Order Code RS21810
Updated April 13, 2004

CRS Report for Congress

Received through the CRS Web

International Monetary Fund: Selecting a New Managing Director (2004)

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Foreign Affairs, Defense, and Trade

Summary

The issue of selection of IMF (and other international financial institutions) has been heightened by the resignation of IMF Managing Director Horst Kohler. Controversy focuses on whether a 60-year old convention reserving the IMF leadership for a European (and the World Bank for a U.S. citizen) is adequate for the current global economy. Proposals for a more open and transparent leadership selection process have been made, although it appears that the current selection process will follow the traditional procedure. Nonetheless, reform of the process is of active concern and will likely arise again in 2005 with the selection of a new World Bank president. This report discusses the traditional process and proposals for reform. It will not be updated.

Introduction

On March 4, 2004, Horst Kohler resigned as Managing Director (MD) of the International Monetary Fund (IMF), following his nomination for the Presidency of Germany. Until a new permanent director is chosen, Anne Krueger, the IMF's First Deputy Managing Director will serve as Acting Managing Director. This sudden opening of the top management position has reopened an active debate on leadership selection for the top management positions at the major multilateral organizations.

Selecting the leadership at the two major international financial institutions (IFIs), the IMF and the World Bank, is guided by a 60-year old convention assuring that the World Bank president is an American and that the IMF Managing Director is a European. This convention was the outcome of a gentleman's agreement struck at the 1944 Bretton Woods Conference establishing these institutions.

Background

An informal agreement — not written into the IMF Articles — the convention reflected the political and economic world map at the end of World War II. At the time, the United States believed that the World Bank should be headed by an American since the United States was the only capital surplus nation, and World Bank lending would be dependent on American financial markets. The U.S. Secretary of the Treasury at the time, Fred Vinson, believed that if an American representative headed the World Bank, the IMF must be headed by a non-American.[1]

A Deputy Managing Director position in the IMF was established in 1949, and an American citizen, nominated by the U.S. Department of the Treasury, has always filled the position. In 1994, the Board of Executive Directors (BED) increased the number of deputy directors from one to three in order to increase the regional diversity of the top management team.[2] Currently, Agustin Carsens, formerly Mexico's Deputy Secretary of Finance, and Takatoshi Kato, former Advisor to the President, Tokyo-Mitsubishi Bank, serve as deputy directors. Once the Managing Director position is filled, Mrs. Krueger, currently serving as Acting Managing Director, will likely return to her position as First Deputy Managing Director. Ms. Krueger was appointed to serve a five-year term in June 2001.

Although the informal convention virtually ensures that the final candidate will be a European, the European member countries cannot independently appoint the Managing Director. In current practice, the managing decision making process is constrained by formal and informal guideline.

Formal Guidelines for Selecting the IMF MD. The formal guidelines for choosing the IMF Managing Director are laid out in Article XII, Section 4, of the IMF Articles of Agreement. It states that "The Executive Board shall select a Managing Director who shall not be a Governor or an Executive Director."[3] This decision may be reached by a 50% majority. There is no mention of the nationality principle in the Articles. Referenced in Section 4, the Board of Governors (BOG) is the highest authority in the IMF and all countries are represented, often at the finance ministry of treasury level. The Executive Board handles day-to-day authority over operational policy, lending, and other matters. It is a 24 member body that usually meets three or more times a week to oversee and supervise the activities of the IMF. The United States, Japan, Germany, Britain and France are the five largest shareholders in the IMF and thus allowed to appoint their own representatives on the Board. The remaining members are elected (for two-year terms) by groups of countries, generally on the basis of geographical or historical affinity. In addition to the five largest shareholders, Saudi Arabia, China and Russia have enough votes to elect their own Executive Directors (EDs). The U.S. Executive Director is nominated by the President, confirmed by the Senate, and directed by the Department of the Treasury's Office of the Undersecretary for International Affairs.

Informal Guidelines for Selecting the IMF MD. The selection process is also constrained by informal guidelines among the Executive Board. Although any Executive Director can nominate an individual as a candidate for the Managing Director position,

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[1] Kahler, Miles, *Leadership Selection in the Major Multilaterals,* Institute for International Economics, 2001, p. 25.

[2] Van Houtven, Leo, *Governance of the IMF: Decision Making, Institutional Oversight, Transparency, and Accountability*, International Monetary Fund, 2002, p. 16.

[3] IMF Articles of Agreement are available at [http://www.imf.org/external/pubs/ft/aa].

the Board has never had an official vote among a plethora of candidates.[4] Within the Executive Board there is a very strong institutional aversion to voting. Executive Board Rule C-10 states that "the Chairman [Managing Director] shall ordinarily ascertain the sense of the meeting in lieu of a formal vote."[5] In deciding on the Managing Director, potential candidates are weeded out by the Executive Board through informal straw polls.

To summerize, the formal requirements that the Articles of Agreement lay out for the selection of the IMF Managing Director is that the Executive Directors appoint, by at least a 50% majority, an individual who is neither a member of the Board of Governors or Board of Executive Directors. There are no requirements on how individuals are selected, on what criteria, or by what process they are vetted. Moreover, although the IMF Executive Directors may select its Managing Director by a simple majority vote, they historically aim to reach agreement by consensus. With these factors combined, the convention guaranteeing European leadership at the IMF and American leadership at the World Bank has remained in force for almost 60 years.

The Debate Over the U.S.-EU Convention

The European-United States arrangement to split leadership at the IMF and World Bank has created a lasting and lingering resentment throughout much of the world. The globalization of finance has had lasting changes on the international economy over the past decades. Whereas United States and Europe overtly dominated the post-World War Two economy, the current international economy is less easily categorized. More and more countries are relevant and can impact the tenor of global finance.

The transition from a dollar based fixed exchange rate system, to floating exchange rate system has changed the IMF's role dramatically. Since the early 1980s, its primary work has been balance of payments and financial crisis support to its developing country members. This has led the IMF to embark on numerous governance and institutional policy reforms stressing increased transparency, accountability, and inclusion of the developing countries in IMF decision-making.[6]

Critics of the current selection process make two general arguments. First, any agreement that grants the leadership position based on nationality must by done away with. They argue that a nationality principle limits the pool of potential candidates, excluding non-Europeans that may be better versed in the financial and development needs of the developing countries who are the major recipients of IFI assistance. Many also argue that the current system lends itself to political horse-trading among the EU countries as they divide up leadership positions themselves. It is important to raise the concern that broadening the process to include many other countries does not inherently

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[4] For example, in 2000, the G-11 group of ED's representing the developing countries nominated Acting Managing Director Stanley Fischer, a U.S. appointee for the Managing Director position. Although his nomination was backed by outgoing Managing Director Michel Camdessus, the United States and Europe were unwilling to break the convention and support Mr. Fischer's candidacy.

[5] Kahler, p. 23.

[6] See CRS Report RS21330, *The International Monetary Fund: Current Reforms.*

solve the horse-trading problem. The election of IMF officials, like at any other major multilateral agencies is a political process and electing the "best" candidate (if such a person can be identified) without engaging the realities of international politics is virtually impossible.

Second, they argue that the current system, where the Executive Board decides among candidates in secret closed door sessions is non-transparent, and potentially undermines the legitimacy of the eventual Managing Director. For any Managing Director to be successful, they need to garner the respect and confidence of the IMF staff and member countries. Since approximately two-thirds of the IMF membership have expressed their view that the current process is not appropriate, any selection process that does not enfranchise the developing countries will be strained, at best. There is also the concern that the IMF "practice what it preaches." The IMF (along with the World Bank) is at the forefront of promoting good governance reforms throughout the world. Critics argue that the reform agenda pushed forward by the IMF's staff of international civil servants may be compromised by the way it selects its own leadership. A practical concern though is that the United States (and the Europeans) are the largest contributors to the IMF and the World Bank. By forcing a situation where the largest shareholders are not necessarily the largest stakeholders could fundamentally change the organizations. Most importantly, the willingness of the United States to support these institutions could be diminished if its increased contributions did not necessarily lead to greater influence.

The 2000 Selection Process

Horst Kohler was appointed as the IMF's eighth Managing Director on March 23, 2000, after the retirement of Michel Camdessus, a French national who was the only Managing Director appointed to three 5-year terms. Mr. Kohler's appointment came at difficult time for the IMF. The late 1990s were a period of numerous international financial crises, during which the IMF's involvement was heavily criticized. Many observers believed that the IMF was too heavy-handed in its imposing rigorous macroeconomic reforms as conditionality for accepting IMF financial assistance. To some extent, this criticism has been acknowledged and accepted by the IMF in its internal evaluations of its lending during the so-called "Asian Financial Crisis."[7]

Mr. Kohler was not Europe's first choice. Camdessus's retirement sparked passionate debate over who his successor would be. Since no German had yet to hold the position, Germany assumed that it should be able to select the next Managing Director. After European negotiations, a European consensus emerged around Caio Koch-Weser, the German Deputy Minister of Finance. Although Koch-Weser received formal European Union (EU) support for his candidacy at the February 28, 2000 meeting of EU finance ministers (ECOFIN), and was nominated on behalf of the EU member-states on February 29, 2000, the United States did not support his candidacy. After Koch-Weser's formal proposal, Joe Lockhart, President Bill Clinton's Press Secretary officially announced the U.S. veto of Koch-Weser's candidacy.[8] Without the support of the United States and many developing countries, who were supporting the candidacy of Acting

[7] See: *The IMF and Recent Capital Account Crises: Indonesia, Korea, and Brazil,* The Independent Evaluation Office of the IMF, September 12, 2003.

[8] Kahler, p. 38.

Managing Director Stanley Fischer, Koch-Weser was unable to get a majority in the informal straw-poll vote.

After a month of debate, Koch-Weser's name was removed from contention, and was replaced by Horst Kohler, also a German national, who was serving as the president of the European Bank for Reconstruction and Development. Kohler was selected as the new Managing Director on March 23, 2000, less than one month after the EU had endorsed Koch-Weser's candidacy. Although the EU-U.S. convention emerged unscathed, this was the first time that the official EU candidate was openly rejected by the United States. Morever, the large amount of press coverage that the selection process received gave the IMF's critics ample opportunities to press for reforms to open up the Managing Director selection process, making it more transparent, more orderly, and more receptive to the needs of IMF borrowers.

The Agenda for Reforming the MD Section Process

In July 2000, the *International Monetary Fund Working Group to Review the Process for Selection of the Managing Director* was created to discuss the selection procedure. A draft report of the Working Group was endorsed by the Executive Directors on April 26, 2001, as guidance for the future selection of Managing Directors. There is no requirement that the IMF Executive Board follow the guidelines proposed in the report. For the following guidelines to be required, the Articles would need to be amended. The report issued five recommendations:

1) Executive Directors should establish clear criteria for identifying, nominating, and selecting qualified candidates for the post;

2) Executive Directors should be informed in a timely manner regarding candidates, including their credentials and knowledge of the institution;

3) There should be a channel for facilitating smooth communication;

4) Transparency and accountability are critical;

5) Any decision concerning the selection process should take into account any impact on the selection process at other international financial institutions.[9]

Immediately following Mr. Kohler's resignation, a wide range of experts advocated revision of the IMF Managing Director selection process. Augosto Carlos-Lopez, chief economist at the World Economic Forum, called for choosing the new Managing Director from the entire IMF membership, in order to "serve the interests of the entire international community."[10] Moises Naim, editor of Foreign Policy magazine, agreed: "the next chief executive of the IMF - and the World Bank - must be selected through a process that gives them and their institutions the legitimacy that only a competitive and transparent process

[9] Kahler, p. 114.

[10] Lopez-Carlos, Augusto, "The IMF is Not the Property of the Rich," *International Herald Tribune*, March 15, 2004.

can bestow."[11] Nancy Birdsall, of the Center for Global Development, specifically points out the need to involve the major emerging markets of South American and Asia, as well as the world's poorest countries. These are the major recipients of IMF lending, and according to Dr. Birdsall, "the unwillingness of the U.S. and the G-7 to share power and responsibility in the global financial institutions is already undermining the legitimacy and effectiveness of these institutions."[12]

Within the IMF, developing country Executive Directors have a voting group known as the Group of Eleven (G-11) to advocate their concerns. This group represents over 100 countries and has an approximately 30% vote on the Executive Board, large enough to veto IMF special majority decisions (those requiring an 85% majority vote, such as increasing the size of the Fund, adjustments to members' quotas, admitting new members, and revisions to the Articles of Agreements. The G-11, along with the Russian, Australian, and Swiss EDs, released a public statement on March 19, 2004, stating "the process of identifying and selecting the candidate must be open and transparent, with the goal of attracting the best person for the job, regardless of nationality. A plurality of candidates representing the diversity of members across regions would be in the best interest of the Fund."[13] In a follow up release, issued on March 21, 2004, the G-11 Executive Directors acknowledge that although abolishing the nationality principle and completely ensuring an open and transparent process are unlikely at the present time, they propose a few procedures to ensure that candidates are proposed and vetted in a clear and systematic process. The proposed guidelines would require, among other things, that once an individual is nominated, their credentials are made available to all Executive Directors and that the candidates should meet with the Executive Board before a decision is reached.[14]

For the 2004 selection, it appears, however, that the Europeans are determined to go ahead with the former process. Efforts are currently underway to identify a common European candidate who will likely be acceptable to the United States and the developing countries. Nonetheless, the issue of procedure for selection remains an active concern. Presuming no major controversy remains after the Europeans select the current nominee, international attention is likely to shift towards preparing for the election of the next president of the World Bank in 2005.

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[11] Naim, Moises, "End the Fund's Succession Fiasco," *Financial Times*, March 4, 2004.

[12] Birdsall, Nancy, "Broaden the Race for IMF Post, *Financial Times*, March 11, 2004.

[13] *Statement by a Group of IMF Executive Directors on the Selection Process for a New Managing Director*, International Monetary Fund Press Release No. 04/55, March 19, 2004.

[14] *Statement by the G-11 Executive Directors of the IMF on the Selection Procedures for Appointing the IMF Managing Director*, International Monetary Fund Press Release No. 04/64, March 31, 2004.