhaps there might be a rather broader representation gulf. I think you have made the very fair point that lenders have a perfect right to set their own conditions and have a substantial say in those conditions. Do you want to add to that approach?
Mr King: No. I think that, in general terms, it is important that the Fund has a very clear sense of its own mission. It has, in the past, been less clear. I think the Managing Director has evolved now a very clear view. I think the membership too must have responsibility for ensuring that it understands the clear mission of the Fund and over recent years there

has been a tendency for groups like the G7, or even the IMFC at times, to say, "Well, here's a new problem we've thought of in the past six months, let's give another responsibility to the IMF." I think that does not make life easy for the Fund. It is very important that we maintain a very clear view of the core mission of the Fund and then to hold the Managing Director and his staff accountable for achieving that.

Q133 Mr Todd: Let me come back on the accountability issue. You disagree very strongly with the World Development Movement who told you that you were wrong in advocating increased independence for the Fund and more accountability within the Fund?
Mr King: I am not sure if they understood entirely what I was suggesting. To hold senior management properly accountable is something which I find it hard to believe they would disagree with. It is important to have proper accountability mechanisms and they must be accountable to the members as a whole. That is why I think that we need to make the Board, which represents all 184 member countries, an effective Board which is capable of holding the management accountable.

Q134 Mr Todd: Rebalancing the representation in decision-making within the Fund is based on decisions about quotas and there is a review with us currently. How do you feel that should be addressed?
Mr King: I think everyone accepts, and that came out of the IMFC communiqué, that there does need to be a change. The reason is not so much effect the day-to-day workings of the Fund.

Q135 Mr Todd: I think it conceded that there needed to be change; it did not say actually quite how people could do it?
Mr King: No, but it made it clear that the Managing Director had to bring forward concrete proposals at Singapore for that, and I would be amazed if we did not get some agreement at Singapore about at least a limited set of ad hoc increases in quotas. The main objective here, I think, is to deal with the perfectly reasonable questioning by many countries of the legitimacy of the Fund, when the quotas represent a rather outdated view of the world economy. Some change is important to ensure the legitimacy of the Fund. I would not expect this to make a dramatic difference, it is cultural, it is a question of legitimacy. It is not going to have much impact on the way the Fund works, because it is an organisation where people make their contribution, how seriously it is taken, how it affects other people, is not a function of their quota, it is a function of their clout and weight in the world economy. The fact that China has a small quota now relative to its calculated quota does not mean to say that people take China less seriously now than they would 12 months from now if the quota were increased.

Q136 Mr Todd: Would you extend that argument to discussion of the USA's quota and to their role effectively as having a veto in the organisation, in the sense that obviously no-one could ignore the USA's position in the world economy, regardless of precisely what voting weight can be given within the IMF?
Mr King: I think if the US were strongly to oppose something it would make it very hard for the Fund to be effective. We have seen that in the G7. If the US does not really go along with a proposal in the G7, the G7 tends not to go off in a different direction, and the G7 as a whole is the major block in the Fund. Countries do have enormous influence reflecting their status and position in the world economy, and the precise quota does not really influence that. That is not an argument against changing quotas at all, because it is of more than just symbolic importance. If there really is to be an institution where people have trust in the neutrality of the management and the fact that it will be objective in its analysis, it must be willing to change the quotas in line with the changing importance of countries in the world economy. It is important in terms of establishing the overall trust and confidence of members in the Fund, but if we had made quite significant changes in quotas I doubt that you would see that reflected in changes in decisions or attitudes, and so on.

Q137 Mr Todd: Do you think the discussion of the US's unique position within the IMF is really an artificial discussion and, in a sense, that everyone accepts they do have a unique position, however we choose to parcel out voting rights and powers within the IMF?
Mr King: I think that is largely the case and I think it would be much better to focus on, for example, something that is very important for governance, the debates on how the Managing Director is chosen. To my mind, this does not have anything to do with quotas or votes, it is to do with the determination of the membership to say, "Well, look, this time we really must put in place a process to ensure we have the choice of the best candidate."

Q138 Mr Todd: You have led me on to a question I was going to ask, which is about the process for appointing the Managing Director. Do you feel that procedure should be altered? Obviously I think it has already been accepted there should be a transparent procedure, but there are lots of procedures which can be transparent without necessarily producing the best outcome. What reforms do you think should be put in place to ensure that we secure a person with widespread acceptability, who may not be, for example, European?
Mr King: Indeed, and I think that what is most important is to put in place a process which is acceptable to the membership overall. It is not at all clear what the present process is. The most important thing is to write down what that process is before there is a vacancy. If you try to develop a process for making an appointment once there is a vacancy then you are in deep trouble, because the question of who the candidate will be is bound up

inextricably with the process. It is most important to put this in place now while there is no vacancy. I think this view is becoming more widely accepted. I think it is particularly incumbent on the European countries to make a reality of this and to say, if a vacancy were to occur, "No, we're not going to fall back on simply having a private European meeting and nominating a candidate. We will abide by the process and we'll put forward some candidates perhaps, but we have to go for the best person."

Q139 Mr Todd: Do you think the IMFC works effectively?
Mr King: Up until now I would have said it is one of those meetings, on a Saturday afternoon in a windowless room in Washington, when you would be sitting there thinking "Is anybody else outside the room taking any notice of this?"

Q140 Mr Todd: Is anyone inside the room taking any notice?
Mr King: Certainly I could be in lots of interesting places where it would be more valuable to be, but this last weekend was the first occasion, I think, where I felt genuinely that there was some real interaction among the people around the table and where we actually took a decision and did something useful.

Q141 Mr Todd: To whom or to what do you attribute the improvement?
Mr King: I think there were three people who played a very important role in this. One is the Managing Director, who really was determined to see a new approach to the running of the Fund. He has been very clear that he wanted to go ahead with the multilateral consultations and he drove this new approach through the IMFC. That is one. Secondly, John Snow, US Treasury Secretary, who in a very quiet but very determined way actually started to run with this under the US Presidency of the G7 in 2004, and under the US Presidency we made some progress. Under the UK Presidency last year, inevitably, because the UK priorities were on debt and development, the issue took a bit of a back seat, but again this spring John Snow, chairing the G7, ensured there was a lot of time to discuss it and he made very clear and forceful contributions, both at G7 and the IMFC. Thirdly, Gordon Brown, who as Chairman of the IMFC made sure that we did discuss the issues of multilateral surveillance and that we did sign up, all of us, to a new remit for surveillance for the Fund. It was actually a different meeting than many of the previous meetings and one where, probably for the first time, I thought this was a better way of spending that particular Saturday than any other previous Saturdays I have spent at these international meetings.

Q142 Mr Todd: One of the British innovations has been the introduction of the IEO and that gets a nod also in the weekend's conclusions as playing an increasingly important part in the surveillance of the effectiveness of the IMF's management. Do you have any qualms about the governance of the IEO in ensuring that they are genuinely empowered to question the capabilities and competencies and delivery of the Fund?
Mr King: I do not think it is a question of governance. I think they have shown that they can do it. I think it is a question of leadership, and we look forward, to see how effective the IEO will be under new leadership, I think it is a question of personal drive and leadership, and they have done it, the first Head of it was very effective and we hope we will see the same under the new leadership.

Q143 John Thurso: I would like to turn, if I may, to the general question of some globalisation phenomena, in particular to the relationship between globalisation and resources. It seems to me that, given some of the shocks we have had in the last century to the world economy, we are in a period of some relative stability, but that the big, potential fly in the ointment is resources, and particularly energy resources. I would like to ask a couple of questions, both how that impacts domestically and on the world scene. Turning to domestically, first of all, we have seen the problems of gas supply that we have had over this last winter; do you think that the UK Government should be seeking to secure supplies in some way, or is this something which can be left to the markets and to individual companies?
Mr King: I think I would want to draw a distinction between the UK position vis-à-vis natural gas and the more general question of resources in the world economy. There are steps which have been taken that in due course will make sure that it will be a perfectly reasonable in the UK to expect that changes in demand for gas would indeed be met by corresponding changes in supply. That may well be beyond next winter; it will depend on how quickly the link to the new pipeline to Norway opens up. More generally, I think one of the changes in the world economy, over quite a long period, has been a growing recognition by countries that prices are helpful, and we should not shoot the messenger. If the oil price goes up, rather than blame the oil price we should recognise this is a symptom of what is happening in the world economy. It is helpful, in a sense, that the higher price will help to discourage demand and encourage investment in new supply, so perhaps we should welcome that. There are messages which tell us that there are these big swings and there are genuine questions about issues such as security of supplies of something like oil, where it is very difficult, in the short run, to find alternative supplies of energy. That is very much a political question, not an economic one, so that is more for politicians than central banks, but I do accept that there are real questions about security of supplies. What I would say is that one of the roles of a body like the IMF is to be part of an approach of working together .The spirit behind the IMF was initially that the world had been through not just war but also protectionism and a deep recession, individual countries realised that pursuing their own national self-interest had not served the world well, some

form of working together, however ill-defined, was desirable. In 1944–46 with the IMF, it was thought to be fixed exchange rates—that was in a world of no capital movement. Countries were trying to find a way in which they could operate together, retaining national sovereignty over their own policy but recognising that there are spill-over effects of one country on another and trying to put in place a framework for enabling us to work together to resolve big conflicts. There is no simple instrument for the international institutions, nothing easy that they can do and clearly no track record of great success. Nevertheless, the Fund could enable countries to come together to talk about these questions. To hear the Saudi Finance Minister explain his policy, his approach and the problems that he faced and to get the oil-consuming countries in the same room, around the same table, listening and talking, is a lot better than people staying at home and making comments to camera which can be dismissive of other countries' problems. It helps people to recognise that we are trading with other countries and not just with some impersonal market force. I think there is some benefit to that but I do not want to claim it is enormous. I do think, however, there are cases where the breakdown of the international trading and financial system will be deeply damaging and in that sense, it is analogous to a central bank. When things are going fairly well no-one should take any notice, no-one should realise it is there, no-one need bother with it really. When things really go wrong that is when it matters that you have a well-run institution rather than a badly-run institution.

Q144 John Thurso: In your response there, and it is fascinating to hear you make that response, largely I agree with it, it seems that there is a basic assumption, if you like, that there is a system which is working well and that things start to go wrong in it and by coming together one can improve it. If you look at resources, in particular energy resources, and, say, the growth in China, I think in the 17th century it was the world's largest economy and it is projected to be back there within 20 years, or whatever it is, the massive increase in consumption of not just oil but steel, copper, every form of raw resource, I would have thought must be putting a very considerable strain on other economies and it is almost as big a strain as to be changing the system. Looking at it from an IMF point of view but looking at it also from a UK economy point of view, is that something which should be of major concern, and what can we be doing and should we be doing about it?

Mr King: It is certainly of major importance, but I think one of the great strengths of a body like the IMF is that it does not look at this in a piecemeal way by saying, "Oh, China's caused a problem because oil or metals prices have gone up." I went to a nickel plant in Swansea last week and the price of nickel has been rising rapidly. This has big effects for companies all over our country, so China is having a big effect. The great virtue of the IMF is that it can look at it in the round, so that, yes, the oil price has gone up, the prices of metals and other commodities have risen, but the prices of many of the other commodities that we import from China have gone down. The net result has been that over 10 years our standard of living has risen faster than it would have done had not China and India and other economies integrated into the world trading system. The whole point of something like the IMF is to pull off what is a very, very difficult political trick, which is to persuade the majority of our citizens that being integrated into a world trading system means that we are all better off, even though any one of them may simply see the adverse impact of competition in the world economy, because their company is laying off people if they are facing competition. Trying to look at this on balance and as a whole is most important; we have all benefited from the success of the international economy. In 1944, when Keynes and the others sat down at Bretton Woods they did so because of how much damage had been done by the collapse of the world trading system in the early 1930s and all the problems which flowed from that. Even though you cannot easily point to an instrument for the IMF, the fact that we have a way of drawing to everyone's attention the benefits of thinking about the world economy and our being integrated into it is of immense importance.

Q145 John Thurso: It seems to me that there is one aspect which may be new and outwith that thinking and that is the climate change agenda, in that for the first time we are actually looking at a bad, if you like, impact on the planet of our consumption of resources, and we are beginning to understand the need to measure that and to look at that, and our problem is how to keep the world economy going whilst, at the same time, tackling that. What do you see as the tensions between the need to ensure secure energy, both for the UK and for the world, and the fact that the UK wishes to be a leader in reducing the causes of climate change?

Mr King: Clearly there are trade-offs between what actions it might be sensible for the world as a whole to take, in dealing with climate change, and policies on particular forms of energy consumption. What is most interesting about this is that everyone must recognise that, although there may be intellectual disagreement about the right way for the world to approach it, nevertheless it is a world problem and not a national problem, and if we try simply to deal with this on our own we will fail. I think climate change is very similar to many of the other problems which the IMF faces, which is, here are examples of issues where we can all be better off if we work together than we can be if we simply go it alone. That does not give you the answer as to what we should do about climate change, and clearly there are genuine differences of view, particularly between the US and other countries, about what is the right strategy for dealing with it. What I think is accepted is that this is a global issue, in exactly the same way as the Americans at the IMF accept that the global imbalances are a matter for the world as a whole and not just for the United States or even the G7.

Q146 John Thurso: Is one of the challenges, therefore, that, for example, if we take the method in which we generate energy or consume fossil fuels, we might have a domestic solution but which would have not a great impact across the whole world? Therefore, if we look to China and India, we have to be looking to solutions which are non-consumptive of fossil fuels and help to lower world carbon emissions, which actually may be a different solution on an international stage from one we might be looking for on a domestic stage?
Mr King: If we look purely at our own self-interest, in a purely domestic sense, the impact that we can make on global warming is tiny, so you just ignore it on the grounds it will be too small. We are concerned about it, because we can see the problem facing the world, but it is one which can be tackled at only the international level, not purely at the domestic level. That is not to say that you cannot do something at the domestic level, but if you approached the problem purely from a domestic point of view you would not be giving very much weight to these global issues. Of course, that is exactly an analogy to the global imbalances. It is why, only when they become sufficiently serious and countries see that they are important, they are willing actually to come together and talk about it. I think we have pretty well got to that stage now on the global imbalances. That is why at the weekend I think the IMF did take this quite significant step forward in setting up the new framework of multilateral consultations to enable us to talk about all these issues. They are quite different from climate change but they have one, very big thing in common, which is the need to talk together internationally rather than approach the problem as a purely domestic one. Even if the United States did not care about the rest of the world, which is not true, but even if it did not, it would not make sense for the United States to think about the resolution of its own current account deficit solely in terms of domestic policies.

Q147 Jim Cousins: Do you not think, Governor, that despite all the very interesting and insightful things that you have told the Committee this morning the risks that imbalances will unwind in a chaotic way of their own accord are increasing rather than decreasing?
Mr King: I think it is very hard to judge. The risks are real. I am not sure whether they are bigger now than they were last year. I think you can argue that, if they were to continue for several more years, the risk of a major adjustment, which would be disorderly, would be greater, because they would be that much bigger. There are many different scenarios that you could imagine for how these imbalances would unwind. They could happen gradually over 10 years in fits and starts, with movements in the exchange rate, not all in one day, such that, after 10 years, we could look back and detect a gradual fall in exchange rates and unwinding of the imbalances. It is very hard to disentangle the underlying trend from what is going on at present. That is not to say that there is not also, at the same time, a significant risk of a sharp adjustment in exchange rates, but what we do not know yet are the consequences of that. We saw in the 1980s there was a very sharp fall in the dollar, which in fact did not have major consequences, at least for the developed world. It is conceivable that we could get big changes in exchange rates, which led to gradual adjustments of imbalances and, provided policy responds in other parts of the world, outside the United States, might well lead to a relatively stable adjustment. Certainly also you could imagine cases where a sharp change in exchange rates could lead to further financial instability and start to lead to a disorderly adjustment, which would be very costly and might involve recessions in some countries; that certainly is a possibility. It is very, very hard to judge the relative probabilities of these events. This was discussed at the special IMF seminar on Friday in Washington, and I suppose it is fair to say that the consensus view around the room was that the probability of a disorderly adjustment was less than a half, much less than a half, but nevertheless it certainly was not negligible. That is why I think there is some urgency to try to renew the efforts for these multilateral consultations.

Q148 Jim Cousins: Do you not think, in that context, that it would be wise of governments to consider how they could protect their people and their own labour markets and their own energy markets from the possibility of these shocks, without actually being protectionist? Indeed, if governments do fail to protect then the demands for much more overly protectionist policies are going to become very forceful?
Mr King: I think that is right, but I think that I would suggest, as the appropriate policy response to avoid getting into that position, trying to make sure that countries have suitable monetary and fiscal frameworks which allowed them to adjust policy when there was an external shock. I think it is important, in monetary policy for example, that if we can keep inflation close to the target, when we get some very adverse shock we can cut interest rates in order to cope with it. What you do not want is a situation in which countries have allowed inflation to pick up and find that when there is an adverse shock their scope for relaxing policy is constrained. Equally, on the fiscal front, one of the main arguments for having a sensible fiscal framework is to ensure that if you are cautious fiscally in the good times then you have got room for manoeuvre in the bad times. Again, if you start with too high a fiscal deficit you do not have room to make that adjustment when the bad time occurs. I think it is not a question of protection, and I am not quite sure what you meant by the "protection" there, but I would suggest putting in place a macroeconomic policy framework which would give countries an opportunity to respond to shocks when they occurred. I am not sure if that is what you had in mind?

Q149 Jim Cousins: It is, but I am left with the feeling that in the end it may be Hugo Chavez rather than Gordon Brown who is offering the right framework

of political responses to these situations; not "the right" in terms of how we would like it to be but the right framework in terms of how it turns out?
Mr King: Can you say what it is about Hugo Chavez that you think is more attractive than Gordon Brown?

Q150 Jim Cousins: That I think is an interesting matter, for another occasion. I do actually have views about that.
Mr King: I would love to hear them.

Q151 Jim Cousins: Yes, indeed, and I would love to share them with you, but really on another occasion. What I mean by that is that the dramatic, populist, immediate political reactions to events and the attempt to wind things up and screw things out may become very, very attractive political mechanisms. That is really what I mean.
Mr King: In addition to a parliament of people who do not respond like that and who continually try to talk to people about the long-run benefits from open markets and integration into the world economy, I think the only defence we have against that, is for policy-makers to ensure that we try to maintain a stable economy and full employment in normal times to demonstrate the real benefits from a market economy. For example, if we had 10 years of high unemployment in Britain then I think it would be much, much harder politically to resist the populist argument when a shock came along. The fact is that over the last 10 to 20 years we have had a stable economy and falling unemployment, at the same time as lots of companies have closed down, as a result of competition with the world economy. New companies have started up. We have seen massive industrial change in Britain in the last 20 years and yet it has not led to mass unemployment, it has not led to economic instability. We have been able to cope with that adjustment. Moreover, the fact that we have made those changes in our industrial structure has led to faster growth in our standard of living. If we can demonstrate that, over a period of time, that is the best defence we have got against someone using the populist card.

Q152 Chairman: Governor, I have just a few questions, in the wash-up, which are important for our inquiry. Evidence given to us, or submitted to us, has suggested that the IMF is developing into a ratings agency for private members and policy support instruments could be seen in this light. How accurate is that assessment?
Mr King: Certainly it should not be seen as a ratings agency, it is not there to take responsibility; otherwise, if it does take on that responsibility, it will come under great pressure to continue to lend to countries when they get into trouble. Perhaps I could ask Mr Salmon to comment on this, because he has been involved in some of that debate about the Fund.
Mr Salmon: On the particular policy support instrument, as I understand it, its main focus is low-income countries, which do not have a lot of market access. It is something which the community itself wants so the Fund can signal if a country is following sensible policies to the rest of the international community which has dealings with those countries. I am not sure there is much of an overlap between the Emerging Market Economies, which care about their ratings, and the countries for which PSIs would be relevant. That is my sense, but I need to go back and look in more detail at the PSI and who it is designed for to give you a fuller answer[2].

Q153 Chairman: If you would write to us on that, that would be good; is that possible?
Mr Salmon: Yes.
Mr King: Yes.

Q154 Chairman: Given that the 13th review of IMF quotas is currently upon us, what reforms of the IMF's governance structure would you like to see? Would one possibility be that surveillance issues are dealt with via "one member, one vote", which would reduce the scope of one country to affect the analysis?
Mr King: I am not sure if voting is directly relevant to what I think of as successful surveillance qualifying, because what we agreed at the weekend was this new approach, of multilateral consultations, switching the focus fromfrom bilateral surveillance, at least for the major economies in the world, more towards the spill-over effects which those economies have on other economies. What I think is more relevant is ensuring that the Fund has a clear, independent voice but that we hold them accountable for it, so they have to think very carefully about what they say. In that sense, it is not a question of voting. Voting I think is more important when it comes to changes in the financial structure of the Fund, or indeed the lending programmes. Typically, with lending programmes, the management does it and asks the Executive Board *ex post* for agreement to it. Again, I just do not see voting as being a major factor in day-to-day decisions. That is not to say that a proper reform of quotas and voting rights is not important, it is, because that produces the legitimacy of the institution.

Q155 Chairman: The framework that you have outlined this morning indicates that there are big changes required in the IMF. The lending element I imagine has gone down anyway, with Argentina and Brazil having repaid that. With these changes, how can we ensure an adequate income stream for the IMF?
Mr King: That is a very interesting question. I will ask Rachel to comment, in a minute, because she works closely with the deputies on the development of these ideas. Clearly, the peak lending of the fund was over 70 billion SDRs, now it is down to 25 billion. Their income has come from a turn on the difference between borrowing and lending rates, so it is going to shrink quite considerably in the next three or four years, and that will focus minds, undoubtedly. I think, at this stage, it makes more

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sense to focus on the question of what the Fund is for and what do we want it to do. Once we have clearly answered that question then we can work out how best to finance that role. Rachel is closer to some of the more detailed discussion than I am.
Ms Lomax: I think there is quite a lot of thinking still to do on this; there are a lot of possibilities. You can move towards something which involves annual subscriptions or contributions of some sort; there are lots of disadvantages in doing that, in terms of assuring the Fund a steady flow of income which is not too dependent on political pressure. Or you could give the Fund an endowment, which would generate an income over a period of time. Or you could do something which I guess is more akin to the kind of framework we have got for the Bank of England, which is a sort of medium-term financial framework which you look at every five years or so and maybe have some form of non-interest-bearing deposit. I think there are a lot of possibilities that people still need to discuss. As the Governor said, it is some way down the track. The important thing is to get some of these more high-level issues resolved.

Q156 Chairman: Maybe one suggestion, would it be possible to levy, say, a basic surveillance fee, further to detach funding quotas and lending from the surveillance function of the IMF?
Ms Lomax: Basic fees; yes, fees is another possibility.

Q157 Ms Keeble: Throughout this morning's session there has been repeated reference to the way we do things in the UK, in terms of the financing, in terms of the models for working, in terms also of the kinds of economic frameworks. Do you actually see, if you like, the Bank of England model as being an important one in the IMF? Do you think we have a particular role to play there? Do you think they should look at what we are doing for a model of how to move forward?
Mr King: I do not want to put it like that. What I will say is there are certain core issues which are relevant. The thing I do believe in very strongly is that public sector institutions should have one very, very clear core mission. It is very important to know what that is and it is very important for everyone in the institution to know what that is in order for it to be effective. The debates we have been having about what the Fund is for are very important. Secondly, you need a very clear framework for accountability of the people who run it. Thirdly, in terms of governance, you want something which is transparent and not vastly bureaucratic. Those are the three key principles I think I would draw out, from our experience.
Ms Lomax: I think they are actually good, general principles of public sector reform which go wider than central banking; they have been applied very successfully to central banking, and not just in the UK. I think that Governor Dodge, of Canada, gave a very interesting speech recently, in which he was drawing an analogy between the lessons that we have learned from central banking and how they might be applied to the IMF.

Q158 Ms Keeble: Do you think Britain has particular lessons to give on this?
Ms Lomax: Central banks have lessons and I think we are regarded as a good example of how you do modern central banking, a very good example.

Q159 Chairman: Governor, just the last point. What certainly I have taken out this morning is that in a global economy the IMF is going to be of increasing importance and I think that is threaded through the responses you have made. To take John's and Jim's points on globalisation, one of the aspects we want to look at is the type of policy responses that the UK will meet in this increasingly globalised world, but the issue of protectionism has been mentioned. I met German politicians the other day who visited us here and I got the feeling there was a much more negative approach to globalisation in parts of Europe than there is here, and indeed seven of us went out with the Foreign Secretary this week, I think he reinforced that particular point. In a bigger inquiry on globalisation, what advice do you have for us, in general terms; yourself and Rachel, just before you leave?
Mr King: I am tempted to say, pat yourself on the back. What I mean by that is that, more than any other country in the world, Britain has resisted the temptations of protectionist, popular sentiment and has seen the benefit of integration into a world trading system. It is easy for a central bank or a central banker to talk about the benefits of an integrated world trading system and for an economist to talk about the benefits of free trade. It is much harder for politicians to do that, faced with constituents who may have lost their jobs, and it is hard for trade unions and it is hard for businesses. Yet Parliament, on all sides, and the trade union movement in this country and the CBI have all not tried to play the protectionist card. I think they deserve enormous credit for that. I think it reflects the fact of our own experiences, that we went through very difficult times, particularly in the 1970s, and we learned that trying to hold back the stem of change and progress was counter-productive. As I said in one of my speeches, if we had the same industrial structure now as we had 30 or 50 or 100 years ago, we would be a lot less well-off. The long-run lesson is that, as a country, we are much better off by embracing change and trying to manage it than we are by trying to resist it. In the end, that does require leadership, it requires political leadership in Parliament, in the trade unions and in business, and we have been fortunate in getting that. There are not many countries in the world where you can say that.
Ms Lomax: I must say, I agree with that. I was thinking, over the weekend, when we were in the States, notwithstanding the fact that they have got a fabulously successful economy, it is quite striking how much more edgy the political debate is there about these issues. I was talking to some of my American counterparts about it. I simply cannot understand really why, and some of that must be to do with the political system, I think; the economy alone does not do it for you.

Mr King: Please do not give up the effort to persuade many of your constituents.

Q160 Chairman: No. Those points have come across to us. Actually when the Committee visited America's realms the same points were made on that. Governor, you and your colleagues, we are delighted with your evidence this morning. It has been very, very helpful to us. Can I say to you that this is not a windowless room, so maybe next time you come along I will get the blinds put up so you have got a nice view while you are giving us good and frank evidence.

Mr King: That will be tremendous. Thank you very much.

Chairman: Thank you.

Thursday 11 May 2006

Members present:

Mr John McFall, in the Chair

Mr Colin Breed	Kerry McCarthy
Angela Eagle	Mr Brooks Newmark
Mr Michael Fallon	John Thurso
Mr David Gauke	Mr Mark Todd
Ms Sally Keeble	Peter Viggers
Mr Andrew Love	

Witnesses: **Rt Hon Gordon Brown**, a Member of the House, Chancellor of the Exchequer, **Mr Jon Cunliffe**, Second Permanent Secretary, Macro Economic Policy and International Finance, HM Treasury, and **Mr Tom Scholar**, UK Executive Director, IMF and World Bank, gave evidence.

Q161 Chairman: Chancellor, good morning to you and your colleagues. We are very grateful for you coming along to speak on this issue of globalisation. Could you introduce yourself and your colleagues for the shorthand writer and then make your opening statement?

Mr Brown: Yes, thank you very much. Jon Cunliffe, who is the head of the macroeconomic and international side of the Treasury, and the Second Permanent Secretary, Tom Scholar, who is our Executive Director on the Board of both the IMF and the World Bank. If I may say so in advance, last month in Washington at the spring meetings we did agree to make 2006 a year of reform for the IMF itself and for the international economy. Faced with the changes that are taking place in the global economy and with protectionist sentiment rising as well as the problem of oil prices, we resolved to make the IMF more fit-for-purpose and more able to address the challenges that are quite different from those of the 1940s when the IMF was created. We agreed that the IMF should focus more on crisis prevention as well as on crisis resolution, and we agreed also that there should be a new focus on surveillance. The International Monetary and Finance Committee set out a new framework for surveillance and, therefore, for the future of the role of the IMF. The IMF should set an annual remit for its work on surveillance; it should identify the risk to the global economy and ask the Fund to report on them and the individual or collective policy actions necessary to address the challenges ahead. That would be what the IMFC would do at its meetings. Multilateral surveillance would be strengthened. The IMF should not only now assess risk to individual countries but also focus on the spill-over effects and the linkages between individual countries' policies and the global economy. Member States should reaffirm the commitments on which IMF surveillance is based and this should include that there be surveillance of monetary, fiscal and exchange rate policy. There should be a strengthening of the independence and the transparency of surveillance work and of the role of the Independent Evaluation Office, and we have put quite specific proposals about the independence of the surveillance work from the other activities of the Fund. We also agree that, to reflect changing times, a country's voice, votes and quotas should reflect the changing international economic weight of these countries in the global economy. The IMF's effectiveness and credibility should be safeguarded and its governance further enhanced to ensure a fair voice and representation for all its members. Fundamental changes in the Fund's governance, therefore, needs to be addressed and we must respond to changes in the structure of global growth and allow increasing involvement in the decision-making process of emerging and developing countries, who are the most under represented today. In Singapore, when we meet in September at the annual meetings, we will now make concrete decisions on how to tackle this, and so the annual meeting in September, which this discussion prefigures today, will be indeed a reform summit both for the IMF and for the structure of economic management in the international economy. Thank you, Chairman.

Q162 Chairman: Thank you, Chancellor. In your foreword to the Treasury's annual report and its dealings with the IMF in 2005, you called for the IMF to become independent of governments in a similar manner to the Bank of England. How do you see this working in practice and what benefit will greater independence bring to the IMF? Do you mean this solely in relation to surveillance or greater aspects?

Mr Brown: I think a lot of this goes back to the original structure of the International Monetary Fund. When it was set up there was one set of proposals, that were actually from Keynes representing the British Government, that suggested the IMF be more like an independent central bank, and there was a second set of proposals that suggested, given the politicisation of the world economic powers, that you would essentially have a political board that would be responsible for the management of the IMF. I think, because the function of the IMF is changing, and it will be increasingly about surveillance instead of dealing with the balance of payment problems of individual countries—and that function of surveillance is best carried out by people who have not the direct responsibility of making allocation decisions about how the resources of the IMF are used—that we should move towards a situation where there is a separate management or a separate structure for the surveillance work of the IMF, and that, I think, is a long-term objective. It may be, of course, that some of the financial allocations that are made by both the World Bank and the IMF could then be brought together, but that is another part of the equation for later. Generally, if we are right that crisis prevention is where the IMF should be, surveillance, transparency, reporting on what is happening in individual countries and the spill-over effects of what they do to the world economy are crucial to that. But we need a new structure in which surveillance can take place where the people who do the surveillance are more independent of the political process in being able to make the judgments.

Q163 Angela Eagle: Chancellor, what opportunities do you think are presented by this vision that you have outlined in the run up to Singapore? Could you give us some idea of how you would see the international financial architecture, particularly the IMF, being structured and actually existing if there is a total success for your vision?

Mr Brown: The first thing, I think, is quite practical. We have got to bind in and give representation and voice to large numbers of countries who are increasingly a big bloc in the world economy who are certainly under represented. There is no doubt that the emerging market countries and developing countries do not have the quotas and the voice that their present economic weight should allow. I think, in a sense, countries that have moved forward very quickly over the last 20 or 30 years have not got the representation. It is quite difficult for African countries, with the structure of governance at the moment in the IMF, to see their views fully represented, and so I think we have got to show that we can deal with these issues. It may be that this will be a two-stage process rather than a one-stage process, but I believe now we will make significant progress at Singapore and there is a will that I found in April, when I was chairing the meeting of the IMFC, to make progress very quickly; so that will happen, in my view, over the summer. There is a second set of issues that are more fundamental, and that is how the international economy is going to respond to these huge changes of globalisation and how we can manage the international economy better to secure growth. There is an obvious thing that is failing at the moment. We do not have a trade agreement. That is under the organisation of the WTO, of course, but it has a spill-over effect to everything that is happening. There is another set of issues about how the World Bank should work for the future and how its work in developing countries can be extended and can be more effective. But as for the IMF itself, it seems to me that we have been slow to recognise that, an organisation with international status that can pinpoint what is going wrong and can send warning signals about what ought to be done and can even bring about a co-ordination of policy to be able to do something about it. That is where we ought to be. In the past, in the 1940s onwards, the IMF would step in to deal with the problem countries that developed, and, of course, most recently, it has been countries in Latin America. It would use most of its funds for only a few countries now dealing with their particular problems. It is under huge political pressure, of course, to do something about these countries when a problem arises, but that is only a small part of what should be the work of an international economic organisation. We have country to country imbalances right across the world, of course. We have problems that, of course, affect the rest of the world because of high deficits in some countries, but there are high surpluses in others.

Q164 Angela Eagle: Is it your view, because of some of the mistaken policies, especially in the Asian economies, that were pursued in the past, that Asian economies have now started storing up their own surpluses in dollars, which has actually added to the problem of imbalances, and do you think that this kind of reform and the move to crisis prevention will actually solve that situation as it has emerged, partly in response to the IMF and its Washington consensus style policies, I think, being seen as illegitimate in some emerging countries, such as in Asia?

Mr Brown: I think you may have seen that there have been a number of proposals being put. Most recently there was a speech by the Governor of the Bank of England, and by Larry Summers, a former Treasury Secretary, about whether, if you had better international arrangements for dealing with imbalances, some countries would need to have such big reserves in future. That is an issue that is raised and I think could be answered. I think there is a more general question about the lessons we have learned from the Asian crisis in the late 1990s, which was, indeed, a very severe crisis, because we found out that at least one country was going virtually bankrupt and yet none of the international community, who should have known, had a great deal of knowledge of what actually was going on within the reserves position and the central bank of that country. That leads me to the conclusion that the one thing that you need to start with is greater information, transparency and, therefore, better surveillance, but, more generally, I think there is a potential coming together of people's views. It is not true to say now that people undervalue the importance of public investment as well as private investment. I think people now throughout the world see that, if a country is going to move forward, it is going to have to invest in education and in infrastructure and in science. I think people are far more aware now that, just as countries need to have proper financial, fiscal and monetary regimes, they need to have good systems of public law, they need to have mechanisms that will deter corruption, and you need all these changes also in civil society in the way countries function if they are going to be successful economies and capable of attracting investment from round the world. I think there is a new consensus developing that an emerging market country and a developing country responding to globalisation will need to have stability, will need to have private as well as public investment, will need to have good systems of commercial and civil law, will need to have transparency and accountability in the way they make their decisions; and that is a shift, I think, from what was called the *Washington Consensus* in the 1980s but, if that is true, you need an international organisation that takes that seriously and monitors what is happening, reports where things are going wrong and can do something about it. One good model is the Financial Stability Forum, which Britain decided to propose a few years ago, after the Asian crisis, and we see it evolving into an early warning signal where there are potential financial crises in the world economy.

Q165 Chairman: Chancellor, I am looking for sharp questions and sharp answers. I want all my colleagues to get in and I want you to get away by 1.30.
Mr Brown: I take that as a signal to have short answers!

Q166 Mr Fallon: Specifically on the Quota Review, Tom Scholar told this Committee four years ago that the UK position was that voting should still reflect to some extent the size of contribution. I do not know whether Tom wants to answer this. Is that still the British Government's position?
Mr Brown: It is our position, and if Tom wishes to say why it is a consistent position, I am very happy that you say so, Tom.
Mr Scholar: Yes, it is still our position. I think the issue that we see now is that there are quite important divergences between the actual quota shares of various countries and the share that they would have using the formula we use to accurately reflect their latest economic situation, and, of course, that is something that also has changed over the last four years.

Q167 Mr Fallon: The other issue is the selection of the next Managing Director. The Governor told us it was a good time now, when there was not a vacancy, to get a process established away from the old kind of European cabal system. You have spoken just now about transparency; you have always championed transparency. Do you think we should be making this process more transparent?
Mr Brown: It was, in the last case, far more transparent. I do not think what was done in the process of selecting Mr Rato has been fully recorded, and this was not a European cabal, as you suggest. It is true that he emerged from Europe as a candidate, but it is also true that there was consultation with every continent. There was detailed consultation with particular countries who were important: members of the IMFC, in other words represented constituencies on the IMFC, and, as the Chairman of the IMFC, I spent a very considerable amount of time consulting round the world about his acceptability. I think Mr Rato would be able to report to you that he met the African constituencies before he was even in a position of being nominated, and he answered questions from them and Asian members were able to talk to him; so it was not a question that we did it in what was the old way 20 or 30 years ago where simply Europe was given the power to nominate and it did not matter in the end who Europe nominated, he or she would be acceptable to the rest of the world; so there is more transparency now, and I suspect it is possible to imagine more transparency in the future, and this is something that we will look at, but it is undoubtedly the case that is a far more transparent system than it was.

Q168 Mr Fallon: The Governor told us it is most important to put this in place now "while there is no vacancy". I wonder if you could look forward to the day when perhaps the Director of the IMF was an African?
Mr Brown: There is no doubt that when we look at the international institutions—the World Bank, the IMF, the United Nations and the WTO—people will increasingly want to have the best candidate from whichever continent they come. Of course, because the IMF and the World Bank are based in Washington, there is clearly a demand that all continents be represented in the initial stages, as you probably understand. The original proposal in 1945 was that the IMF would have a Chief Executive, Managing Director who was an American and the World Bank would have a Chief Executive, what is now called the President, who would be a European, and that was changed at the last minute so that the IMF had a European Managing Director (and there is a very big and interesting historical story about why that happened) and then the World Bank President was to be an American. Over time I think this will change, but I think you have got to take into account all the international institutions that have an impact on the world economy and not just one.

Q169 Mr Newmark: Chancellor, you have welcomed the opportunity for a more fundamental review of the Fund's internal governance. Charles Dallara, the Managing Director of the Institute of International Finance, has said that for Europe to give up some of its voting share in the IMF would not only be in line with the progress on European integration but also help increase the voice of emerging markets. Are you prepared to accept that the price of management reforms will be paid with a dilution of European and British influence over the Fund?
Mr Brown: I think there are two proposals here. We must not conflate them both together. One is what is the appropriate quota and level of representation of Europe? The second thing is do the international institutions want to take more account of the fact that there is a Euro currency and should there be more integration of the European position or the Euro area position in the IMF? I think the second one is, to a large extent, answered by the views of individual countries in Europe, and while the Managing Director of the European Central Bank is in attendance at the International Monetary and Finance Committee, I think there is a general view still that the individual countries—Germany, France Italy—will retain their separate seats in the

IMF. That is one issue, but I think it is quite separate from the other issue. The other issues is: can you see a situation where Asia can get more quota and more representation and so can Africa, particularly, get more representation, and does that mean that that is at the expense of Europe? If I put this to the Committee, because these are obviously discussions that are taking place in the run up to Singapore, my own sense is that it is possible to imagine a situation where there is a bigger influence of Asia while at the same time Europe maintains a very considerable amount of its position. I think that is probably what the initial result will be, but I do not think it would be helpful to propose a settlement at the moment, I think we have got to listen.

Q170 Mr Newmark: But you are prepared to defend Britain's interest and influence as it currently stands?
Mr Brown: No, Britain's position is not at issue.

Q171 Mr Newmark: It is as part of an overall European influence.
Mr Brown: No, I think you are wrong here.

Q172 Mr Newmark: I do not think I am wrong here.
Mr Brown: Britain's position is not an issue. Even if there was a Euro-seat, Britain, not being a member of the Euro, would have its own position, and I do not think you should make any suggestion it would be anything other than that.

Q173 Mr Newmark: So we will maintain our influence; thank you. My second question is this. There is speculation that you might replace Horst Köhler as Managing Director of the IMF when he stepped down in 2004 to stand for the German Presidency. Do you believe that the fundamental reform of the IMF could have been achieved sooner had you been at the helm from 2004?

Q174 Chairman: Would you concentrate on the second part of the question!
Mr Brown: I think this is probably the year, if I may say so, and the Committee may wish to reflect on whether they agree with this, where reform of the IMF has moved faster than at any point for decades, because there is a growing recognition that, in a sense, two issues have come together. One is that global economic change and certain insecurities about change forced the IMF to act differently and to realise it must have been wrong, and the second thing is the changing structure and composition of the world economy put on the agenda the voice, quota and representation issues for Asia and Africa. I think the two things have come together and there are the makings of a major reform agreement at Singapore in September as a result of that. If you like, for 60 years now the IMF has essentially been an organisation that has focused on crisis resolution, where countries, and it was Britain's fate in the 1970s, have a huge balance of payments problem that has got to be addressed, sometimes arising from fiscal difficulties. Now I think people see that in the future, if the IMF is going to be as effective as it should be, it has got to deal with crisis prevention, and that is about surveillance and not just about individual countries, and that is a big shift-change that we have been arguing for some time in the way the IMF should think of itself, but we are nearer to agreement on these changes than I think we have ever been.

Q175 Mr Newmark: Your point brings me to my third question, which is on the issue of surveillance. You have said that in a modern rapidly changing global economy the Fund's surveillance role is critical. The Governor of the Bank of England agrees, but adds that, "Balance sheet analysis should be at the heart of the surveillance process." Do you believe that more rigorous balance sheet analysis by the Fund should be confined to the developing world or will the UK's national accounts also benefit from a beefed up surveillance remit for the Fund?
Mr Brown: I would put this another way round, if I may. Every country must be prepared to be part of similar processes. It is clear that the results of any investigation would probably focus on different aspects of policy in developing countries and emerging market countries than in advanced industrial economies, but monetary, fiscal, financial policy, all these things, I think, have got to be part of IMF surveillance; and I think what the IMF has recognised is that these financial sector issues are more important than they used to be, not least because in Asia in the late 1990s the failure to do surveillance on these problems was one of the reasons why nobody spotted that Korea, in this case, but also other countries, were in severe financial problems.

Q176 Mr Todd: The Governor has made some intriguing and revelatory remarks about the operation of the Executive Board of the IMF in which he disclosed that typically Board members might have 300 pages of reading material each and every working day. Do you believe that his remarks perhaps suggest a need for a dramatic reform in the way in which the Board functions?
Mr Brown: Or a speed-reading course for the members!

Q177 Mr Todd: Indeed.
Mr Brown: There is no doubt that reforms are evolving in the way the Board operates, but where you have country by country reports being done, you would be the first to complain if they were not detailed and substantive, and where you have an Executive Board that is looking at these issues, particularly if money and allocations are going to be involved, they have got to take these things seriously.

Q178 Mr Todd: Does not micromanagement distort the accountability of those—
Mr Brown: Is it micromanagement? If it were, I would agree with you, but the Board has a responsibility for the allocation of what are essentially public funds, and while one wants the reports to be precise and as concise as possible, I do not think when you are allocating public funds you

should fail to go into detail of some of the issues which are raised by country investigations, but maybe Mr Scholar will explain some of the issues that demand a level of detailed investigation.
Mr Scholar: I think it is absolutely true that on the issues of allocating public money the Board plays a very important part in the accountability of the Fund, so the people that take the decisions are the representatives of the countries of the world. In the case of the UK, that is me, and I am accountable to the Chancellor, and the Chancellor is accountable to Parliament and the British people, and that is the way it should be. At the same time, as the Chancellor has already mentioned, there are other areas, such as surveillance, which are essentially technical areas, and I think that could be an area where there could be quite significant economies in the use of Board time.

Q179 Mr Todd: The Governor did not confine his remarks to the Board. He also commented on the IMFC, "I would have said that one of these meetings where you have got a Saturday afternoon sitting there in this windowless room in Washington thinking, not only, 'Is anyone else outside the room taking any notice of this?'", not a particularly flattering description of this important function. Do you share his view? He did make a laudatory remark about the most recent IMFC meeting.
Mr Brown: That is because we met in a new room actually. I know the Governor would prefer to be at an Aston Villa football match than at the IMF, even with the season that Aston Villa have had. When I first attended the meetings of the IMFC, they could go on, because the communiqué had to be agreed, sometimes until two, three, or four o'clock in the morning because each country had to agree the communiqué that was being issued on behalf of the world economies. Now I think we operate to a fairly tight procedure where the meetings last, I think, five or six hours and, by the time the meeting is finished, you have agreed the communiqué, which, if I may say so, is having an increasing influence on the way the debate is focused in the world economy. If we, for example, set an annual remit at the meeting in the autumn for the surveillance work of the IMF and we say to them, "Look, there is an issue about oil prices. We want you to report over the next year both on the effect of oil prices on individual economies and what can be done to get greater stability in the oil market", there is no organisation internationally that is doing that on behalf of the world economy successfully at the moment, and that would be a major shift and make the work of the IMFC, as well as the IMF, far more relevant and more focused on what I think is a modern remit for an international economic organisation.

Q180 Mr Todd: A brief comment on the role of the United States in the IMF. Should we not just face facts that the US will always have a dominant and veto position in the IMF and that debates about its position are redundant?
Mr Brown: I do not think that is the way the IMF works, if I may say so. It is never normally a case of the US with a huge vote against the rest. It is usually countries working together for a common purpose by the dialogue that is achieved through the Executive Board. For example, I would not suggest that the Executive Board should be removed at all, I think it does an important piece of work, and while diplomacy can be carried out by telephone and by video conferencing, I think the detailed work of having an executive for this organisation probably does still need resident directors.

Q181 Mr Gauke: Can I return briefly to the issue of the impact of the Euro zone on voting rights. You have been very clear that you do not think there should be a merger of all EU countries and their voting rights and that Britain, maintaining its own currency, must stand outside. That was the view that the Governor of the Bank of England gave to us as well. The Governor of the Bank of England did, though, say that those Euro zone countries might be well placed to merge their voting rights. I would be interested to know your attitude on that specific point.
Mr Brown: I think you have got to recognise that at the moment the German representation of the IMFC is held by the Bundesbank and not by the German Government; so even within the European area there are different practices and different ways of doing things. If the euro area were to press this, then we would obviously have to take it seriously, but I go to meetings of the European finance ministers and there are still a large number of people who wish to have separate representation through constituencies in the way we have at the moment. This may change, and obviously this is an opportunity for everybody to put their views, but I do not think we are near reaching agreement on that.

Q182 Mr Gauke: You have placed, indeed, this morning the need for reform of the IMF in the context of increased protectionist sentiment throughout the world. You have spoken in Treasury Questions about the need for Europe to open up its markets more?
Mr Brown: Absolutely.

Q183 Mr Gauke: To what extent are you dissatisfied with the EU's trade policy, particularly in the context of the Doha trade round?
Mr Brown: I think there is a general drift towards protectionism, and I think international institutions like the IMF should play their part, alongside the WTO, in resisting that. I think you can see protectionist sentiment in almost every continent of the world, and, therefore, it is not restricted to Europe. The problem in Europe is not just external trade, and we are not talking about this specifically today, but the operation of internal trade within the European Union and how fast we can liberalise the markets in utilities, energies, services, financial services, those areas which have been focused upon by setting timetables in the past, so that we have an energy timetable for the domestic and business

market for liberalisation by 2007; but, generally speaking, what has happened is that this is a political agreement which, if a country does not adhere to it, it is difficult to see what to do other than reach a new agreement. What we are proposing is that you use the competition authorities to carry out independent investigations into those areas, with not only powers of investigation but powers, in the end, of enforcement. I think that may be a way forward to dealing with recalcitrant areas where we have not made the progress that we should. Certainly, if you combine internal inflexibility with external risk of protectionism, then the world economy could slip back, and, although growth is relatively high this year, there is no doubt that if there were a trade agreement it would be higher and in future years we would be able to guarantee it would be higher through the liberalisation of trade.

Q184 Mr Gauke: I am interested to hear that you are keen on timetables.
Mr Brown: I actually said that the timetable in Europe was not actually working, because basically the truth is that the liberalisation that is promised, if you do not succeed to another political agreement, would probably need the competition authorities working.

Q185 Mr Gauke: I get the impression, although I am sure there is no doubt, that you would have a much more liberal approach to trade barriers than the European Union is seeing at the moment.
Mr Brown: There is no doubt that many of us want to see more progress, particularly on those areas of agriculture where we have not yet got an agreement. I had hoped, and it is still possible, that India and Brazil would lead one set of countries in the world by making concessions at the same time as America and Europe could come together to produce a new agricultural deal, and I think there is still the possibility of that. We talked at some point about there being a heads of government meeting to look at these things. It will certainly be on the agenda of the G7 meeting in St Petersburg in a few weeks' time, and I think there is a letter in the newspapers today about the progress that the European Commissioner wants to see in the trade round as well.

Q186 Mr Gauke: Peter Mandelson?
Mr Brown: Yes. There are a lot of people who now recognise that a stalled trade round is something we wish to avoid and we want to take initiatives to move it forward.

Q187 Mr Gauke: Do you not feel that the European Union is not delivering at the moment on this and, when it comes to free trade and globalisation, there is a hesitancy there, there is a desire to hold on to what we have got rather than take risks and go for a greater prize from which we would all benefit?
Mr Brown: We published a document, which I will send to the Committee, about open markets in Europe[3], and one of the benefits of a more liberalised attitude to trade, I think, would be an improvement in the trading and commercial relationships between the United States of America or the NAFTA area and the European Union. We have commissioned, with other countries, a study which shows that there would be a very substantial impact on the national income of both Europe and America if we could remove the remaining tariff and non-tariff barriers between America and Europe. There are issues in financial services, in regulation, in attitudes to mergers and everything where, if we had a more common position, we might be able to see huge advantages in trade, in prosperity and particularly in jobs.

Q188 Peter Viggers: In trying to develop a better relationship between the European Union and the United States in terms of trade, does it help to have Peter Mandelson there as the Commissioner responsible?
Mr Brown: Of course. He is the British representative who was chosen to be the Trade Commissioner. He is the British nominee.

Q189 Peter Viggers: So it helps having a British person in post?
Mr Brown: In such an important job as trade, it is good for our country that the Commissioner is British, yes.

Q190 Peter Viggers: You referred to the IMFC communiqué and the focus on surveillance. One aspect of this is multilateral surveillance. How will this change the focus of the work done by the IMF in terms perhaps of the Article IV studies, the detailed studies of each economy?
Mr Brown: I think, as regards the individual studies, the emphasis will be not only on what is happening within the borders of an individual country but the spill-over effects of what is happening in the biggest economies as well as the categories of economies, like developing country economies and emerging market economies, but I think we should put emphasis on another aspect of this. Every year, I think, we will focus on issues of anxiety or of worry about how the world economy will develop, and I gave an example this year of oil prices and what we might be able to do create greater stability. You can imagine reporting on the effect both for the countries that are the borrowers and the countries that are the lenders for the deficits and the current account imbalances we have round the world at the moment. You can imagine studies also on environmental issues. There is a range of cross-country studies where, if you could look at the effects on all continents and different types of economies, the IMF might produce recommendations which could lead to an agreement that, if one continent or one set of countries did this, the other set of countries would do that.

[3] H M Treasury, Long-term global economic challenges and opportunities for Europe, March 2005.

Q191 Peter Viggers: If this is extra work, is some work currently undertaken superfluous? I am thinking particularly of the work done on the financial sector assessment programme in the United Kingdom, for instance?
Mr Brown: The reason that the United Kingdom volunteered—if I am right they volunteered—to be one of the first financial sectors to be assessed is not because we thought we were a particular case of difficulty but we wanted to show that all major economies were prepared to open up their financial sectors to the investigation that we thought should be taking place generally as part of Article IV assessments. I do not think that was a waste of money. I think that was the United Kingdom, which has a strong financial sector, showing that we were not afraid to be assessed and we thought that other countries should then follow and invite the assessment. If countries that are some of the best performers were prepared to be assessed, then we could persuade other countries, where there were risks and instabilities that might lead to damage to the world economy, to volunteer, to come forward; so I think that was an important study.

Q192 Peter Viggers: The recent Managing Director's report suggested that, "More emphasis must be given to the original goal of surveillance, i.e. assessing the consistency of exchange rate in macroeconomic policies with national and international stability." Is that global approach the area where the IMF should focus or should it be looking at domestic policies?
Mr Brown: I think your question puts the challenge very well. If the IMF were only to look at what was happening inside the borders of an individual country and not even look at the spill-over effects of policies in one country or one continent to another, it would be failing in its duty. The IMF is essentially an international economic body that is charged on behalf of the economies of the world with looking at the overall performance of the world economy as well as individual national economies. If it says there are current account imbalances that have got to be addressed, inevitably its recommendations will mean, for example, that America should look at its deficits, Europe has got to grow faster so that it can play a bigger part, therefore, it has got to have a good structural form, Japan has had a period where financial sector reform has been too slow and, therefore, it ought to speed up its financial sector reform, and it may be it would wish to comment on the Chinese policy in relation to currencies. That is how I see an international body looking at how, by one set of countries taking some actions, they could persuade other sets of countries to take reciprocal actions, and you need an international body that is capable of both recommending that and having some authority to persuade people to take these actions. This is the modern role for the IMF, that it will do these things and also have the credibility and the legitimacy to be able to see, as a result of its recommendations, people prepared to come together to take action.

Q193 Peter Viggers: One aspect of globalisation seems to be the manner in which private investment, through PFIs, PPPs, has enabled some countries to move forward and move to a kind of post nationalisation phase, which was commented on by your colleague Alan Milburn in a leading speech recently. Do you think the IMF should get involved in that area?
Mr Brown: You are talking about the growth of public/private partnerships, where Britain has a particular expertise, which is actually at the moment being marketed round the world very successfully by organisations like Partnerships UK. Many people come to us and ask for advice about how, for major infrastructure projects, they can follow some of the guidelines that have been developed in the Treasury and elsewhere around government. That is a more likely way in which people will move forward, they will take the successful countries or the countries that are doing these things and look at whether they are relevant to their countries, but there is no doubt that a body of expertise could be developed at an international level as well. However, I suspect that the IMF would not see that as its primary job. I may add, we are talking about the IMF here, but the World Bank may see this as something because it is involved in major infrastructure projects and it is involved in advising on structural reform.

Q194 Kerry McCarthy: You have already talked about the need to ensure that the IMF is independent from political influence in its surveillance activities, but in the Treasury's report on the IMF you highlighted the fact that often the intertwining between surveillance and lending activities can sometimes cause complications in that respect, particularly in terms of giving policy advice to surveillance reports. Could you comment on that? I think you suggest that institutional reform is needed to bring about clearer delineation between surveillance and lending activities?
Mr Brown: There are two issues here. The IMF, until recently, would not publish what it thought was the effect of a set of policies that individual countries could perform, and so you would recognise that the financial sector is in difficulty in one country, you would realise that that could cause a major crisis, but, because of the sensitivity of markets, you would decide that it was not relevant to publish that sort of information. I think these days are over. I think, in informed and educated markets, the IMF has a major role to play. Then there is a second set of problems. If you take a country that is running major deficits or is in real fiscal trouble, inevitably the IMF is asked to move in. The IMF wishes to make certain recommendations but, because of the politicisation of the process, inevitably you have got pressure groups, press statements, public lobbying and the IMF is constantly being forced to yield more resources to solving the problems of that country than it may wish to or may think is wise as a result of its surveillance and, even then, the IMF is usually blamed by populist elements in the country to which it is allocating resources but not giving enough to solve these problems. You must find a way of

separating the advice that is necessary to be given, which can be public in most cases, from the allocation of money and, if you had an authoritative set of advice being given about what should be done, then I think markets, citizens within countries, would look at this advice and see whether it was relevant and it would form a subject of debate and then, quite independently, you would decide "is there a case for giving money?" rather than merging the two processes so closely together I think there are real advantages in the separation.

Q195 Kerry McCarthy: There has been a suggestion by some groups that the surveillance role has a negative impact on other donors that are giving money. The Bretton Woods project, for example, cites AFRODAD reports on the IMF poverty reduction and growth facility in Malawi and Zambia, where the signalling role of the facility sent out negative messages and donors and other people giving aid were adversely influenced by that.
Mr Brown: You are absolutely right that you have got to recognise there is balance, but the important thing is that we have realised over many years that to be silent where there is not sufficient transparency and, in some cases where there is corruption, is the wrong thing. I am not talking about individual countries here, but to be silent is the wrong thing. To insist on transparent structures based on the codes and standards of the international community that would guarantee there would be greater stability in these countries is in their best long-term interests; so I think it is important that we say that we do not only believe in surveillance, we believe in openness and we believe, as result of that, in the need for good governance.

Q196 Kerry McCarthy: In terms of identifying appropriate policy prescriptions for countries, the Treasury report says that the IMF currently lacks a framework or methodology for assessing this, and certainly Christian Aid has said, "In pushing structural reform in particular the IMF is stepping beyond its mandate into an area in which it does not have a clear competence." Would you comment on that?
Mr Brown: We are dealing at the moment with a quite specific problem, and I will give that as an example, where I think we wish to persuade the IMF to act differently. If you take any one of the African countries that is trying to expand their education system, to make a decision to spend money on teaching and education may breach the limits of the IMF's recommendations about what borrowing there should be and what the public sector decides if the public sector needs to deal with other issues of reform in that country. We have got to recognise that some of these arbitrary limits on, for example, the amount of investment that can be made in education, is not necessarily the best way to help some of the countries. We are looking at this at the moment, and one way round this is through the *Education For All* initiative that we have just announced where we can guarantee countries long-term and predictable finance. On that basis, I think the IMF's assessment of what countries ought to be able to invest publicly in their education system would change, but these are specific problems that I think people are now raising in a way that can be dealt with. I think Oxfam, and Christian Aid, who also do a great job, have raised these issues. I was in Mozambique a few weeks ago. The amount of resources that could be invested in education was raised with me directly. The answer is partly that we provide, as we are doing, quite specific resources to help the investment in education, and the rest of the world community joins in. The other answer is, of course, that the IMF would look at the limits that it sets on investment in education.

Q197 Kerry McCarthy: What role do you see the Independent Evaluation Office playing? Particularly in terms of its role as an independent monitor, my concern is that it only produces about three or four reports a year at the moment. Its work programme is decided in collaboration with the Executive Board, and I think its new Director is actually a previous employee of the IMF and the World Bank. Do you think it is independent enough? Do you think its work programme needs to be expanded?
Mr Brown: Yes. We proposed the IEO. They are currently working, if I may tell the Committee, on evaluations on the role of structural conditionality, which is the issue that I think you were hinting at. They are also looking at the IMF's role in the determination of the external resource input of sub-Saharan African countries and at the advice and exchange rate policy, and so these are some of the most controversial issues. They are consulting publicly on the work programme for next year for 2007. Again, for this Committee and others who wish to suggest what might be done, I think that would be very useful. I think where the IEO has done work it has actually been quite effective. I think the Committee will have a note of the previous reports, and the most recent ones were on support to Jordan, capital account liberalisation, IMF technical assistance, and these are all areas, again, where some of the NGOs that you have quoted have rightly raised issues that have not been properly addressed.

Q198 Ms Keeble: I want to ask some questions about the IMF and developing countries. Assuming that the requirement is for 7% basic year on year economic growth, which is what underpins all the MDG targets, you said previously that there was a requirement for some quite substantial systems improvements, for example, dealing with corruption, tax reviews and so on. How do you get both developing country governments and the international community, including the NGO community in particular, to accept the legitimacy of the IMF in insisting on, or requiring, those systems to be put in place which are perfectly obvious systems to be put in place if you are going to get 7% year on year growth? How do you get the legitimacy accepted and what kind of sanctions should the IMF have in terms of lending?

Mr Brown: The first thing, I think, comes back to an earlier set of arguments. If you are going to have codes and standards that we believe contribute to the stability of individual economies; and the fact that transparency as well of the regime itself will help attract a flow of funds to invest in your country, all countries should accept obligations, including the richest, including countries like America, Britain and the rest of the European Union. We should accept that we too are subject to the codes and standards and will try to do our best both to abide by these codes and standards and to ensure that there is proper transparency and reporting upon them, the publicity of the reports as well. That is the first thing that can persuade developing countries that this is not a regime that is a new form of colonialism that is trying impose some new regime that is against the interests of the people of the countries. We know that in a global economy, if you as an individual country are incapable of generating economic stability for your domestic economy, you will be incapable also of being able to attract investment funds, and I think it is a very important message that every country is subject to the same rules. On the introduction of the Policy Support Instrument and the Shocks Facility, but also an adequately financed PRGF (Poverty Reduction and Growth Facility), I think the IMF is trying to show that it can actually be at the service of low-income countries. Mistakes have been made in the past. There have been quite difficult examples of the World Bank giving with the one hand, the IMF taking with the other. There have been some controversial issues, like imposing charges where people are unable to pay them. I think these days are now recognised as what happened in the 1990s and 1980s. I think there is a new sense in which the IMF has got to be at the service of the developing countries, and there is a new sense also that it has got to work far more closely with the World Bank and, if I may say, the United Nations agencies that are operating in some of these countries as well.

Q199 Ms Keeble: The legitimacy of the IMF in either having conditions or in having frameworks for economic development is not accepted, is it? There is a basic issue about the legitimacy of it.
Mr Brown: The IMF?

Q200 Ms Keeble: Yes.
Mr Brown: You used to call it structural adjustment, then we called it sustainable development, but I think what we have now recognised is that you have got to work with countries who develop their own programmes, and it is not a question of the IMF coming in and imposing a programme so much as the IMF working with countries with their own programmes and using their own targets as their conditions, and I do think there is a growing recognition that externally imposed change will bring far fewer beneficial results than internally generated change with the support of the international institutions.

Q201 Ms Keeble: What do you do about the sort of deals and the events that go on outside the consensus? Probably the most obvious one is China and its role in Africa, particularly in relation to Zimbabwe. How do you start to try and bring those inside the loop?
Mr Brown: I think Zimbabwe is a very difficult case. Do you want to say something on what is happening here, because it is a very difficult case for the IMF?

Q202 Ms Keeble: Particularly the role of China. It is not just Zimbabwe.
Mr Scholar: Perhaps I may comment on the general policy issue. It is a very big issue, which we see now: a number countries who are new to the business of sovereign lending making quite big loans, sometimes non-concessional loans to countries, including those that have recently benefited from debt relief. What, of course, nobody wants to see following debt relief is re-accumulation of unsustainable debt, and so what we have asked the Fund and the Bank to do on this is to develop a new framework for assessing debt sustainability, and that has been done and it is now being put in place. What is essential is that we can reach an international consensus on how to avoid the re-accumulation of debt. That would include, in part, decisions of the IMF and the World Bank but also, very importantly, other countries, and it is through this process of reaching consensus, both through the IMFC and the development committee and the two Boards, that we hope to reach agreement on a framework which will be respected widely.

Q203 Ms Keeble: That is how you deal with developing countries, in particular those that have had debt relief, but what do you do about China, which is in a position to be able to extend these kinds of facilities and which have a profoundly distorting impact?
Mr Brown: I think we should also look at, not just the IMF and the World Bank, but the Paris Club and how it operates in relation to debt, and Jon is involved in this.
Mr Cunliffe: There is a general movement to work with the Chinese and a number of others to try and give the sort of consensus that Tom Scholar was talking about. Actually, it is an unhelpful step for developing countries to lend money to countries that are not sustainable and their lending and their aid programmes need to be more integrated in what is happening through the World Bank and with other donors; and that effort is going on in the IMF and the World Bank and it is going on through the Paris Club of Official Creditors that has now made contact with the Chinese; so there is a job of persuasion and consensus building there to do, which has started.

Q204 Chairman: I think that focuses on the multilateralism and the bilateralism which seems to be happening just now. It is a bigger question. We are looking at that in the wider globalisation economy.

Q205 Mr Breed: Chancellor, a couple of times you have touched on the relationship between the IMF and the World Bank and clearly co-operation is vital. Is there now a requirement to get greater clarification in terms of their roles and responsibilities, and in particular is it now time perhaps for the IMF to leave the development work almost exclusively to the World Bank?

Mr Brown: I think myself that would be a mistake. There is a review taking place about the relationship between the IMF and the World Bank and the joint work that they should undertake, but let us remember that if we are setting the IMF a task of surveillance and saying that it is to the benefit of the world economy that we examine both at a national level and for continents and the global economy as a whole what is happening within these economies and what recommendations we have, then the IMF becomes a very specialist organisation that is dealing with surveillance and it is not necessary then to say that the IMF should be out of developing countries; it should be involved in surveillance of developing countries. Where I think you are raising an important point is where there is an overlap in the allocation of resources. I am finding, because I am a member of the UN Commission that is looking at the UN organisations and their relationship between the World Bank and the IMF, that you can have in some countries, such as in Africa, a situation where you have IMF involvement with some resources, you have the World Bank with some resources and you could have 20 UN organisations, some of them giving as little as two million dollars each to that individual country, which clearly is a signal that what is being paid for by that two million is maybe staff rather than services, so there is indeed a need to examine how in the provision of services in particular, like education, capacity building and health, the international organisations can work far more effectively, and where overlaps happen you either say that this is good because it is competition between networks and you are finding who is the best provider, or it is simply a waste of resources. There is a need for an investigation in that way but I would not say that the work of surveillance should simply be for the advanced industrial economies and for the emerging markets. Increasingly we are going to understand the importance of transparent systems of monetary and fiscal policy operating in developing countries as well where there is a need for advice and the IMF would be the expert organisation providing it.

Mr Scholar: The review has been commissioned jointly by the Managing Director of the IMF and the President of the World Bank and there is a high level panel, including the finance ministers of Nigeria and Indonesia and the former Chairman of the New York Federal Reserve, and they will be looking precisely at collaboration between the two institutions, ensuring that there is complete coverage of all issues but without duplication. I think this is a very important and welcome review that is going on which will report later in the year and will be discussed both in the two boards but also at the committees.

Mr Brown: And I think we should applaud the Managing Director, Rodrigo de Rato, and President Wolfowitz for deciding that this was necessary, and, of course, Mr de Rato has brought forward a number of the reforms that we are talking about today in surveillance.

Chairman: We were in Washington last time when President Wolfowitz gave us ample time and we had an excellent discussion with him on the role of the World Bank and how things are changing.

Q206 Mr Love: In his recent evidence to the committee the Governor of the Bank of England said that one of the good news stories over the last five years was that the IMF was lending less. What role should the IMF have in lending?

Mr Brown: As little as possible. Its role has been traditionally where there is a crisis that it has got to be managed and therefore the fewer the crises the less the lending and the better the situation is. This is something that you would say for the IMF in operating in that capacity, yes. I do not know what the figures are for recent years, Tom, but it has mostly been concentrated on two countries; is that right?

Mr Scholar: Yes. Until the end of last year 70% of the IMF's outstanding credit was concentrated in the three biggest borrowers and they were Brazil, Argentina and Turkey. As the committee knows, both Brazil and Argentina repaid their loans earlier so there is a very low level in historical terms of outstanding credit and, as the Chancellor says, that is a very welcome thing.

Q207 Mr Love: Implicit in what the Governor said to us was that if the focus of the IMF is to be the avoidance or prevention of financial crisis does it really need to lend at all?

Mr Brown: In an ideal world you would not want to have to lend to get countries out of crisis, but the purpose of an international institution should be to prevent crises where possible but also to deal with them where it becomes necessary. We have seen advanced industrial economies have balance of payments problems that have had to be dealt with and that has affected European economies. We are seeing Latin American and Asian countries that have a mixture of these problems and financial sector crises. You cannot exclude the possibility that crisis resolution will have to happen in relation to economies in the future but you wish to minimise both the crises and the liabilities or the loans you have to make to deal with them.

Q208 Mr Love: I think we all accept that on the committee. I was just asking a theoretical question. If I can press you just a little bit on particular facilities, in your recent press conference at the IMF you welcomed the new shocks facility, yet there have been some reservations expressed about the variety of facilities that are now available to the IMF. Is there a need for rationalisation of all the facilities that currently exist?

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Mr Brown: I think this committee might wish to comment on this because it is wider than simply a financial shock. When Pakistan had its terrible earthquake, when the tsunami hit so many different countries, you had a mixture of emergency relief required, reconstruction investment needed and financial support because of the effect of these crises on the general economy of these countries. Before the tsunami there was no emergency relief fund held in the United Nations or anywhere that was available for countries where they had immediate needs and what happened was that you had to phone round different countries and essentially ask for donations after the crisis had hit you. Now we have a situation where, thanks to Hilary Benn's initiative in New York we have the UN Central Emergency Response Fund, but we still do not have a dedicated reconstruction force or team, so where a country needs specialist help for reconstruction I think we can make progress on that and more needs to be done. Then there is this issue of how you deal with shocks that are, if you like, the economic effects of a physical disaster—oil price rises or any other commodity shock, and that is why Rodrigo de Rato recommended the shocks facility. We have contributed to it and other countries like France have contributed recently. The oil producing states are being asked (rightly so) to make a contribution because one of the shocks we are talking about is the effect of high oil prices on poor countries. The shocks facility is in being but it will be up and running with a wider range of funding pretty soon and we are pressing other countries to make a contribution to it. Again, it is an example of how the international community is realising that the institutions that were developed for the problems of the past are not fit for purpose given what we now know. We ought to be able to get disaster relief to a country quickly because (a) we know about it and (b) we have the engineering, the technology, the science, the medicine and the general physical ability to do it. What we need is the political will to have the sorts of resources available so that we can act instantly. It was a tragedy that we could not act instantly in certain recent natural disasters, so we realise we have to do more on that, more on reconstruction and more on the economic effects of a natural or physical crisis.

Q209 Mr Love: You have made a very good case for the shocks facility but I read in our report that the contingent credit line facility introduced in 1999 has never been used and has been allowed to just fade away. Is there a role for further rationalisation of funds within the IMF as some of these funds have no real purpose at all and they could be got down to a relatively small number of facilities?

Mr Brown: Yes. I think I remember this facility. It was time limited and nobody had the need to use it, which is not the same thing as saying it was unnecessary. We are looking at a new facility and maybe Jon will say something about it.

Mr Cunliffe: The CCL had a sunset clause so it came to an end at a certain date if there was not support in the membership to renew it and that is why it ended. It had some design problems because you had to find a way of designing an assurance for countries that the Fund would step in with potentially large amounts in the event of a crisis while maintaining the Fund's ability to set some conditions on the use of its funds, and that is quite a difficult problem to solve. However, there is a lot of pressure from emerging market countries for a facility of that sort and it would give the Fund a relationship with countries before a crisis because they would have this facility and they would have to discuss with the Fund their programme in order to maintain it, and I think there is going to be quite an effort over the next year to try and solve some of those design problems to see if it can be made to happen.

Mr Brown: And it is very important that it is done right because the signal that is sent out by your application for help from this fund has got to be one that is stabilising rather than destabilising, and it is also important that the terms on which it is available are not too onerous, so there are difficult issues but I would not say that the lack of use of the contingent credit facility proved that there was no need for it. There was no specific need at that time and some of the terms on which it was available were disputed by the countries that might have used it. I met a number of countries who had considered making an application to it but had decided that it was not appropriate for them to do so because it would send out perhaps the wrong signal and be too expensive. This is what we have to look at. If we are in the business of crisis prevention then we ought to be in the business of making it possible to draw on the support of the IMF to avoid a crisis.

Q210 John Thurso: Chancellor, we have talked a lot in this session about the changing role of the IMF and I am interested in the impact that that could have on its own finances. It seems that there are two factors here. One is the globalisation of the capital markets and therefore the availability of capital and the fact that middle income and rich countries do not need to access the IMF funds. The second is the changing role of the IMF itself, and we have all, I think, agreed that it should be more of a proactive institution, preventing crises and into surveillance and less reacting to crises. Will these two factors actually lead to a shortfall in the IMF's own funds?

Mr Brown: Undoubtedly, if there is no interest being paid on IMF loans, which was the most important source of income to the IMF then that creates a funding issue, so we will have to make a decision that the surveillance work of the IMF is important enough to the international community that we, the international community, are prepared to make it possible for it to be funded. There are various ways of doing this that do not involve considerable public expenditure, at least in the short and medium term, by a country like ours, but these are things that have to be addressed. In a sense it is a good situation that loans have been repaid and therefore there is no interest being paid to the IMF, but it does create the shortfall that you are talking about and that will have to be addressed, and actually we have set in motion a process to help address this issue.

Q211 John Thurso: Can I ask you about some of those? For example, the IMF is examining options for broadening its income base, I think, through investment of the Fund's reserves or revaluing its gold reserves. Do you think that is an appropriate way for the Fund to go forward?
Mr Brown: I will ask Jon to answer that because he is dealing in detail with this and he might be able to give you more detailed information of the process as well as the proposals.
Mr Cunliffe: We do think it is appropriate for the Fund to make the best use of resources that are deposited with it, and therefore to invest those resources we think it is appropriate for the Fund to look again at the rate at which it is building up reserves and precautionary balances. Clearly if you are lending less that changes the picture. It needs to look at some of the services it could charge for and also the balance of how much is paid for by debtors and creditors.

Q212 John Thurso: So it is quite possible that we could move to a model that was more in the way of being fee based where it was paid for for surveillance and things like that?
Mr Cunliffe: It is possible. With some of the Fund's activities, surveillance and technical assistance, one has to be quite careful because the countries that want and need it most, I would say technical assistance to developing countries, cannot pay and so you do not want to go a system that is fee based.
Mr Brown: You are not hiring a consultant. This must be independent authoritative surveillance, but I do not think we should forget that the Fund has considerable assets, which is again one of the ingenious proposals that Lord Keynes made after the Second World War.

Q213 John Thurso: Would the UK Government support an endowment to provide a separate funding stream for surveillance by the IMF in general?
Mr Brown: That is one of the things you should consider but obviously you need a consensus for this. Let us be clear: surveillance cannot be individual countries commissioning their own reports from people who are then paid for the work that they do on a direct basis, and nobody is suggesting that. There would have to be some consensus.

Q214 John Thurso: It would be more along the lines of an insurance premium?
Mr Brown: Yes. You could get a consensus on this but clearly that is one of the ways forward.

Q215 John Thurso: Another aspect is that having it abandon its role, in a way, in regulating the wealthy countries, which is the way it should be because the economies have moved on, with middle income countries now turning their backs on the Fund to a certain extent, the Fund could be left with only the poorest countries as its clients. Do you believe that the IMF has enough resources to mount a large scale lending operation in its financial crisis management mode, given those circumstances?
Mr Brown: I do not accept your first premise precisely because of what we have been saying today. If the IMF was simply intervening to deal with balance of payments problems or some financial crisis in an individual country, then as the world economy moved on you might expect that the focus of its activity would move to the countries that were emerging and the countries that were most likely to experience difficulties. We are saying the opposite. We are saying that the Fund has as big a role with the advanced industrial economies as with the emerging markets and developing countries because the surveillance of the world economy will lead the IMF to say, "Look, this continent [America or Europe or Asia], here are changes that it is necessary for you to consider making if you are going to contribute to the stability and growth of the world economy". I think it is that vision that they had in 1945 that prosperity was indivisible, that unless you had continents working together to agree what was best for the world economy you would have lower growth and less prosperity than was possible. It is that vision that is being resurrected by the idea that it is surveillance and acting upon the results of that surveillance that is the proper direction of the priority work of the IMF in the future. It will not be a Fund that is less relevant to Europe or America than to Asia. It will be a Fund that will be relevant perhaps in different ways to some countries because of the allocation function, but it will be relevant to all countries because each country should operate according to codes and standards that are internationally agreed. Each country should be examined for the stability of its system and its financial sector and the transparency of its work and that is why I think it is incredibly important that we endorse this positive vision of an international economic organisation moving forward. I repeat what I said, that if the codes and standards and the transparency are seen as a new form of colonialism that would be the worst possible outcome because the countries that would need the benefit of opening up to transparent systems would use that as an excuse for not doing what is essentially the right thing to make their contribution to their own continent and the world economy.

Q216 Chairman: In light of John's point, Chancellor, how will the IMF fund itself in light of its diminishing lending book?
Mr Brown: The IMF is not without assets; I will just repeat that. It is not without resources.

Q217 Chairman: It is still a big question to be addressed.
Mr Brown: Yes. Jon is involved in the group that is looking at this in some detail, and you may want a written note as well[4].

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Mr Cunliffe: There is no immediate problem. The Managing Director is now working up proposals and there are a number of different options that can be looked at. The membership is agreed that we have to find a stable, long term source of finance.

Q218 Chairman: To go back to Kerry's question about the Independent Evaluation Office, would there be a need to provide that with a firmer basis in the articles of agreement of the IMF to provide for its operational independence both in selection of staffing and in funding?

Mr Brown: That is obviously an issue that arises from the degree of independence that exists and perhaps Tom might say something about that.

Mr Scholar: The reference in the articles of agreement is to the Managing Director being appointed by the membership through the Executive Board and the Managing Director then having the authority and the responsibility to make his or her own decisions about staffing. That is something that is very important. In the case of the IEO, the Independent Evaluation Office, the head of that office is appointed by the board rather than by the Managing Director because it is an independent office, it examines the working of the Fund and it reports to the membership through the board. The IEO is not formally speaking part of the staff of the IMF. It is a separate and independent body reporting to the board.

Q219 Angela Eagle: There is an interesting balance developing, I think, in the shift away from crisis management to crisis prevention and Sally Keeble referred to it earlier, this tension between legitimacy and being able to have enough legitimacy in the new world to leave behind some of the culture and perhaps mistakes of the past if it is going to work. How do you think that legitimacy can be built in the run-up to the Singapore meeting and how can the whole world, rather than just those that have been involved in the past or have been seen to be involved in the past, be confident that an institution such as this can emerge from some of the mistakes of the past and do a good job for us in the future?

Mr Brown: It is partly that we have to find an agreement on quotas of representation, so the legitimacy of the IMF moving forward is enhanced by it being more inclusive and more representative and taking into account the changes in the world economy. It is partly, as I said before, that all countries subject themselves to the surveillance and the transparency that is necessary and it is partly that the IMF shows clearly that it is shifting its role to crisis prevention and therefore people see it as serving them as they try to avoid a crisis rather than imposing its will when a crisis develops. It is mainly fiscal. The idea that all the IMF did was deal with fiscal crises has developed over a period of years but once you see the emphasis on surveillance and that it is about crisis prevention the IMF then seems less of a threat than people had seen it to be when it came into the country with its programmes and more of a service to prevent there being a crisis in the first place.

Q220 Angela Eagle: There are some NGOs that say that the move to independence, which Britain has led and I can accept the technical reasons for it in surveillance, actually make the institution even more remote and decrease its legitimacy. What would be your comment on that?

Mr Brown: I just give you the example of monetary policy in Britain. Because monetary policy is operated technically by the Bank of England that administers our monetary policy—we set the inflation target but the Bank of England administers it—I do not think that monetary policy is seen as more remote or that interest rate decisions are seen as more remote. I think they are seen as more credible and legitimate as a result of the changes we made. Equally, I think that would happen with the IMF, that people would see a coherent and comprehensive system of transparency arising from surveillance and it would be credible and more legitimate to people because of that. Remember also that the IMFC, which is the committee of the stakeholders that I have the privilege of chairing, will guide this process, so there is political representation. It is not, if you like, moving out of the ambit of representative government at all. In fact, under our proposals and the agreement that we had in April the IMFC, which is the representative committee, would have a bigger role in shaping the agenda for the surveillance work of the IMF.

Q221 Mr Gauke: Can we briefly return to the issue of lending conditionality? One area that has been controversial has been when the IMF has imposed cost recovery programmes on borrowing governments that have required schools and hospitals to charge fees. As far as you are aware has the UK representative at the IMF ever supported such conditions in the period that you have been Chancellor?

Mr Brown: I shall ask the representative because he makes the rules.

Mr Scholar: On the one hand the IMF has a responsibility to give its best advice on fiscal sustainability, but on the other hand it has a responsibility to respect country sovereignty over choices as to how it achieves that. One thing we have been very much at the forefront of stressing in these last few years is that it is very important for the Fund not to get too much into, but the detail of micro-managing countries' choices rather try to explain to them what the choices are, and also wherever possible to respect attempts to preserve fiscal space for public services, whether it is education or health or social safety nets. That was one of the lessons of the Asian crisis, that if the social safety nets are abandoned in an attempt to reach a fiscal target it is not a sustainable solution. We of course support best advice on sustainable solutions but we also think it is very important that the IMF recognises the right of countries to choose themselves how they do that.

Mr Brown: Specifically on fees, on education, which is primarily the work of the World Bank, there is an agreement now that we support this (and the World Bank advocates this), that we should provide support for education so that for primary schooling there should be no fees. I think that is generally the view of most countries that are donor countries around the world. On the general issue of conditionality and how the IMF should proceed in the future, and this affects the World Bank and the IMF, the UK policy paper that was produced in March last year, *Partnerships for Poverty Reduction, Rethinking Conditionality*, I would recommend to the committee. Here the emphasis is on less conditionality from the IMF and more on accountability of governments to their own people so that they have to answer to their own people for how they are spending the money.

Q222 Mr Gauke: I am grateful for those answers but I am not sure I have got an answer to my specific question as to whether we have ever supported those conditions. I accept the position as to where we stand now but historically have we ever supported imposing fee-charging conditions?
Mr Brown: I do not think we are supporting fees in education in votes on the IMF board but I do say that these are fees that primarily come up in the discussions of the World Bank, and health charges are a much more controversial issue, but I have just seen in the last few days that Zambia, as a result of our debt relief package of about six billion, has been able to abolish health charges, so the debt relief that has been provided is enabling countries to move forward on these issues.

Q223 Ms Keeble: I just want some clarification, Chancellor, of something I thought you said earlier, which was, do you not accept the assumed IMF convention that there is a ceiling on the amount of development assistance that developing countries can absorb because of the impact that the inflow of hard currency has on local currency and exchange rates? Are you specifically rejecting the notion that there should be a ceiling?
Mr Brown: That is part of the strategic review. I think I was answering a rather different question about a fiscal—

Q224 Ms Keeble: That is why I was asking for clarification as to whether that was what you were specifically saying.
Mr Brown: What you are asking about now is part of the strategic review in which there will be conclusions drawn soon. The fiscal ceilings, so to speak, that had prevented countries investing in education are a matter that I think our proposals on education for long term finance can deal with. If the IMF can see that the guarantees are there anyway, that money will be provided over the next 10 years for education, it removes much of the problem.
Mr Scholar: There has been some criticism of the Fund in recent years, that it has not paid sufficient attention to the achievement of the Millennium Development Goals and—

Q225 Ms Keeble: I do not want to interrupt but it was just a specific point about the ceilings on development assistance because of the impact on exchange rates.
Mr Scholar: It is precisely on that point. They will now in each and every country look at the macro implications of increased aid flows and they have done a research programme on that which we have been very much pushing.

Q226 Mr Newmark: I want to touch briefly on debt restructuring just to get a better understanding of where the Chancellor's thoughts are on this. None of us likes to see particularly the poorest of developing countries having bad debt and we want to try and resolve that by coming up with solutions up front and resolving those problems. Therefore, I am curious to hear: do you see any role for the IMF in the area of debt restructuring and should it be promoting either collective action clauses or resurrecting sovereign debt restructuring mechanisms?
Mr Brown: I probably should send you a note on this. We have been debating these issues since 1997 and, particularly as a result of the Asian crisis, we did make some progress, but remember this has got to involve the private sector as well as the international institutions. A private sector advisory forum was created by the last Managing Director, Mr Köhler. I note that those new proposals have come from the IIF, from Charles Dallara, and we would be very happy to look at it, but this is a long-running issue and progress is going to be gradual rather than dramatic.

Q227 Mr Newmark: So effectively the whole Chapter 11 process bringing best practice from the private sector studio you would be supporting?
Mr Brown: We have been very supportive of the changes. Perhaps I should send the detailed proposals that we have made[5].

Q228 Mr Newmark: I would love to receive them, Chancellor.
Mr Brown: I may say they were made six or seven years ago.
Mr Cunliffe: The IMF is supporting collecting collective action clauses, particularly in the US markets. It is also supporting the private sector and emerging market governments' voluntary code on debt restructuring.
Chairman: We look forward to that, Chancellor, as well as the one on IMF funding.

Q229 Mr Love: A lot of the media comment following the spring meeting of the IMF in relation to multilateral surveillance was about how implementation of the recommendations that were made for those meetings would occur. The Governor of the Bank of England has got a whole series of issues relating to greater independence and transparency. What is the Treasury take on how we ensure that when these multilateral meetings take place any agreements are actually implemented?
Mr Brown: That is going to be an increasing role of the IMFC as well. Basically you are going to have to persuade countries. There are certain sanctions you

[5] Ev 89

have, there are certain incentives you have. Part of the power of this comes from the power of information, people seeing the consequences of their actions, but in the end you are going to have a far more cohesive international community so that they recognise that what affects one continent also affects another and therefore reciprocal actions or sometimes joint actions are totally necessary.

Q230 Chairman: Chancellor, this is the initial phase of a wider inquiry into globalisation and we hope that when we come back in the autumn you can give us evidence on that. Ahead of that are there any issues that we should focus on that merit particular scrutiny in the wider issue of globalisation?

Mr Brown: I think particularly the inter-relationship between all the institutions is an important issue, and that includes the United Nations and the World Trade Organisation, and where there are gaps I think we should look at that, but also where there are overlaps and the unfortunate resulting waste of resources we should be pretty keen to look at that as well. If the committee wishes to follow that through we could have some private discussions on it where we could provide papers for you. On the overall question of globalisation I would just say this: unless there is a debate about the impact of globalisation the natural result in some countries is going to be more protectionism, because people can see what is happening to an individual manufacturing company and whether it is going to, or it is losing jobs. People cannot so easily see the general benefits that are flowing either to the consumer or indeed to potential or actual employees as a result of global changes, so unless you have a debate explaining what is happening the danger is that people see the down side and they do not see much of the up side. The danger then is that protectionist ideas—and sometimes it is called economic patriotism but certainly xenophobic ideas—develop and these are prejudices that can mean that people see globalisation as a threat when it is also clearly an opportunity as well as something that we have got to beat rather than think it can be wished away.

Chairman: Chancellor, we hope to produce our report ahead of the Singapore meeting and it would be helpful if we could. We are grateful to the Governor of the Bank and yourself for giving us evidence on this and we look forward in the autumn to coming back on that. Thank you very much.

Written evidence

Memorandum from ActionAid International

Introduction

1. ActionAid International is an international NGO working in more than 40 countries worldwide, including the UK. This submission reflects the experiences of ActionAid staff and partners in Africa, Asia, North America and Europe.

2. We welcome the decision of the UK Treasury Select Committee to conduct an enquiry into "Globalisation: the role of the IMF." Our work around the world has demonstrated that there is urgent need for reform of many aspects of the IMF's role and functioning. The UK is the fourth largest shareholder in the IMF, and we believe that this gives the UK a particular opportunity, and responsibility, to press for reform.

Impact of Globalisation on the Current and Future Roles of the IMF

3. As developing countries have become more integrated into the global economy and more heavily dependent on donor funding, the role of the IMF as arbiter of "appropriate" economic policies has increased. This brings with it two problems.

4. Firstly, it gives the IMF a much stronger role in determining national economic policy decisions. This is despite the fact that the IMF is an institution which stands outside national democratic processes and accountability mechanisms, and is itself deeply undemocratic and unaccountable (see below.)

5. Secondly, the IMF's definition of sound economic management is often inconsistent with the policies needed for sustainable growth and poverty reduction.

6. The IMF generally requires borrower countries to maintain very low rates of inflation. Research by ActionAid International found that in 45 out of 63 recent IMF programmes, the inflation target was set at 5% or less. This contradicts peer reviewed economic research, including by the World Bank, which has demonstrated that countries can sustain inflation rates of up to 20% without damaging their growth prospects.[1] Such low inflation targets inevitably constrain the level of public expenditure that can be sustained, with knock-on effects on health and education spending and hence on the capacity of poor countries to meet the MDGs.[2]

7. Moreover, in-depth interviews conducted with finance and central bank officials in eight countries (Bangladesh, Ghana, Malawi, Uganda, Zambia, Guatemala, Sierra Leone and Nigeria) found that there was a lack of awareness of alternative or more expansionary fiscal and monetary policies.[3]

8. IMF programmes often include other conditions which prevent poor countries from investing in education and healthcare. For example, the IMF continues to recommend that the wage bill be reduced in order to contain recurrent expenditures to "sustainable level." In 2005, for example, the IMF recommended a reduction in the wage bill in Kenya from 8.5% of GDP in 2005–06 to 7.2% by 2007–08. Although it has eliminated user fees, Kenya is unable to hire the estimated 60,000 teachers required to staff the expanding number of students enrolled in schools.[4]

9. Significant numbers of IMF programmes also involve conditions in controversial policy areas such utility privatisation and trade liberalisation, which have often been shown to hurt rather than help poor people. For example, in Tanzania, privatisation of energy was included as a condition in the IMF's Poverty Reduction and Growth Facility (PRGF) for 2003–06, while privatisation of the Dar es Salaam Water and Sewerage Authority as included in the PRGF 2000–03.[5] In Kenya, reduction of the top external tariff rate from 35 to 25% was included in the PRGF agreed in 2003.[6]

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[1] Bruno, M (1995) "Does Inflation Really Lower Growth?" Finance and Development, Vol 32 no 3 Sept 1995 pp 35–38.

[2] ActionAid International USA (2005) "Changing Course: Alternative Approaches to Achieve the Millennium Development Goals and Fight HIV/AIDS."

[3] Ibid, ActionAid International (2005) "Contracting Commitments: How the Achievement of Education for All is Being Undermined by the International Monetary Fund."

[4] ActionAid International (2005) "Contradicting Commitments: How the Achievement of Education for All is Being Undermined by the International Monetary Fund."

[5] Actionaid International UK (2004) "Money Talks: How Aid Conditions Continue to Drive Utility Privatisation in Poor Countries."

[6] Christian Aid (2005) "Business as Usual: The World Bank, the IMF and the Liberalisation Agenda."

UK Perspective on the IMF's Strategic Review

10. ActionAid International welcomes the IMF Managing Directors' decision to review the role and function of the IMF. However, we are concerned that the process for undertaking the review appears to be very opaque and the opportunities for input from civil society groups are not apparent. ActionAid International believes that it is vital that such groups, particularly those from IMF borrower countries, are able to provide feedback on their experience of IMF policy and practice in their countries.

11. The IMF Strategic Review should focus in particular on the impact of IMF policies on women and girls. This is an area to which scant attention is paid at present, despite the fact that the poor are predominantly female.

Current UK and European Policy Towards the IMF

12. ActionAid International is concerned that UK activities in the IMF board are not made sufficiently transparent. We would like to see publication of the UK's positions within Executive Board discussions, both in terms of formal voting and views expressed during IMF board discussions.

Governance and Management of the IMF

13. The governance and management of the IMF need to be radically overhauled. At present, the institution is deeply undemocratic, and lacking in basic transparency and accountability.

14. ActionAid International would like to see as a priority:

(a) Increased transparency of Executive Board discussions, for example publication of board minutes and all board papers before discussions take place.

(b) Much greater representation of borrowing countries in the governance and decision making processes of the IMF.

(c) A greater role for Parliaments in scrutinising and approving IMF loan conditions.

January 2006

Memorandum submitted by the Bank of England

FOLLOW-UP TO TREASURY SELECT COMMITTEE HEARING

During the TSC evidence session on 27 April, the Chairman raised the question of whether the IMF is developing into a ratings agency for private lenders, especially following the creation of the Policy Support Instrument (PSI). This short note complements our verbal evidence, setting out: (i) the key features of the PSI; and (ii) why the Fund should not adopt the role of a ratings agency.

(i) *The Policy Support Instrument*

The Policy Support Instrument (PSI) provides a mechanism through which low-income countries that neither need nor want to borrow from the IMF can enter into a programme relationship with the Fund. Since its introduction in October 2005, two countries—Nigeria and Uganda—have sought and obtained a PSI arrangement.

For eligible countries, there are three potential benefits from securing a non-borrowing IMF programme under the PSI. First, it allows national authorities to draw on the expertise of Fund Staff in developing a macroeconomic policy framework designed to achieve sustainable growth and reduce poverty. Second, and most important, a programme relationship with the IMF should strengthen the credibility of the policy framework and provide a signal (of policy strength) to donors and creditors. Finally, a PSI arrangement can facilitate rapid access to IMF resources in the event that an unanticipated shock creates a financing need.

Access to the PSI is currently restricted to low-income countries eligible to borrow from the IMF under the Poverty Reduction and Growth Facility (PRGF) and which have a suitable Poverty Reduction Strategy (PRS) in place.

The approval of a PSI arrangement and the outcome of subsequent programme reviews can have a significant impact on the actions of donors and creditors (actual and potential). In principle, this could include exerting influence over the lending decisions of private creditors. But very few low-income countries have the ability to access international capital markets on affordable terms. Rather, a large majority of these countries' financing needs are met by grants and low-cost loans from official donors, the multilateral development banks and bilateral (Paris Club) creditors. Accordingly, it is not realistic to argue that the creation of the PSI has moved the IMF in the direction of becoming a ratings agency for private lenders.

Importantly, the creation of the PSI does not change the well-established role of the Fund in acting as a "gatekeeper" for aid flows from donor countries and other multilateral institutions (including the World Bank). These flows are typically contingent upon IMF endorsement of a recipient country's macroeconomic policies. One of the benefits of the PSI is that the Fund will now be able to provide such endorsement without extending new loans to low-income countries that are already heavily indebted.

(ii) *Should the Fund become a ratings agency?*

The IMF routinely assesses the economic prospects of all 184 member countries as part of its bilateral surveillance activities. It is reasonable to claim that the private rating agencies conduct a similar exercise, albeit for a more restricted set of countries. A key difference, however, is in the focus of the analysis. For the Fund, the intention is to develop largely qualitative policy recommendations that can be conveyed to the relevant authorities in the country concerned. The rating agencies, by contrast, aim to construct a quantitative measure of the likelihood of sovereign default (encapsulated in a rating), primarily for the benefit of private creditors.

Furthermore, the premise that the IMF should act as a rating agency is inconsistent with the role of the Fund as a provider of temporary financial support to member countries that encounter balance-of-payments problems. Analysis produced by the ratings agencies exerts significant influence over the lending decisions of private investors in emerging market economies in particular. But it is inevitable that there will be occasions on which sovereign credit ratings fail to predict a financial crisis. In a situation where an over-optimistic rating was produced by the IMF itself, the institution would be placed under considerable pressure to remedy the situation by providing a large "bail-out" package. There is a clear risk that this dynamic would prevent the Fund from focussing on its core surveillance mandate, undermine the credibility of IMF access policies, and distort the international financial system.

These concerns notwithstanding, several commentators have suggested that IMF surveillance should move in the direction of providing a more precise assessment of member countries' policy performance. For example, a recent IMF Working Paper by Jonathan Ostry and Jeromin Zettelmeyer proposes that the Fund should assign to each member country a "summary rating" that would map directly to access levels.[7] Under this model, a strong record of prudent policy choices would translate into greater availability of financial support, should the need arise. In this way, the incentive to implement IMF policy recommendations would be strengthened.

Although a significant contribution to the debate, it is important to emphasise the Ostry-Zettelmeyer proposal stops far short of turning the IMF into a ratings agency. The authors envisage just three alternative summary ratings. By contrast, S&P employs more than 20 different ratings, ranging from AAA to D (default). More importantly, there is no suggestion that IMF-produced ratings should attempt to measure of the likelihood of sovereign default. Rather, the intention should be to ensure that the level of access available to member countries is consistent with the quality of their national policy frameworks.

June 2006

Memorandum submitted by the Bretton Woods Project

Introduction

1. The Bretton Woods Project is an independent NGO established by a network of UK-based NGOs in 1995 to take forward their work of monitoring and advocating for change at the World Bank and IMF. See www.brettonwoodsproject.org/about for more details.

2. Past Treasury Committee inquiries (January 1999 on Fund reaction to East Asian crisis; February 2000 on the challenges of a globalised economy; and January 2001 on IMF accountability) have provided useful opportunities to better develop UK policy approaches to the IMF as well as increase UK accountability for its actions at the Fund. The current inquiry comes at a particularly opportune time, coinciding with the IMF medium-term strategic review and the early stages of discussion for the IMF's thirteenth quota review.

3. The IMF faces challenges on all fronts. Most visibly, its governance structure is in desperate need of reform. More fundamentally, the dwindling of the Fund's lending portfolio at a time of rising (and unnecessarily costly) levels of national reserves, denotes recognition that de-linking from the Fund and the financial costs that entails, is superior to submitting a country to the exigencies of its economic prescriptions. Having abandoned its role in regulating wealthy countries, and with middle-income countries now turning

[7] "Strengthening IMF Crisis Prevention", IMF Working Paper WP/05/206, November 2005. As with all IMF Working Papers, a disclaimer is included to emphasise that the views expressed are personal those to the authors and do not reflect an official IMF position.

their backs, the Fund could soon be left with only the poorest countries as its clients—those who can least afford to pay. Steps taken by the Fund to prevent and manage financial crisis in the wake of the East Asian Crisis are widely seen as inadequate.

4. The Fund must take bold steps to end the democratic deficit in its governance structures and "go back to the drawing board" in terms of its functions. This should include a re-think of its surveillance and exchange management role vis à vis wealthy countries; the elimination of all but fiduciary conditionality on its lending to middle-income countries (returning to its initially envisioned role as a quick-disbursing fund in times of balance of payments difficulties); and the adoption of more flexible macroeconomic policy advice in low-income countries.

Impact of GLobalisation on the Roles of the IMF

Crisis management

5. The flagship role of the IMF is the prevention of financial crises, and the mitigation of the impact of crises when they do occur. The Fund's actions have—in many cases—contributed to the frequency of financial crises and aggravated their impacts.

6. The pursuit of rapid financial liberalisation, primarily through the liberalisation of the capital account, has led to increased financial volatility and vulnerability. This was conceded in a paper co-authored by the Fund's former chief economist Ken Rogoff.[8] According to a study by the Independent Evaluation Office, IMF management, staff and board were "aware of the risks of premature capital account liberalisation", such awareness "remained at the conceptual level" and did not lead to operational advice on preconditions, pace and sequencing of parallel reforms.

7. The Fund's best attempts to prevent future financial crises have centred on the establishment of standards and codes. In its third report of 1999–2000,[9] the Treasury Committee urged the government to ensure input from developing countries into the development of such standards, to make certain that the costs of implementation did not exceed the benefits of having the standards in place. We support the use of standards which have been adopted with the full involvement of developing countries in their design and cost-benefit assessment. However, the ability of such standards to prevent future financial crisis should not be overestimated. Financial crises can and have occurred in countries with sound financial regulatory regimes.

8. Similarly, reliance on so-called "early warning systems" is predicated on the false belief that the mere provision of information will lead investors to behave in ways which stabilise the economy. For these reasons, we would support a "trip wire—speed bump" approach such as advocated by Grabel and Chang.[10] This would require the Fund to assist developing countries in preparing a range of policy measures, including capital controls, to manage the challenges associated with increasing financial integration.

9. Often missing from the discussion of financial crisis is the need for greater attention to the role played by the policies and institutions in rich countries in triggering financial crises. The G4 group of Belgium, Netherlands, Sweden and Switzerland, agrees: "surveillance of larger developed countries should include more analyses on aspects of global financial stability". Yilmaz Akyz, former director of UNCTAD's globalisation division, in a technical briefing prepared for the G24, supports previous British calls for a greater separation of surveillance and lending functions. However he concludes that asymmetry in surveillance between borrower and creditor countries can only really be reduced by "minimising conditionality for borrowing countries and increasing the degree of automaticity of access to Fund resources".[11]

10. Resolving sovereign debt issues in the wake of a financial crisis is an integral part to burden-sharing and minimising the impact of the crisis on the most vulnerable. In its third report of 1999–2000, the Treasury Committee urged the UK to take a stronger lead in pushing for the private sector to take responsibility for high-risk loans.[12] The UK support the IMF's defeated proposal for a Sovereign Debt Restructuring Mechanism, and continues to support the development "of a practical operational framework for the restructuring of unsustainable sovereign debts".[13] The SDRM proposal was fundamentally flawed in placing the IMF in a hypocritical position as both creditor and arbitrer of debt workouts. The UK should consider supporting the proposal for a Fair and Transparent Arbitration Procedure.[14]

[8] *Effects of Financial Globalization on Developing Countries: Some empirical evidence,* Prasad et al., available at http://www.imf.org/external/np/res/docs/2003/031703.htm.

[9] Treasury Committee third report 1999–2000, paragraph 42.

[10] Trip wires and speed bumps: Managing.

[11] Reforming the IMF: Back to the drawing board, Yilmaz Akyuz, G24. Available at: http://www.g24.org/Akyu0905.pdf.

[12] Treasury Committee third report 1999–2000, paragraph 48.

[13] The UK and the IMF 2004–05, HM Treasury.

[14] Jubilee framework for international insolvency, available at:
http://www.jubileeresearch.org/analysis/reports/jubilee—framework.html

Poverty reduction

11. The Fund has begun to realize that, in low-income countries, the policies it supports should place greater emphasis on attainment of human development objectives. Matthew Martin of NGO Debt Relief International, has urged the Fund to "start from GDP growth rates needed to attain the MDGs". This would mean a reversal of its traditional logic of "designing programmes on the basis of inflation targets and availability of financing."[15] Martin argues that the Fund's stabilisation targets—primarily inflation rate and fiscal deficit targets—could be made more flexible in a number of ways: by greater emphasis on growth where it will not undermine stability; by allowing countries to propose alternative means of achieving targets; and through the inclusion of programme "adjusters" which would allow higher expenditure if more aid or revenue materialises than expected. Adopting alternative macroeconomic policies would help to end what ActionAid has described as the Fund's undermining of the achievement of MDGs in education and health.[16]

12. Any major shift in macroeconomic policies which low-income countries adopt should be based on evidence of its distributional impacts. For this reason it is important that the Fund mainstream Poverty and Social Impact Assessments (PSIA) in its work. A recent study from the European Network on Debt and Development[17] finds that the IMF's commitments to evidence-based policy making are not translating to action: "The IMF has failed to take the PSIA approach seriously. The small PSIA team established in September 2004 is poorly resourced and has produced extremely limited research." Further, it finds that of what little PSIA has been done by the Fund, "macroeconomic frameworks continue to be off the agenda despite the increasing debate around the impacts of stringent IMF policies on growth and poverty reduction."

IMF Strategic Review

13. We have significant concerns about the process of the Fund's strategic review. It is not clear how shareholder governments or civil society will be able to input, evaluate or influence the review process. It is not unreasonable to assume that the process for a medium-term review of the structure and functions of a critical institution in global financial architecture would have been consulted upon and clarified before it was undertaken.

14. As for the substance of the review, we see no convincing argument as to why the Fund's institutional purposes should be changed. Under the Fund's articles of agreement,[18] its main purposes are to facilitate the balanced growth of trade (in order to maintain high levels of employment), to promote exchange stability and to lessen the duration and degree of disequilibrium in balances of payments. We find these purposes both concrete and still relevant for today's economy. Conversely, "helping members meet the challenges of globalisation", as suggested in the review—particularly in the absence of a clear definition of what is meant by globalisation—is unfocused and open to interpretation.

15. Our specific concerns about the direction that the review is taking include:

— the failure to sufficiently address the need for greater surveillance of the policies and institutions in wealthy countries which trigger financial instability;

— the failure to take bold steps to address the need for a debt arbitration procedure; and

— the assumption of a role in promoting capital account liberalisation in the face of empirical evidence which suggests that such measures make developing countries more and not less susceptible to financial crisis.

The full commentary of the Bretton Woods Project on the strategic review can be found at: http://brettonwoodsproject.org/article.shtml?cmd[126] = x-126-438665.

UK and European Policy Towards the IMF

UK accountability at the IMF

16. Scrutiny of the government's activities at the IMF by parliamentary committee is a critical measure of accountability. The annual hearings of the International Development Committee on the World Bank and IMF play a central role. However, due to the natural focus of the IDC on issues which relate to the World Bank, there has been less attention given over recent years to the IMF. In the last six years, Chancellor Gordon Brown has only appeared once in front of the annual IDC session on the World Bank and IMF (in November 2003, while the Secretary of State for International Development has appeared at every such session). Similarly, after a series of regular hearings between 1999 and 2002, culminating in the appearance

[15] "A Changing Role for the IMF in Low-Income Countries", Martin and Bargawi, in *Helping the Poor? The IMF and Low-Income Countries,* Teunissen and Akkerman (eds.), FONDAD, 2005.

[16] *Changing course: Alternative approaches to achieve the MDGs and fight HIV/AIDS,* ActionAid International, available at: http://www.actionaidusa.org/pdf/Changing%20Course%20Report.pdf

[17] Open on impact? Slow progress in World Bank and IMF poverty analysis, EURODAD, Sept 2005. Available at: http://www.eurodad.org/articles/default.aspx?id = 650

[18] Article 1, IMF Aricles of Agreement: http://www.imf.org/external/pubs/ft/aa/aa01.htm.

of IMF Managing Director Horst Koehler before the Committee, interest of the Treasury Committee in IMF issues in the last four years appears to have tailed off. For this reason we particularly welcome the current inquiry.

17. The Treasury Committee played a key role in convincing the Treasury of the importance of an annual report on its activities at the Fund. The Bretton Woods Project has been monitoring these annual reports since their inception. The reports have improved over time in the breadth and depth of coverage, and we believe they continue to serve an important function. To further improve the reports, more could be done to detail who within Treasury is leading on which issues, how policy positions were arrived at (and especially why civil society consultation was or was not taken into consideration) and how Treasury and other government agencies are collaborating on relevant issues. Greater attention should be given to the evaluations of the IEO in the report.

Bretton Woods Project commentary on the UK and the IMF 2005:

http://brettonwoodsproject.org/article.shtml?cmd[126]=x-126-298644.

European policy towards the IMF

18. The Bretton Woods Project, along with many of its partners in the EuroIFI civil society network, have been closely monitoring developments in European countries' relations with the international financial institutions. We view as positive the continuing trend towards greater cooperation of European representatives. This has taken the form of the Sub-Committee on the IMF (SCIMF) under the Economic and Finance Ministers' Council in Brussels; and an informal body called EURIMF which meets regularly in Washington.

19. Research co-commissioned by the Project[19] concludes that, especially given the ratification failure of the draft EU Constitution Treaty, European power in the IFIs will remain, in the short term, in national administrations. However, in light of increasing calls for a re-structuring of IMF governance (see below), European countries would be better to address the issue of European coordination in a forward-looking manner. We believe a number of steps would usefully advance European cooperation at the IMF:

- European member states should agree to a list of countries of common interest for Article IV review where they would commit to coordinate;
- EURIMF should be strengthened through the creation of a coordination office in Washington. This office would be responsible for liaising between European EDs and other member state representatives at the IMF, and profiling the EU at the IMF; and
- European EDs at the IMF should hold an annual visit to the European Parliament on the model of what currently happens for World Bank European EDs.

It is vital that transparency be a priority in any such developments. This would entail public access to EURIMF and SCIMF documents.

Governance and Management of the IMF

20. It has been recognised by all sides that the future legitimacy of the Fund rests at least partially on fundamental reform of its governance structures.

21. The thirteenth review of IMF quotas, to be completed by January 2008, opens up a window of reform. The UK has supported calls for enhancing the voice of developing countries in the IFIs. It has very usefully backed suggestions for both an increase in the basic vote and an additional chair for African countries. However, further steps may be needed if the legitimacy question is to be addressed. The UK should clarify its position on:

- separate formulas for contribution and voting power (while access should be determined by an assessment of need, as *de facto* occurs currently);[20]
- the use of purchasing-power parity in the calculation of voting power;[21]
- a voluntary reduction in the UK quota (for ad hoc distribution to countries which are especially under-represented);
- the selective use of double majority voting;
- the re-alignment of constituencies to ensure a maximum number of countries in any one constituency; and
- a consolidation of European representation.

[19] *European Coordination at the World Bank and at the IMF: A question of harmony?* ADS insight. January 2006.

[20] "Reforming the IMF: Towards Enhanced Accountability and Legitimacy", Kelkar et al, in *Reforming the Governance of the IMF and the World Bank,* Buira (ed), Anthem Press, 2005. pp 54–55.

[21] "Purchasing Power Parities and Comparisons of GDP in IMF quota calculations", John McLenaghan, in Buira (ed) 2005, Anthem Press, 2005. pp 171–194.

22. On the question of leadership selection, the status quo (whereby the leadership of the Fund is in the gift of the EU) must be rejected. In its response to the TSC's third report of session 1999–2000 (paragraph 19), the government committed to "work with other members to consider whether changes should be made to the selection process". The UK took some initial steps during the nomination of Rodrigo de Rato, but should work with European finance ministers to ensure a truly open and meritocratic selection process for all positions at the IMF.

23. On the question of board effectiveness, there has been no announcement of whether there will be an assessment of the impact of the Analytical Trust Fund established to increase the capacity of African EDs on the board.[22] The UK is the largest donor contributing to the Fund. Further research and a public UK position is sought on the recommendation of the Commission for Africa to replace the current Board of Governors with decision-making councils made up of elected representatives.[23]

24. We support previous calls by the Treasury Select Committee for the full disclosure of board minutes and we appreciate UK government advocacy on this issue. Experience with the World Bank pilot of disclosure of board minutes which has not proved very revealing, has led us to request transcripts. Currently the IMF allows access to board minutes (which includes transcripts) after 10 years, making a mockery of the public's right to access information in a timely fashion.

25. We welcome improvements to Fund transparency more generally such as increased rates of publication of Article IV reports.[24] However, we feel there is still a long way to go. Draft policies and strategies are not disclosed;[25] more consistent and timely disclosure of letters of intent, PRGFs and PSIA is needed; and publication of the board's work programme is extremely limited (the executive board calendar only gives the agenda for the next week, as compared to the World Bank calendar which gives the agenda for the next month). We would encourage the IMF to change its approach to transparency, as advocated by the Global Transparency Initiative.[26] This would involve the adoption of the presumption of disclosure. Disclosure of information at the IMF is currently presumed in some situations, but voluntary in many others. There may be narrowly defined exceptions to the presumption of disclosure, but importantly, there should be an appeals mechanism to ensure that these exceptions are not abused.

26. We support previous calls by the Treasury Select Committee to have senior Fund officials appear in front of parliaments. The issue of parliamentary accountability is central to increasing the voice of developing countries and their citizens. The International Parliamentarians' Petition,[27] signed by over 1,000 MPs in over 50 countries, calls for greater parliamentary scrutiny of IFI activities and an end to IFI board sign-off on national development strategies. Further steps are needed, such as those being taken by DFID to support the formation of parliamentary oversight committees such as the Malawian Parliamentary Committee on Oversight of the IFIs.[28] Recognising the necessary confidentiality of some of the Fund's work, suggestions have been made for increasing the role of cross-party parliamentary committees operating under confidentiality arrangements, or institutions such as Public Accounts Committees or Auditors General.[29] Finally, there is a need for better guidelines for IMF staff interaction with parliamentarians.

27. The UK played a key role in the establishment of the Independent Evaluation Office. The IEO has provided insightful analysis of Fund activities, however, neither Fund management nor shareholders have put sufficient effort in to following up on its recommendations. As the IEO begins the second round of evaluations of topics which it has already covered, this will provide an ideal opportunity to determine why previous recommendations either were or were not adopted. This will require that the IEO has both the necessary financial resources and sufficient political backing to do its work. The work of the IEO has not received sufficient attention in the annual UK and IMF reports. This point is especially important considering that the IMF is not included in most evaluations of multilateral organisations, such as DFID's assessment of Multilateral Organisational Effectiveness (MEFF), or the like-minded group's Multilateral Organisations Performance Assessment Network (MOPAN).

28. Professor Daniel Bradlow at American University has raised a critical gap in the IMF's governance structure. He points out the absence of any mechanism at the IMF for dealing with cases of staff or management non-compliance with applicable policies and procedures. This becomes critically important as

[22] African directors' capacity fund underway: http://brettonwoodsproject.org/article.shtml?cmd[126]=x-126-62981.

[23] Africa Commission: World Bank and IMF "increasingly irrelevant" http://brettonwoodsproject.org/article.shtml?cmd[126]=x-126-150399

[24] Staff review of the Fund's disclosure policy, available at: http://www.imf.org/external/np/pp/eng/2005/052405.htm

[25] IFI transparency resource database on IFI disclosure requirements, available at: http://www.ifitransparencyresource.org/en/InstitutionsDetail.aspx?id=10

[26] Global Transparency Initiative (GTI) is a network of civil society organisations promoting openness in the IFIs. http://www.ifitransparency.org.

[27] International Parliamentarians' Petition, http://www.ippinfo.org.

[28] Malawian Parliamentary Committee on the IFIs, details available at: http://www.ippinfo.org/documents/MAPCOIREPORT2005.doc

[29] Democratizing the IMF, Woods et al in *Accountability of the IMF,* Carin and Woods (eds), IDRC, 2005. pp 52–61.

the IMF consults with a broader range of government officials, parliamentarians and civil society. He recommends the creation of operational policies and procedures supported by the establishment of an independent ombudsman.[30] This recommendation deserves further investigation from the government.

January 2006

Memorandum submitted by Center of Concern

EXECUTIVE SUMMARY

In April 2004 the IMF launched the Trade Integration Mechanism (TIM), a policy oriented to enhance the predictability of access to financing by member countries experiencing difficulties as a result of certain trade events. While the establishment of the TIM implies a welcome recognition of the financial problems triggered by trade liberalisation in developing countries, it represents an ineffective and far from sufficient response to such problems.

Moreover, the TIM arguably distorts the IMF's function of providing short-term balance of payments support to all its members, without discriminating regarding the sources of the financial shortfall. The TIM, however, implies an attempt to influence the trade policy decisions of its members by providing them a sense of comfort and setting up a counterargument that makes it harder for them to resist multilateral liberalisation measures that will bring large dislocations to their economies.

The TIM does not represent access to additional resources; does not ensure access to concessional resources; does not ensure fast and easy access to financing, is of limited scope and its time coverage is not symmetrical to the time coverage of the trade rules generating the losses.

INTRODUCTION

1. In April 2004 the IMF launched the Trade Integration Mechanism (TIM). In the Fund's own words, the TIM is not a new facility, but a policy oriented to enhance the predictability of access to financing by member countries experiencing difficulties as a result of certain trade events.

2. A given country could apply to financing under this policy when their balance of payments problems arise from trade liberalisation measures introduced:

(a) by other countries;

(b) resulting in more open market access for goods and services; and

(c) under a WTO agreement or on a nondiscriminatory basis (IMF 2004a: 15/16).

3. Three examples provided by the IMF are: the country is suffering erosion of preferences as a result of other countries opening their markets; a net-food importing country is experiencing surge in the prices of food imports as a result of subsidy removals by another country; a country experiencing losses of textiles markets as a result of elimination of bilateral quotas.

4. Given that the TIM is a policy designed to shape access to existing facilities without creating a new one, any country wishing to obtain financing under this policy will need to do so in the context of an existing facility or arrangement with the Fund, eg, the country is borrowing under an upper-tranche Stand-by, Extended Fund Facility or a Poverty Reduction and Growth Facility arrangement. This means that all conditions the borrower needs to satisfy in order to borrow from the facility in question (at the very least, the basic tenets of a Fund adjustment program), will still need to be met. Also, with some caveats, it is the levels of access and financing terms of such facilities that will apply.

5. While the establishment of the TIM implies a welcome recognition of the financial problems triggered by trade liberalisation in developing countries, it represents an ineffective and far from sufficient response to such problems. Moreover, there is a concern that the TIM represents a distortion of the IMF's function of providing short-term balance of payments support to all its members. In fact, if the Fund were to be true to its mission, it is hard to justify a policy that guarantees to members undergoing balance of payments problems stemming from a particular event financial help that the Fund, actually, should not be able to deny to any member undergoing a balance of payments problem.

6. Such a policy, however, can be understood as one more chapter in the series of Fund's undue interferences in the trade policy decisions of its members. As expressed by Fund staff, one of the key factors delaying the liberalisation agenda at Doha and Cancun is that several countries, though "accepting the overall value of liberalisation", question its impact for their own economy (Press Conference). TIM seeks to influence the trade negotiating stance of these countries by providing them a sense of comfort and providing a counterargument that makes it harder for them to resist multilateral liberalisation measures that will bring large dislocations to their economies.

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[30] "Operational Policies and Procedures", Daniel Bradlow, in Carin and Woods (eds) 2005. pp 88–107.

7. In particular, the TIM suffers of the following limitations: *The TIM does not represent access to any additional resources.*

8. The IMF does explicitly clarify that the TIM "would not be a special facility that would provide resources under special terms. Rather, it is a policy designed to increase the predictability of resource availabiity under existing facilities." (IMF 2004a: para 24).

9. This means that the level access to resources by affected countries will continue to be governed by the current rules that rule upper credit tranches, Extended Fund Facility or PRGF arrangements. (IMF 2004a: para 33).

TIM does not ensure access to concessional resources

10. The TIM does not ensure access to concessional resources in order to compensate countries for trade losses. Under current Fund rules, the only facility that provides concessional financing under what countries could invoke is a case foreseen by the TIM is the PRGF.[31]

11. The lack of available concessional resources raises a number of issues. To the extent that compensatory financing comes in the form of non-concessional resources, it means that the affected countries are being pushed to address their trade-related BOP problems by increasing their debt, not a healthy choice for any economy, let alone for those countries that are struggling to service an already high debt overhang.[32] In turn, the Debt Sustainability Framework focuses on setting limits on countries' ongoing ability to borrow under non-concessional terms. For countries with debt at unsustainable or nearby levels, this means that the actual impact of third party trade measures on their BOP might be totally irrelevant if there are no available concessional funds for them to access. Finally, absent debt considerations, non-concessional resources might just be too expensive for countries to access them, this being especially so in the case of the countries that need them most. The experience of the Compensatory Financing Facility (CFF) is worth recalling in this regard. The CFF was established in the 1960s to help countries dealing with certain externally caused commodity shocks. However, especially beginning in the 1980s, it came to be of little or no use to the low- income countries, because of the non-concessional character of the CFF loans.

TIM does not ensure fast and easy access to financing

12. Given that this mechanism is about compensating countries for trade shocks that are motivated by trade measures beyond their control, it seems just reasonable that the access to financing should be ensured in fast and simple terms. However, being the TIM not a new facility with different terms but rather a policy that applies in accessing an existing facility, all conditions for access to the facility in question apply.

13. In the context of searching for effective mechanisms to compensate for trade losses, the question of how easy to meet are the conditions to access the financing is a crucial one for at least two reasons. Firstly, several analysts have criticised the IMF policy-based prescriptions, the IMF's jurisdiction to make them and their actual performance. In addition to the usual problems with these prescriptions, a factor at stake when countries seek compensation for losses that stem from third country trade liberalisation measures is that the requesting country is, by definition, one whose own policies are not the ones causing the BOP problem. Therefore, in principle, there should not be need for an adjustment program together with the financing. However, the fact that any assistance will be provided under existing facilities ensures that any financing will be accompanied by the controversial type of conditionalities associated to adjustment. Second, the need to meet the tough conditions of an adjustment program usually mean time delays that, while probably acceptable in other situations, become defeating in the context of compensation that is supposed to operate anti-cyclically in order to smooth the effects of the shortfall on the economy.

14. In fact, in drawing the TIM, IMF staff explicitly considered and dismissed the possibility of having an arrangement outside existing facilities. This was done on the argument that "financial support of this nature still needs to be associated with an appropriate macroeconomic environment, which may entail adjustment." (IMF 2004 a: para 28). In support of this conclusion staff quoted the 2000 review of the CFF where it was decided that disbursements need to happen in the context of adjustment, unless in cases where the balance of payments was otherwise found to be satisfactory, adding that this test "is not often met" (IMF 2004 a: idem).

15. Another factor to keep in mind in assessing the difficulties and speed in accessing financing under the TIM is that the estimation of the adverse shocks that the third-party liberalising measure has on the country's BOP will be done by the Fund itself. The Fund's experience in projecting growth, debt sustainability and financial crises provide enough reasons to be very cautious about the Fund's ability to

[31] The PRGF lends at maturities of $5\frac{1}{2}$ to 10 years and an interest rate of 0.5 a year. Roughly described, the PRGF Trust Fund is made up of loan funds provided by bilateral creditors where some bilateral donors and the IMF provide grants in order to subsidise the interest rate. The grant element of this concessional funding is not very high, either, especially in the light of currently low market interest rates. (For more on this see IMF 2004b: 13/15).

[32] In addressing a question, an IMF official acknowledged that a country should not trespass debt sustainability thresholds in order to make up for trade losses. If the solutions to these countries is not more debt, and there are no grants available to make up for their trade losses, then it should follow that the problem belongs to the trade system and is there where it needs to be addressed through significant changes to the rules.

get it right in terms of projecting trade losses. The staff paper on the TIM provides important indications that affected countries tend to have a heavy burden of proof in demonstrating that a particular BOP problem is due to certain exogenous trade events rather than (1) to its own "mismanagement" of the economy or (2) not canceled out (or entirely offset) by the positive effects of the liberalising measure at stake.[33]

TIM is of Limited Scope

16. As explained above, a member country could apply to financing under this policy when their balance of payments problems arise from trade liberalisation measures introduced (a) by other countries, (b) resulting in more open market access for goods and services and (c) under a WTO agreement or on a nondiscriminatory basis (IMF 2004a: 15/16).

17. The policy does not cover impact of a country's own trade liberalisation measures. In justifying this, Funds staff argues that "in these cases, the balance of payments impact, and indeed the occurrence of the negative event itself, cannot be considered separately from the macroeconomic framework and the authorities' policy response." This is not an uncontroversial assertion. Premature liberalisation, of the kind many countries have engaged in as a result of the advice of the Bretton Woods Institutions themselves, or as a result of legal frameworks where negotiations are highly unequal or do not offer enough flexibility for countries to appropriately sequence the efforts and explore levels of openness on a trial basis, exposes countries to unforeseen vulnerabilities that are beyond their control. Moreover, if countries are suffering impacts of exogenous trade events at the same as they open their borders, it might become very difficult for the Fund to disaggregate the impacts of the country's own policies from those of third-party liberalisers.

18. In order to qualify, the benefits of the measure have to accrue to the whole WTO membership. (It does not need to be bound in the WTO, though, as long as the benefits accrue to the whole membership through operation of the MFN clause). This requirement brings important connotations. While liberalisation of South-South trade can have positive effects for developing countries, some experts have explained that such liberalisation, to be useful to those countries, needs to happen in the context of tariff negotiations in the regional arrangements among the developing countries or tariff negotiations in the framework of the GSTP (Global System of Trade Preferences). Reduction of South-South tariffs in the context of the WTO would make any benefits immediately available to all WTO members, exposing the liberalising country to competition with industrial countries with larger supply capacity and export infrastructure. However, this is exactly the kind of liberalisation for which the TIM provides incentives, as it is the only one whose impacts would qualify under the TIM. Neither would the BOP impacts of measures undertaken in the context of regional or bilateral agreements qualify. Again, almost insurmountable methodological problems are posed by the fact that most countries are engaged in negotiations at different levels, what makes the effects of different and sometimes simultaneous measures hard to disaggregate. Countries trying to meet the requirements for access to finance will certainly find this hard to proof.

The time coverage of TIM is not symmetrical to the time coverage of the trade rules generating the losses

19. It is important to note that the trade liberalisation rules that might be agreed in the WTO under the comfort provided by the TIM, will be irreversible, even if the dislocations prove to be more lasting than expected, or chronic, as the terrible experience of too many liberalising countries has shown.

20. The TIM has been put in place for an initial period of three years after which it will be evaluated. (IMF 2004a: para 44) Although after this period the Board could decide to continue it, there is not guarantee that this will be the case. In fact, the prospects of an extension in current terms and without worsening the modest terms of access (as it has been the case with other facilities over the past several years) are rather limited. As stated by the Fund, given that it is designed to "ease adjustment to specific trade events, which will be implemented over a limited time horizon" the policy is envisioned as temporary in nature. This statement reflects a large measure of optimism regarding the effects of the events and the time needed for adjustments. Optimism is not warranted, given the problems low income countries experience in inserting themselves into new income-generating activities where barriers to late entrants are high and competition large and skewed towards incumbents. At the least, there should be some guarantee that TIM will not be discontinued until appropriate, independent verification that countries under need to implement radical changes in their productive structures as a result of impacts of trade policies have been able to do so.

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[33] Some examples of this:

— Based on "model simulation . . . the impact of preference erosion is unlikely to be large for most countries" (IMF 2004 a: para 14).

— "Several food importing developing countries are net exporters of some nonfood agricultural products and price effects may partly cancel out in their impact on the balance of payments." Also, "domestic production in some NFIDCs (Net Food Importing Developing Countries) is likely to expand in response to higher prices, thus improving the domestic food balance." (IMF 2004 a: para 15).

— "In some cases, different trade events might have directly offsetting impacts on the balance of payments" (IMF 2004 a: fn 14) Along the same lines, the IMF refers to simulations with the Global Trade Analysis project model which "demonstrate that any negative impact tends to be more than offset by other factors."

— "BOP implications would also depend on the foreign exchange regime in place in the country in question"(IMF 2004 a: para 20).

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Memorandum submitted by Christian Aid

Introduction

1. Christian Aid welcomes this opportunity to give evidence to the Treasury Select Committee on the role the International Monetary Fund (IMF) plays in the process of globalisation. Given Christian Aid's work in more than 50 developing countries, our submission will focus on the role that the IMF plays in the developing world.

2. We will highlight the different ways in which the IMF limits the policy choices available to developing-country governments and pushes them into rapid and extreme liberalisation. This "structural adjustment" has caused massive increases in poverty and severely hampered the ability of developing countries to participate in the global economy.

3. This submission will consider how the IMF has stepped far beyond its original mandate in compelling developing countries to liberalise. It will show that the IMF continues to attach liberalisation conditions to their loans, despite their protestations to the contrary, and uses other informal means such as research, technical assistance and policy advice to push further liberalisation.

4. Finally, this submission will consider the democratic deficit evident at the IMF. This deficit pervades its activities at a country level, where the IMF negotiates with government in ways that undermine democratic process, and the institution itself, where decision-making is opaque and balance of power lies in the hands of the world's most powerful countries.

5. Our recommendations to reform this situation are as follows:

— The IMF should ensure that its support for development strategies is objective—not rigidly bound by liberalisation dogma. This means examining the viability of alternative policies, not automatically assuming that all forms of liberalisation will foster growth or poverty reduction. Instead, the impact of liberalisation options should be carefully assessed, enabling countries to make their own informed choices.

— The IMF must end the practice of making loans or grants conditional on the recipient adopting specific economic policies. It should also review all activities which influence the policies of client countries, not just the conditions attached to loans, with a view to reducing those that aim to promote liberalisation.

— The IMF should actively and publicly support developing countries' use of the flexibility their international trade agreements allow them, in particular, their right to raise tariffs.

— Where there are provisions for parliamentary approval or civic involvement, IMF practice should change to ensure that they are complied with. This means immediately withdrawing a loan if a parliament rejects it and requiring that all relevant documents are submitted to parliament. This could include country strategies and analytical work, as well as standard loan documentation.

— We believe that the IMF voting structure should be based on the principle of one country, one vote. However, we recognise that this is unlikely to be achieved in the near future. We therefore call for the share of basic votes allocated to all countries to be increased, and for remaining votes to be allocated through a fair and transparent formula that ensures low-income countries greater representation than at present. Board seats should also be redistributed to achieve more of a balance between industrialised, middle-income and low-income countries.

— Detailed board minutes should be published within two weeks of a meeting. Formal votes should replace consensus decision-making. At a minimum, executive directors should be required to publish statements they make to the board.

— A democratic process for selecting the World Bank and IMF's leaders is essential. All countries should be able to nominate candidates; there should be no restrictions placed on a candidate's nationality; and the voting process should be fair and transparent. When selecting leaders, each country should have a single vote.

Mission Creep

6. The IMF's role was initially limited to policy-surveillance, or an annual check, on countries' monetary and exchange-rate policies to help them avoid financial difficulties. It was also mandated to provide short-term foreign-exchange assistance to countries suffering from temporary shortages because of trade deficits.

7. However, as industrialised countries' need for the Fund's short-term lending declined, the IMF moved into new areas: providing loans to emerging-market countries in financial crisis and giving long-term loans to developing countries. IMF policy-surveillance also "evolved rapidly"[34] to cover other economic areas such as financial systems (banks, securities exchanges, pension funds, insurers, central banks and national regulators); institutional issues (central-bank independence, financial-sector regulation, corporate governance, and policy transparency and accountability) and structural policies (such as a country's international trade, labour markets and energy sectors).[35]

8. The IMF's loans help developing countries with ongoing balance-of-payments difficulties, but also compel such countries to adopt macroeconomic and structural reforms. In pushing structural reform in particular, the IMF is stepping beyond its mandate into an area in which it does not have a clear competence.

9. The IMF's power over poor countries' economic policies is further reinforced by the influence it has over other donors. If the IMF labels a poor country "off-track" on its macroeconomic and structural-policy performance, then most donors are unwilling to offer it debt relief or will cut the amount of aid they give it. In some cases, this sudden drying up of aid can actually trigger a macroeconomic crisis—the very thing the IMF is meant to guard against.

10. Often IMF economic conditions require countries to liberalise far further than the World Trade Organisation (WTO) agreements they have signed up to. For example, there are conditions that compel governments to privatise or commercialise public services, regardless of the exemption provided by the General Agreement on Trade in Services (GATS). IMF conditions also undermine the position of developing countries at WTO negotiations. If a country has completely dismantled trade barriers in a particular sector prior to trade negotiations, it has given up its bargaining chip and lost its ability to make tariff reductions conditional on beneficial reforms from richer countries. Developing countries negotiate hard to obtain provisions for special treatment in WTO agreements, but IMF conditions can undermine this.

11. In response to widespread criticism that it is not its place to push structural reforms, the IMF claims to have reduced the extent of its trade conditionality. This was a welcome assurance, but the IMF is continuing to strongly influence poor countries' trade policies, as we will show in the following section.

Enforcing Liberalisation

12. In response to IMF claims that it had reduced its trade-policy conditions, Christian Aid commissioned research to analyse the full impact of IMF and World Bank activities on trade policy in eight low-income sub-Saharan African countries.

13. The findings were published in Christian Aid's recent report, *Business as Usual: The World Bank, the IMF and the Liberalisation Agenda*. It showed clear evidence that the IMF continues to have considerable influence over trade policy in developing countries and still pushes its dogmatic vision of trade liberalisation.

14. In direct contradiction to the Fund's claim that trade-policy conditions have been "sharply reversed", such conditions are still being attached to aid and debt relief in many countries.

15. In countries where previous IMF conditions have already secured the rapid reduction of trade tariffs, the institution has shifted its attention to other policies to free up the flow of money and goods across borders, such as fiscal reform, non-tariff barriers to trade, customs and trade facilitation, to complete the liberalisation process. While reforming these areas is not necessarily harmful in its own right, the IMF's strongly pro-liberalisation philosophy forces countries down a particular path, regardless of their own spending or trade priorities.

16. At present, the burden of IMF conditions falls mostly on low-income countries that require the institution's funding and the positive signal being "on-track" with IMF conditions sends other donors. But the IMF is designing a new tool, the policy support instrument (PSI), which will allow it to introduce an

[34] "IMF Surveillance", factsheet, September 2005 available at www.imf.org/external/np/exr/facts/surv.htm

[35] Op cit.

invasive programme of monitoring and conditionality for countries that do not need or want IMF money. This new tool will significantly increase the IMF's influence over all developing country governments, who will need to be on track with the PSI if they want donors to provide them with funds.

17. The IMF only measures formal conditions, while turning a blind eye to the other ways in which it influences governments. As the IMF itself notes, "Recent years have seen . . . an upswing in aspects of trade-related surveillance, research and other activities."[36] This includes annual assessments of countries' economic policies, which make recommendations that countries need to implement to access IMF loans.

18. The Fund's general research and advice also influences the policies of developing-country governments. The pursuit of greater coherence between the IMF, World Bank and WTO has seen the IMF produce numerous "speeches, letters and communiqués in support of the Doha round"[37] of WTO negotiations, consistently pushing poor countries to adopt a more liberalising or "ambitious" stance. This often directly contradicts developing-country submissions and negotiating positions, and undermines their ability to negotiate successfully. The IMF has encouraged countries to set tariffs far lower than those they have agreed at the WTO, for example.

19. Christian Aid is particularly alarmed by the "aid for trade" package promoted by the IMF and World Bank. This is being linked to an "ambitious" result in the current round of WTO talks that brings about greater liberalisation and integration between members, and will increase technical assistance and lending to "help the poorest countries take advantage of new opportunities and cope with any adjustment costs"[38] of trade agreements. Unless this funding is additional to existing pledges, has no conditions attached and finances activities that are demand-driven then it will push countries into signing up to policies that are often damaging. No amount of financing will be enough to compensate a country if its trade policies are wrong for its economic circumstances.

20. The IMF continues to hold a very dogmatic position on liberalisation, and uses various methods to force countries to liberalise, despite recent proclamations by both the UK government and the G8 that countries should be allowed to decide their own economic policies. A recent IMF strategic review defined the Fund's role as being to support its members to meet the challenges of globalisation.[39] But the risk of this definition is that it will allow the IMF to further enforce liberalisation on countries desperate for both its cash and its approval.

Recommendations

21. The IMF should ensure that its support for development strategies is objective—not rigidly bound by liberalisation dogma. This means examining the viability of alternative policies, not automatically assuming that all forms of liberalisation will foster growth or poverty reduction. Instead, the impact of liberalisation options should be carefully assessed, enabling countries to make their own informed choices.

22. The IMF must end the practice of making loans or grants conditional on the recipient adopting specific economic policies. It should also review *all* activities which influence the policies of client countries, not just the conditions attached to loans, with a view to reducing those that aim to promote liberalisation.

23. The IMF should actively and publicly support developing countries' use of the flexibility their international trade agreements allow them, in particular, their right to raise tariffs.

Undermining Developing-country Democracy

24. As well as being important in their own right, good governance and democracy are vital if poor countries are to develop. However, the IMF frequently undermines and opposes democracy in these countries. The IMF negotiates with governments behind closed doors, demanding policy shifts that have a massive effect on the lives and livelihoods of the world's poor, while resisting scrutiny by citizens or their elected representatives.

25. In 2005, Christian Aid published the findings of a study examining the IMF's role in the government of Ghana reneging on its decision to increase import tariffs on poultry, as part of a plan to rescue the domestic industry.[40] The tariff increases were part of a parliamentary approved budget. But numerous sources in Ghana confirmed that the IMF had told the Ghanaian government not to implement the tariff increases, immediately prior to its policy u-turn. This reveals the IMF's power in pushing governments into following liberalisation policies, regardless of the impacts of those policies on the country's people and the effect on democracy.

[36] IMF review of work on trade, 7 February 2005.

[37] Ibid.

[38] Joint statements by the heads of the World Bank and the IMF October 2005, quoted in update 48, Bretton Woods Project, November 2005.

[39] *IMF Strategic Review: Reform or left Behind,* Update 48, Bretton Woods Project, November 2005.

[40] *The Damage Done: Aid, Death and Dogma,* Christian Aid, May 2005.

26. Christian Aid and many of its partners have been actively supporting the International Parliamentarians' Petition, signed by MPs from rich and poor countries alike. The petition calls for democratically elected representatives to have the right to control their countries' economic policies, rather than the IMF and World Bank.[41]

Recommendation

27. Where there are provisions for parliamentary approval or civic involvement, IMF practice should change to ensure that they are complied with. This means immediately withdrawing a loan if a parliament rejects it and requiring that all relevant documents are submitted to parliament. This could include country strategies and analytical work, as well as standard loan documentation.

Democratic Deficit at the IMF

28. The majority of the world's countries are members of the IMF. However, while its influence is mainly felt by the poor countries that receive its loans, it is the world's richest countries who have most of the power. All countries have a basic vote, or share, in the IMF, but this is worth only three per cent of the total votes. The rest of the votes are allocated according to a formula which leaves the US with a 16 per cent share, while the combined votes of 80 of the world's poorest countries amount to only ten per cent of the total.[42]

29. This inequality is further evident in the distribution of board seats. The UK, US, Germany, Japan and France each have their own seat, while the other 19 seats are multi-country constituencies. The sizes of those constituencies vary considerably, with the two sub-Saharan African seats for 44 countries.

30. In addition, the disclosure practices of the institution are highly opaque, making it hard to hold decision-makers to account for the IMF's policies and activities. Detailed minutes are not available for meetings of the board of governors (which Gordon Brown chairs) nor for the board of executive directors (on which a senior UK civil servant sits), which oversees the day-to-day running of the institution on behalf of its member countries. Transcripts of Gordon Brown's speeches to the governing board are available, but those of the UK director are not.

31. In 2004 the IMF executive board conducted only one formal vote to reach a decision, while the board of governors conducted just five. The rest of the Fund's decisions were reached by consensus, so it is vital that the relevant minutes and statements are made public to allow citizens and their elected representatives to scrutinise the activities of the UK government at the IMF. This is especially important given the disjuncture between the new UK position on not using conditions to force liberalisation, and the IMF's continued use of such conditions.

32. Despite the international community's pledges to reform the IMF and its sister institution, the World Bank, progress to date has been very slow. The Monterrey Consensus of March 2002 agreed that the IMF and World Bank should "continue to enhance the participation of all developing countries and countries with economies in transition in their decision-making".[43] However, since then, very little has happened beyond the establishment of an analytical trust to fund research and policy dialogues for the two executive directors from sub-Saharan Africa.

Recommendations

33. We believe that the IMF voting structure should be based on the principle of one country, one vote. However, we recognise that this is unlikely to be achieved in the near future. We therefore call for the share of basic votes allocated to all countries to be increased, and for remaining votes to be allocated through a fair and transparent formula that ensures low-income countries greater representation than at present. Board seats should also be redistributed to achieve more of a balance between industrialised, middle-income and low-income countries.

34. Detailed board minutes should be published within two weeks of a meeting. Formal votes should replace consensus decision-making. At a minimum, executive directors should be required to publish statements they make to the board.

35. A democratic process for selecting the World Bank and IMF's leaders is essential. All countries should be able to nominate candidates; there should be no restrictions placed on a candidate's nationality; and the voting process should be fair and transparent. When selecting leaders, each country should have a single vote.

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[41] To date the petition has gathered over 1,000 signatures and been particularly popular in the UK where 282 MPs have signed up to it www.ippinfo.org

[42] *Struggling to be Heard: Democratising the World Bank and IMF,* Christian Aid, September 2003.

[43] The International Conference on Financing for Development was held at Monterrey in 2002. The declaration and more information are available at www.un.org/esa/ffd/.

Memorandum submitted by Jubilee Research at nef (the new economics foundation)

Introduction

1. In the light of the short time-frame allowed for submissions for this inquiry, our submission consists of this covering note and a number of attachments prepared for other fora.

2. We have concentrated on the following elements of the request for submissions:

— the impact of globalisation on the current and future roles of the IMF; and

— governance and management of the IMF.

Other members of the Bretton Woods Project are making submissions on the other elements.

3. The attachments consist of:

(a) "The IMF and the World Bank in the 21st Century: the Need for Change" (written submission by Jubilee Research at nef to the European Parliament on "Strategic Reforms of the IMF", 9 May 2005);

(b) "The IMF: the Wrong Business Model—or the Wrong Business?" (Jubilee Research at nef, 13 January 2006); and

(c) an extract from "Chapter 9/11: Resolving International Debt Crises—the Jubilee Framework for International Insolvency" (Jubilee Research at nef, 2002).

[these articles are available at http://www.jubileeresearch.org]

The Impact of Globalisation on the Current and Future Role of the IMF

(a) *Current Role*

4. As our submission to the European Parliament observes, the international financial environment has changed radically since the foundation of the IMF in 1944. It was designed to provide occasional and temporary support to its (mainly developed) member countries in balance-of-payments difficulties within a fixed exchange rate system, with capital controls. By contrast, the international financial system is now characterised predominantly by floating exchange rates, capital account liberalisation, and commercial capital flows which are both much larger than in the 1940s and of a nature not envisaged at that time. However, the Fund has failed to adapt adequately or appropriately to this fundamentally different context.

5. As the developed countries' need for recourse to the Fund has disappeared, the IMF has become involved exclusively in developing countries, and at a policy level undreamed of in 1944. Balance of payments problems have often been general rather than country-specific, and either chronic in nature (such as the debt crisis) or arising from types of capital flows that did not exist in the 1940s. The IMF's policy interventions have been inappropriate, both in the 1980s debt crisis (contributing to its continuation in low-income countries after more than 20 years), and, as is recognised even by the Fund itself, in the succession of financial crises from Thailand in 1997 to Argentina today. In the latter case, the modalities of Fund programmes and support are also clearly inappropriate to the nature of the crises, primarily because of the delays and uncertainties involved.

6. However, there is no sign that the Fund has developed either more apt policy prescriptions or more appropriate financing mechanisms to respond to similar circumstances in the future. Taking into account the Fund's role in promoting the dismantling of capital account controls—now widely seen as damaging in many circumstances—it is highly questionable even that it is making a net positive contribution to international financial stability.

7. The IMF is now heavily involved in directing economic policies in developing countries using its role as gateway to debt relief and aid, as well as its own lending, to dominate policy making on behalf of the developed country governments, and enforcing the "Washington Consensus" agenda of trade liberalisation, privatisation and globalisation. By largely removing control of large areas of policy and seriously limiting political choice, this undermines sovereignty, democracy and the legitimacy of national institutions, actually encouraging the poor governance which the Fund ostensibly deplores. It also perpetuates an unjust international economic order that condemns large proportions of the world's citizens to poverty, disease and hunger.

8. The second attachment discusses the implications of the dramatic fall in the loans outstanding to the IMF (from \$107 billion in 2003 to \$50 billion at the end of 2005, and an expected \$33 billion during 2006). It argues that this is a result of the developing countries becoming polarised between two groups: "emerging market" economies, who are following in the footsteps of the developed countries in making the transition away from reliance on the Fund, partly in response to the Fund's failure to deal with financial crises effectively; and most poorer countries, who cannot now afford to borrow from the IMF, at least partly

because of its failure to resolve their debt crises. Since the IMF relies on the interest on its lending to fund its own operational costs, this poses a critical problem for the institution, and casts further doubt on the appropriateness of its current role in the 21st century.

(b) *Future Role*

9. In our first attachment, we conclude that the signal failure of the IMF in recent decades demonstrates the need for fundamental changes in the international financial system—not least the nature and role of the Fund itself—and recommend alternative mechanisms for dealing with international financial problems.

10. For dealing with debt crises, we call for a Fair and Transparent Arbitration Process (FTAP), independent of both debtors and creditors. The current mechanisms and institutions for dealing with debt (such as the Paris Club and IMF) allow creditors to be judge and jury in a process in which they are also plaintiffs. They also put no onus on creditors to take any responsibility for the consequences of their own reckless lending; and they fail to protect the economic and social rights of the population of debtor countries (who often had no say in selecting the government that contracted the loans, and little or no benefit from them). The role of the FTAP would be to establish the legality and legitimacy of any debts where this was in dispute, and to designate a debt work-out based on the human development approach to debt reduction[44]. Its very existence should discipline both lax lenders and reckless borrowers.

11. The third attachment (Chapter 9/11) makes the case for an FTAP in greater detail, and presents a specific proposal based on Chapter 9 of the US bankruptcy code, which deals with local authority insolvency. The essential components of an FTAP are its independence of both debtors and creditors, and the protection of the rights of citizens to participate in, and if necessary object to, the outcome of the insolvency process. Its proceedings should be transparent and accountable both to creditors and to the citizens of debtor nations.

12. To deal with financial crises such as those of the late 1990s, we propose a system based on a "crawling peg" exchange rate system, to promote economic stability, backed by a global intervention fund to deter and/or counter speculative pressures[45]. This would place much greater emphasis on the prevention of crises rather than resolving them when they arise, and ensuring an automatic response at a speed and on a scale commensurate with the nature of such crises.

13. In this proposal, developing countries would set their own exchange rates, with a pre-announced rate of gradual appreciation or depreciation, according to their needs and circumstances. These would be backed by appropriate use of capital controls; a two-tier currency transactions tax (also raising funds for development); and a global intervention fund. In the event of acute balance of payments problems in a particular country, for example arising from a speculative attack on its currency, the intervention fund would automatically intervene to support the currency, while the rate of exchange rate depreciation would automatically be adjusted to allow a sustainable and benign rate of adjustment. This should both deter speculative attacks and avert crises which might otherwise arise from them.

14. These proposals would largely remove the need for IMF involvement in the international response to debt and financial crises. While some role might remain in providing policy advice, capacity-building and other forms of technical assistance, it is essential that this should be impartial and pragmatic, and should be provided in a way that left developing country governments, in tandem with civil society, clearly in control. This would require very different approaches from those which currently operate.

Governance

15. There is a lack of transparency, democracy and accountability in the IMF's governance which would not be contemplated for a moment at the national level. Its voting structure is heavily skewed in favour of the developed countries, being weighted according to the size of their economies. This means that the developed countries, with just 14% of the world's population, and not directly affected by the Fund's activities, have 60.4% of the votes. This is compounded by a constituency which means that some developing countries are "represented" by Directors from developed countries. As a result, only 10 of the Fund's 24 Executive Directors are from developing countries, casting just 28% of the votes. Moreover, the Directors are considered employees of the Fund, not of their own countries, and what they say on behalf of their respective countries in Board discussions is confidential. (UK interventions are not even available under the Freedom of Information Act.) The Managing Director of the IMF is always nominated by its Western European members.

[44] For details of the human development approach to debt reduction, see Henry Northover, Karen Joyner and David Woodward (1998) "A Human Development Approach to Debt Reduction for the World's Poor". CAFOD, London, http://www.csae.ox.ac.uk/conferences/1999-cpa/Papers/SessionA/Northover.PDF

[45] For details of this proposal, see David Woodward (1999) "Time to Change the Prescription". Catholic Institute for International Relations, London.

16. Coupled with the developed country governments' apparent determination to retain and exploit their political privileges within the Fund, this undemocratic and unaccountable system serves to ensure the continuation of the existing global economic order; and it casts serious doubt on the Fund's capacity to remould itself as an institution suited to the 21st century. The World Bank's World Development Report 2006[46] observes that:

> Economic and political inequality tend to lead to economic institutions that systematically favour the interests of those with more influence . . . . There is unequal capacity to influence the policy agenda: the interests of the disenfranchised may never be voiced or represented[47].

While this is directed at the national level, it would be difficult to find a better description of the iniquities of the existing international economic order, or a better demonstration of this than the IMF's system of governance.

Conclusion

17. The IMF has singularly failed to perform its core functions, and the developing countries have suffered considerably as a result. This failure reflects its inability to adapt to a changing global economic environment, or even to the changes in governance standards associated with the passing of the colonial era. The proposals summarised above are intended to offer some initial ideas as to how these functions could be better performed through an alternative institutional structure.

18. There are three critical needs:

— to remove the IMF (and the World Bank) decisively from the policy-making process in developing countries, where their activities have been damaging economically, socially and politically;

— to institute more effective mechanisms to prevent and resolve debt and financial crises at a lower social cost; and

— fundamental changes to the Fund's system of governance, to ensure that it is genuinely accountable to the people of its member countries, and that developing countries have an influence within the Fund commensurate with their share of the world population and the impact Fund policies have on them.

19. There may be some residual functions which could usefully be performed by a much smaller IMF (possibly merged with a similarly reformed World Bank) in such a scenario. These include policy review (such as the IMF's Article IV Consultation process), data collection and dissemination, and possibly some analysis. Even with such a reduced role, however, it would be essential to ensure that the organisations' governance structures were democratised, and their approach non-ideological, particularly in policy-related analysis.

David Woodward
Head, New Global Economy Programme,
nef (the new economics foundation)

January 2006

Supplementary memorandum submitted by Jubilee Research at nef (the new economics foundation)

1. Further to our submission of January and my oral evidence to the Committee on 31 January, we would like to submit the following as supplementary evidence for the Committee's consideration. It comprises commentaries, in the context of our previous evidence, on three recent documents: Mervyn King's speech to the Indian Council on International Economic Relations on 20 February 2006; HMT's report on the UK and the IMF in 2005, published in March 2006; and the IMF "Managing Director's Report on Implementing the Fund's Medium-Term Strategy" of 5 April 2006.

2. The discussion in this submission leads us to three key conclusions:

(a) that it is vital to establish genuinely democratic decision-making in the IMF if it is to fulfil its purpose effectively, whatever other reforms might be implemented;

(b) that it should be incumbent on the IMF, as a specialised agency of the United Nations, to prioritise the achievement of economic and social rights over commercial and financial interests; and

(c) that IMF member governments, including HMG, are reneging on their responsibilities under Article 28 of the Universal Declaration on Human Rights by failing to act to establish "an international order in which the rights and freedoms set forth in this Declaration can be fully realised".

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[46] For a more extensive discussion, see *Physician, Heal Thyself! The World Bank's World Development Report, 2006: Equity and Development,* Jubilee Research at **nef**, September 2005, www.jubileeresearch.org/analysis/articles/worldbank280905.htm.

[47] World Bank (2005) *World Development Report, 2006: Equity and Development.* Washington DC: World Bank.

Mervyn King: "Reform of the International Monetary Fund". Speech to the Indian Council on International Economic Relations (ICRIER), New Delhi, 20 February

3. Mervyn King's speech accurately identifies many of the problems now confronting the IMF: that its remit is unclear (p2), that it has failed to adapt itself adequately to the fundamental changes in the global economy of the last 30 years (p2), that it is failing to fulfil its founding purpose of promoting international monetary cooperation (p11), that "it lacks the legitimacy to be an effective secretariat" (p11), that it needs greater focus and independence (p12), and that "it is not best served by its current governance arrangements" (p13). These points add up to a damning indictment of one of the central institutions of the global economy; and the fact that they are being highlighted publicly by the Governor of the Bank of England is a serious danger signal.

4. We would also share King's view that we need to consider "the fundamental question of what the Fund is for" (p2), and that "fundamental reforms" (p12) are required. In view of his comments, this conclusion would seem inevitable. However, his proposals fail to address the problems adequately or, in some cases, appropriately, and in some instances stride confidently in the wrong direction.

5. The Fund's central role in recent decades has been to provide financial support for countries with foreign exchange shortages. As King observes, this "has not been the role for the IMF vis-a-vis any developed country for many [more than 20] years. Moreover, nor is it likely to be true of many emerging market economies in the future." As discussed in our earlier submission, the latter is the case, not because the underlying causes of financial crises in emerging markets have been resolved, but rather because the nature of the Fund's response and the form of support provided seriously limit its effectiveness as a safety net, so that emerging markets are forced to make strenuous (and expensive) efforts to avoid reliance on it.

6. This leaves, essentially, low-income countries. However, the financial position of most such countries has now been so severely damaged by the Fund's incapacity to deal effectively with the debt crisis for the last quarter century that they will not be in a position to make use of conventional IMF resources for the foreseeable future. Their need is not for the "temporary balance of payments support" which forms part of the Fund's mandate, but for debt cancellation and long-term grants in response to fundamental solvency problems.

7. By far the greatest threat to international monetary stability in the foreseeable future is the need to manage what King acknowledges as an "inevitable correction" to the rise in the US current account deficit to its current unsustainable level, and to do so in such a way as to minimise its impact on the most vulnerable economies. However, the Fund is unable to do this effectively because of the disproportionate influence of the US on the Fund's decision-making. The US, with just 4.6% of the world population, has 17.14% of votes in the IMF—more than the total combined votes of China, South Asia, Sub-Saharan Africa and Latin America, which together account for 63% of world population.

8. This is the perhaps the most urgent issue around the Fund's independence—that its voting structure leaves it impotent in the face of the greatest financial threat in its history, because of the level of control it gives to the one country which poses the greatest challenge in its area of responsibility. Dealing with this issue effectively would require much more than the "cricket umpire" King envisages—not only is the US not "walking" (and unlikely ever to do so), but it is in a position to tie the umpire's hands behind his back.

9. This is highlighted by the recent news that the IMF is to undertake "multilateral surveillance" between countries with large imbalances—essentially to address the US deficit with the Asian emerging economies. With anything resembling the current voting structure, the Fund cannot play a neutral role in these proceedings. At present, the US has nearly two-thirds more votes than all developing countries in Asia combined, although the latter have more than eleven times the US population. The result will inevitably be that the process will emphasise actions by the Asian economies to reduce their surpluses (eg through exchange rate appreciation) rather than actions by the US to reduce their deficit.

10. This is the polar opposite to the approach to the debt and financial crises of the 1980s and 1990s, when pressure was applied exclusively on (developing) deficit countries. The IMF's distorted voting structure makes such blatant and systematised double-standards inevitable. It means that the Fund can never be more than a mechanism of control by which the developed countries can exert pressure on the developing world to correct imbalances—whether surpluses or deficits—so as to minimise the adjustment required of themselves.

11. The result of the virtual disappearance of the Fund's core activity is to reduce the role of the IMF to little more than a talking shop. This appears to be what King envisages: an institution which will "provide and share information", "encourage countries to abide by their commitments by promoting greater transparency"" and provide "a forum for national authorities to discuss risks to the world economy".

12. Such a reduction in the IMF's role would clearly leave a gap in terms of the Fund's role in dealing with debt and financial crises—but this is a gap which the Fund has proved itself ill-suited to fill. Debt work-outs need to be genuinely independent, not creditor-controlled, and based on the need to minimise the adverse impacts of crises on the rights of people in the affected countries. Given the Fund's apparently insoluble problems in rectifying the shortcomings in its anachronistic governance structure, as discussed below, it seems preferable to establish a new institution better-suited to the task.

13. However, the Fund's governance structure, which is at the heart of its lack of legitimacy, also seriously impairs its capacity to perform even the more limited "talking shop" function. Besides the issue of the US veto, the developed countries as a whole, with just one-seventh of the world's population, have more than 60% of the votes, to the developing world's 40%; and the position of Managing Director is almost entirely in the gift of Western European governments. While King notes that "all members must feel that ownership of the Fund is shared and that all have a voice", this seems almost an afterthought, and stops far short of calling for the application of basic democratic principles; and he fails to mention the selection process for the Managing Director at all.

14. King's other proposals actually make the problems of democracy, legitimacy and voice worse rather than better. He envisages a massive reduction in the Board's role, reducing it from three meetings per week to just six per year. Its responsibilities would be partly devolved to the Fund's Management; and partly fragmented between discussions among "more flexible" sub-groups of the membership to discuss particular topics, so that "the big members . . . [can] meet at a relatively small table" (p12).

15. However, shifting responsibility from the Executive Board to the Manager is unthinkable as long as the position of MD is in the gift of a small sub-set of the membership. And, while King states that "India and China have to be at the table", it is far from clear that smaller developing countries can be incorporated in this approach effectively, although in many cases they will be impacted by the issues under discussion far more seriously than larger economies, relative to their capacity to cope. Far from resolving the grotesque power imbalances in the Fund, King's proposals thus seem more likely to take away what little voice the developing countries now have, making the Fund more than ever into an exclusive club for the rich and/or powerful. In effect, it is a further step away from controlling the economic "law of the jungle" at the global level.

HM Treasury: "Meeting the Challenge of Globalisation for All: the UK and the IMF, 2005", March 2006

16. The Treasury report is a useful, if small and belated, step towards increasing the transparency of the UK's role in the IMF. However, while it is useful in providing information on HMG's position in relation to certain issues within the IMF, it falls far short of the standards of transparency one would take for granted in national or local government. (It is noteworthy that its discussion on transparency is limited to the publication of IMF documents, ignoring the secrecy of Board discussions, and the inability of UK citizens to find out what has been said on their behalf.) Perhaps unsurprisingly, given its nature, it addresses the fundamental problems highlighted by Mervyn King to only a very limited extent. And the views it presents on the one issue it does address—representation—are extremely questionable, and largely sidestep the issue.

17. The Treasury opens its discussion on "Quotas and Voice" with the extraordinary assertion that "There is broad agreement . . . that members' representation should broadly reflect their economic weight". We would contend that the validity of this statement is wholly dependent on whose views are considered, and what weights (democratic or "reflecting economic weight") are given to them. It may well be the view of the governments of developed and better-off middle-income countries; but the general view within civil society is that the governance structures of international institutions should be based on democratic rather plutocratic principles.

18. Equally, the report presents the issue of developing countries' voice as reflecting "the fact that these countries form the bulk of the call on Fund resources and the commitments made in the Monterrey consensus". This seems perverse. The primary reason to see the current level of representation for poor countries as inadequate, and for this to undermine the Fund's legitimacy, is that it is inconsistent with the fundamental democratic principles which are expected at the national level. The damage to the Fund's legitimacy does not come primarily from the relatively limited (though increasing) under-representation relative to economic weight of rapidly growing countries as their economies expand. Rather it comes from the vast disparity in representation between the people of rich and poor countries highlighted above; and the conspicuous iniquity of an institution which has been largely running the economies of much of the developing world for a quarter of a century (and doing so with a spectacular lack of success) being run by the world's rich minority, who are themselves virtually unaffected by its policies. It is, in short, the fact that the Fund's voting system has allowed it to be transformed into little more than an instrument and embodiment of neo-colonial power.

19. In this context, the Treasury's proposals do not even scratch the surface of the problem. Increasing basic votes can do no more than dilute the effect of economic weighting to a very limited extent, and seems unlikely to do more than neutralise the effect on poorer countries of increasing the weight of middle-income countries. (It is ironic that the declining economic weight of the poorest countries, which underlies their declining quota share is itself largely a result of the IMF's failure to deal effectively with the debt crisis, and the adverse effects of its policy prescriptions, which are at least partly a product of the power imbalance within the institution.) The Treasury's other proposals, though potentially helpful in other respects, do not help to rectify the imbalances in voting power.

20. Perhaps the most serious aspect of the problem is that of inertia—that the power given to the richest countries enables them to prevent that power being taken away from them. The result is that—barring an improbable act of unanimous self-sacrifice on the part of developed country governments—the Fund can never undertake a genuinely democratic reform, or, therefore, establish the genuine legitimacy it needs to perform its role effectively.

21. In this context, the only way to establish the legitimacy essential to the Fund's effectiveness—which even Mervyn King recognises to be lacking—is to take the reform process out of the Fund's own undemocratic and illegitimate decision-making processes. In our view, this can only be done through a transparent, inclusive, participatory and genuinely democratic global process to establish an international economic order designed to meet the needs, objectives and standards of the 21st century.

IMF: "Managing Director's Report on Implementing the Fund's Medium-Term Strategy", 5 April 2006

22. The Managing Director's Report highlights a second problem with relying on the IMF to reform itself—that of institutional (as opposed to political) inertia. As one might expect, given its source, the Report is less a recipe for meeting the profound global challenges we now face than an attempt at damage limitation from the perspective of the Fund's own institutional interests.

23. Rather than starting from the needs of the 21st century, and considering how they can best be met, the Report starts from the Fund's current nature and activities and considers only incremental changes, within its own institutional mind-set. This falls far short of what is needed if the Fund, or an alternative institutional framework, is to contribute positively to the achievement of 21st century objectives, such as poverty eradication and climate change, within the context of the contemporary global economy.

24. Like the Treasury, the report refers to the need for "a fair distribution of quotas, reflecting the important changes in the weight and role of countries in the world economy", with no acknowledgement of the institution's democratic deficit. And, while the issue of selection of the Managing Director is raised, the call is only for an increase in the transparency of the process, with no mention of the application of democratic principles, or even the inclusion of the membership as a whole in the selection process. Once again, this appears to indicate a failure even to recognise the nature of the problem of the Fund's democratic deficit.

25. Equally, while the report highlights the need for "more effective engagement in low-income countries", this is seen as requiring the Fund only to "marshal the expected increase in aid flows" and "new understandings with the World Bank and other agencies on the division of labour", with no recognition of the Fund's failure of the last 25–30 years in terms of resolving the debt crisis and in terms of its policy prescriptions. The emphasis remains firmly on the design of policies which enable countries to live within their means, rather than ensuring that the means are available to pursue policies which would enable governments to fulfil the rights of their populations.

26. Even within these constraints, the Report's attitude to national economic policies is epitomised in paragraph 12 of the report: "Building consensus around Fund policy advice requires more active outreach". This suggests that it is for the Fund to determine what policies are appropriate, and that it merely needs to persuade governments (and others) that the policies it prescribes should be implemented. This belies the Fund's rhetoric about country ownership and the supposedly participatory approach of Poverty Reduction Strategies.

27. Beyond the Fund's own lending, little role is seen in expanding the resources available for developing countries as a whole to relieve the financial constraints within which policies need to be designed. In particular, there is no indication of any role for the Fund in persuading donors to fulfil their 36-year-old commitment to provide aid equivalent to 0.7% of their national income, although the $125 billion annual shortfall in aid from this level is a major reason for the financial imbalances afflicting a major part of the Fund's membership. The Report also asserts that "the Fund must be neutral between sovereign debtors and private creditors". (There is no mention of the position vis-a-vis official creditors—a much more problematic issue as the IMF is both controlled by bilateral official creditors and is a multilateral official creditor in its own right.)

28. The insistence on putting the financial interests of commercial entities on an equal footing with the needs of national governments is, in our view, wholly inappropriate. Apart from the fact that they are members of the Fund, national governments are legally responsible, under international conventions, for the rights of their populations, within the resources available to them. By giving equal priority to private creditors, the resources available—and therefore both the ability and the obligation of the government to fulfil its citizens' rights—are diminished.

29. As a specialised agency of the United Nations, under whose auspices the human rights conventions have been signed, it should be incumbent on the IMF to prioritise the achievement of economic and social rights over commercial interests. It is still more important, given the amounts involved and their focus on countries where needs are greatest, that the Fund should take an active role in ensuring that the 0.7% commitment (also made under the auspices of the United Nations) is fulfilled.

30. While the obligations of international organisations themselves under the Declaration are a matter of legal dispute, there would appear to be a clear obligation on IMF members, as signatories, to ensure that the IMF acts to promote UN human rights standards. The objective of the Universal Declaration on Human Rights, as stated in its Preamble, is that "every organ of society . . . shall strive . . . by progressive measures, national and international, to secure universal and effective recognition and observance" of the rights and freedoms it establishes. Article 28 states explicitly that "Everyone is entitled to a social and international order in which the rights and freedoms set forth in this Declaration can be fully realised".

31. It is beyond question that economic and social rights fall far short of the standards established in the Declaration across much of the developing world; and there can be little doubt that various aspects of the international economic order—not least the continuing failure to resolve the debt crisis—are a major reason for this. It is clear, therefore, that the international economic order is not conducive to the universal achievement of the rights established in the Declaration; and that signatories are therefore in breach of their legal obligations under Article 28, and will remain so until they act to establish a world economic order consistent with this Article.

David Woodward
Head, New Global Economy Programme,
nef (the new economics foundation)

27 April 2006

Memorandum from The One World Trust

1. Executive Summary

The One World Trust believes that the IMF needs to balance and strengthen its accountability to its key stakeholders. In particular, the Fund is currently not sufficiently accountable to citizens whose lives may be adversely affected by the IMF's lending decisions. The submission identifies three obstacles to a more accountable IMF: power imbalances among members, shortcomings in democratic oversight, and a lack of transparency. The submission also suggests ways in which the organisation can work to overcome these obstacles.

2. The One World Trust promotes education and research into the changes required within global organisations in order to achieve the eradication of poverty, injustice and war. It conducts research on practical ways to make global organisations more responsive to the people they affect, and on how the rule of law can be applied equally to all. It educates political leaders and opinion-formers about the findings of its research. Its guiding vision is a world where all peoples live in peace and security and have equal access to opportunity and participation.

3. Increasing the accountability of Intergovernmental Organisations (IGOs) is central to the work of the One World Trust. Our recent publication Pathways to Accountability: The GAP Framework,[48] provides a baseline for what is important if organisations are to improve their accountability to stakeholders. While many IGOs, such as the IMF, assume a number of important functions in the conduct of global affairs and have the authority to make decisions that impact on the lives of billions of world citizens, the existing mechanisms for ensuring the accountability of these organisations to the full range of their stakeholders are not sufficient.

4. The IMF should seek to balance its accountability relationships with three important overlapping stakeholder groups: member states, national legislators, and affected citizens. With its current governance arrangement, the IMF's accountability is heavily skewed towards those member states that provide the vast majority of its financial resources. As a result, the interests of many affected citizens are not sufficiently taken into account in the IMF's decision-making procedures. We believe that the IMF's accountability to those citizens that experience the consequences of its actions needs to be strengthened. This is only possible if:

(i) the IMF balances its internal accountability to member states;

(ii) the IMF strengthens its accountability to national legislators; and

(iii) the IMF becomes more accountable to the public at large, allowing affected citizens to engage in an informed debate about the IMF's activities at both the national level and with the IMF directly.

5. There a number of reasons why the interests of affected citizens are not sufficiently represented at the IMF's decision-making level. This submission will focus on the three most pressing:

(i) the power imbalances that exist between member states (as reflected in the current voting arrangements) at the IMF which result in inequitable representation in key decision making bodies;

[48] Monica Blagescu, Lucy de Las Casas, Robert Lloyd (2005). *Pathways to Accountability: the GAP Framework.* London: One World Trust.

(ii) the disconnect between constituencies, elected representative and foreign policy decision-making in the context of the IMF; and

(iii) the continued lack of transparency within the IMF, in particular with respect to its principal decision-making body, the executive board.

6. In terms of internal member control, there are severe shortcomings apparent in the governance structure of the IMF. These deficits are the result of the existing power imbalance within the organisation which prevents many developing countries from having a sufficient amount of voice or influence in the IMF's decision-making processes. Besides perpetuating existing inequalities at the global level, this situation also undermines the IMF's capacity to serve the purpose for which it was established. Countries of the South that lack a sense of ownership of important decisions made by the organisation, are likely to regard these decisions as lacking legitimacy and will be reluctant to give them their full support and uphold them within their own countries.

7. In the Trust's opinion, progress towards achieving a more equitable decision-making structure at the IMF could be made through the extension of a double-majority voting system as already applied by the IMF to alter the Articles of Agreement and for general decision-making by another international financial institution, the Global Environment Facility. Ngaire Woods points out that "the effect of a double-majority voting rule applied to a wider range of decisions would be to ensure that the Board's consensus reflected not only a majority of voting power but also the support of a majority (or set percentage) of members of the organisation."[49] As a result, one important element of accountability—balanced internal member control—would be considerably strengthened.

8. In addition to member states being in a position to make balanced accountability demands on the IMF, the One World Trust's work also highlights the importance of allowing the citizens of these member states to hold IGOs accountable through their elected representatives, particularly in the national legislature. For this to be effective a number of conditions must be met:

(i) legislators require clear, contextualised and timely information from the IMF;

(ii) the recognition and support of the right of parliaments to determine national economic policy; and

(iii) the opportunity for national legislatures to question IMF officials directly.

The International parliamentarians' petition for greater democratic oversight of the World Bank and IMF' has had a huge success in the UK parliament with over 280 current MPs and Peers from all parties supporting the principle of national control of economic policies.[50]

9. An important requirement for greater accountability to all three stakeholder groups—member states, national legislators and affected citizens—is that these stakeholders are able to access relevant and timely information about the Fund. Although the IMF needs to be commended for the progress made in recent years in addressing issues of its transparency, the continued lack of openness in relation to the executive board raises significant cause for concern. A lack of meaningful transparency within this principal decision-making body is a major impediment to greater accountability. It reinforces the existing inequalities among member states (through disadvantaging those members that have fewer resources available to gather knowledge and expertise about the IMF), makes it harder for legislators to improve democratic oversight of the Fund, and for affected citizens demanding greater accountability of their elected representative for their actions at the IMF or lobbying the Fund directly.

10. Although releasing summaries of board discussions and a calendar of board meetings are useful they do not go far enough. Without a clear record of the proceedings and formal votes of the Executive Board, citizens and parliamentarians are unable to hold their national representatives to account. For this reason the Trust emphasises the need for the minutes and voting record of executive board of directors meetings to be disclosed. These should be made available on the IMF's website and should be disclosed in a timely manner.

January 2006

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[49] Ngaire Woods. *A note on decision-making reform in the IMF.* Paper prepared for the G24 Technical Meeting in Manila, March 2005.

[50] For more information see www.ippinfo.org.

Memorandum from the Tax Justice Network

Background

The Tax Justice Network is a global network of academics, NGOs, financial professionals, economists, journalists, trade unions, faith groups, and other civil society representatives. More information about the network and how it functions is available at www.taxjustice.net and from our briefing document, *tax us if you can*, which outlines our broader concerns about how the globalised international financial system in its current state facilitates capital flight, tax evasion and tax avoidance. *tax us if you can* is available as a free download from our website.

Our principal concerns in respect of the Treasury Committee's Inquiry into Globalisation: the role of the International Monetary Fund relate to (i) capital flight to offshore tax havens and the consequent tax evasion, and (ii) the fiscal impacts on developing countries of trade liberalisation programmes pursued by the IMF.

The IMF and Capital Flight

The scale of capital flight to the offshore economy is immense. According to research undertaken on behalf of the Tax Justice Network, US$11.5 trillion of personal wealth was held offshore at end 2004. The tax revenue losses from this capital flight are estimated at $255 billion annually, more than sufficient to fully finance the Millenium Development Goal of halving world poverty by 2015.

The current architecture of the global financial architecture facilitates capital flight and encourages tax evasion. This architecture must be redesigned. The solution to capital flight and tax evasion is to over ride banking secrecy arrangements and to implement an international framework for automatic information exchange of tax related data. This was proposed by both Lord Keynes and Harry White during the negotiations at Bretton Woods in 1944 but was fiercely resisted by banking lobbies and consequently never implemented. This failure has become the Achille's Heel of financial globalisation, encouraging and facilitating the laundering of the proceeds of crime, corruption and illicit commercial activities, including tax avoidance.

As David Spencer argues in the attached paper *The IMF and Capital Flight: Redesigning the International Financial Architecture*, the IMF should consider policies relating to information exchange in tax matters, banking secrecy and automatic reporting of information as significant factors when undertaking assessments of financial sector regulation in the context of its Reports on the Observance of Standards and Codes (ROSCS).

The IMF and the Fiscal Impacts of Trade Liberalisation

In June 2005 an IMF working paper prepared by two Fund economists revealed that for every $1 of trade tax revenue lost to the governments of lower income countries as a result of trade liberalisation programmes promoted by the IMF, those governments have recovered, at best, 30 cents from taxes (principally sales taxes like VAT) substituted to replace trade taxes. The Fund economists, Baunsgaard and Keen, find that lower income countries, which are generally more dependent upon trade taxes than middle income or developed countries, have "very largely failed to recover from domestic sources such revenues as they have lost from trade reform." Faced with these important findings they conclude that the "auspices for further trade liberalisation are troubling." A copy of the Baunsgaard/Keen paper is attached for the Committee's information.[51]

This research has confirmed what members of the Tax Justice Network have contended for some years. In promoting trade liberalisation programmes to developing countries the IMF has paid insufficient attention to the fiscal impacts of these programmes and has worked on the untested assumption that the longer term economic benefits of trade liberalisation might compensate for the immediate revenue losses arising from cuts in trade tax revenues. Baunsgaard and Keen acknowledge this assumption in their paper when they comment: "It is possible that indirect effects (of trade liberalisation) have more than offset the direct loss of revenue." But as Alex Cobham (Oxford Council on Good Governance) comments in his recent paper (attached)[52]: "Even if the more optimistic Baunsgaard and Keen result is used . . . the growth effects of liberalisation would have to be large indeed to justify the policy if revenue sustainability is treated as a serious goal."

The IMF's preference for substituting sales taxes for trade taxes is especially harmful in low income countries because of the generally regressive nature of sales taxes in both a social and macroeconomic sense. In the context of low and middle income countries, the majority of the poorer households spend proportionately far more of their total household disposable income on consumption and therefore pay more of their income on tax as a result. This tendency is illustrated by data from Brazil which shows that

[51] Not printed.
[52] Not printed.

the lowest income households pay 26.5% of their disposable income on VAT whereas the highest income households pay only 7.3%. Furthermore, higher income households tend to spend far more of their disposable income on luxury, imported goods (Brazil providing ample evidence of this propensity).

Conclusions and Recommendations

It seems that revenue sustainability has not been treated as a serious goal of the IMF. In pursuit of the twin objectives of trade and capital account liberalisation, Fund advisers appear to have largely discounted the problems caused by capital flight, tax evasion and revenue losses. In combination these problems have undermined the potential for low income countries to mobilise domestic resources to finance their developmental objectives, which has had the outcome of increasing their dependence on (volatile) aid flows and (expensive) external debt.

The IMF should attach far greater weight to these issues when assessing the impacts of liberalisation on the countries they advise. Until present the assumption that indirect effects of liberalisation might in the long term outweigh the losses from capital flight, tax evasion and falling trade tax revenues, remains untested. The Baunsgaard/Keen paper suggests that this assumption might be incorrect. We would argue that the onus now lies with the IMF to prove that the growth benefits to developing countries of liberalisation outweigh the overall loss of their domestic resources, and in all cases to seek viable remedies to these losses.

John Christensen

January 2006

Memorandum submitted by Professor Ilene Grabel, University of Denver

A Proactive Role for the IMF: Trip Wires and Speed Bumps in Service of Global Financial Stability

Executive summary

Since the 1990s, financial crises in developing countries have become both more frequent and more severe. The interconnected nature of financial markets means that financial crises easily spread across national borders. By now, there is incontrovertible evidence that financial crises impose significant economic, political and social costs. Financial crises in developing countries also have powerful effects on financially stable economies, such as the UK. Moreover, the UK shoulders some of the cost of resolving financial crises through the controversial bailouts that are financed by member country contributions to the IMF. Thus, taxpayers in the UK ultimately bear the burden of providing financial support for the Fund's role in responding to crises.

It is in the UK and the global interest to encourage the IMF to become a pro-active rather than a reactive institution. Toward this end, I argue that the IMF should use its technical expertise and the financial contributions of its members to mitigate the financial risks that so often culminate in financial crises in developing countries. This new role would involve a program of "trip wires and speed bumps." Trip wires and speed bumps are straightforward, transparent policy tools that can be used to identify and mitigate financial risks as soon as they become apparent to the IMF and to national policy makers.

Trip wires are a type of diagnostic tool. Specifically, trip wires are indicators of vulnerability that can illuminate the specific risks to which developing economies are exposed. Among the most significant of these vulnerabilities are the risk of large-scale currency depreciations, the risk that domestic and foreign investors and lenders may suddenly withdraw capital, and the risk that the depreciation of the local currency or an increase in the cost of new foreign loans will make it more difficult for a developing country to repay its existing obligations to international lenders. Speed bumps are narrowly targeted, gradual changes in policies and regulations that are activated whenever trip wires reveal particular vulnerabilities in the economy. It would be the task of policymakers within their own countries to work with the technical staff of the IMF to establish appropriate thresholds for each trip wire, taking into account the country's particular characteristics (eg, size, level of financial development, regulatory capacity) and its unique vulnerabilities (eg, existing conditions in the domestic banking system, stock market, corporate sector, etc.). The trip wire-speed bump approach calls upon the IMF to recommend that national regulators activate gradual speed bumps at the first signs of vulnerability.

The time is ripe to reconceptualise the role of the IMF. The trip wire-speed bump program described here represents a promising means by which the IMF can reduce the specific financial risks that so often culminate in costly and painful financial crises in developing countries. The chief advantages of this approach are that it can target only those risks that IMF staff and national policymakers deem most important, it can be implemented gradually, it is transparent, and it provides a way for the IMF and developing country policymakers to promote both global financial integration and global financial stability.

Introduction

1. Since the 1990s, financial crises in developing countries have become both more frequent and more severe. The interconnected nature of financial markets (also known as "financial globalisation") means that financial crises easily spread across national borders. A partial list of the financial crises that have occurred since the mid-1990s includes Mexico, Thailand, South Korea, Indonesia, Malaysia, the Philippines, Russia, Brazil, Argentina and Turkey.

2. By now, there is incontrovertible evidence that financial crises impose significant economic, political and social costs. For instance, there is a large body of evidence that shows that financial crises cause sharp downturns in overall economic activity and investment, and increase levels of unemployment, poverty and income inequality. In addition, evidence shows that financial crises are associated with political instability as regime shifts and social turmoil often follow financial crises. In this manner, financial crises in developing countries have powerful effects on financially stable economies, such as the UK. The UK also shoulders some of the cost of resolving financial crises through the controversial bailouts that are financed by member country contributions to the IMF. Thus, taxpayers in the UK ultimately bear the burden of providing financial support for the Fund's role in responding to crises.

3. This memorandum makes the case that it is in the UK and the global interest to encourage the IMF to become a pro-active rather than a reactive institution. Toward this end, I argue that the IMF should use its technical expertise and the financial contributions of its members to mitigate the financial risks that so often culminate in financial crises in developing countries. This new role would involve a program of what I term "trip wires and speed bumps." Trip wires and speed bumps are straightforward, transparent policy tools that can be used to identify and mitigate financial risks as soon as they become apparent to the IMF and to national policy makers. In what follows, I describe the workings of a trip wire-speed bump program in some detail (for further details, please contact the author, or see Grabel, 2004, G-24 Discussion Paper No 33, www.g24.org.005gva04.pdf].[53]

4. What are trip wires? Trip wires are a type of diagnostic tool. Specifically, trip wires are indicators of vulnerability that can illuminate the specific risks to which developing economies are exposed. Among the most significant of these vulnerabilities are the risk of large-scale currency depreciations, the risk that domestic and foreign investors and lenders may suddenly withdraw capital, and the risk that the depreciation of the local currency or an increase in the cost of new foreign loans will make it more difficult for a developing country to repay its existing obligations to international lenders.

4.1 In what follows, I suggest trip wires that focus on the particular financial risks identified above.

4.1.1 Currency risk refers to the possibility that a country's currency may experience a sudden, significant depreciation. Currency risk can be evidenced by the ratio of official reserves held by the government to total short-term external obligations (the sum of accumulated foreign portfolio investment and short-term hard-currency denominated foreign borrowing); and the ratio of official reserves to the current account deficit.

4.1.2 Fragility risk refers to the vulnerability of an economy's private and public borrowers to internal or external shocks that jeopardize their ability to meet current obligations. Fragility risk arises in a number of ways. Borrowers finance long-term obligations with short-term credit, causing what is termed maturity mismatch. This leaves borrowers vulnerable to changes in the supply of credit, and thereby exacerbates the ambient risk level in the economy. A proxy for maturity mismatch could be given by the ratio of short-term debt to long-term debt (with foreign-currency denominated obligations receiving a greater weight in the calculation).

4.1.3 Fragility risk also arises when borrowers contract debts that are repayable in foreign currency, causing what is termed locational mismatch. This leaves borrowers vulnerable to currency depreciation that may frustrate debt repayment. Locational mismatch that induces fragility risk could be evidenced by the ratio of foreign-currency denominated debt (with short-term obligations receiving a greater weight in the calculation) to domestic-currency denominated debt. In general, we might think of the dangerous interactions between currency and debt market conditions as introducing the possibility of inter-sectoral contagion risk.

4.1.4 Lender flight risk refers to the possibility that private, bi-, or multi-lateral lenders will call loans or cease making new loans in the face of perceived difficulty. An indicator of lender flight risk is the ratio of official reserves to private and bi-/multi-lateral foreign-currency denominated debt (with short-term obligations receiving a greater weight in the calculation).

4.1.5 Portfolio investment flight risk refers to the possibility that portfolio investors (that is, investors in a country's stock and bond markets) will sell off the assets in their portfolio, causing a reduction in asset prices and increasing the cost of raising new sources of finance. Vulnerability to the flight of portfolio investment can be measured by the ratio of total accumulated foreign portfolio investment to gross equity market capitalization or gross domestic capital formation. Lender and portfolio investment flight risk often

[53] I. Grabel, "Trip Wires and Speed Bumps: Managing Financial Risks and Reducing the Potential for Financial Crises in Developing Economies," prepared for the XVIIIth Technical Group Meeting of the G-24 in Geneva, Switzerland, 8–9 March 2004. Published as G-24 Discussion Paper No 33, November 2004, United Nations and Geneva.

creates a self-fulfilling prophecy that deflates asset and loan collateral values, induces bank distress and elevates ambient economic risk. In addition, lender and/or portfolio investment flight risk can interact with currency risk to render the economy vulnerable to financial crisis (causing inter-sectoral contagion).

5. What are speed bumps? Speed bumps are narrowly targeted, gradual changes in policies and regulations that are activated whenever trip wires reveal particular vulnerabilities in the economy. It would be the task of policymakers within their own countries to work with the technical staff of the IMF to establish appropriate thresholds for each trip wire, taking into account the country's particular characteristics (eg, size, level of financial development, regulatory capacity) and its unique vulnerabilities (eg, existing conditions in the domestic banking system, stock market, corporate sector, etc.). Critical values for trip wires and the calibration of speed bumps would be revised over time in light of experience, changes in the economy, and improvements in institutional and regulatory capacity.

5.1 Sensitive trip wires would allow policymakers to activate graduated speed bumps at the earliest sign of heightened risk, well before conditions for investor panic had materialized. When a trip wire indicates that a country is approaching trouble in some particular domain (such as new short-term external debt to GDP has increased over a short period of time), policymakers could then immediately take steps to prevent crisis by activating speed bumps. Speed bumps would target the type of risk that is developing with a graduated series of mitigation measures that compel changes in financing and investment strategies and/or dampen market liquidity.

5.2 Trip wires could indicate to policymakers and investors whether a country approached high levels of currency risk or particular types of fragility or flight risk. The speed bump mechanism provides policymakers with a means to manage measurable risks, and in doing so, reduces the possibility that these risks will culminate in a national financial crisis. Speed bumps affect investor behavior directly (eg, by forcing them to unwind risky positions, by providing them with incentives to adopt prudent financing strategies, etc.) and indirectly (by reducing their anxiety about the future). Together, their effects mitigate the likelihood of crisis. Those countries that have trip wires and speed bumps in place would also be less vulnerable to cross-country contagion because they would face lower levels of risk themselves.

5.3 Note that there is precedent for the trip wire-speed bump approach in the stock markets and futures exchanges in both the UK and the USA. Within these markets, automatic circuit breakers and price limits are used to dampen market volatility and stabilize extreme market swings. Regulatory authorities also have discretionary authority to stop trading or temporarily close an exchange or the trading in one particular security or derivative.

5.4 Speed bumps can take many forms. A range of possible speed bumps that correspond to the specific financial risks illuminated by trip wires is presented below.

5.4.1 Currency risk can be managed through activation of speed bumps that limit the fluctuation of the domestic currency value or that restrict currency convertibility in a variety of ways. Historical and contemporary experience demonstrates that there are a variety of means by which currency convertibility can be managed. For instance, the government can manage convertibility by requiring that those seeking access to the currency apply for a foreign exchange license. This method allows authorities to influence the pace of currency exchanges and distinguish among transactions based on the degree of currency and financial risk associated with the transaction. The government can suspend or ease foreign exchange licensing as a type of speed bump whenever trip wires indicate the early emergence of currency risk. The government can also activate a policy of selective currency convertibility, if trip wires illuminated the emergence of currency risk. Specifically, a speed bump might allow the currency to be convertible for current account transactions only. It is important note that the IMF's Articles of Agreement (specifically, Article 8) provide for this type of selective convertibility.

5.4.2 Policymakers would monitor a trip wire that measures the economy's vulnerability to the cessation of foreign lending. If the trip wire approached an announced threshold, policymakers could then activate a graduated speed bump that precluded new inflows of foreign loans until circumstances improved. Alternatively, a speed bump might rely upon the tax system to discourage domestic borrowers from incurring new foreign debt obligations whenever trip wires indicated that it would be desirable to slow the pace of new foreign borrowing. In this scenario, domestic borrowers might pay a fee to the government or the central bank equal to a certain percentage of any foreign loan undertaken. This surcharge might vary based on the structure of the loan, such that loans that involve a locational or maturity mismatch incur a higher surcharge. Surcharges might also vary based on the level of indebtedness of the particular borrower involved, such that borrowers who already hold large foreign debt obligations face higher surcharges than do less-indebted borrowers. This tax-based approach would encourage borrowers to use (untaxed) domestic sources of finance. Surcharges might also vary according to the type of activity that was being financed by foreign loans. For instance, borrowers might be eligible for a partial rebate on foreign loan surcharges when loans are used to finance export-oriented production.

5.4.3 If a trip wire revealed that a country was particularly vulnerable to the reversal of portfolio investment inflows, a graduated series of speed bumps would slow the entrance of new inflows until the ratio falls either because domestic capital formation or gross stock market capitalization increased sufficiently or because foreign portfolio investment falls. Thus, a speed bump on portfolio investment would slow unsustainable financing patterns until a larger proportion of any increase in investment could be financed domestically. I emphasise the importance of speed bumps governing inflows of portfolio investment because they exert their effects at times when the economy is attractive to foreign investors, and so are not as likely as outflow restrictions to trigger investor panic. Though not a substitute for outflow controls, inflow restrictions also reduce the frequency with which outflow controls must be used, and their magnitude.

5.4.4 The fragility risk that stems from excessive reliance on inflows of international portfolio investment or foreign loans could be curtailed by the speed bumps that focus on these types of flight risks (see above). The fragility risk from locational and/or maturity mismatch could be mitigated by a graduated series of speed bumps that requires borrowers to reduce their extent of locational or maturity mismatch by unwinding these activities, or by imposing surcharges or ceilings on them whenever trip wires revealed the early emergence of these vulnerabilities.

5.5 There are several guidelines that might guide the design of speed bumps in particular countries.

5.5.1 Speed bumps that govern inflows are preferable to those that govern outflows because measures that target outflows are more apt to trigger and exacerbate panic than to prevent it. This does not mean that outflow controls are not useful during times of heightened vulnerability, especially if the government uses the "breathing room" garnered by temporary outflow controls to make changes in economic policy or to provide time for an investor panic to subside. Indeed, Malaysia's successful use of temporary controls on outflows in 1994 and again in 1998 shows that temporary outflow controls can protect the economy from cross-border contagion risk in a time of heightened financial risks.

5.5.2 Graduated, modest, and transparent speed bumps can address a financial risk before it is too late for regulators to take action. Such speed bumps are also less likely to cause an investor panic.

5.5.3 Finally, should speed bumps be automatic (ie, rule based) or subject to policymaker discretion? Automatic speed bumps have the advantage of transparency and certainty, attributes that may be particularly important to investors. They also have lower administrative costs. But discretionary speed bumps have advantages, too. They provide regulators with the opportunity to respond to subtle and unique changes in the international and domestic environment. However, discretionary speed bumps have higher administrative costs and require a greater level of policymaking capacity. The most prudent answer to the question of discretion is that there is no single, ideal framework for speed bumps in all developing countries. In general, the best that can be said is that speed bumps should be largely automatic and transparent in their operation, though this does not mean that regulators could or even should be expected to eliminate all discretion in the activation of speed bumps. It is the task of the IMF and national policymakers to determine the appropriate balance between automatic and discretionary speed bumps, particularly in light of their assessment of immediate technical capacities.

6. I anticipate and respond to a number of concerns that could conceivably be raised by skeptics of this approach.

6.1 Concern #1: A trip wire-speed bump program cannot reduce the unpredictability and volatility of cross-border and/or cross-currency capital flows. Therefore the utility of this approach is questionable.

6.1.1 This approach to policy responds precisely to the volatility and lack of predictability of cross-border capital and currency flows in largely unregulated global financial markets. Rather than trying to do a better job of predicting what cannot be predicted (ie, financial flows in unregulated global financial markets), this approach manages and "domesticates" otherwise unruly flows.

6.2 Concern #2: The activation of trip wires and speed bumps might ironically trigger the very instability that they are designed to prevent.

6.2.1 This concern does not take account of the possibility that if an economy is less financially fragile by virtue of a trip wire-speed bump program, then investors and lenders will not be so likely to rush to the exits at the first sign of difficulty. Moreover, an economy in which financial risks are curtailed (by trip wires and speed bumps) will be more resilient in the face of investor/lender flight risk.

6.3 Concern #3: The trip wire-speed bump proposal is unnecessary because private investors and credit rating agencies can do a better job of identifying financial vulnerabilities than can governments.

6.3.1 There is no reason to expect that private investors will identify financial risks as they emerge, and engage in behaviors that curtail these risks. Moreover, the panicked responses of private foreign and domestic investors to identified risks can actually aggravate—rather than ameliorate—financial instability. Indeed, we saw precisely this dynamic unfold in all of the recent financial crises in developing countries.

6.3.2 The experience of the East Asian crisis of 1997–98 provides no basis to expect that trip wires and speed bumps are unnecessary since private credit rating agencies provide useful diagnostics on emerging financial vulnerabilities. Indeed, evidence shows that assessments by private credit rating agencies failed to highlight emerging problems in Argentina, Turkey, East Asia and Turkey.

6.4 Concern #4: Trip wires and speed bumps will not achieve their objectives because economic actors will evade them.

6.4.1 Policy evasion (in any domain of policy) cannot be ignored. In the case of trip wires and speed bumps, financial innovation may provide a means for some economic agents to evade these polices. However, the middle-income countries that have the most to gain by trip wires and speed bumps are also in the best position to enforce them. It is also important to acknowledge that a degree of policy evasion does not imply policy failure. It is imperative that the particular speed bumps adopted be consistent with national conditions, including state/regulator capacity.

6.5 Concern #5: Many developing countries do not have the technical policy-making capacity that is necessary for the success of trip wires and speed bumps.

6.5.1 It is certainly true that policy-making capacity differs dramatically across developing countries. Those developing countries (generally speaking, middle-income countries) that have the highest levels of policy-making capacity are certainly in the best position to utilize trip wires and speed bumps. This is, in some sense, a happy coincidence because policymakers in these same countries have the most to gain by curtailing many of the financial risks that are targeted by trip wires and speed bumps.

6.5.2 It also bears mentioning that the technical prerequisites for operating trip wires and speed bumps are no greater than those that are demanded of policymakers that operate in an environment of liberalised, internationally integrated financial markets. Moreover, technical capacity can be acquired, particularly were the IMF's role reconceptualized so that institution offered the technical support and the training necessary to make a trip wire-speed bump program viable in the developing world.

6.6 Concern #7: Countries that implement trip wires and speed bumps will face increased capital costs and lower rates of economic growth.

6.6.1 There is no unambiguous empirical evidence of a tradeoff between speed bumps and increased capital costs or reduced economic growth. This may be because although foreign investors value the liquidity associated with unregulated financial markets, they may come to favor economies that give them less reason to fear financial crisis (since during sudden crises liquidity is jeopardized). For this reason, developing economies as a whole might find it substantially easier and less costly to attract private capital flows if they reduced their vulnerability to crisis through collective implementation of trip wire-speed bump policies. Moreover, given the losses sustained by investment funds in the UK following financial crises in developing countries, there is good reason to expect that fund managers are placing an increasing value on financial stability in the developing world. Taxpayers in the UK, too, have reason to value financial stability in the developing world, particularly in light of recent concerns about taxpayer support for IMF bailouts.

6.7 Upon examination, I find arguments against the feasibility and utility of a trip wire-speed bump approach unconvincing.

7. The time is ripe to reconceptualise the role of the IMF from a reactive to a proactive institution. The trip wire and speed bump program described here represents a promising means by which the IMF can serve to reduce the specific types of financial risks that so often culminate in costly and painful financial crises in developing countries. The chief advantages of this approach are that it can target only those risks that IMF staff and national policymakers deem most important, it can be implemented gradually, it is transparent, and it provides a way for the IMF and developing country policymakers to promote both global financial integration and global financial stability.

Director of the Graduate Program in Global Finance, Trade and Economic Integration
Graduate School of International Studies

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Memorandum submitted by Professor Sayantan Ghosal, Dr Emanuel Kohlscheen and Professor Marcus Miller, University of Warwick and CSGR

RESERVE POOLING, MORAL HAZARD AND SUSTAINABILITY: THE ROLE OF THE IMF

Preamble

This paper relates to the first topic for investigation in the inquiry, namely the impact of globalisation on the current and future roles of the IMF.

In considering the issues of (a) Reserve Acquisition and Reserve Pooling; (b) Moral Hazard and Political Economy; and (b) Sustainability and Debt Swaps, we draw on three papers we are to present at the Easter Meetings of Royal Economic Society[54], namely:

(1) Emanuel Kolscheen: "International Liquidity Swaps: an Assessment of the Chiang Mai Initiative";

(2) Sayantan Ghosal and Kannika Thampanishvong "Optimal Sovereign Debt Write-downs"; and

(3) Sayantan Ghosal and Marcus Miller: "Growth, sustainability and delay: a model of sovereign debt restructuring".

[54] The papers will posted on the Royal Economic Society website; (1) and (3) will feature in a Special Session at the Meetings.

1. *Introduction: Setting up the IMF*

When the IMF was established at Bretton Woods in 1944, it was to oversee and help manage a global system of "fixed but adjustable" exchange rates. Countries were only meant to change exchange rates in "fundamental disequilibrium"; and one role of the Fund was to judge whether or not this was the case.

Another key role for the Fund was to provide short-term financial support to countries experiencing payments difficulties. With speculative flows held in check by controls on international capital movements, it was anticipated that the resources of the Fund would be used for temporary assistance to members in financing balance of payments on current account, Crockett (1977, p 217).

The contribution of each member to the IMF's financial resources was (and is) determined by its assigned "quota", broadly determined in relation to a country's size and its openness—a quarter paid in the form of widely accepted hard currency, the rest in own currency. A country's quota determines both its borrowing rights and effectively the weight it has in the weighted majority voting of the Executive Board, where decisions require a simple majority, except for constitutional issues where a supermajority of 85% is necessary[55].

The size of the Fund itself is decided by a vote of the members in the Annual General Meeting of Governors, every five years at least. When it was first established in the 1940s with 45 member countries, total quotas subscribed amounted to about two percentage points of global GDP[56]. Though the 1998 quota review saw a substantial increase in the value of quotas to about $300 billion, the review of early 2003 resulted in no change in quotas. Despite the increase of membership, total quotas are now only about one percent of global GDP[57].

Capital Account Liberalisation

Increased freedom of transactions on capital account have wrought major changes, however. In the first place, with markets able to anticipate adjustments in pegged exchange rates by speculative flows, the Bretton Woods system of fixed-but-adjustable exchange rates was no longer viable: and it came to an end in the early 1970s, when countries were free to adopt floating exchange rates. Secondly, potential calls on IMF resources could now be driven by adverse capital flows, with the need to speed up IMF lending in response to capital account reversals being discussed as early as 1972 (De Vries, 1985).

As capital account liberalisation accelerated in the 1990's, "capital account crises" became widespread, beginning with that of the European Exchange Rate Mechanism in 1992–93. After an initial widening of currency bands, the European response has been closer monetary and political integration, leading to the abolition of many national currencies and the creation of the euro. But emerging market countries with implicit or explicit pegs against major currencies have remained exposed to repeated financial crises, beginning with the Mexican peso crisis of 1994–95, and soon followed by the East Asian crises of 1997–98 which the economist Jeffrey Sachs likened to a "bank-run".

The rise in sovereign spreads consequent upon the Russian default of 1998 exposed many Latin American and other emerging markets with substantial external debts in dollars to self-fulfilling runs. Indeed, in a recent IMF Discussion Paper advocating a Country Insurance Facility, Cordella and Levy-Yeyati (2005, p 3) conclude that there is "an increasing consensus that self-fulfilling liquidity runs have triggered many of the recent financial crises, as sudden increases in perceived rollover risk set off an escalation of interest rates that rendered otherwise sustainable debt levels unsustainable"[58].

The initial reaction by the IMF to such events was to assemble financial packages ("bailouts") involving levels of assistance much larger than the two-times-quota seen as an appropriate limit for current account crises. IMF disbursements were about five times quota for Mexico (1995), 18 times for Korea[59] (1998), 7.7 times for Brazil (2001 and 2002 combined) and 17 times for Turkey (1999–2001 and 2002 combined)[60]. Latterly, however, the IMF has sought to limit its exposure by recommending policy changes by the debtor—with respect to exchange rate for example—and debt restructuring or "bail-ins" for creditors[61].

The reaction by many emerging economies has been self-insurance by the accumulation of international reserves. For a sample of 35 emerging markets, reserve holdings measured on this basis has doubled over the last decade—from 8.9% of GDP in 1992 to 18.1% in 2002[62]. Korea and China hold reserves valued at 22% of GDP. There have been moves towards co-insurance at a regional level: and suggestions for novel co-insurance provisions by the IMF.

[55] Though votes are seldom taken, the voting rules are nonetheless important: the fact that the US has a 17% share of the subscriptions means that it has a veto on any change of the Fund's Articles, for example.

[56] Irwin et al (2005).

[57] World GDP was valued at $32, 300 for 2002, The Economist, *Pocket World in Figures*, 2005 Edn.

[58] See Cohen and Portes (2004) for a similar diagnosis.

[59] In the case of Korea, however, when outflows threatened to overwhelm the $41 billion assembled as first and second lines of defence in this way, G7 countries engineered a successful "bail in": instead of raising fresh funds to finance the exit of banks, they persuaded their banks to roll over their lending to the country.

[60] See Roubini and Setser (2004a). Additionally, in most cases except Turkey, the amounts made available were substantially augmented by other bilateral commitments mainly supplied by G7 countries (Roubini and Setser 2004a, Table 4.1).

[61] Roubini and Setser (2004a) Chapter 4 "Experience with Bailouts and Bail-ins" provides a good review.

[62] Cordella and Levy-Yeyati (2005).

Key issues for debate

Ex ante mechanisms to help prevent capital market crises:

(a) a shift towards floating—but managed—exchange rates;

(b) the increase in owned-reserve positions since the East Asian crises of 1997–98, particularly by countries in the region (Jeanne and Ranciere, 2005);

(c) the development of intra-regional co-insurance mechanisms such as the Chiang Mai agreement of SE Asia (discussed in section 2 below);

(d) the creation of an automatic Country Insurance Facility (CIF) as a complement to existing IMF arrangements (Cordella and Levy-Yeyati, 2005); and

(e) possible use of capital controls (Levy-Yeyati, 2005).

Ex post mechanisms for crisis resolution:

(a) Collective Action Clauses (see, for example, Sayantan Ghosal and Kannika Thampanishvong, 2005a);

(b) The risks that governance problems pose for IMF lending and implications for conditionality (discussed in section 3 below); and

(c) Improvements in bilateral bargaining procedures (discussed in section 4).

2. *Ex ante co-insurance: Regional Agreements*

A new form of coinsurance has emerged in East Asia: the network of bilateral swap agreements (BSAs) launched under the Chiang Mai Initiative. A BSA is a bi-lateral arrangement that gives either signatory access to a fixed amount of the co-signatory's international reserves, upon request. China, Japan and South Korea have now signed such agreements with each other and also with Indonesia, Malaysia, the Philippines and Thailand. The total amount of these agreements (U$ 37.5 billion) may be small compared to the volume of international reserves accumulated by the larger economies of the Far East in the last few years: but for smaller economies[63] the amounts involved are significant and already correspond to about four times the reserve tranches of these countries at the IMF[64].

The network has already been seen by some observers as the first step towards an Asian Monetary Fund. While there is no evidence that BSAs have so far affected bond valuations, Kohlscheen (2005) finds that the network reflects the potential gains from co-operation in that larger agreements have been signed between countries for whom international reserves tend to move in opposite directions. He points out that the same economic logic implies that BSAs could be signed between countries of different regions (eg Asia and Latin America).

The increase in the prevalence and magnitude of the BSAs (the Chinese government has already pledged to double its commitments) brings important politico-economic questions to the forefront. Although they have yet to be tested, the existence of regional networks that can quickly supply liquidity may provide an additional line of defence and help shield signatories from the perils of sudden capital flow reversals. Bilateral or regional swap agreements could lead to a more efficient use of existing international reserves—possibly reducing the aggregate demand for international reserves. This may change demand for IMF resources from signatories.

Could the prevalence of such regional arrangements lead to a "moral hazard" problem as countries that are members of such networks underinsure themselves? Given the substantial accumulation of own reserves, this does not appear to be an issue. Note too that 90% of the disbursements are conditional on the existence of an IMF programme.

3. *Governance issues*

Provision of ready access to foreign exchange to help insure against crises may seem a clear welfare improvement: and if debtor countries are well-governed and the use of loan facilities subject to explicit "conditionality", the possible perverse effects on incentives—the problem of debtor moral hazard—may not seem an issue. But what if there are problems of governance and there is an interaction between international bailouts and domestic policies?

In these circumstances, as two economists from the IMF have argued, "The international financial safety net increases the scope for bad policies as well as good policies. Increasing the borrowing capacity in such circumstances may lead to worse outcomes, not better. International bailouts can help countries implement

[63] Such as the last Indonesia, Malaysia, the Phillipines and Thailand.

[64] For the Philippines, for example, the $5.3 billion made available through BSAs amounts to about a third of its stock of international reserves.

good policies, but they could also make the consequences of bad domestic policies much worse." Jeanne and Zettlemeyer (2001, p 411).

In the paper they are to present at the RES conference, Ghosal and Kampanishvong (2006) consider the situation when government is by an elite which is not representative of the population as a whole. Instead of providing public goods, such as health, education and social infrastructure, the elite pursues its own idiosyncratic objectives with an emphasis on short-run payoffs. It may, for example, use public funds for ostentatious investment and conspicuous consumption: additionally, public borrowing offshore may be diverted to finance the acquisition of private bank accounts in safe havens such as Switzerland, where ownership of accounts is not divulged.

Where poor governance involves domestic distributive conflict and myopia, the authors argue that conditionality imposed by external funding agencies can and should be designed strategically to help deal with such issues. Debt write-downs can be made conditional on government's provision of public goods, for example; and limits may be imposed on new issuance of public debts and on taxes levied on the non-elite[65]. If not, external support may simply provide more resources for the elite to misuse. The paper cited focuses on African countries, but the problems of governance they discuss are much more widespread.

In emerging markets of East Asia and Latin America, where private external finance is readily available, the provision of financial bailouts may have perverse incentive effects on creditors. For if creditors know they have an exit option, they will have less incentive to monitor the uses to which their funds are being put; and will be willing to lend at lower rates. This problem of creditor moral hazard will be reflected not in high sovereign spreads but by a "rush for the exit" when prospects take a turn for the worse.

If the creditors do not charge high spreads for the risk of default, who pays? It is a popular fallacy that the international community pays, via the lending programmes of the IMF and World Bank. But it has been shown beyond any reasonable doubt[66] that IMF lending does not mask economic transfers: except for some poor countries, the Fund lends short term and recovers its money. A key feature of the economic programmes that accompany IMF packages is the requirement that the debtor does repay the IMF in full: otherwise the IMF would be driven out of business.

In the absence international transfers and of a significant write-down of private debt, it is therefore the debtor that pays—and this will typically mean the non-elite. By allowing for exit by the private lenders, but insisting that it is paid in full, the IMF must needs use the conditionality of its lending to extract *ex post* what capital markets would have charged *ex ante*: and it is often the non-elite who bear the burden of earlier excess borrowing.

4. *Ex post resolution: Delay in Debt Swaps*

In the late 1990s the IMF took steps to extricate itself from the invidious position of acting as debt collector for careless creditors; the idea being to "bail in" the creditors rather than bail them out. The high point of this attempt came in 2001 when Ann Krueger proposed an official Sovereign Debt Restructuring Mechanism, based on Chapter 11 of the US bankruptcy code, to oversee debt write downs ex post.

This initiative was rejected, however. Instead, as the case of Argentine has shown, write-downs may need to be negotiated in face-to-face bargains between debtor and creditors, without the intermediation of the IMF[67]. (In future, such negotiations should be expedited by the widespread incorporation of Collective Action Clauses into sovereign debt contracts.)

While creditors have been "bailed- in" in several recent cases, negotiations proved to be fairly lengthy. Default by Ecuador, for example, which led to a 60% "haircut" (write-down of face-value) took a year to resolve. The defaults by Russia and Argentina, which involved the largest amounts of debt (around $30 billion and $80 billion respectively) and resulted in the largest haircuts (closer to 70%), both took a year and a half of negotiation.

In the paper they are to present to the RES, Ghosal and Miller (2006) focus on reasons for delay in bargaining, with special reference to the case of Argentina[68]. A model of bargaining is used to show that settlement may well be delayed until the economy recovers: and delay occurs when growth prospects exceed

[65] In similar vein, Rochet (2005) argues that crisis lending by the IMF may need to be accompanied by a constitutional amendment limiting debt creation by the government.

[66] See Jeanne and Zettlemeyer (2001).

[67] See Dhillon et al (2005) for a bargaining approach applied to this case.

[68] The delay between Argentine default and restructuring (40 months) was a lot longer than the period of negotiation (19 months): this is because the interim administration appointed in early 2002 regarded debt restructuring as outside its competence so negotiations did not commence until President Kirchner was elected in mid-2003 with a mandate to negotiate.

the rate of discount. In addition, however, the need to ensure a sustainable settlement appears to have played a key role in the Argentine debt negotiations, as the debtor was desperate to avoid a repeat experience of default.

When bargaining is adapted so to reflect concern for sustainability, this tends to increase in the debtor's bargaining power; but asymmetric information about the debtor's situation increases the likelihood of delay. The debtor claims that the write-down is needed to ensure economic viability, but the creditor isn't sure if that is true: delay is one way that the debtor can make the point. Could this been why the Argentine episode involved the longest delay—and largest write-down—in recent sovereign debt restructuring[69]?

If sustainability is a key factor—but creditors are unsure about the details—the IMF could help to reduce delay by providing reliable information: where sustainability conditions are made common knowledge, there is no need for the debtor to use delay as a signalling device[70]. A potentially serious challenge to carrying out this informational role is that the IMF, as senior creditor, faces a "conflict of interest": there is presumably an incentive to exaggerate sustainability requirements in favour of the debtor so as minimise other claims on the debtor's resources. Perhaps such induced compassion for debtors would be checked by its creditor-dominated Executive Board? If not, this informational task could be delegated elsewhere: to the IADB for example.

5. *Conclusion*

Increased mobility of capital has opened a Pandora's box of issues for discussion. In this submission we have focussed on three that have implications for the IMF: the provision of ex ante co-insurance through regional swaps that could reduce the calls on IMF resources; governance problems in borrower countries which may limit the IMF's incentives to provide co-insurance; and the delays that may attend ex post resolution in the absence of agreement of the parameters involved. The last of these suggests a role for the IMF as provider of information and judgement on issues of debtor sustainability—so long as its credibility is not compromised by conflict of interest.

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[69] Some observers argue that the Argentine swap has a new era of the rogue debtor, Porzecanski (2005). If so, one would expect sovereign spreads to rise sharply as creditors "price in" the cost of future write-downs. As yet, there is no sign of that.

[70] In their assessment of the reasons for delay, add that the IMF can play a key role in coordinating creditors Roubini and Setser (2004b): they also argue that the IMF could orchestrate "debtor in possession" finance, Roubini and Setser (2004a).

Roubini N and B Setser (2004b), "The Reform of the Sovereign Debt Restructuring Process: Problems, Proposed Solutions and the Argentine Episode" *Journal of Restructuring Finance*, 1, 1, 173–84.

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January 2006

Memorandum submitted by World Vision

Poverty Reduction Strategies, the overall country strategies are designed to tackle poverty with country specific policies. Currently, most developing countries are designing and negotiating their 2nd generation PRSPs (or the equivalent) With the World Bank and IMF.

World Vision has been engaging with the review process, and based on extensive research in Bolivia and Zambia World Vision designed a number of recommendations for consideration[71]—primarily around the needs of accountability and civil society engagement at the time of planning and implementation of PRS. What was agreed in principle now needs to be implemented in practice, pressure now needs to be put on the World Bank and the IMF from the UK government and other EU governments to ensure these changes happen and promises are met.

Making the second generation of PRS more effective is not only vital in development terms, but is also politically salient, particularly as issues of aid effectiveness are likely to raise to the fore as aid flows are increased substantially in coming years—following recent G8 and EU commitments.

In response to the inquiry by the Treasury Select Committee World Vision would like to raise concerns about the space given by the IMF for dialogue around macro economic framework that supports the implementation of PRSPs. One of the areas that need to change is the space available to civil society and parliamentarians to negotiate around the Poverty Reduction and Growth Facility. This submission will address the financial relationship of the UK with the IMF and the funding agreements of IMF.

Negotiation Space

1. Negotiation space around this needs to be opened up as part of the PRS process, currently the dialogue process for the PRSP is not able to change the PRGF framework. This means that there is greater dialogue on the micro-part and not the macro, which is already fixed, creating a bottleneck. To say that the PRGF is drawn from the PRSP is not the same as the PRGF dialogue taking place together with the PRSP or at some point within the PRS cycle that feeds into the PRS process. PRGFs have a strong trigger/signalling effect on the behaviour of other donors, despite the size of funding under them.

2. Currently the IMF provides analysis in the PRGF to the country government, which determines the budget for a number of donors categorising the priority sectors with which the country should be concentrating on. It is not about giving greater discussion between the country government and the IMF country representative on the budget. The issue is that the IMF needs to be making available the information for dialogue and consultation to all. The analysis of the IMF, which takes into account impacts of inflation rates/bank rates and resource mobilization for MDGs, need to be made available for dialogue to interested stakeholders within country allowing greater transparency.

3. When we speak of greater "dialogue" it may not always include civil society organisations, but transparency on what those issues are, especially the underlying policy assumptions that are being used to come up with policy options and their links to poverty reduction. Most civil society organisations can adequately engage with the assumptions rather than the economic detail, which the IMF plays, this could be a function that donors could play.

4. The demand by civil society organisations on governments and the IMF to make this process more transparent and create dialogue around the results and analysis made by the IMF is very high. This has become increasingly apparent now that the issue of mutual and domestic accountability has been brought to the frontline of international negotiations eg the UN Summit resolutions, the Paris Declaration, the Africa Partnership Forum etc. The 2005 PRS review itself projects a strong emphasis on balancing accountabilities by working more domestically. Macro-economic dialogue is a significant part of this accountability framework.

5. Equally critical is addressing IMF staff behaviour, including their lack of attendance at PRS thematic group dialogue meetings and donor meetings, reliance on donor missions from Washington to review PRGF and other macro-economic issues within few days. CSOs deplore the lack of adequate time to prepare for these meetings and mostly even lack of knowledge of their coming into a country This is not just about government failure but transparency on both government and IMF part.

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[71] Tembo, Dr Fletcher/World Vision UK, "Poverty Reduction—are the strategies working?", 2005—World Vision UK research based on case studies of Zambia and Bolivia.

6. Strong governments need strong civil society and parliaments which are able to exploit their comparative advantage eg in the area of addressing rights and voices of the marginalized groups, such as children and women. This will support greater opening of space for dialogue, without undue fear of "sensitive areas", as alluded to in the PRS report. Training is also not adequate, a genuine "capacity development" approach would also enable the IMF staff themselves to learn the politics of interrelationships and negotiations among government, civil society, parliaments, donors and the private sector at country level, instead of limiting themselves to macro-economic formulae, as a technical project. Examples of good practice are emerging in countries such as Tanzania and Mozambique. This should be about capacity building and not "technical assistance".

7. This means that donors have to invest in either more IMF staff in each country, with an exit strategy, and linking IMF staff skills to available in-country skills with civil society organisations and research institutes to develop a multiplier effect.

8. Donors should invest in capacity to demystify macro-economic policies in working with both government and civil society. However, civil society would add value to this by enabling such information to reach citizens at low cost, for example the case where the Civil Society for Poverty Reduction in Zambia was able to communicate their government's Memorandum of Understanding with the IMF. This should, however, not be about only the decisions already made but including debates on the assumptions and options included in the PRS dialogue at different stages.

9. Tools such as the poverty social impact analysis that the World Bank, IMF and donors such as DFID are using to assess the impact of economic policy on the poor need to be opened up for dialogue with the countries civil society and parliament. So that they are sufficiently tailored to there priorities.

January 2006

Supplementary memorandum submitted by World Vision

Introduction

1. This evidence builds on World Vision's earlier written evidence submitted on 18 January 2006 and the subsequent oral evidence given before the Treasury Committee on 31 January 2006, in order to take into the recent developments in the debate on the role of the IMF, especially with regard to the new position of HM Treasury.

2. In particular, this submission focuses on the two key documents that have been produced in the HM Treasury since January, which are, "The UK and the IMF 2005: Meeting the challenges of globalisation for all, March 2006"; and "Reform of the International Monetary Fun", speech by Mervyn King, the Governor of the Bank of England, at the Indian Council for Research on International Economic Relations (ICRIER) in New Delhi, India; 20 February 2006. In doing so, the submission also takes into consideration the statement by the Right Hon. Gordon Brown, in his capacity as the UK Chancellor of the Exchequer and Chairman of the IMFC, at the 13th meeting of the IMFC on 22 April 2006 and the statement given by the Managing Director of the IMF to the Development Committee on 20 April 2006, both as part of the programme of the 2006 Spring meetings of the Bank and Fund.

3. In this submission, World Vision makes specific recommendations to the UK government, and to HM Treasury in particular, in order to ensure that the current IMF reform debates put the case for better IMF support to low-income countries central, for a genuine move from rhetoric to practice. World Vision commends the UK government for taking full advantage of the 2005 coincidence of chairing the G8 and presidency of the EU to raise the political and moral stakes towards achieving MDGs by 2015, alongside the NGO community's call for Making Poverty History. Now is the time for action and the IMF has to become an actor of positive contribution to poverty reduction.

4. With a focus on the two key documents highlighted above, and the associated references to the just ended Spring meetings of the World Bank and IMF, World Vision identifies the key areas of the IMF's approach to globalisation, the role of policy prescription or advice, surveillance, transparency, instruments and issues of voting and quotas, as critical areas where the IMF has to reform if the institution has to become a credible player for low-income countries. From World Vision's current experience of working in low-income countries, walking alongside the poor and engaging with their governments, we argue that the key issue for a credible IMF for low-income countries is not one of adopting "measures to improve the influence of the IMF" (HM Treasury, 2006, p 23). The IMF is already too influential through its signalling and macro-economic framework expertise. What is required is transformation to an institution that is relevant to the MDG agenda both local and global and offers the necessary and demand-led leverage to low-income countries complex interfaces with the medium and big players in the international monetary game, the game that Mervyn paper dwells on. Mutual accountability, between the IMF and national authorities, and domestic accountability, between the national authorities and their citizens, is a double-edged interface that

the new role of the IMF has to embrace as a central part of its approach to diverse environments of low-income countries[72]. World Vision makes the following key recommendations, put together under headlines and explanations for clarity.

The IMF approach to globalisation, growth and poverty reduction

5. The IMF approach to globalisation, as evident in the Managing Director's report on the Medium-Term Strategy (MTS) of 15 September 2005 on which his report to Development Committee of 20 April 2006 builds, is one of looking at low-income growing their economies by integration into the global economy, their adaptation to globalisation and modernisation. This model shapes the IMF's understanding of economic growth and poverty reduction, and we argue that it is still one of putting new wine into an old bottle. Low-income countries and their populations are already included or integrated in the global economy but included problematically, that is why, in our view, "Capital has flowed 'uphill' from poor to rich countries", as Mervyn observes (p 8). Globalisation is not an "actorless" phenomenon and Mervyn is also right here to project the international economic system as a game of many players pursuing their different objectives.

6. World Vision recommends that a focused IMF institution, that contributes its expertise to the achievement of both growth and MDGs in low-income countries, needs to adopt a kind of "drivers of change" approach to growth with poverty reduction in its surveillance and other streamlined functions. This approach will dwell on using local analysis by other actors, including the Bank, in-country "think-tanks" and civil society organisations to shape its conclusions. The emphasis will shift from use of "one-size fits all" expert approaches, nevertheless based on "proven" economic principles, to respect for contextual differences especially in critical political economy factors that the IMF is ill-suited to analyse and account for. The economic growth model in this case, becomes one of the products of the local contextual analysis of both bottle-necks[73] and opportunities for driving growth with poverty reduction. This would also include a focus on finding the best way to achieve social inclusion in growth, and how the micro[74] and macro analyses of aid absorption interplay. This cannot be achieved by a simple division of labour between the Bank and Fund, as alluded to in the Managing Director's report to the Development Committee. It cannot also be achieved by mere independence of surveillance under Article IV as the UK government proposes, a point we refer to in a later bullet point below.

7. The IMF in this approach to globalisation will seek to engage with low-income country MDG processes, through PRSs better together with the Bank and local actors because that is where localised and national bottlenecks and opportunities for driving growth with poverty reduction can be accounted for without the IMF itself being required to do the analysis in areas that it is ill-suited. This is a different position to one where the IMF minimises or disengages its analysis from other areas on grounds of becoming focused and cutting down on its own resource commitment. World Vision and other NGOs have for instance, observed in various countries where we work that despite the introduction of the PRGF as an lending instrument that would draw from PRSPs in its macroeconomic framework recommendations for low-income countries, practice shows that countries draw their PRSP macro-economic sections from PRGFs[75]. More recently the IMF sought to disengage from Joint Staff Advisory Notes (JSAN) with the Bank on grounds of limiting use of resources and without provision for an alternative mechanism where its joint analysis of PRSs with the Bank would be monitored[76]. Given the further endorsement of the PRGF and the newly introduced Exogenous Shock Facility (ESF) by the IMFC and the UK government in the Treasury document (sections 2.35 to 2.40), such disengagement from the PRS process, without an alternative monitoring mechanism, would lead to promotion of the IMF's "one-size-fits all" approach to globalisation and growth in low-income countries. Instruments are powerful agents of ideology.

[72] This is a key World Vision position eg in Tembo, Dr Fletcher/World Vision UK, "Poverty Reduction—are the strategies working?", 2005—World Vision UK research based on case studies of Zambia and Bolivia.

[73] An interesting analytical discussion on diagnostic approaches to growth and poverty reduction, with a focus on bottle necks is given by Dani Rodrik (2005), Rethinking Growth Strategies, WIDER Annual Lecture 8, UNU World Institute for Development Economics and Research.

[74] Some of the micro analyses here include the debate over investments of aid and debt relief in social sectors versus investing in productive sectors as countries prepare their second generation PRSPs. Our experience in various low-income countries (especially Bolivia and Zambia) shows that this debate is both an economic and political one and it takes varied dimensions in different countries.

[75] See current five country case study of the impact of PRGFs on social services conducted by the African Forum and Network on Debt and Development (AFRODAD), for example:
http://www.afrodad.org/index.php?option = com—content&task = view&id = 105&Itemid = 54

[76] "Joint Staff Assessment Notes. To free resources for higher priorities eg, more careful debt sustainability analyses, it is proposed to eliminate this note, and have staff reports summarise relevant aspect of the poverty reduction strategy" (section 32 of the April 05 2006 report of the IMF Managing Director towards implementation of the MTS that was tabled at the IMFC). World Vision wrote a letter to Gordon Brown, dated 19th April 2006, asking him to use his position as chair of the IMFC to challenge this position and hence we commend Gordon Brown for arguing in his statement to the IMFC, that "the Fund and Bank's work through the JSAN is key to ensuring advice and programme are more effectively integrated with countries own poverty reduction strategies". This does not mean that JSANs should go unchallenged, especially if they are used to undermined national ownership. It means, instead that the IMF does not distance itself from PRSs in its new role.

Challenging the relevance of Policy Prescriptions/Conditionality

8. Mervyn King's trajectory of balance sheets, strategies, objectives, policies and the failure of "the invisible hand of international capital markets" to coordinate monetary and exchange rate policies, is very useful for conceptualising the IMF that we are looking for, in our case for supporting growth and poverty reduction in low-income countries. For us, it agrees with our lobby for greater space for policy experimentation by low-income countries and inclusion of civil society, which has been a critical problem in IMF practice despite mentioning it in the MTS, and our lobby for donor to stop using policy prescriptions as a means for buying policy change. This is because, it is true that we now exist in "a world of atomistic countries", where the international economy and the actors involved are game theoretic in their objectives, our interpretation of "no assumptions to be made about the objectives of others". In this situation, Mervyn rightly argues, "Policy makers, therefore, are most likely to make incompatible choices if they make decisions independently relying solely on international prices as their guide . . ." (p 8).

9. To us this reinforces our view that globalisation goes beyond policies to intentions, strategies and objectives, including hidden ones. In such a world, the IMF, and any other donor for that matter, cannot achieve their objectives through ex ante policy conditions, except where such policy is already in line with what governments wanted to achieve in the first place. The alternative is where conditionality leverages what citizens want their governments to do, and hence enhances the citizens ability and power to challenge or make it difficult for governments which would be interacting with the IMF based on other intentions and strategies rather than those stipulated in the Memorandum of Understanding. It further strengthens the contract between citizens and their governments, a point also raised in the Secretary of State for International Development's statement consultation for the White paper.

10. The UK government, in the Treasury positional document, has not done enough in developing this argument in order to challenge the IMF conditionality and hence leads to contradictions with its own position in "Rethinking Conditionality". It also does not send a strong and clear message to the 2006 review of IMF structural conditionality that will conducted by the IEO, with respect to the UK's own position. For instance, the UK position provides for opting out of IMF conditionality if not in line with its analysis of a particular government's overall programme. However, this could be the same government that has received IMF endorsement based on the PRGF, ESF or PSI, to which the UK is increasing its funding support. How can the UK government easily support the same government through the PSI or PRGF and yet act differently when it comes to conditionality? Furthermore, opting out is only as effective as offering a temporary measure in a country situation where donors are increasing budget support and coordination, and hence each donor will face pressure to oblige. Instead of settling for the temporary mechanism of opting out, the UK should push for greater investment by the IMF into strengthening mutual and domestic accountability (achieved by drawing conditions from PRSs and through dialogue that involves domestic actors and parliaments) and a roll back from policy prescriptions because many research findings have proven them to be ineffective.

Independent Surveillance

11. In the two documents, and also in the Chancellor's speech to the IMFC, HM government has argued for independence of the IMF as a way forward in the reform process, so that it can carry out its core business of surveillance effectively. However, if we take Mervyn's analysis of "a world of atomistic countries" in a game of many players of different sizes and objectives, the challenge becomes one that is more than managing "spill-over" effects of one country's policies to another to one of understanding the politics of negotiation that is informed by intentions both hidden and apparent. In this case, the fundamental role of the IMF to low-income countries needs to take into account the political economy of information and leverage their programmes for addressing the information "bottle-necks" that they face. Becoming a forum for discussing risks, as Mervyn suggests, is only one important issue but more fundamentally, the IMF needs to take into account other relationships that poor countries have with the international system, in the IMF conclusions, which will be drawn from the work of other agencies, including the Bank.

12. Furthermore, such independence cannot be achieved if only rich countries are endowed with ownership of the institution, an issue we refer to under Voting and Quotas below. We agree with Mervyn to say that IMF should at best be independent of government. However, we observe that Mervyn contradicts this argument when he argues for meetings of the big players on their own (eg G7) without at the same time recommending that their conclusions should be assessed by the IMF in the same way and criteria as those of small ones.

13. The UK government's call for a framework for assessing the effectiveness of surveillance (section 3.17) is commendable. We recommend, however, that in low-income countries, this framework should go beyond addressing the question of traction and accuracy of IMF assessments to including results from Poverty Social Impact Analysis (PSIA), which will show impact of policy advice on poor people, including vulnerable groups especially children. It will also show how negative impacts of policy implementation are addressed in future PRSPs and macro-economic policy frameworks that countries adopt with IMF advice. This does not necessarily mean that it is the IMF that should conduct PSIA but that it must provide clear

channels of learning and accountability in its undertaking of functions in its core areas. As a matter of mutual accountability, this analysis should also be part of the benchmarks within the implementation of the Paris declaration on aid effectiveness at country level.

Increasing Transparency

14. Increasing publications of IMF documents is a significant measure for ensuring transparency but should include accounting for the extent to which country authorities make these publications transparent to their own citizens, which does not necessarily mean breaching Article IV. As noted in the previous World Vision evidence, CSOs made a difference in Zambia when they published an accessible version of their country's MOU with the IMF for the ordinary citizens in Zambia, for example. They, however, still have limited access to donor-government negotiation information on PRSs in order to scale-up this practice. CSO networks are also increasingly developing innovative ways of working with country parliaments so that democratic decision-making, based on improved key PRS information and the IMF, is improved. Although there is no such practice in rich countries, the objective of achieving MDGs by 2015 should mean that donor countries should do all they can to positively contribute to developing country government's accountability to their own citizens rather than only to donors.

Voting and quotas

15. An economic weighted representation formula is not based on justice in a world of atomistic players with different objectives. In this game, power shapes deliberations and communiqu€s well before the agenda is discussed at the various tables. Increasing the basic vote is the way forward and the UK government should make this much clearer. It is interesting to note African Finance Ministers asked for this increased representation at the Spring meetings, arguing against a two staged formula that would start with India and China as the new economic powers and then the low-income countries[77].

April 2006

Memorandum submitted by HM Treasury

Meeting the Fund's Administrative Costs

1. At present most of the IMF's administrative costs are met using income from charges on outstanding Fund credit. This system has to date in every year provided income in excess of the IMF's costs. However it leaves the Fund's income dependent on the level of credit outstanding. Following early repayments by Brazil and Argentina of their IMF loans, credit outstanding has fallen to its lowest level for 25 years. If lending were to remain at the current level, then to provide the same income level, the rate of charge on the remaining Fund credit outstanding would become prohibitively high. This could in turn precipitate further early repayments of loans, meaning the IMF's income would fall even more. The current income shortfall raises issues about the sustainability of the IMF's current financing model.

2. While it would be a measure of the Fund's broader success if policies improved to the point where no country needed to borrow from the Fund, it would remove entirely this source of income from the Fund. While this would be exceptional, there could nevertheless be periods in future when the use of Fund credit, and therefore its income, is very low. This is due in part to the trend towards self-insurance through significant reserve holdings by countries with historically volatile access to private capital markets and the creation of alternative co-insurance arrangements, such as the Chiang Mai Initiative. Given that the Fund will continue to require funding to maintain its surveillance and technical assistance activities, it would benefit from more assured, less volatile, sources of income to meets its costs in the future.

3. The Fund earlier this year came forward with options to address the projected income shortfall in the year to April 2007.[78] The IMF also recognises that there is a need to develop a more durable medium-term solution; and has created a Committee of Eminent Persons to Study Sustainable Long-Term Financing of IMF Running Costs, chaired by Andrew Crockett.[79] The committee will identify and assess the range of options for the sustainable long-term financing of the IMF's running costs, and is expected to make specific recommendations to the Managing Director in the first quarter of 2007. This paper offers some principles which could guide thinking about this issue, and sets out the main options for financing different areas of IMF activity and their pros and cons.

[77] See the transcript of a Press Conference of African Finance Ministers, Washington DC, 22 April 2006.

[78] *"The Fund's Medium-Term Income—Outlook and Options"* (SM/06/69) of 17 February 2006.

[79] *IMF Managing Director de Rato Appoints Committee of Eminent Persons to Study Sustainable Long-Term Financing of IMF Running Costs*— IMF Press Release No 06/100, 18 May, 2006

Principles

4. There are a number of principles which could be used in trying to find a longer-term solution. These include:

— Reforms should aim to ensure a more stable flow of income from more diverse sources. The higher the volatility of income, the more difficult it becomes to plan future Fund activities.

— The planning of the Fund's annual budget will be aided by a system in which decisions on income and expenditure are taken in an integrated framework.

— Making the Fund's system of financing simpler and more transparent is a key priority. Currently, Fund finances are complex and opaque; making the Fund less accountable to its shareholders.

— A new financial structure should also avoid the theoretically possible incentive problem which exists under the present model, in which the Fund could encourage countries to borrow in order to generate income.

— In order to ensure support across the membership, reforms should seek to address what is increasingly viewed as an inequitable distribution of the Fund's financing burden. In the Bretton Woods system, individual countries could move from being debtors of the Fund to creditors at different times—ensuring a relatively equitable apportioning of the Fund's running costs. In recent times, however, industrial countries have largely ceased to borrow from the Fund while some emerging and developing countries have become regular borrowers. A small subset of the membership which still borrow from the Fund (which does not include wealthy industrialised countries) now meets most of the IMF's costs.

5. Two options for different ways to finance the Fund's costs are possible. First, IMF member countries (or a subset of the membership) could make annual contributions. Secondly, an endowment could be created from which investment income is earned and used to meet part of the Fund's costs.

Options for long-term reform

6. Annual contributions could help increase transparency and ensure an equitable apportioning of costs. Being required to make an annual contribution could also help focus shareholders' minds on what functions they really value having the Fund perform. Contributions could be based on quotas, or could be weighted to draw primarily on the Fund's wealthier members. However, members would have to provide annual subscriptions from public expenditure. This could make the IMF dependent on annual budgetary approval by members, and therefore introduce a different sort of uncertainty into the Fund's income. Furthermore, annual contributions based on quotas would require a change in the Articles.

9. An Endowment could be established, which would be invested in interest-bearing assets. This could provide a more regular source of income that could be used to meet all or part of the Fund's running costs, though it would still be subject to fluctuations in rates of return on investments. The proportion of the costs met by this method would also depend on the size of the endowment the shareholders were prepared to create.

10. The key challenge in establishing an endowment would be how the substantial amount of capital that would be needed could be raised. There are at least three possibilities: (a) creditors could provide zero or low-interest rate loans on a voluntary basis; (b) the IMF could draw down quotas and pay no remuneration (or a very low rate) on the amounts drawn down; and (c) the IMF could sell a proportion of its gold reserves.

(a) Voluntary contributions: low or zero interest loans are a potential way of providing the Fund with an endowment and are currently used by some countries to finance the PRGF. But although loans would be an asset in the public accounts, they still imply significant public expenditure. It is not clear whether countries would be prepared to provide sufficient resources on a voluntary basis.

(b) Draw down and invest an unremunerated proportion of quotas: The IMF remunerates most of members' reserve tranche positions (ie the part of quotas that have been lent to other members), except on a small portion that is provided to the IMF as interest-free resources. These interest free resources could be increased by drawing down a larger share of the quotas than currently from countries in the IMF's financial transactions plan. However, since these funds would be drawn down for long continuous periods, would not revolve, and would not pay any interest, it is debatable whether countries could count these amounts as part of their foreign exchange reserves. Also, the amount of quotas drawn down in this way would reduce the Fund's immediately usable resources since they would be invested in income-generating assets and not be available to finance IMF loans.

(c) Gold sales: The IMF's gold holdings of 103.4 million ounces are currently valued on its balance sheet at SDR35 per fine ounce, rather than at the current gold price. If the IMF were to sell gold at market prices and invest the profits then these could be used to establish an endowment. However, gold cannot be sold without the agreement of 85% of the IMF's voting power, and some IMF members have voiced strong opposition to sales.

11. At present the IMF's Technical Assistance (TA) is financed from a combination of external donations and the IMF's lending income. There are, however, at least three other possible sources for financing TA:

(a) Payment by TA recipients—however, low-income countries may not be in a position to be able to pay for high marginal value TA; and some TA, as well as benefiting the recipient, can be viewed as a public good.

(b) Increased contributions from bilateral and multilateral donors (in FY 2005, external financing accounted for approximately a quarter of the IMF's total TA and training activities); however, donors' willingness to contribute is uncertain and may fluctuate from year to year; or

(c) Income earned on an endowment. This would provide more certainty; but would mean that the size of the endowment would need to be larger.

Sovereign Debt Restructuring

The Asian financial crisis and the subsequent crises affecting Russia, Turkey, and Latin America highlighted weaknesses in the IMF's tools for crisis resolution. The UK, along with other countries, called for the radical reform of the arrangements for handling sovereign debt in vulnerable countries. The IMF was asked in 2001 to prepare proposals for the establishment of a new Sovereign Debt Restructuring Mechanism (SDRM). The UK's statement to the 2002 Spring Meetings set out the UK's proposals for action in this area(see http://www.imf.org/external/spring/2002/imfc/stm/eng/gbr.htm).

The IMFC agreed at the 2002 Annual Meetings on a "twin track approach" to sovereign debt restructuring. The parallel strands of this were:

— a statutory approach (embodied by the IMF's Sovereign Debt Restructuring Mechanism, SDRM) to enable a sovereign debtor and a supermajority of creditors to reach an agreement that is binding on all creditors; and

— a contractual approach to involve incorporation of contractual clauses into sovereign debt instruments which facilitate collective action and majority restructuring.

The 2002 Annual Report on the UK and the IMF reports on progress made at the 2002 meetings (see HM Treasury, *The UK and the IMF 2002*, paras 3.35–3.46).

Proposals on both strands were developed further by the IMF and in other fora, notably the G10, in discussion with members and Bond markets during 2002–3, along with work on a voluntary code of conduct. At the 2003 Spring Meetings, the IMFC considered progress on the voluntary and contractual approaches, and detailed proposals from the IMF on a statutory framework for the restructuring of unsustainable sovereign debts. The IMFC decided not to pursue a statutory framework further. The 2003 Annual Report on the UK and the IMF (see HM Treasury, *The UK and the IMF 2003*, paras 3.29–3.37) reports these discussions. Work has continued since 2003 on both the voluntary and contractual approaches:

On contractual approaches, market practice has converged toward broad acceptance of the use of Collective Action Clauses (CACs) in international sovereign bonds. With only two exceptions, all sovereigns that have issued under New York law since May 2003 have included CACs in their bonds. In 2005, more than 95% of new issues, in value, included CACs, while the share of bonds with CACs of the outstanding stock of sovereign bonds of emerging market countries climbed to around 57% as of January 2006. The recent shift in market practice to accommodate majority amendment clauses in sovereign bond contracts issued under New York law constitutes a significant step forward.

In November 2004, a set of voluntary "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets" were released, as the culmination of a co-operative dialogue involving the Institute of International Finance (IIF), other private sector representatives and major sovereign issuers of international bonds. The UK and the diverse member governments of the G20 also stated their support for the Principles. The IMF continues to monitor the implementation of the Principles. through a Principles Consultative Group, including emerging market countries and the private sector.

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