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# The IMF's Unmet Challenges

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The International Monetary Fund is a controversial institution whose interventions regularly provoke passionate reactions. On one side are those like Krugman (1998) and Nissan (2015) who argue that the IMF is an "indispensable institution." On the other are critics who object that the Fund is unrepresentative, inefficient, and an engine of moral hazard and conclude that the world would be better off without it (International Financial Institutions Advisory Commission 2000; Global Exchange 2015).

Dispassionate analysis should start with articulation of the problems that the IMF is designed to solve. It should then turn to the question of whether the Fund is appropriately structured to solve those problems—and whether it can do so without creating other equally serious problems through its own actions.

We will argue that there is an important role for the IMF in helping to solve information, commitment, and coordination problems with significant implications for the stability of national economies and the international monetary and financial system. In its role as a trusted advisor to governments, the Fund can apply lessons from the experience of other countries, basing its analysis on information that national authorities are not inclined to share with other interested parties such as rating agencies and investment banks. It can raise awareness of cross-border spillovers of

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policies that governments would otherwise have little incentive to acknowledge and encourage mutually advantageous policy adjustments to internalize those externalities. As emergency lender, it can prevent cash-strapped governments from having to resort to policies that could endanger domestic and international financial stability. By combining lending with advice, it can strengthen the hand of national authorities seeking to put in place stability-enhancing reforms.

In executing these functions, the effectiveness of the IMF, like that of a football referee, depends on whether the players see it as competent and impartial. We will argue that the Fund's perceived competence and impartiality, and hence its effectiveness, are limited by its failure to meet four challenges. Certain of these challenges are conceptual: the trusted advisor doesn't always know what to advise. Others are practical: as a result of its organization, the IMF's impartiality is called into question. All four of the challenges threaten the legitimacy of the institution and therefore its capacity to execute its core functions.

The first unmet challenge is how to organize the *surveillance* through which the IMF "monitors the economic and financial policies of its 188 member countries. . . highlights possible risks to stability and advises on needed policy adjustments" (IMF 2015a). The view of its founders was that the Fund should focus like a laser on the prerequisites for stable exchange rates and engage in ruthless truth-telling when those prerequisites were not met.[1]

But over time, surveillance moved away from the exchange rate issues that were central to the Fund's original mandate. Surveillance expanded to where it now encompasses virtually anything and everything with implications for economic and financial stability. Blunt truth-telling, meanwhile, remains more the exception than the rule. It may be unrealistic to expect that the Fund should have anticipated and warned of the US subprime crisis, the global financial crisis, and the Greek debt crisis. But the IMF batted 0 for 3 on these three events, which suggests that its capacity to "highlight risks to stability" leaves something to be desired.

Second, there is confusion about what kind of *conditionality* should be attached to IMF loans. Conditionality refers to policy commitments by governments made in return for receiving assistance. But there is disagreement about how many and what kind of commitments to require. Why should the IMF impose conditions on a government that the latter does not view as in its self-interest? How can it do so without infringing on the member's sovereignty, which the IMF as a multilateral institution is obliged to respect? Since governments are sovereign, why should one expect them to meet conditions designed to achieve goals and objectives that they do not fully embrace? Conversely, if the Fund and a government have the same objectives, why are conditions needed in the first place?

[1] The phrase "ruthless truth-telling" is commonly attributed to John Maynard Keynes in connection with negotiations to establish the institution. In fact, the phrase is due to Keynes, but in a different (earlier) context, in a letter written to Jan Smuts concerning the post–World War I peace negotiations at Versailles. See Johnson (1977, p. 8).

Third, there is disagreement about the IMF's role in *the management of sovereign debt crises*. Multiple stakeholders, significant transactions costs, and the absence of an internationally agreed legal framework for resolving sovereign debt crises create coordination problems that constitute a prima facie case for the involvement of a multilateral institution like the IMF. But there is confusion about the form that involvement should take. Officials give lip service to the idea that the IMF should provide emergency liquidity assistance when a government's debt is sustainable but private investors are unable to coordinate the provision of such liquidity, and only facilitate a debt restructuring when the debt burden is not sustainable. However, such statements beg deep questions about whether the concept of debt sustainability is meaningful and, if it is, whether the Fund is capable of determining the sustainability of a sovereign's debt in practice. Reflecting these uncertainties, the IMF has regularly continued lending for too long and put off the restructuring decision. This IMF pattern allows private investors to cut their losses and creates moral hazard. When the restructuring finally comes, it is more expensive for the country and more disruptive to the economy.

Fourth, *governance problems* raise questions about the Fund's impartiality. Some members have disproportionate voice, enabling them to sway decision making in directions consistent with their national interest even when those directions are at odds with both the interest of IMF membership and the stability of the international monetary and financial system broadly defined. Other members are inadequately represented and consequently see the Fund's decisions and advice as neglecting their interests. Both groups are therefore reluctant to give IMF staff and management more autonomy in designing programs and choosing tactics.

The IMF's failure to more successfully meet these four challenges causes its critics to question its competence and impartiality and—returning to the earlier analogy—to see it as a discredited referee. In the language of political theory, the Fund's failure to meet these challenges leads members to question its *legitimacy*. Political scientists define legitimacy as the presumption "by an actor that a rule or institution ought to be obeyed" (Hurd 1999; see also Beetham 1991, Dahl 1994, Scharpf 1997, and Flathman 2012). The legitimacy of a multilateral institution such as the IMF thus determines the willingness of agents—governments and their constituencies in the present context—to accept its recommendations and bend to its authority.

Political theorists argue that legitimacy has two sources. "Output legitimacy" refers to public assessments of the quality of the institution's performance. If its results are good, then the institution's advice is respected and agents are willing to acknowledge its authority. "Input legitimacy" refers to the process through which decisions are reached and power is exercised. If that process gives voice to and empowers relevant stakeholders appropriately, and if the interests of different parties are properly weighed—if the decision-making process is even-handed and subject to checks and balances—then the institution's advice is again more likely to be accepted.

The first three challenges—concerning the quality of surveillance, the relevance of conditionality, and the utility of the Fund's approach to debt problems—create

doubts about the IMF's output legitimacy. The fourth challenge, the Fund's failure to adopt a system of governance that gives appropriate voice to different stakeholders, raises questions about its input legitimacy. These problems of legitimacy will have to be addressed in order for the IMF to play a more effective role in the 21st century.

## Surveillance

Article IV of the 1944 Articles of Agreement, the IMF's original constitution, obliged members to maintain fixed par values for the foreign exchange rate of currencies and to obtain the Fund's concurrence before changing them. Compliance with this obligation was the touchstone of the institution's efforts to monitor and advise on national policies.

With the collapse in 1971–73 of the Bretton Woods System of pegged but adjustable exchange rates, IMF surveillance (like those exchange rates themselves) was cast adrift. Discussions about how to proceed culminated in a 1977 decision on surveillance that shifted the goal posts. Where the original Article IV had alluded to a system of stable exchange rates, the 1977 decision referred instead to a stable system of exchange rates. This minor change had major consequences: it reoriented surveillance from the stability of exchange rates to the stability of the "system"—and, by implication, to the policies influencing that stability.

Reviews of national economies were therefore expanded to consider whether monetary, fiscal, and financial policies were consistent with "stability" broadly defined. IMF staff met with government officials annually in so-called Article IV consultations. They gathered information on the national economy and provided analysis of the external environment facing the country. They assessed the mutual consistency of their forecasts for individual countries and attempted to gauge threats to the stability of the international monetary and financial system in a growing list of exercises and reports: a *World Economic Outlook*; an *International Capital Markets Report*; a *Global Financial Stability Report;* a *Fiscal Monitor*, a set of *Financial Sector Assessments* integrating macroeconomic and financial surveillance; and a series of *Spillover Reports* concerned with how the policies of large countries affect the rest of the world.

Risks and spillovers have thus become the central focus of IMF surveillance (IMF 2014a), which is consonant with the rationale for the existence of the Fund as we frame it above. Risks to economic and financial stability are complex. They are difficult for national authorities to assess. They will depend on conditions not just at home but also in other countries, information which is difficult to assemble. There is thus a role for the Fund in assembling and conveying information about global economic and financial conditions and imparting lessons learned from its experience in other countries to members in need of this expertise. Those members, for their part, are more likely to share sensitive information with a multilateral institution like the Fund than with interested parties like rating agencies and investment banks.

In addition, elected officials with a limited tenure in office often have short horizons and consequently high discount rates, which blunts their incentive to invest

in analyzing and heading off future risks. They are likely to take inadequate account of the cross-border spillovers of their policies insofar as these do not directly impact domestic constituencies in the near term.

On all these grounds, there is a role for IMF surveillance as corrective. The underlying rationales are not unlike those motivating the stress tests used by national supervisors to gauge risks to the stability of domestic banks, with the subject in this case being the national balance sheet rather than a bank balance sheet. That the Fund undertakes both bilateral and multilateral surveillance (surveillance of individual countries in the first instance and of groups of countries and the global system in the second) is then analogous to the pursuit of both micro-prudential and macro-prudential policies by domestic authorities responsible for financial stability (Tucker 2015).

Viewed in this light, the Fund's failure to sound louder warnings in the run-up to the subprime crisis in the United States, the banking crises in Iceland, Ireland, and other countries, and the sovereign debt crisis in Greece is troubling. The IMF had never conducted a Financial Sector Assessment Program review of the United States before the crisis. (The first such review of the US economy took place in 2009–2010.) In a financial sector assessment of Ireland released in August 2006, an IMF team concluded that "the financial system seems well placed to absorb the impact of a downturn in either house prices or growth more generally." While an IMF staff mission to Greece, in its concluding statement in May 2009, acknowledged the likelihood of a slowdown in growth and the desirability of fiscal consolidation and structural reform, its assessment of the state of the Greek banking system was sanguine ("[t]he banking system appears to have enough buffers to weather the expected slowdown"). It projected a budget deficit for 2009 of "at least 6 per cent of GDP," less than half the level acknowledged by the new Greek government at the end of the year.

In a seminal analysis of IMF surveillance, Mussa (1997) pointed to several explanations for such failures. Some of the issues stem from the practical limitations of economic analysis. "The economics profession has not discovered the magic formula that assures rapid and steady economic growth, low inflation, financial stability, and social progress," as Mussa disarmingly put it. There is the analytic challenge of integrating macroeconomic and financial analysis. There is the organizational challenge of overcoming informational silos within the institution. There is the struggle to staff up an agency traditionally dominated by macroeconomists with individuals possessing the specialized skills of bank regulators and schooled in the working of financial markets. There are the special difficulties of conducting surveillance reviews of countries that are members of a monetary union and therefore lack some of the instruments of national economic policy. There is the worry that warning of economic and financial weaknesses could precipitate a loss of confidence and a crisis that would not otherwise occur. There is the challenge of deciphering the state of the economy though the practice of flying visits to a country several times a year.[2]

[2] More intensive engagement, on the other hand, creates the danger of IMF staff going native—of identifying with their interlocutors and believing what they are told—and the resulting tendency of growth forecasts to err in the direction of overoptimism (de Resende 2014).

*Table 1*
**Deletions in Article IV and UFR (Use of Fund Resources) Staff Reports (2012–2014)**

| | *2012* | | *2013* | | *2014* | |
|---|---|---|---|---|---|---|
| *Reports by group* | *Number published* | *% of reports with deletions* | *Number published* | *% of reports with deletions* | *Number published* | *% of reports with deletions* |
| All Article IV and Use of Fund Resources reports | 178 | 18% | 179 | 17% | 180 | 19% |
| **Advanced markets** | **35** | **23%** | **41** | **32%** | **39** | **23%** |
| European Union | 23 | 26% | 31 | 39% | 26 | 12% |
| Other Europe | 4 | 25% | 4 | 25% | 3 | 0% |
| Rest of advanced markets | 8 | 13% | 6 | 0% | 10 | 60% |
| **Emerging markets** | **73** | **26%** | **73** | **19%** | **80** | **26%** |
| **Developing countries** | **70** | **7%** | **65** | **5%** | **61** | **8%** |

*Source:* IMF (2015b, p. 6).
*Notes:* Governments can request that passages of IMF reviews be deleted from the final report. The numbers in the table refers to documents considered by the Board during the calendar year, and published within six months of the end of the calendar year: for example, the publication rate for 2014 refers to the documents discussed by the Board in 2014 and published by June 30, 2015. The data are based on definitions in World Economic Outlook reports, including the new definition of Low-Income Developing Countries established in 2014 (IMF 2014c; http://www.imf.org/external/np/pp/eng/2014/060314.pdf), and on discussions held with members' territories and currency unions in the context of Article IV consultations with their constituent members.

A concern expressed in surveys of the Fund's emerging market members is that advanced countries with disproportionate voice and power in the IMF can bias surveillance reviews in their favor or avoid those reviews entirely. Some surveillance activities are voluntary, like Financial Sector Assessment reviews. Members must first request that they take place, and powerful countries like the United States can resist pressure to volunteer. Governments can request that passages of IMF reviews be deleted from the final report, based on statements that information is market-sensitive or that it does not refer to a policy intervention. These deletion rates are generally higher for advanced and emerging economies, as shown in Table 1.

In their most recent surveillance review, IMF (2014a) staff acknowledged that "key messages, including on spillovers, are sometimes buried deep in reports. External studies and interviews suggest that this may reflect additional internal pressure and scrutiny associated with surveillance of systemic economies."[3] In a survey by the Fund's Independent Evaluation Office (2013, p. 26), nearly 60 percent of

[3] Systemic economics are to the global economy what "global systemically important financial institutions," or G-SIFIs, are to the global financial system. The Financial Stability Board published a list of G-SIFIs in 2011, and the recent revision of the Basel Accord (Basel III) is intended to target the risks they pose for global financial stability.

mission chief respondents who worked on advanced countries acknowledged "pressure to dilute the candor of staff reports in order to avoid upsetting the country authorities" (Callaghan 2014, p.15). Blunt truth-telling about risks and spillovers evidently remains easier in theory than in practice.

To some of these criticisms, the appropriate response is: Don't ask too much. As Mussa (1997) observed, the IMF shouldn't be expected to predict all crises. To other criticisms, the appropriate response is: The Fund must try harder. It should focus its resources more effectively where the case for surveillance is strongest, namely, where risks to stability are *serious*, where information and commitment problems are *acute*, where spillovers are *pronounced*. That said, evidence on deletion rates, questions about evenhandedness, and the difficulty of blunt truth-telling suggest that reforms of IMF procedure and governance would help to strengthen the surveillance function.

## Exchange Rates and Capital Flows as a Case in Point

The IMF was founded to address the problems created by disorderly and unstable exchange rates in the 1930s and to discourage exchange rate policies that might injure national economies and disrupt the operation of the international system. Article I of the Articles of Agreement describes the central purpose of the Fund as "to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation." The 1977 shift in the meaning of surveillance, noted earlier, acknowledged the demise of the Bretton Woods System of pegged but adjustable exchange rates but continued to place exchange rates at the center of surveillance.

The question is whether exchange rates still deserve that singular position in surveillance today and, if so, what form monitoring and advice should take. Lack of clarity on the answers, we believe, is a significant part of what creates doubts about IMF surveillance in practice. This is an area where, for historic reasons, the Fund is supposed to possess special expertise. Lack of clarity on the rationale and terms of exchange rate surveillance is therefore especially damaging to perceptions of its competence.

An emphasis on risks and spillovers suggests focusing on the exchange rate in two specific instances: 1) in small open economies where the exchange rate has an especially powerful effect on inflation, growth, and financial-market conditions—where, as the point is sometimes put, the exchange rate is the single most important price in the economy (Eichengreen 1994, p. 2); and 2) in large ("systemic") economies whose exchange rate policies are a source of significant cross-border spillovers—where it really matters that the exchange rate is the *relative* price of two currencies. In countries that fall between these stools, in contrast, focusing on the exchange rate does more to diminish the effectiveness of surveillance than enhance it.

However, what it means to have "stable" exchange rates in a modern global economy is not altogether clear. At times, the Fund has encouraged members to

move toward more flexible, market-determined rates, albeit with less than full success. At other times, it has encouraged countries with rigid exchange rates to maintain them, lending to governments when their currencies were under pressure, as in Argentina in 2000–2001 (an episode that did not end happily). It has urged large countries like the United States and China whose exchange rates affect the stability of the international financial system to allow their currencies to move to levels "consistent" with the stability of that system without providing much specificity on what is meant by consistent. It has failed to adapt its surveillance and lending adequately to the circumstances of monetary unions whose members lack a national currency.

In response to such complaints, the IMF commissioned a survey and review by its Independent Evaluation Office (2007), which concluded that the Fund was "simply not as effective as it needs to be in both its analysis and advice, and in its dialogue with member countries." Internal discussion then produced another "Decision on Bilateral Surveillance" in 2007. This focused on external stability as the organizing principle for bilateral surveillance, defining external stability as "a balance of payments position that does not, and is not likely to, give rise to disruptive exchange rate movements." The document concluded that members should "avoid exchange rate policies that *result* in external instability, regardless of their purpose" and that IMF monitoring and advice should be geared to this end.

But this definition of stability—avoid steps that cause instability—is not very useful as a basis for concrete advice. In attempting to operationalize it, the Fund seems to have embraced the "bipolar view" of exchange rate regimes (Fischer 2001). In this view, countries with financial markets that are relatively open and are therefore exposed to large international capital flows should adopt either flexible market-determined rates, a la Chile, or rigid pegs in the manner of Latvia (before it joined the euro area in 2014).[4] Only countries with significant restrictions on international financial transactions and therefore insulated from large capital flows should contemplate intermediate options. Operationally, of course, this still begs the question of how open is "open" and how flexible is "flexible." One has the feeling that IMF economists, when giving advice on exchange rate policy, are still flying by the seat of their pants.

Insofar as countries have been moving in the direction of financial opening, one would expect to see the IMF recommending flexible exchange rates with more frequency. A review of documents by the Independent Evaluation Office (2006, p. 7) confirmed that the Fund's advice on exchange rate policy had indeed shifted in favor of greater exchange rate flexibility. Takagi et al. (2014) found that about half of all programs between 2008 and 2011 called for greater exchange rate flexibility.

[4] In its 2008 program with Latvia, negotiated when the currency and the country were under duress, the IMF agreed to support the government's continued maintenance of a rigid peg to the euro. On the other hand, Chile has intervened in the foreign exchange market only on rare occasions (Claro and Soto 2013).

The alternative for countries with increasingly open capital accounts is to hold their exchange rates fixed using a rigid currency peg, a currency board, or membership in a monetary union. Most recent movement in this direction has taken the form of additional members of the European Union adopting the euro. One would therefore expect to see the IMF offering pointed advice on whether euro adoption is appropriate for a country's circumstances and on how to adjust domestic and euro-area-wide policies so as to make that arrangement operate smoothly.

Given that euro experience has been fraught with difficulty, it is striking that the IMF did not sound louder warnings. It did not warn of the problems of monetary union without banking and fiscal union, despite the fact that seminal work on these points was done by IMF economists. In hindsight, it is clear that the institution was too disposed to accede to the preferences of its European members, who account for a substantial share of voting power and financial contributions to the Fund.

Once the euro was established, IMF surveillance then took inadequate account of large intra-area capital flows that laid the basis for the crisis that erupted in late 2009. It failed to highlight the exposure of euro area banks to sovereign risk and to flag how such risks were heightened by the operation of the monetary union. Despite establishing a review aimed at the euro area as a whole, national Article IV consultations remained the main focus of surveillance, preventing the Fund from obtaining and enunciating a clear picture of threats to the stability of the monetary union (Pisani-Ferry, Sapir, and Wolff 2011, p. 15).

The IMF then participated in a rescue program for Greece, although it contributed only one-third of the finance and therefore had limited influence over its design. It bowed to the wishes of the European Commission and the European Central Bank, its partners in the program, to avoid an early debt restructuring. Its intervention did not restore market confidence, and doubts about Greece's financial prospects spilled over to other euro-area economies. Greece itself experienced a severe recession, and its debt to private creditors was finally restructured in 2012. As a participant in this decision-making Troika, the IMF hardly covered itself in glory.

Exchange rate and capital-flow-management policies are closely bound together, as already noted. In the 1990s the IMF consistently warned against the use of capital controls except in the most exceptional circumstances. The advice at the time was that controls were at best ineffective in managing the stability risks posed by international capital flows (Schadler, Carkovic, Bennett, and Kahn 1993); at worst, they discouraged necessary macroeconomic adjustments. Controls also ran counter to the presumption that financial development and international financial liberalization went hand-in-hand and that financial development was important for economic growth. These views were most forcefully advanced in the second half of the 1990s when, reflecting pressure from the US government, IMF officials mooted the possibility that capital account convertibility—that is, the removal of all significant restrictions on the ability of a firm or individual to exchange currencies whenever they wish—might be made a statutory obligation of members.

The Asian financial crisis of 1997–98 raised doubts about this approach. Volatile and poorly regulated capital flows—inflows in the run-up to the crisis and then

outflows once it was underway—played a prominent role. In the wake of the crisis, a number of academic and policy studies, including some by the IMF itself, cast doubt on the presumption that capital account liberalization contributed more to financial development and growth than to stability risks (Kose, Prasad, Rogoff, and Wei 2006; Prasad and Rajan 2008). Policymakers in emerging markets, their views colored by first-hand experience with those risks, had long been skeptical of full capital account liberalization, and they now reasserted their position. Those officials gained a mechanism for sharing and expressing their views with the creation of new venues outside the Fund such as the Group of Twenty representing the world's largest national economies, which issued sympathetic studies of the role of capital controls as macroprudential policy tools (Group of Twenty 2011). The IMF then moved toward their position, partly, it has been argued, in order to avoid losing influence and jurisdiction over such matters (Gallagher 2015).

The global financial crisis came next. After-the-event analysis, including the IMF's own, showed that countries with capital controls in place before the crisis fared better (Ostry, Ghosh, Habermeier, Chamon, Qureshi, and Reinhardt 2010). Officials from emerging markets who were skeptical of the merits of capital account liberalization became even more assertive once the crisis cast a pall over the policy advice of the advanced economies (Grabel 2015). Iceland, itself an advanced country, experienced large capital inflows and outflows and resorted to controls as a crisis management expedient. This served as a reminder that the problems created by capital flows and recourse to controls were not limited to developing countries.

The result was a series of staff studies constituting a "new institutional view" of capital controls, endorsed by the Executive Board (IMF 2012). (The Executive Board is the IMF's day-to-day governing council; more on this below.) This new view acknowledged that capital flows have substantial benefits but also risks, and that capital-flow-management measures, including controls, "can be useful," although such measures should not substitute for warranted macroeconomic adjustments. The document pointed to circumstances justifying controls, taxes, and financial regulations affecting capital inflows prior to crises (such as when capital inflows heighten risks to domestic and international financial stability that cannot be adequately neutralized by conventional macroeconomic and prudential policies). Equally, it pointed to circumstances justifying their use in response to outflows and crises (to instances when controls might be used to avert collapse of an exchange rate, the depletion of reserves, and restrictions on the operation of the banking and financial system). Gallagher and Tian (2014), analyzing Article IV reports, conclude that the change in staff guidance resulted in a significant change in IMF assessments and advice regarding capital controls.

The crunch will come when the IMF's new view on capital controls brings the institution into conflict with its largest shareholders. Specifically, it is not clear how the Fund will proceed when advising governments with whom the United States is attempting to conclude trade and investment treaties that would limit a country's recourse to capital controls and that lack temporary safeguard provisions "compatible with the IMF's own approach" (IMF 2012).

## Lending and Conditionality

In the Bretton Woods era, IMF loans were extended to support the maintenance and orderly adjustment of exchange rate pegs. The Fund lent when a government, lacking adequate foreign currency reserves, needed temporary financial assistance to defend the existing or newly established value of the exchange rate. The conditions attached to those loans consequently focused on monetary and fiscal actions needed to render policies compatible with the declared exchange rate parity.

With the shift in focus from the maintenance of stable exchange rates to the maintenance of stable economic and financial conditions broadly defined, IMF lending programs—Stand-By Arrangements (SBAs) as they are technically known—were extended not merely to help a government defend the particular level of the exchange rate, but to enable it to take various steps needed to maintain economic and financial stability and, equally, to avoid having to take other steps, like suspending the operation of banks and financial markets, in response to a crisis. As the IMF (2015c) puts it in its Stand-By Arrangement Factsheet, the Fund provides Stand-By Arrangements "to respond quickly to countries' external financing needs, and to support policies designed to help them emerge from crisis and restore sustainable growth."

As the range of considerations in response to which the Fund made loans expanded, so too did the conditions it attached to its loans. These conditions came to encompass a panoply of structural, institutional, and procedural measures ranging from public enterprise privatization and pension reform to labor market liberalization and changes in tax administration. This approach reached its apogee in the Asian crisis of 1997–98. It was epitomized by the program for Indonesia, which featured a veritable Christmas tree of conditions (including dismantling the plywood export cartel, eliminating the government monopoly on trade distribution, and removing state subsidies for motor vehicle production). The program was controversial, and the government fell—two events that were seen as not unrelated.

The result was a backlash against expansive conditionality as intrusive, ineffectual, and counterproductive and a 2002 decision by the Executive Board encouraging a more "focused" approach. But that decision, in turn, raised additional questions. Conditions focused on what? Should structural conditions always be avoided, or can structural distortions be the principal source of economic imbalances and even crises, in which case only structural conditions can address the root causes of instability?

Answering these questions requires stepping back and asking why IMF conditionality is needed in the first place. Conditions are attached to loan contracts when there is a conflict of interest between the lender and borrower—when the lender wants the borrower to focus on actions that maximize the likelihood of repayment while the borrower is inclined to give weight to other goals. Thus, one role of IMF conditionality is to "safeguard members' assets" (as maximizing the likelihood of repayment is described in Fund-speak).

But defaults on IMF loans are rare, since defaulting threatens to antagonize important trading partners and to disrupt access to a valued source of emergency

credit. To the extent that this rationale applies, moreover, it suggests prioritizing actions by the borrower that can be completed within 12 to 24 months, the duration of a typical IMF stand-by arrangement, where in practice many elements of IMF conditionality, such as "combatting corruption and strengthening rule of law" (as in Ukraine's recent Stand-By Arrangement) can be implemented and produce results only over much longer periods.[5]

In some sense, the very notion of a conflict between the IMF and a government is problematic. As a condition for lending, the IMF insists that governments should embrace its goals—that governments should take "ownership" of their programs. Drazen (2002) defines ownership as "the extent to which a country is interested in pursuing reforms independent of any incentives provided by multilateral lenders." But, as he proceeds (p. 41) to note: "Conditionality makes little or no sense if there is full ownership, but it also makes no sense if there is no ownership." The IMF, in other words, has no reason to impose requirements on a government if that government is fully committed to meeting those requirements. Equally, however, there is no purpose if the government of a sovereign state is opposed to those requirements, since the implication of sovereignty is that those conditions have no prospect of being met.[6]

Perhaps there is uncertainty about the extent of ownership, in which case conditions can be useful as a signal. Investors may be uncertain about whether a government is committed to reform. Requiring conditionality in return for a loan may enable investors to distinguish which governments are truly committed. This will give the Fund's shareholders, who fund the loan, confidence that they will be paid back. In addition, an IMF loan conditioned on key reforms, by sending this signal, may "catalyze" private capital inflows or stem capital flight (Ghosh, Lane, Schultze-Gattas, Bulír, Hauman, and Mourmouras 2002).[7]

Or perhaps conditions are useful when the IMF and a government share priorities but a domestic constituency disagrees. Lending, coupled with policy conditions, may tip the balance between outcomes when its extension directly affects the welfare of the dissenting group or strengthens the bargaining power

[5] In fact the repayment period can be longer (three to five years) than the duration of the Stand-By Arrangement itself. In addition, the IMF has lesser-used windows like the Extended Fund Facility through which it lends for longer periods to countries with chronic problems. But the tension flagged in the text remains.

[6] The IMF has in fact established two lightly conditioned facilities, a Flexible Credit Line (FCL) for "very strong performers" where safeguarding resources is a nonissue, and a Precautionary and Liquidity Line (PLL) for "countries with sound policies" where it is almost a nonissue. The FCL can be drawn without conditions, the PLL subject to only very limited conditionality. In the language of the text, countries that qualify to borrow from these facilities can be thought of as "fully" and "almost fully" committed to necessary adjustment policies. But there has been little inclination to prequalify for these facilities (only five countries have applied despite the IMF's repeated efforts to make the facilities attractive), and exactly zero appetite to borrow from them, presumably for reasons of stigma. Evidently, countries that don't need to borrow from the Fund can do so without conditions, while countries that need to borrow are unable to do so without conditions.

[7] For this signaling story to be consistent, a variety of ancillary conditions have to be met, as in the famous education-as-signaling model of Spence (1973).

of the authorities. The government and a majority of domestic stakeholders may agree, for example, that cuts in public sector salaries are needed for debt sustainability and the restoration of financial market access, while public employee unions strenuously resist. A loan from the IMF conditioned on public sector pay cuts may then strengthen support for the government's policies among the public at large and moderate the opposition of public sector unions by allowing the adjustment to be phased in more gradually.

Building coalitions for reform or favoring general over special interests is delicate business politically. The more delicate the business, the more important it is that the IMF be seen as evenhanded. This suggests that expansive conditionality, where the areas subject to reform are not tightly linked to the IMF's mandate, is problematic insofar as it creates scope for powerful shareholders to enlist the institution in advancing their national interests. The US Executive Director at the IMF is obliged by Congress to support a range of structural policies in other countries, from promoting economic deregulation to privatizing industry. The US Treasury lists its successes in pressing for such policies in its reports to Congress: US Department of Treasury (2000, pp. 12–13), for example, reports success in pressing for accelerated privatization in Indonesia, Romania, Bulgaria, Nigeria, and the Gambia. This leads governments that are the subject of Fund programs to question the motivations for such policy advice and challenge its legitimacy. It also suggests that governance reform that addresses doubts about whether conditionality is attuned to the welfare of the crisis country and not just the interests of the IMF's principal shareholders would enable the Fund to go about its business more efficiently.

What conditions exactly are appropriate in light of these rationales? The simple answer is that conditionality should focus on policy reforms central to the borrower's ability to restore financial stability and economic growth and exit its IMF program on time. While in some cases these will be macroeconomic policies, in others, they will be financial and structural policies. From this perspective, calls for the IMF to return to earlier practice where conditionality focused exclusively on macroeconomic policies, and was therefore in some sense "less intrusive," are fundamentally misplaced.

Within these categories, should the IMF focus on a short list of key policy adjustments or long menus of macroeconomic, financial, and structural conditions? Here there is an analogy with the "big bang" and" gradualist" approaches to stabilization and adjustment in the transition economies of Central and Eastern Europe in the 1990s. (The literature on this debate is large; useful starting points include Dewatripont and Roland 1992, Roland and Verdier 1994, and Wei 1997.) Proponents of the big bang approach argued that policy reforms are complementary—that the gains from a given reform will be greater in the presence of others. They suggested that it was easier to build a reform-minded coalition when the adjustment burden was shared widely. Gradualists, in contrast, argued that undertaking a wide range of adjustments simultaneously could be disruptive and create unnecessary costs. Attempting to implement multiple reforms could overload the political system; it might foster the development of a broad-based coalition opposing reform. In an environment of uncertainty,

targeting a subset of key reforms is more feasible politically. Society will then be better able to learn about the costs and benefits of further reform. This list of countervailing arguments suggests that there is no general answer to the question of whether lists of IMF program conditions should be long or short.

IMF conditionality will always be criticized. Compliance is painful, especially when costs are front-loaded and benefits are deferred. Powerful special interests will inevitably be opposed. Even focusing on key reforms central to the borrower's ability to restore economic growth and, at the same time, to exit its Fund program—the two obviously legitimate goals of conditionality—is easier said than done. Strengthening the police, judiciary, and tax administration, for example, will be priorities for an IMF that believes economic growth depends on rule of law, but laying off judges, policemen, and tax administrators may be necessary to balance the budget and ensure that the Fund is repaid at the end of three years.

Overall, the IMF needs to specify exactly what its policy conditions are designed to achieve and how exactly they are designed to achieve it. Doing so disciplines the design of those conditions; it encourages a more focused conditionality that avoids overloading the political system. And governance reform that addresses complaints about whose interest is behind the conditions will enhance the perceived legitimacy of the Fund's interventions and the prospects for country ownership and compliance.

## Resolution of Sovereign Debt Problems

The IMF has been embroiled in sovereign debt problems continuously in recent years. Procedures for restructuring sovereign debts are ad hoc and imperfect, creating uncertainties for investors and governments.[8] The number and diversity of stakeholders and the absence of an internationally agreed legal framework virtually cry out for a multilateral entity to coordinate negotiations (IMF 2003). The Fund is a logical such entity, since unsustainable debts can threaten domestic and international financial stability and, consequently, are central to its mandate.

But deciding when and how sovereign debts should be restructured poses challenges. Most fundamentally, there is the challenge of determining whether a country's debt is sustainable—whether, given reasonable adjustment effort and short-term liquidity assistance, the government is able to pay. Assessments of debt sustainability require assumptions about future interest rates and growth rates, which are intrinsically uncertain over the long horizons relevant to sovereign debt contracts. Ability to pay is not easily distinguished from willingness to pay. In other

[8] It is sometimes argued that procedures for restructuring *should* be ad hoc and imperfect, since if they were perfectly predictable it would become too tempting for debtors to restructure their obligations. But the point, developed below, is that a strong argument can be made that they are too imperfect, causing restructurings to be unnecessarily delayed. An earlier review of these issues in this journal is Eichengreen (2003).

words, a government's decision on whether to make or suspend payments depends on political as well as economic considerations.

How should the IMF factor in these political considerations when deciding whether to provide an emergency loan or instead insist on a restructuring? Again there are unlikely to be hard and fast answers. IMF officials have no choice but to use their best judgment, which in turn makes it important that their judgment is seen as seeking to enhance the stability of the member and the international system, and that it does not simply reflect the narrow interest of a group of powerful stakeholders. The Fund's decision not to insist on a Greek debt restructuring in 2010 is a widely cited example of what not to do. In that instance, the French and German governments were concerned that restructuring Greece's debt might adversely affect their banks, and they were powerful enough to get their way (Blustein 2015; Orphanides 2015). Again, this observation points to governance as a factor affecting the legitimacy of IMF decision making.

While Greece is a prominent case in point, the criticism that the IMF has often waited too long to recommend sovereign debt restructuring is more general (IMF 2013b provides additional examples). In part, this criticism is informed by 20/20 hindsight when matters have turned out poorly: evaluating debt sustainability, as already noted, is not a matter of black or white. In addition, there can be uncertainty about whether the restructuring will be executed smoothly or the offer to exchange old bonds for new ones of lesser value or longer maturity will be rejected by investors, causing the country to lose financial market access and incur other costs. There are also worries about spillovers—concerns over how a debt restructuring might affect the market access and financial systems of other countries.[9]

For all these reasons, there is a temptation to provide emergency finance, some of which goes to keeping debt service current, while hoping that good news turns up. When it doesn't, and restructuring is unavoidable—Table 2 lists countries that experienced restructuring following an IMF program—it typically takes place against the backdrop of a weaker economy, making it harder for the country to regain market access. It takes place against the backdrop of heavier debts, now including debt to the IMF that is effectively senior to the private debt being restructured (because the IMF generally gets paid back in full), requiring more severe principal reductions ("haircuts") for other creditors. It takes place after private investors have exited, avoiding losses, and thus is a source of moral hazard in encouraging problematic sovereign loans to be made in the first place.[10] For all

[9] These issues arose in the case of Greece in 2010. Still, the vast majority of retrospective assessments, including the IMF's own (IMF 2013a), agree that it would have been better for France and Germany, if they were worried about the impact of a Greek restructuring on their financial systems, to inject capital into their banks and for the institutions of the European Union to support other members threatened with loss of market access, rather than blocking that restructuring.

[10] In all these respects, there is an analogy with the dilemma of a central bank confronted with a potentially insolvent commercial bank in a country lacking a proper resolution regime for insolvent financial institutions (Shafik 2015). Lacking alternatives, there too it may see no alternative to lending in the hope that good news turns up.

*Table 2*
**Countries in an IMF-supported Program with External Debt Restructuring**

| *In IMF-supported programs, 1995–2012* | *IMF program* | *External debt restructuring* | *Private creditor bailout?* | *IMF program amount agreed (millions of US dollars)* | *IMF program type* |
|---|---|---|---|---|---|
| Pakistan | October 1997 | November 1999 | Partial | 1,552.0 | Extended Credit Facility |
| Russia | July 1998 | July 1998 | Partial | 5,339.8 | Supplemental Reserve Facility |
| Ukraine | September 1998 | September 1998 | No | 2,597.1 | Extended Fund Facility |
| Ecuador | January 2000 | July 2000 | No | 311.8 | Structural Adjustment |
| Argentina | March 2000 | April 2005 | Yes | 23,288.3 | Supplemental Reserve Facility |
| Turkey | December 2000 | N/A | Yes | 7,523.7 | Supplemental Reserve Facility |
| Uruguay | March 2002 | May 2003 | No | 2,479.5 | Supplemental Reserve Facility |
| Dominican Republic | January 2005 | May 2005 | No | 665.7 | Structural Adjustment |
| Seychelles | November 2008 | February 2010 | No | 25.9 | Structural Adjustment |
| Jamaica | February 2010 | February 2010 | — | 1,267.6 | Structural Adjustment |
| Greece | May 2010 | March 2012 | Yes | 39,341.8 | Structural Adjustment |
| St. Kitts & Nevis | July 2011 | April 2012 | No | 84.5 | Structural Adjustment |
| Jamaica | May 2013 | February 2013 | No | 932.3 | Extended Credit Facility |
| Ukraine | March 2015 | August 2015 | Yes | 17,500.0 | Extended Credit Facility |

*Source:* IMF (2014b, p. 13), with authors' updates.
*Notes:* This table lists countries with an IMF-supported program that have restructured their debt since 1995. Turkey completed a debt exchange in 2001 which the IMF did not categorize as an external debt restructuring. Jamaica's 2013 debt exchange was voluntary although strongly encouraged by the IMF, and it was known that a default was very likely without the operation.

these reasons, "debt restructurings have often been too little and too late," as the IMF (2013b, p. 1) has acknowledged.

How might this tendency be corrected? One possibility is for the IMF to adopt rules preventing it from lending to countries with debts of dubious sustainability. This step would require that there be a restructuring sufficient to restore sustainability in conjunction with the initial IMF loan. The IMF moved in this direction in 2002 following an unsatisfactory experience in Argentina, to which it lent just prior to that country's default. The 2002 "Framework on Exceptional Access" committed the Fund to provide large-scale financing without also requiring a debt restructuring

only if it determined that a country's debt was "sustainable with a high probability" (IMF 2002).[11]

But tying one's hands leaves open the possibility of untying them. In 2010, responding to worries the shock from a Greek restructuring might spill over to other European countries, the IMF Board, on which European countries are heavily represented, invented a "systemic exemption" to the exceptional access framework, permitting the institution to provide Greece with a large financing package despite doubts that the country's debts were sustainable with high probability. The systemic exemption authorized exceptional access in cases where the Board agreed that there was a high risk of "international systemic spillovers." So much, then, for tying one's hands.

The Greek loan was the largest in IMF history. Emerging markets that had been subject to the earlier exceptional access policy complained, not without reason, that large shareholders in the Fund received preferential treatment.

In response, the IMF tried again in 2013–14 to enunciate a rule for debt restructuring. Instead of placing countries into two groups—those whose debts were sustainable with high probability and those that were not—there would now be a third group made up of countries whose debts might be sustainable but not with high probability. The Fund announced that it would only grant exceptional access to countries in the "unsustainable" category if they first engaged in an up-front debt restructuring. In contrast, countries in the new intermediate category might qualify for funding only if the government undertook a "soft re-profiling" of its debt, which meant a bond exchange that involved an extension of debt maturities without any reduction of principal and interest. In conjunction with this change, the systemic exemption would be eliminated.

Why this approach should work better is unclear. The next time fears of contagion arise, nothing will prevent the Board from reviving the systemic exemption. Moreover, requiring a larger share of members, including those in the new intermediate category, to engage in some form of restructuring, even in the form of a soft re-profiling, might encourage investors to rush for the exits at the first sign of trouble. The incentive to minimize the size of the intermediate category, and to delay, would remain.

A different approach to encouraging earlier debt restructuring is to make it less disruptive. To this end, the IMF has encouraged governments to add collective action clauses (CACs) to their sovereign bond contracts. CACs allow a qualified majority of holders of a sovereign bond issue, when they vote to accept a restructuring offer, to impose the same terms on the dissenting minority. These clauses thereby seek to reduce coordination, holdout, and litigation problems that delay

[11] In this context, "exceptional" means access to more than three times a country's nominal IMF quota, which is what is permitted by the Fund's standard procedures. In today's era of large international financial markets, with whose growth IMF quotas have not kept pace, loans larger than three times quota have frequently been required.

restructurings. CACs have been incorporated into the bond contracts of emerging market countries since 2003 and of euro area countries since 2013.

But these collective action clauses apply to individual bond issues, and with the growth of institutional investors it has become easier for a single investor to acquire a sufficiently large share of an issue to block a positive vote. "Super-CACs," where votes are aggregated across all bonds issued by a government, might help, but markets and governments have only limited experience with them.

Starting in 2013, the case for collective action clauses was further complicated by a series of decisions by the District Court for the Southern District of New York, with jurisdiction over Argentine bonds under New York State governing law. The court held that holdout creditors were entitled by the equal treatment (or *pari passu*) clause of their contracts to be paid in full rather than being forced to accept restructured terms. This decision threatened to weaken the incentive for creditors to agree to a restructuring. Again the IMF's response was to promote the use of "enhanced" clauses that eliminate this legal ambiguity by explicitly prohibiting "ratable payments" to holdout creditors (IMF 2015c).

This approach may be effective as a mechanism for mitigating the bias to delay once this contractual language is widely incorporated into new bond issues. But doing so will take time: adding clauses to newly issued bonds will do nothing to dissolve the legal haze covering the inherited stock of long-term, yet-to-mature bonds. This fact has resuscitated arguments for the statutory alternative, where the IMF or another multilateral institution would have the powers of a binding arbitral tribunal—the international equivalent of a national bankruptcy court—to "cram down" restructuring terms on dissenting creditors (Krueger 2002; Stiglitz and Guzman 2015).

Resistance to such proposals is strong. This is especially true of variants that seek to anoint the IMF as international bankruptcy judge or binding arbitrator, because, as Stiglitz and Guzman (2015) put it, the IMF is perceived as "too closely affiliated with creditors."[12] For these reasons, the problem of transactions costs and coordination problems as barriers to timely restructuring, the tendency for the IMF to continue lending for too long, and the resulting moral hazard for investors all remain unresolved. The situation also illustrates how issues of governance and perceptions of impartiality and legitimacy can limit the IMF's own policy room for maneuver.

[12] In addition there is the fact, as Stiglitz and Guzman (2015) go on to note, that the IMF "is a creditor itself." The question to which this points is whether debt to the Fund itself should be subject to restructuring. The IMF has traditionally dismissed this as unacceptable on the grounds that its losses "would mean additional contributions by the international community and some of these countries are in a direr situation than those seeking the delays," as the IMF's managing director Christine Lagarde put it in the context of discussions of a Greek restructuring in 2015. Rodrik (1996) argues that coupling lending with conditionality is a way for a multilateral institution like the World Bank or IMF to create confidence in the quality of its advice—to, in effect, put its money where its mouth is. The presumption that IMF loans are never restructured is problematic from this point of view.

## Governance Reform

Problems of governance feed doubts about the IMF's competence and impartiality. Governments and their constituents question whether its advice is well-tailored to their circumstances or simply reflects the self-interest of the institution's dominant shareholders. They point to pressure from the United States for countries to accelerate public-enterprise privatization in the 1990s and pressure from large European countries to avoid a Greek debt restructuring in 2010. IMF members who see themselves as inadequately represented therefore dismiss the Fund's decisions and advice as illegitimate. Their skepticism weakens the role of the Fund as a venue for governments, with guidance from staff and management, to discuss issues with an eye toward reaching a consensual diagnosis of their nature and appropriate treatment. It weakens the role of the Fund as a mechanism for orchestrating the adjustment of national policies with the goal of internalizing cross-border spillovers. Governments oppose giving the IMF the autonomy to engage in "blunt truth-telling" because they doubt that what it tells will be equally truthful in all cases. They resist giving the Fund additional responsibility as the organizer of a sovereign debt restructuring mechanism because they see the institution as overly influenced by a small set of advanced creditor countries.

Hence governance reform that gives appropriate voice and weight in decision making to all members is critical for enhancing the legitimacy and effectiveness of the institution. To understand what this means in practice, it is necessary to explain how IMF governance works. When a country joins the IMF, it must make a certain amount of resources available. These resources are known as its quota. The current quota formula is a weighted average of GDP (weight of 50 percent), openness (30 percent), economic variability (15 percent), and international reserves (5 percent). Voting power in the Fund is largely based on quotas: each country gets a "basic" vote, but in addition it gets more votes in proportion to the size of its quota.

Major decisions at the IMF require an 85 percent majority of voting power. Under the existing system, the United States holds 16 percent of votes, giving it a veto. European Union member states hold about one-third of quota shares, which means that these countries, voting together, have a veto as well. The Managing Director of the IMF has always been European and the First Deputy Managing Director has always been American, a convention that is not unrelated to the distribution of voting power. Quota shares have not been altered over time to reflect fast growth in emerging markets and developing countries, leading these members to be underrepresented in IMF decision-making.

While the ultimate decision-making body in the IMF is the Board of Governors, on which every member country is represented, day-to-day management occurs through the 24-member Executive Board chaired by the Managing Director. Countries with more voting power have their own representatives on the Executive Board: for example, the countries with the five largest quotas—the United States, Japan, France, Germany, and the United Kingdom—each have an individual representative. China, Russia, and Saudi Arabia also have individual representatives, but other

countries share a representative. Decisions in the Board are "by consensus"—votes are rare, in other words. But having a seat at the table still matters; in practice the chairman announces the existence of a consensus when, according to the secretary's tally, a majority of directors have spoken in favor of a motion. Moreover, countries with their own representative have the loudest voice, since that representative is able to channel the views of his or her national government, while representatives of multi-member constituencies must balance the opinions of different governments whose views are not always aligned.

In 2010, the Board of Governors recommended a set of governance reforms, pending ratification by governments. The package included a doubling of quotas, thereby increasing the Fund's lending power.[13] The reforms would realign quota shares so that the ten largest members would be the United States, Japan, France, Germany, Italy, the United Kingdom, Brazil, China, India, and the Russian Federation. It would abolish the right of the five largest quota-holders to appoint their own members of the Executive Board; instead, it provided that all Executive Board members would be elected by groups of countries.

Each reform has costs or disadvantages for certain members. Doubling quotas will require all countries to contribute more. Realignment will reduce Europe's voting share. The right of the United States, United Kingdom, France, Japan, and Germany to replace or dismiss their own Executive Directors would be replaced by a requirement for these countries to form constituencies, whose members would elect a director who would then have greater independence from individual governments.

Although countries with about 80 percent of current voting shares have agreed, implementation of the reform requires an 85 percent supermajority, and therefore it requires the consent of the US Congress—which has been reluctant to ratify the agreement. Disaffected countries have consequently looked elsewhere. Emerging market economies have accumulated vast quantities of international reserves, at considerable cost to themselves (Rodrik 2006), to limit the likelihood that they might need to resort to the IMF for assistance. But self-insurance is costly, since returns on reserve assets are significantly less than those paid on domestic bonds. It is especially costly when reserves can't be used without sending an adverse signal about a country's relative economic strength (Shafik 2015).

These observations point to obvious advantages of pooling reserves and coordinating their use. To this end, various central banks have negotiated bilateral currency swap lines to provide one another with additional insurance. Brazil, Russia, India, China, and Republic of South Africa (the so-called BRICS countries) have signed a Contingent Reserve Arrangement establishing a network of such swaps. The Chiang Mai Initiative Multilateralization (CMIM) of the ASEAN+3

[13] Since 1990, only one increase has been approved (45 percent in 1998), with three other reviews resulting in no increase. The previous largest-ever increase in IMF capital quotas was 60.7 percent in 1958/59. In addition, there was a temporary increase in IMF resources in 2009, at the height of the global financial crisis, arranged via the New Arrangements to Borrow through which 38 members stand ready to provide the Fund with additional financial resources.

countries (the Association of Southeast Asian Nations plus China, South Korea, and Japan) has consolidated the bilateral swap lines of its members in a first step toward pooling their reserves. An Asian Macroeconomic Research Office (AMRO) has been established in conjunction with CMIM with an eye toward developing a surveillance function and providing policy advice. One can begin to see the outlines of alternatives to the IMF developing alongside the institution.

But these new institutions have no track record. They are limited to subsets of countries or regions, and not obviously suited for addressing global problems. To the extent that disturbances affect a particular class of economies (all emerging markets, or all Asian countries, for example), they are not well designed for sharing risks, since reserve pooling buys the participants little in this instance. They are not free of governance problems of their own. These are arguments for strengthening the effectiveness and, to that end, the legitimacy of the IMF.

It is clear why the 2010 governance reforms are supported by countries whose voice and votes in the IMF would be enhanced by them. The argument for why the United States should favor them—despite the fact that it could eventually see its voice and voting share decline—is that the United States benefits from an institution with the legitimacy to act as trusted advisor and emergency lender to governments, to serve as a global venue for discussions of risks to economic and financial stability, and to encourage policy adjustments that take into account cross-border spillovers. Governance reform is necessary in order for the IMF to possess that legitimacy. US Treasury Secretary Jack Lew (2015) has called the reforms "essential to modernizing the IMF's governance and bolstering its ability to respond to urgent international crises."

Governance reform will not automatically make the IMF fit for the future. But without governance reform, the IMF has no future.

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