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Governance Structure for the New Architecture

An aspect that has received less attention in the architecture discussions than it deserves is the need for an appropriate governance structure for the international financial system. Thus far, the governance structure of the Bretton Woods Institutions, with the Interim Committee and the Development Committee at the apex, has served as the effective political level governance structure for the international financial system. It is necessary to review the existing structure in the light of the changes that have taken place in the functioning of the world economy and their impact on the role of the Bretton Woods Institutions relative to private capital markets.

5.1 The Changing Role of the IMF

The role of the IMF has obviously changed dramatically from the days when it was the centre piece of the Bretton Woods architecture. The shift to floating exchange rates in the 1970s, and the enormous growth in private capital markets since then, eliminated the Fund's role as a possible source of finance for industrialised countries. It has also become less important for those emerging market countries which have access to capital markets and can therefore handle the more run-of-the-mill balance of payments problems on their own, though even these countries may need support from the Fund for large-scale crises, because their access to capital markets is subject to sudden interruption in times of difficulty. For the overwhelming majority of developing countries, which do not have significant access to capital markets, Fund financing remains as important as ever.

The elimination of the Fund's financing role for industrialised countries inevitably weakened the its ability to influence policies in the major economies, even though these policies can have adverse effects on the rest of the world. The surveillance function of the Fund was at one stage projected as a possible mechanism for overseeing the consistency of macro-economic policies of the major industrialised countries, but this has not happened in practice. The Fund was not a significant player in either the Plaza Agreement or the Louvre Accord, both crucial examples of policy co-ordination among industrialised countries. Its contribution to the process of policy co-ordination among industrialised countries since then is also limited.

Policy co-ordination among industrialised countries is now conducted, if at all, only in the G-7 forum. There is extensive interaction among the G-7 countries at senior official level, at the Ministerial level, and finally at annual summit level meetings. Although the Fund provides inputs into the process, the process itself is not multilateral. The consultations are limited to a relatively small group of countries which are both economically more integrated and also much more politically cohesive than other international groupings. The position of these countries on international economic policy issues is usually decided as part of this process and decisions which concern the Fund and the Bank are then presented at Interim and Development Committee meetings, more or less as a *fait accompli*. Since developing countries are excluded from this process during its early and formative stages, and they do not have the power to force reconsideration at later stages, it is not surprising that they often feel that the G-7 functions, in effect, as the 'Directorate of the World'. This is, of course, a reflection of power realities. Indeed, in

the post Cold War environment, it would not be an exaggeration to say that the G-7 agenda itself is often set largely by the G-1!

The expansion of private capital markets into a dominant position has also forced some reconsideration of the role of intergovernmental forums in overseeing the functioning of the international financial system. Governments in industrialised countries increasingly distance themselves from direct intervention in the functioning of private financial markets, relying instead upon independent regulators to ensure that markets function efficiently. The growing demand for the independence of Central Banks is a reflection of this trend. If this logic is extended to international financial markets, it would imply that oversight of the functioning of these markets must increasingly be entrusted to representative bodies of regulators. This has already happened to some extent. The preferred forum for co-ordination and harmonisation of policies and standards in the banking sector is the Basle Committee and the BIS, with IOSCO and the IAIS playing a similar role in the securities markets and insurance, respectively. Any new governance structure for the international financial system must find ways of linking with the work of these organisations.

The recently established Financial Stability Forum represents an effort to achieve an integrated overview of the system allowing for interaction between governments and the representative bodies of regulators. However, as pointed out earlier, the FSF is not a representative body since it excludes developing countries. It is also interesting to note that the Secretariat of the FSF is located in the BIS and not the Fund. This adds to the perception that the Fund is not viewed by the G-7 countries as the preferred forum for discussing international financial issues which concern the industrialised countries.

These developments have naturally led to a re-positioning of the role of the Fund and the governance structure associated with it, i.e. the Interim Committee. The Fund is no longer perceived by the industrialised countries as the critical international forum for discussion of their own policies, or even as the critical forum to oversee the functioning of the international financial system which is today dominated by private capital markets. It is, however, the undisputed inter-governmental forum for discussing balance of payments problems of individual developing and transition countries, or groups of these countries, and also for considering problems arising from the interaction of these countries with the international financial system. As the principal crisis manager, it has the financing role of providing official resources to help these countries cope with balance of payments difficulties when they arise. It also has the role of catalysing private flows to the same end. And yet there is a case for arguing that this is too narrow a conception. As the emerging market economies integrate more fully with the world economy, problems in emerging market countries will grow in scale and could also have larger potential effects on markets in industrialised economies. There is a need for a forum which can consider these issues in a more holistic manner and in which emerging market countries are adequately represented.

5.2 Towards a New Governance Structure

The deficiencies in the existing governance structure, represented by the Interim and Development Committee, have been known for some time and various proposals for modifying this structure were discussed inconclusively by the Executive Boards of the two institutions only a year ago. The G-7 Finance Ministers, in their report to the Cologne Summit, recommended the continuation of the existing two-committee structure with only marginal changes. The Interim Committee was converted into a permanent International Monetary and Financial Committee, with the same membership as at present, but giving the President of the World Bank a 'privileged role' in the new Committee while the Chairman of the Financial Stability

Forum was given observer status.[45] The overlap between the two Committees, which was perceived to be a problem earlier, is not significantly reduced, although it has been decided that joint meetings of the Interim and Development Committees can be held on important issues of common interest.

The new arrangement, which was formally implemented in September 1999, is very similar to the previous one and therefore retains some of its drawbacks. A major weakness of the structure is that the composition of the Committees reflects country representation on the Boards of the two institutions, which means that all the systemically important developing countries are not represented. This was one of the reasons why the USA, when it wanted to discuss international stability issues following the crisis in East Asia, chose to convene an ad hoc group of 22 countries which included the major emerging market economies, rather than seek the same discussion in the Interim Committee.

Recognising the need to interact more intensively with the systemically important developing countries, the G-7 Finance Ministers have established a new forum, the G-20, specifically for this purpose. The G-20, which was formally launched in September 1999, consists of 19 member countries and the European Union plus the Bretton Woods Institutions represented by the Managing Director of the Fund and the President of the Bank.[46] The membership includes the 7 industrialised country members of the G-7 and the key emerging market countries. The Chairpersons of the International Monetary and Financial Committee and the Development Committee will also participate in the discussions. The mandate of the Group is to 'promote discussion and study and review policy issues among industrialised countries and emerging markets with a view to promoting international financial stability'. The group will have no permanent secretariat, but, like the G-7, it will have a deputies process to support the Ministers.

The establishment of the G-20 achieves the objective of creating a forum for informal consultation with the systemically important developing countries, but it is not a substitute for a more formal structure which would involve these countries and which would be linked to the Bretton Woods Institutions, and to the two Committees which supervise them. One way of involving the systemically important developing countries more formally in the governance structure would be to revive a proposal which was earlier considered in the context of restructuring the Interim and Development Committees. This proposal involved the creation of a single over-arching group at Ministerial level to address global economic issues, while retaining the two separate committees to address specific Fund and Bank issues.

The composition of the expanded group was to be the combined membership of the Interim and Development Committees. The Fund and the Bank were expected to be full partners in the new group, while other institutions were envisaged as permanent observers (possible candidates were WTO, UNCTAD (UN Conference on Trade and Development) and BIS). The institutional members were expected to be involved in the preparatory work for agenda items in their specialised areas. It was envisaged that the group could meet twice a year, with a plenary session in the morning for the over-arching group, followed by separate Interim and Development Committee meetings as at present. The group could also meet on other occasions if circumstances warranted without being linked to meetings of the two Committees.

45 The long-standing proposal to convert the Interim Committee into a Council at the Ministerial level does not enjoy sufficient support and remains on hold. This proposal in any case does not alter the governance structure significantly, although it brings about greater interaction between the Fund management and the memberships of the Interim Committee at the political level.

46 The country members of the G-20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the UK and the USA. The EU is the twentieth member.

The creation of a new over-arching Ministerial group, with a direct supervisory role over the Bretton Woods Institutions, and a linkage to other international institutions concerned with the functioning of the financial system, could provide an opportunity to create a top level governance forum with a more representative membership. However, merely combining the membership of the two Bretton Woods Committees would not give adequate representation to systemically important emerging market countries. An alternative approach would be to constitute a group consisting of the top 8 industrialised countries by size of quota in the Fund, plus the top 12 among the other members, which includes oil-exporting countries, transition countries and developing countries, plus all those countries not already covered by this criterion but which currently represent constituencies in the IMF Board.[47] Adding constituency representatives in this way would ensure adequate representation of smaller countries on a transparent basis.

This formula is likely to produce a group of around 30 countries which would include all the major 'stakeholders' defined in terms of economic potential as well as all members of the International Monetary and Financial Committee. The forum could include the heads of major international institutions concerned with the functioning of the international financial system and the world economy, i.e. FSF, WTO and UNCTAD. It could also include representatives of the international bodies of regulators (i.e. BIS, IOSCO and IAIS) which is necessary given the enormously increased role of private markets. The proposed composition has a somewhat larger membership than is ideal, but some expansion in size is unavoidable if a minimal degree of representation is desired.

An over-arching Ministerial Group of the type described above would create a formal Ministerial forum which could take an integrated view of the functioning of the global economic system in which operational issues related to the Fund and the Bank would be only part of the agenda. Major issues relating to the role of the Fund and the Bank could be considered by the over-arching group while detailed discussion of operational issues relating to these two institutions could be left largely to the two specialised committees.

Will the establishment of a new over-arching Ministerial Group really add value to the present structure of governance? This is a difficult question to answer. It is easy to be sceptical about what can be gained by setting up political level groupings to oversee the functioning of private market activity. On this view, political level international groupings are useful only when they oversee the policy and functioning of international public sector institutions; if the role of these institutions has been dwarfed by expanding markets then political structures created to oversee the former should not try to expand their mandate to cover market related activity. Against this view, it can be argued that as countries integrate into the world economy, they have to subject themselves to new international disciplines and reshape their domestic institutions in a manner that enables them to cope with the requirements of integration. This is an onerous task under any circumstances and one that often raises fears about loss of sovereignty and a sense of helplessness among many developing countries. This can only be countered by developing a greater sense of involvement and ownership. This is only possible if developing countries are more substantively involved shaping the new institutions and the new rules necessitated by the process of international integration.

47 The 20 countries that would qualify on this basis in the first two categories are the USA, Germany, Japan, France, UK, Italy, Canada and the Netherlands among the industrialised countries and Saudi Arabia, Russia, China, India, Brazil, Venezuela, Mexico, Argentina, Indonesia, South Africa, Nigeria and Korea among the others. All the G-22 participants are included except Australia, Hong Kong, SAR, Malaysia, Poland and Thailand. Some of these are likely to become eligible for inclusion as constituency representatives.