Self Reform: The IMF Strategy

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Abstract

The IMF faces a drop in its income over the next two years because the crisis-lending operations that generate its primary source of income are down. Managing Director de Rato's initiative to find a new income base outside of lending activities may prove to be an important reform for the IMF because it addresses Fund incentives. Public choice theorists have long argued that the IMF engages in over-lending to generate income. If income no longer comes from lending, the incentives to over-lend may be reduced. Other perverse incentives the IMF faces – such as international political pressures – should also be addressed. There is a growing body of evidence showing that the IMF is abused by its major shareholders to pursue international political imperatives through lending activities. This note suggests that the IMF Executive Board be made independent of international politics, much as central bankers are made independent of domestic politics.

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Recently, *The Economist* reported that the IMF faces a 30 percent drop in its income over the next two years because, of late, the organization has not had to engage in the crisis-lending operations that generate its primary source of income. In the aftermath of the East Asian Crisis, critics from Stiglitz to Meltzer suggested that the IMF should scale back its operations, diminishing its involvement in the "development business." Some would say that the current shortfall in income is a golden opportunity for the IMF to trim back its development business operations.

Instead, however, the IMF is seeking to strengthen its role in development, delving more deeply than ever before into the domestic politics of IMF program countries. Instead of cutting back, it is looking to secure new, steadier sources of income. A public choice view of this international bureaucracy would see the plea cynically (see, e.g., Vaubel 1986, 1991, 1996; Dreher and Vaubel 2004). Like any bureaucrats, the IMF staff seeks to justify and maximize its budget.

Yet, the initiative to find a new income base outside of its lending activities may prove to be an important reform for the IMF to pursue because it addresses *IMF incentives*. Public choice theorists have long argued that the IMF engages in over-lending to generate income. If IMF income no longer comes from lending, the incentives to over-lend without enforcing conditionality may be reduced.

Other perverse incentives the IMF faces – such as the incentive to follow international political pressures in its lending decisions – should also be addressed. There is a growing body of evidence showing that the IMF is abused by its major shareholders to pursue international political imperatives through lending activities. Such a discussion is notably absent in the IMF strategy review.

This note will focus on the new strategies for surveillance, ownership, and governance, noting the positive changes, but also noting how ostensibly positive directions may be viewed with some cynicism. Critics of Fund "mission creep" may remain skeptical that these changes will make a difference in the IMF's ability to promote economic development. The IMF has a poor track record in the area of economic growth,[1] a mixed record on inflation,[2] and consistently shows success only in the area of balance of payments.[3] While the changes the IMF is proposing at this juncture are new, the fact that the IMF is redefining its role in developing countries following a crisis is not new. The IMF always seems ready to adapt, but still does not seem to promote economic development. Maybe its time to stop looking at *how* the IMF can do better, but *why* the IMF should bother. That is, it is time to look at IMF incentives.

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[1] Przeworski and Vreeland (2000), Hutchison and Noy (2003), Barro and Lee (2005), Dreher (2006).
[2] Stone (2002) reviews 22 studies of the effect of IMF programs on inflation. There appears to be no consensus. More recent studies find no significant effect. Stone, however, finds that inflation was reduced in post-Communist countries where conditionality was enforced.
[3] Pastor (1987a,b), Gylfason (1987), Khan (1990), Killick, Malik, and Manuel (1992), Conway (1994), Haque and Khan (1998), Bird (2001b).

The note concludes with a brief discussion not of the new strategies of the IMF but of the *incentives* facing the IMF and how, perhaps, they should be considered in discussions of IMF reform. In particular, the paper suggests that the IMF Executive Board be made independent of international political pressures, much as central bankers are made independent of domestic political pressures.

1. Transparency

There are few who disagree that the IMF should continue to collect and disseminate the economic data of its members. The data published in *International Financial Statistics* (IFS) produce enormous externalities for people analyzing countries' economies. It is not obvious that such data could not be collected by private firms – democratic governments have a particularly strong an incentive to reveal information, so the encouragement of the IMF may not be necessary for most countries.[4] Yet the goal of surveillance is not just to collect and disseminate data, but rather "to identify – and promote effective responses to – risks to economic stability, including from payments imbalances, currency misalignments, and financial market disturbances" (IMF 2006: 1). This is a lofty goal which has notably escaped the IMF on occasion in the past. The IMF hopes to improve surveillance by "choosing focus and effectiveness over comprehensiveness, with deeper analysis of financial systems, a multilateral perspective to surveillance, and more regional context and outreach."[5]

The fact that the IMF wants to streamline the focus of surveillance is a good sign. It demonstrates a recognition that too much information – or "noise" – transmits little more information than non-transparency.

In 1999, the IMF adopted its *Code of Good Practices on Transparency in Monetary and Financial Policies* to make the operations of its members publicly available. Yet, this was only part of the problem. The IMF had imposed transparency on its members, but not on itself. The IMF took a step in the right direction, however, in January 2001, when the Executive Board took the "Transparency Decision," making information about the IMF's own operations more accessible to the public. Under this policy, the IMF publishes all country documents, provided the country gives permission. This includes publishing the annual Article IV consultations with each country as well as most Letters of Intent.

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[4] On the incentives of democracy for transparency, see Rosendorff (2004) and Rosendorff and Vreeland (2006).

[5] The shift in focus from country to region will prove useful, however, the IMF should not let *geographical* region alone be the guide. The relevant region for the work of the IMF is the "*financial region*." Geographical and financial regions coincide – countries of the same region are more likely to trade, have the same political systems, and adopt similar economic policies. They are thus likely to face similar risks. Yet, financial regions do not perfectly coincide. From a regional perspective, for example, it is not obvious why the contagion of the East Asian financial crisis spilled over to Brazil and Russia, and not Chile, Mexico or China. So, perhaps the IMF should not focus just on regions but rather on financial networks. These may largely coincide, but there is a potential to learn more by removing regional blinders.

The publication of so much information, however, limits transparency in an ironic new way. Take, for example, Letters of Intent:

Even with access to the details of IMF Letters of Intent, which the IMF claims have been somewhat streamlined, the criteria for punishing noncompliance with IMF arrangements are still unclear. Various detailed conditions continue to be laid out in many different policy areas from poverty reduction to growth, fiscal austerity, monetary policy, trade policy, privatization, banking regulations, tax collection, financial and banking regulations, and the list goes on. Some conditions are laid out as prior actions, others have a long time horizon, and still others are subject to waivers and exceptions.

If IMF loan disbursements are to be contingent on compliance, the criteria should be made transparent – meaning *verifiable* by outsiders – and the IMF should be consistent in its lending decisions with respect to compliance.

Why is there so much discretion with respect to punishing noncompliance with IMF conditionality? The fault may lie not with the IMF staff and management but with the Executive Board. Babb and Buira (2005) argue that the level of detail in IMF arrangements allows for *political discretion*. If compliance is ambiguously defined, major IMF shareholders like the US can pressure the Fund to disburse loans to politically important countries.

The main point to make in this section, however, is that too much information can lead to non-transparency. The IMF's recognition in the area of surveillance that the *focus* of data is more important than its *comprehensiveness* is a move in the right direction. *The IMF should take a similar attitude with conditionality*. Unfortunately, the political motivated executive board may not have an incentive make conditionality more transparent if it uses ambiguity to pursue political ends.

2. Ownership

The recent IMF strategy review re-affirms the role of conditionality in emerging markets and developing countries. What is remarkable about this is that it flies in the face of what many critics suggested. The "ownership" direction of the IMF represents a stark departure from the consensus across the political spectrum that the IMF should scale back its activities, limit its lending to short term liquidity, and get out of the development business. On the contrary, the IMF has shifted its resources, focusing on long term programs for the explicit purpose of promoting growth and reducing poverty.

"Ownership" should thus be seen as a bold stand by the IMF that the institution can do better at development than critics believe. It requires the IMF to be more selective in choosing which governments to work with, and then requires the IMF to work closely with these governments to figure out how to make economic reforms politically possible. It is a lofty goal.

Why does the IMF consider ownership to be an important reform? The IMF argues that ownership should solve the problem of noncompliance, and with higher rates of compliance the IMF expects better results from its programs. How does ownership work? First of all, the IMF enters into agreements only with governments that are planning to implement the reforms the IMF requires because these are the policies the government wants to pursue. The government is also expected to be an active participant in designing the program – and this participation should include more actors beyond just the finance ministry.

The problem, of course, is that this is what was supposedly happening all along. This is why IMF arrangements are spelled out in a Letter of Intent signed by the government, not the IMF. The fact that domestic politics should be accounted for in the design of IMF programs is an idea that was floated in the 1970s. Moreover, if the economic program is exactly what the government plans to pursue, why is conditionality needed? It seems that all the IMF needs is an excellent screening process by which the IMF can tell ex ante which countries really believe in economic reform and which ones are simply paying lip service just to get an IMF loan. There is, unfortunately, no such magic screening process. If there were, presumably the IMF would have been using it long ago.

Is there anything new about ownership? One difference is that the IMF is now reaching out to broader segments of society in the development of economic programs. A 2002 IMF report on transparency notes that “Fund missions consult more regularly with a broad group of interested parties.” This followed a 2001 IMF staff report that suggested the IMF could play a role in explaining IMF policies in recipient countries “by holding substantive discussions with other groups [outside the finance ministry], including other ministries, trade unions, industry representatives, and local non-governmental organizations, especially at a stage at which the design of the program is still under consideration.” Generally speaking, governments appear to be more involved in the drafting of their Letters of Intent. No longer is a signature the only contribution of the government. The IMF hopes that greater communication and participation will engender higher rates of compliance.

3. The more thing change…

Can we expect the IMF to do a better job in the development business than it has in the past? Or should the IMF pull out of development and focus more on its surveillance role? The IMF focus on ownership appears to be a promising direction. Only time will tell, but there is reason to be skeptical. With several decades’ worth of chances, the reform of IMF conditionality should not continue in circles.

Conditionality has grown steadily since the 1950s. Conditional lending began as early as 1952, when the IMF introduced “Stand-by Arrangements.”[6] Conditional lending

[6] An Executive Board Decision on February 13, 1952 announced that Fund resources should be used to help members provided “the policies the members will pursue will be adequate to overcome the problem.”

was codified in the IMF Articles of Agreement in 1968.[7] When the world came off of the gold standard in the early 1970s, the IMF responded by turning its focus away from monitoring exchange rates and increasing an already growing focus on the developing world.[8] In a review of conditionality during the late 1970s, the IMF stated that:

> the Fund will pay due regard to the *domestic social and political objectives*, the economic priorities, and the circumstances of members [IMF Annual Report 1979: 137; emphasis added].

The IMF also sought to extend the scope of conditionality, encouraging countries to turn to the IMF early on before a balance of payments problem becomes too severe. It even stated that some prior actions or "pre-conditions" might be required of some governments before a Stand-by Arrangement can be put in place.[9] It was decided that the problem of the 1960s and 1970s had been *too little* conditionality – hence the shift from "macroconditionality" to "microconditionality."

Soon after these guidelines were published, the Latin American Debt Crisis of the early 1980s ensued. The fact that these particular developing countries faced such a deep and widespread crisis was a striking problem for the IMF. After all, countries of this region had participated in more IMF programs than any other in the world. Most Latin American countries entered into their first IMF arrangement during the 1950s. By 1965 *every* Latin American country had participated – and most of them on a repeating basis. Why did Latin America face the debt crisis after extensive participation in IMF programs? Were IMF policies the wrong ones? The IMF argued not. It was instead argued that programs had not gone deep enough. The macro-conditions had failed to address fundamental weaknesses in developing countries' economies.

"Structural adjustment" was deemed necessary. The problem with imposing broad conditions was that countries could comply with the letter of the program without complying with the spirit. It was not only important that balance was restored to an economy but also *how* balance was restored. If the fundamental structure of a country's economy was not addressed, the balance of payments problem would return.

Thus, the IMF began to impose more specific and deeper policies on countries. For example, rather than simply calling for a reduction of the fiscal deficit, the IMF called for privatization and deregulation. Other structural changes might involve fundamental changes to taxation policies, labor market policies, or national pension

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[7] The amendment was: "The Fund shall adopt policies on the use of its resources that will assist members to solve their balance of payments problems" (IMF Annual Report 1968: 155). See also Sidell (1988: 5).

[8] It is noteworthy that the IMF strategy review suggests a "review of the 1977 on exchange rate surveillance… [to] update guidance on the treatment of exchange rate regimes, the notion of disequilibrium in a world of capital mobility and floating exchange rates, and the procedures for monitoring by the Fund." The fact that this decision has to be reviewed 30 years later is telling of just how involve the IMF became in the development business in the 1980s and 1990s, and how little attention was paid to monitoring exchange rates, the intended purpose of the Fund.

[9] Executive Board Decision No. 6056-(79/38) of March 2, 1979, published in the IMF Annual Report 1979. Also see Hooke (1982: 37-40).

programs. Structural conditions sometimes even involve reducing barriers to trade, such as tariffs on imports or subsidies to exports.

In the 1990s, the term "microconditionality" began to be used to describe the level of detail of IMF program conditions. The overall number of conditions included in agreements exploded. As Polak (1991) reports, the average number of conditions went from below 6 in the late 1960s/early 1970s, to 7 in the late 1970s/early 1980s, to over 9 in the late 1980s. Then, as Bird (2001a) describes, the average number of conditions per IMF arrangement went up to 9.9 in 1993, 10.5 in 1994, 11.0 in 1995, 13.0 in 1996, and 16 in 1997.

"Microconditionality" came under attack, however, in the aftermath of the East Asian Financial Crisis. Too much detail led to confusion about priorities and what constituted compliance. In response to failures, the IMF has now proposed a new approach to conditionality: "*ownership*." Again, the IMF has argued that its overall approach to economic crises is correct – the problem continues to be that countries failed in some way to implement the program. Officials and staff at the IMF reason that the problem is a lack of commitment on the part of participating countries. As the IMF describes on its webpage,[10] "During 2000-01, the IMF worked to streamline its conditionality-making it more sharply focused on macroeconomic and financial sector policies, less intrusive into countries' policy choices, more conducive to country *ownership* of policy programs, and thus more effective" [emphasis added].

It should be noted that this new approach to IMF conditionality is not entirely new. It echoes the guideline published in 1979, cited above, calling for due regard to domestic social and political objectives and domestic economic priorities.

It is furthermore interesting that the solution to IMF program failures of the 1970s was *increasing* conditionality in the 1980s and 1990s, and the solution to IMF program failures in the 1990s is *reducing* conditionality in the new century, and engaging greater cooperation – greater ownership – from participating countries. Maybe the IMF finally has it just right.

Maybe, however, the problem is not just the form of conditionality, but the willingness of the IMF to follow through. So perhaps instead of fiddling around with various forms of conditionality and showcasing buzzwords like "ownership," it is time to look at IMF incentives.

The major shareholders of the IMF have been known to interfere with the enforcement of conditionality for countries it deems politically important. These countries are both more likely to get IMF loans, and less likely to have conditionality enforced. To the extent that this accounts for the failures of conditionality, then only a dramatic change in the incentives facing the IMF's governing body can help.

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[10] See "What is the International Monetary Fund" under www.imf.org. The version cited here was updated July 30, 2004: www.imf.org/external/pubs/ft/exrp/what.htm.

4. Governance

Given that the IMF remains committed to involvement in emerging markets and poor countries, it is perhaps time for these countries to have greater say in the institution. Presently, the governance of the IMF favors countries that do not participate in IMF programs. Ten of the 24 seats on the Executive Board are filled by Europeans – an eleventh is held by the US. This leaves just five for Asia, three for Latin America, three for the Middle East and North Africa, and just two for the rest of Africa. Of the 24 people who presently sit on the Executive Board, only six of them come from countries that have actually participated in IMF programs in the past ten years. Yet, as Woods (2005) points out, with the exception of only the US, all of the original major shareholders at the IMF were expected to be recipient countries.

To change the governance of the IMF, Stiglitz (2003) argues that first the size of the Executive Board should be expanded so that there are more seats at the table for African countries as well as other recipient countries. Even if official vote shares are not altered, the fact of having more recipient country voices around the table may open debates about what policies should be attached to IMF loans.

This suggestion is consistent with the spirit of Executive Board meetings, considering that votes are rarely taken on the Board, and that the IMF operates according to the “consensus” of meetings.

In addition, Stiglitz believes that the actual distribution of votes at the IMF should change. He is not alone – even the current Managing Director of the Fund, Rodrigo de Rato, supports the idea (*The Economist* 2006). Ariel Buira, Director of the G-24 Secretariat and former IMF staff member and Executive Director, has proposed a formula by which governance at the IMF can be recalibrated (Buira 2005).[11]

Note that vote share at the IMF is determined by a country’s economic size and exposure to trade. These economic variables can be measured in various manners. GDP, for example, can be calibrated using exchange rates, or potentially using “purchasing power parity” rates. Almost all cross-national research in political science and economics – and, in particular, almost all cross-national work *at the IMF* – uses GDP measured in terms of purchasing power parity (PPP). Yet when calculating subscriptions to the IMF, the IMF uses GDP measured in terms of exchange rates. Why does the IMF use market rate GDP? The standard argument is that this best reflects country’s ability to contribute to IMF efforts to finance balance of payments problems. But Buira points out that contributions to the IMF amount to less than one percent of GDP, so the “ability to pay” argument is not persuasive. Developing countries could contribute more to the IMF; this would give them a stronger voice.

Indeed, if the IMF were to switch to using GDP measured in terms of PPP, the voting shares of many countries would dramatically change. The major shareholder’s

[11] See also Bird and Rowlands (2006).

votes would not change very much – *the US would still have the most voting power by far*. But smaller industrialized countries, like Belgium or Denmark, would have their vote shares cut significantly. The windfall would go to emerging market countries. China, for example, would have nearly double the votes of Japan – instead of the other way around, which is the way it is currently. Belgium would have less than one third of the votes that Brazil would have – presently Belgium has fifty percent more votes than Brazil.

The question of whether IMF governance should be reformed, thus, rests on questions about who should have more say: Japan or China? Belgium or Brazil? A change in governance would promote role reversals among these types of countries. The very top (the US) and the very bottom would not change much.

One question behind reforming the governance of the IMF, however, looms large: What difference would it make?[12] Specifically with respect to conditionality, would changes in governance generate changes in policy? There are some reasons to question this.

First of all, even with governance reform, the United States would still have the most votes. Unless changes were extreme, the US would retain veto power over major IMF decisions. To paraphrase a recent conversation I had with former Brazilian and Mexican government officials, increasing Brazilian and Mexican voting power at the IMF would certainly be the correct thing to do, but it would not be consequential – the United States would still call the tune at the IMF.

There is evidence that the IMF is used for political purposes by big shareholders besides the US, like Germany, Japan, and France. Anecdotal evidence abounds – consider Pakistan post-9/11 as an example. Pakistan was definitely on track to receive a new IMF arrangement in 2001 – they had complied with the previous arrangement and had a long history of participating in consecutive arrangements over and over. What was suspicious was the size of the IMF loan associated with the new arrangement – double the previous loan (Vreeland 2002). More important than such anecdotes, however, is the growth of *systematic* evidence:

- Thacker (1999) shows that countries that vote with the US on key issues at the UN are more likely to get an IMF loan.

- Stone (2002, 2004) shows that the more US foreign aid a country receives, the lighter punishments it receives from the IMF for noncompliance. The phenomenon holds both areas he has considered, post-Communist Eastern Europe and Africa.

[12] One innovation might be the creation of a new "rapid insurance" facility to rush loans to strong economies if hit by a serious shock (*The Economist* 2006). As governance stands, the powerful members of the Fund fear the perverse incentives of moral hazard that this facility could induce. A new facility like this might go into effect, however, if governance changed at the IMF because the idea is supported by large emerging market countries, like Brazil, for example.

- Dreher and Sturm (2006) show that countries voting at the UN with the G-7 receive more IMF loans.

- Dreher, Sturm, and Vreeland (2006) show that rotating UN Security Council members are more likely to have an IMF arrangement than other countries.

- Oatley and Yackee (2004) show that the amount of US bank exposure in a developing country is a determinant of the size of the IMF loans the country received.

- Broz and Hawes (2006) find that the total amount of US lending as a proportion of a developing country's GDP is a significant predictor of both whether or not a country receives a loan, and the size of the IMF loan as well.

- Babb and Buira (2005) contend that the increasing length of IMF arrangements allows for political discretion in the defining of "compliance" on a case by case basis. Important recipient countries are given leeway under this ambiguity.

There is no question that the IMF is abused for the purposes of international politics. But changing vote shares at the IMF would not change this. It would simply change whose political interests the IMF would serve. So, the IMF might be subject to new political pressures from China to help its preferred countries. But the basic political problem would remain.

Changing vote shares is a level of changing governance at the IMF that is weak with respect to international political pressures. ***A real governance change would involve making the IMF Executive Board independent, with members appointed for the kinds of terms that independent central bankers serve*** (Dreher et al. 2006).

Another problem with governance reform is that even extreme governance reform will not make the IMF a democratically accountable institution. Woods (2005) stresses that governance reform should be pursued, but also warns that it is no panacea for the problems of accountability that plague the IMF. The actions of the IMF staff are simply too far removed from the Executive Board, which in turn is too far removed from the Board of Governors, which in turn is too far removed from the direct control of the citizens of the world they supposedly represent. As pointed out by Dahl (1999), international organizations simply lack the capacity to be as accountable as domestic political systems because they are not subject to the major mechanism that citizens have to hold their officials accountable: elections.[13]

Woods and Dahl suggest that ultimately we should be wary of ceding too much authority to the IMF.[14] Everyone from Meltzer to Stiglitz agrees that the IMF should become less involved in the domestic politics of program countries. They suggest that the

[13] But consider the suggestion of Frey and Stutzer (2006) who propose that a representative random sample of citizen "trustees" play a role in the actual governance of international institutions.
[14] Also see Kapur and Naim (2004).

IMF narrow its focus, moving away from development and towards data collection and the surveillance of economies.

5. Incentives incentives incentives

The IMF, however, has chosen not to scale back its role in development. The current shortfall in resources is instead an opportunity to build a "stronger and multilaterally-engaged institution." The Fund strategy review asserts that in emerging market countries the IMF can "do more by way of crisis prevention and response." As for poor countries, the IMF calls for "deeper but more focused engagement by the Fund" (IMF 2006: 2). How can such operations be funded with IMF lending down?

IMF Managing Director Rodrigo de Rato announced on May 18 his team of "eminent persons" to look into new ways of generating income to finance IMF activities. His team reflects new views on global governance – it includes one central banker from the United States, one from South Africa, one from Mexico, one from Saudi Arabia, one from Europe, one from China, and is chaired by a private finance representative.[15]

To finance more surveillance and a bigger sustained presence in development, the IMF strategy review notes that "a new business model is needed to finance Fund activity in the future, with less reliance on margins from lending and more on steady, long-term sources of income." This may represent and important change for the IMF because it can potentially influence the incentives of staff and management.

Reform of the IMF typically focuses on improving IMF policies: *How* can the IMF do a better job? One should also address, however, why it should bother to do better: *Why* should the IMF do a better job – what's in it for the IMF? Instead of tinkering with the increasing, the decreasing, the selling or the owning of policy conditionality, one should focus on the *incentives* of the IMF to lend and to enforce conditions in the first place. Perhaps the problem is not the policies that the IMF has in place, but rather a failure to stick to them.

Two of the most devastating critiques of the IMF come from the Public Choice school of thought and a flavor of Realist thinking about the IMF. Both schools of thought have noted the ambiguity with which the IMF enforces conditionality.

Public choice theorists see the IMF as an international bureaucracy with an incentive to lend to countries without enforcing conditionality. By lending, the IMF

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[15] The chair is Andrew Crockett, President of JP Morgan Chase International. The other members include Alan Greenspan, former Chairman of the US Federal Reserve Board; Tito Mboweni, Governor of the Reserve Bank of South Africa; Guillermo Ortíz, Governor of the Bank of Mexico; Hamad Al-Sayari, Governor of the Saudi Arabian Monetary Agency; Jean-Claude Trichet, President of the European Central Bank; and Zhou Xiaochuan, Governor of the People's Bank of China. It also includes Mohamed A. El-Erian, President and Chief Executive Officer of Harvard Management Company.

secures revenue. By not enforcing conditionality, economic problems persist, and continued lending is required.

Realists see the IMF as a tool of foreign policy. The United States and other major shareholders of the Fund pressure the IMF to lend – without enforcing conditionality – to allies and politically important developing countries.

If these are the problems of the IMF, then effort to once again redesign conditionality may be misplaced. For conditionality to work and for the IMF to play an effective role in economic development, the incentives of the IMF need to change.

This should not be surprising to the IMF staff – indeed, it is well known to them. When designing an economic program of reform, incentives are changed. This is the whole idea of economic reform. Thus it is surprising when it comes to reforming the IMF that there is not more discussion of changing the incentives of the IMF itself.

De Rato's move to secure resources outside of lending may be a good decision with respect to Fund incentives of the Fund. Public Choice theorists may bemoan the fact that at a time where resources are short, the IMF chooses to seek new sources of income instead of cutting its budget, but a non-lending source of revenue for the IMF may be preferable in the long run. At least it may lower the incentive to lend continuously to governments. Potentially, the IMF can go about the important business of surveillance and lend selectively only in crisis situations. It should not lend to generate income. Not only should the IMF have a non-lending source of income, perhaps this should be its only source of income, with any dividends from lending going instead to shareholders.

What about the Realist critique? How can we remove the incentive of the IMF to follow international political imperatives?

To prevent the abuse of the IMF, the main governing body of the IMF – the Executive Board – must be made independent, much like central bank presidents have been given independence domestically in many countries. The Directors who sit on the IMF Executive Board should be appointed for long, non-renewable terms, which do not coincide with the election cycles of the major shareholders. To the extent shareholders control the purse strings, they may still pressure the IMF for political reasons, but making the Executive Board is at least a step in the right direction.

Only when the governance of the IMF is freed from pursuing foreign policy objectives can we expect the institution function according to its mandate.[16]

[16] This idea comes directly from the conclusions of Dreher et al. (2006).

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