SM/09/172
Correction 1

July 24, 2009

To: Members of the Executive Board

From: The Acting Secretary

Subject: **IMF Governance—Summary of Issues and Reform Options**

The attached correction to SM/09/172 (7/1/09) has been provided by the staff:

Factual Error Not Affecting the Presentation of Staff's Analysis or Views

Page 10, paragraph 13 (bullet 2, second sentence):

for "The EU, for instance, occupies 8 chairs in the Board, compared to 2-4 for other regions."
read "The EU occupies 8 chairs in the Board at present, compared to 2-5 for other regions."

Questions may be referred to Mr. Teja (ext. 34520) and Mr. Goyal (ext. 36875) in SPR, and Mr. Eastman (ext. 36884) in LEG.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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involved in organizational minutiae rather than in providing broad oversight and strategy [IEO ¶s 70-72].

Box 2. Responsibilities of the Executive Board

Broad allocation. The Articles set forth in broad terms the general allocation of responsibilities between the Fund's decision making organs: The Board of Governors is vested with "[a]ll powers under this Agreement not conferred directly on the Board of Governors, the Executive Board or the Managing Director" (Article XII, Section 2(a));[1] The Executive Board "shall be responsible for conducting the business of the Fund, and for this purpose shall exercise all the powers delegated to it by the Board of Governors" (Article XII, Section 3(a)); The Managing Director "shall be the chief of the operating staff of the Fund and shall conduct, under the direction of the Executive Board, the ordinary business of the Fund" (Article XII, Section 4(b)).

Board decisions. For the most part, members exercise control over the decision making process through the Fund's Executive Board, as it has a central role in both policy formulation and in the application of those policies in the operational work of the Fund. Policy decisions may involve broad financial issues (e.g. approval of the general terms for the use of Fund resources) as well as regulatory issues (e.g. the approval of the 2007 Surveillance Decision). Operational decisions involve the day-to-day application of those policy decisions, be it in the financial area (e.g. the approval of a member's request for a Fund arrangement) or regulatory (e.g. the assessment of a member's policies under an Article IV consultation). The Executive Board is also responsible for policy decisions in administrative matters, such as approval of the budget and the broad employment policies of the Fund.

Delineation of responsibilities. As is clear from the provisions of the Articles, the Executive Board and the Managing Director exercise separate but closely related powers in the conduct of the business of the Fund. Although the provisions in Article XII could be further clarified so as to be made more prescriptive (through a formal interpretation pursuant to Article XXIX), the Executive Board has refrained from doing so. Rather, the delineation of the responsibilities of the Executive Board and management has evolved through the adoption of specific decisions by the Executive Board or, in the absence of such decisions, through practice. There are numerous examples where the scope of management's authority has been specifically defined through general decisions (e.g. the Guidelines on Conditionality) or through the Fund's Rules and Regulations (e.g. the modification to Rule N-16(d) authorizing management to accept requests for technical assistance from members without Executive Board approval). The Board has also adopted decisions that have had the effect of circumscribing the Managing Director's authority (e.g. the exceptional access policy created a limited but important exception to the previous practice whereby the Managing Director had exclusive authority to negotiate programs supported by the use of the Fund's resources).

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[1] Pursuant to Section 15 of the Fund's By-Laws, the Board of Governors has authorized the Executive Board "to exercise all the powers of the Board of Governors except those conferred directly by the Articles of Agreement on the Board of Governors". Powers conferred directly on the Board of Governors include decisions such as: changes to members' quota subscriptions; admission of new members; approving proposals to amend the Articles of Agreement; and compulsory withdrawal of members.

A. Size and Composition

12. ***Size***. The Board has doubled since its inception to the current 24 Directors, reflecting the imperative to provide representation to a growing membership (Box 3). There is no consensus as to the right size: according to the IEO, about half of Executive Directors think it is too large, while a slightly higher proportion of country authorities believe it adequately balances effectiveness and representation [IEO ¶ 42]. The corporate governance literature cited by the IEO, however, suggests that effectiveness declines above 12 Board members [IEO ¶ 40]. Several of the reports summarized here consider a downsizing to 20 chairs—which, in fact, is the number of chairs envisaged in the Articles of Agreement, and which can be exceeded only if an 85 percent majority of the Board of Governors agrees. Thus, the US, or any group of countries controlling more than 15 percent of votes, could force a return to a 20-chair Board at the next regular election in October 2010. Greater size reduction could in theory yield more tangible effectiveness benefits, but these may be outweighed by the concerns about adequate representation and managing sensible consolidation (see ¶ 13).

13. ***Composition***. Concerns center on three related areas.

- *The voice of emerging market and developing countries*. While the issue of under-representation is primarily related to quota shares, it also has a component relating to the distribution of chairs at the Board. Although it could be argued that, as a group, emerging and developing economies are not obviously underrepresented relative to economic weight (holding 10-12 chairs of 24 chairs, depending on rotation within constituencies), the reality is that most of these Executive Directors represent large constituencies. The largest face an extremely heavy workload given that those Executive Directors are the ones whose constituencies rely more on Fund advice and financial support. This limits the voice of the relevant countries and their ability to hold to account the Director representing them. Civil society thus argues for reshaping constituencies to ensure a more even distribution of countries.

- *Europe*. The perceived over-representation of this region is also a major theme of the studies covered in this paper [see e.g., Manuel ¶s 27, 41]. The EU~~, for instance,~~ occupies 8 chairs in the Board at present, compared to 2-~~4~~5 for other regions. Calls for greater consolidation can be heard within Europe itself, the argument being that such consolidation, even if it results in a reduction in aggregate voting power, will enhance rather than weaken the voice of Europe in the Fund [Bini Smaghi, 2006]. The de Larosière Group, in arguing for greater consolidation, noted that the existing representation is not only fragmented but the EU as a whole is also perceived to be over-represented, to the detriment of emerging market economies [de Larosière ¶ 256].

- *Appointed chairs*. A major constraint on Board composition is the entitlement and obligation of the five largest shareholders to appoint their own Executive Director.