The International Monetary Fund and Democracy:

Some Reflections from the II General Assembly of the Club de Madrid

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The International Monetary Fund and Democracy: Reflections on Recent Experiences

November 2003

ON 1-2 NOVEMBER, 2003, members of the **Club of Madrid** —former Heads of State and Government of democratic countries— met in Madrid, Spain with experts from around the world to discuss the challenges that the international financial system, particularly the International Monetary Fund (IMF), poses to democratic values and institutions. The international community has engaged in a vigorous debate about the role of the IMF in pursuing financial and macroeconomic stability, but there has been less scrutiny of the impact IMF policies have had on the development of democratic political stability. The **Club of Madrid** believes that it can make a practical contribution by initiating a series of studies on this question from the perspective of former democratically-elected heads of state and government who themselves had to face the dual challenge of undertaking difficult economic as well as political transitions to more open, just and market societies.

To ensure the discussion was well-grounded in the actual experiences of democratic governments, the Club commissioned expert papers on Brazil, Korea and Poland —three middle-income countries which lived through financial crises over the last dozen years as they underwent dramatic reforms to consolidate democracy and whose former President (Brazil) and Prime Ministers (Korea and Poland) are members of the **Club of Madrid**. In addition, the Club's General Assembly examined the role the Group of Seven industrial democracies have played in steering IMF policies, as well as proposals for overcoming the weaknesses of IMF governance. The discussions were greatly enriched by the participation of 26 former heads of state and government from 21 countries in Europe, Latin America, Africa, North America and Asia. They were assisted by a team of academic and policy advisors who composed a set of questions to guide the discussion, ranging from the nature of the financial crisis in each country, the design of the national and international policy responses, the political process around the stabilization package, and the balance between liquidity and conditionality. The overarching question on the table was whether the IMF approach contributed to the strengthening of democratic governance in the country under review and what lessons could be drawn for designing future reforms to the international financial system.

The assembled members reached agreement on a Final Declaration, which is included in this report. To the surprise of many of us, we concluded that, in the case of these three countries, economic crises were surmounted while at the same time democratic political systems were constructed and strengthened. This is a remarkable achievement, which was facilitated by the financial assistance of many governments and organizations in the international community, including the International Monetary Fund. At the same time, we recognized that many other countries, particularly less fortunate countries faced with entrenched poverty, inequality and weak institutions, have had different experiences with the international financial community.

In light of the complexity of this problem and the wide disparities among big and small countries as well as rich, middle-income and poor countries, the **Club of Madrid** has decided to carry out additional work in this field. It will endeavor to examine the experiences of countries with weaker democratic systems that may not have the same bargaining power vis-à-vis the international financial and trade institutions. It will also continue to examine the issue of how to improve global governance to ensure it becomes more democratic and transparent.

The **Club of Madrid** convened its second General Assembly at a time of great hope and great despair regarding the international order. On the one hand, processes of economic globalization and integration are speeding ahead, creating both winners and losers. On the other hand, the promise of democracy is spreading far and wide accompanied by rising citizen demands for governments to carry out more equitable social and economic policies. The result is a growing tension between the imperatives of the market place and the basic values and

practices of democracy. For example, there is a serious and valid concern that, without real improvements in public services —health care, education, pension systems, among others— individuals will be ill-equipped to exercise their rights as citizens and democratic governments may not survive. Yet these same democratic governments, many of which inherited unsustainable economic policies from authoritarian regimes, find themselves trapped in a storm of unregulated capital flows, distorted trade regimes and high debt and therefore handicapped in their ability to cope and to foster job creation and poverty reduction.

At the eye of the storm, in the view of many, stand the IMF, the World Bank and the other Bretton Woods institutions. Created in the wake of World War II as a means for nations to coordinate international financial and currency policies, the IMF has evolved to become both a bank of last resort and an enforcer of macroeconomic policy prescriptions designed to alter a nation's basic approach to regulation of economic power. As the excellent essay by Moisés Naím and Devesh Kapur included in this volume observes, an external actor that exercises its influence on a democratic system inevitably provokes criticism as being anti-democratic. The conditionality dilemma has led the IMF to rethink its approach and to emphasize country "ownership" of a stabilization program. The Poverty Reduction Strategy Process (PRSP) launched by the World Bank and IMF in 1999 is one way to expand consultation with stakeholders in society to ensure both the transparency and democratic accountability of Fund-supported programs. It deserves further evaluation from the standpoint of those concerned with strengthening democratic processes.

During the conference, participants also examined the democratic deficit of the IMF governance structure, which is marked by a quota system that gives the G-7 democracies and other wealthy donors a controlling voice in IMF policies. The IMF has taken positive steps to enhance the transparency of its own proceedings, but ultimately further improvements depend on member states deciding to reveal more information to the public and parliaments. We concluded that the international community also must address such challenges as increasing the resources available to countries under financial strain, as well as developing ways to control erratic flows of short-term capital.

Any summary of such a complex and highly-charged subject cannot do justice to the thoughtful papers and deliberations presented in Madrid. We invite you to read the material contained in this report as well as the background papers prepared for the conference, which are available on our website at www.clubmadrid.org.

Finally, we wish to reiterate the spirit in which we approach our work. For democracy to grow there must be a guaranteed space for public debate, a forum designed to improve the quality of citizenship. The **Club of Madrid** contributes to the debate by offering the valuable personal experience of its members, and the knowledge of and advice from an outstanding group of political and academic experts.

With our direct knowledge of the challenges and difficulties confronting not only young but also mature democracies, the members of the **Club of Madrid** pledge their efforts to actively promote democracy and to share their experiences in order to help others navigate the difficult road to freedom.

We, the members of the **Club of Madrid**, have taken on this serious obligation; as a group we seek to spark the democratic advances that could guarantee peace and the advancement of humankind. Part of this task will also be to contribute to overcoming the lack of international governance. We believe that it is extremely important to apply specific measures and practical recommendations, such as those developed in the course of the second General Assembly in Madrid.

FERNANDO HENRIQUE CARDOSO
President, Club of Madrid
Former President of Brazil

KIM CAMPBELL
Deputy President, Club of Madrid
and Interim Secretary General
Former Prime Minister of Canada

Final Declaration of the 2003 General Assembly of the Club of Madrid

1-2 November 2003

WE, THE MEMBERS OF THE **Club of Madrid**, all former heads of state and government of democratic countries from all corners of the earth, gathered in Madrid for our annual General Assembly on November 1-2, 2003, to assess the relationship between the International Monetary Fund (IMF) and countries undergoing democratic transition and consolidation that faced severe financial crises during the past dozen years. We also pondered the Fund´s relations with the main industrial democracies. We have focused on these issues because we believe that democracies must deliver on the promise of a better life for their citizens. The prospects for democratic survival and success require more effective international cooperation to assist democratic governments in times of financial crisis and to prevent crises from recurring.

We drew on the considerable expertise of our membership regarding democratic leadership to address urgent public demands for economic, social, and political change. We expect to issue a report regarding the relationship between the IMF and democratic countries in early 2004. But now we wish to make public certain conclusions concerning the essential role of democracy in achieving the IMF's goals and the impact of IMF policies on democracy.

We reaffirm the inherent value of democratic institutions and practices: liberties of citizens to express their ideas and to associate as they wish, respect and protection of the rights of minorities to sustain their beliefs and ways of life, an independent media and a vibrant civil society. Democracies should deliver fairness and justice for their citizens, and a concerted effort to reduce poverty.

We encourage all democratic governments to pursue sound economic policies within the framework of a market economy and their own democratic procedures. We urge them to focus on effective strategies to foster and enhance sustainable development in the long run.

We examined in particular the cases of Brazil, Korea, and Poland. We celebrate that these countries surmounted their profound economic crises while at the same time they sustained and strengthened and, in Poland's case created, their democratic political systems. They achieved this with the assistance of many governments and organizations in the international community, including the International Monetary Fund. We recognize that other nations also have been successful, while many have been less fortunate in their dealings with the international community and less successful in stabilizing their economies. Different lessons could be extracted from those cases.

The solution to the crises that Brazil and Korea faced required making creative use of democratic institutions and procedures. The crisis broke out as each country was in the midst of a presidential election. The key agreement that the IMF reached with Brazil and Korea was subscribed to not just by the IMF and the respective governments but also by the main presidential candidates. The agreement with the IMF worked thanks to the effective commitment of democratic leaders, parties, and voters from government and opposition to sustain the panoply of economic policies required to overcome the crises. Democratic legitimacy enabled the incoming governments to make economic programs their own, thereby facilitating their credibility and sustainability.

Poland's complex transition to democracy and the market economy required several agreements with the IMF but also the rotation through the presidency and cabinet of many political leaders and parties. Democratic Poland in this way came to design, shape, and own its market-economy transition. Plural democratic participation and political learning resulted in binding agreements to implement effective policies. Poland's democratic diversity was a key to securing cooperation between parties and the most credible guarantee that future Polish governments would abide by the agreement with the IMF.

Democracies are much stronger with good economic policies and performance. The experience of these three countries demonstrates that democracies can implement good economic policies, and that the IMF should be sensitive to the importance of strengthening, not weakening democracies.

We exhort the IMF to deepen its efforts toward transparency in formulating, communicating and explaining the economic policy requirements that it expects from governments that seek its assistance. Such transparency should enable governments to debate and choose policies that respond to the democratic values and aspirations and the social and economic needs of their own citizens, while they at the same time carry out their agreements with the IMF. Policies must be technically correct, but citizens must also perceive them to be politically and socially fair.

The IMF should also endeavor to become more democratic in its own operations, including the composition of voting rights and the transparency of its proceedings. We recognize the crucial role played by the Managing Director of the IMF and we stress the need to improve the methods and procedures used to identify and appoint her or him.

We reaffirm the importance of the international community, and especially the developed countries, paying greater attention to the urgency of updating the international financial architecture so that it can better meet its original goal of stabilizing the world economy. Challenges such as increasing the resources to be put at the disposal of countries under financial strain, as well as identifying mechanisms to prevent and control erratic flows of short-term capital, must be addressed. It is no less important for developed nations and the Bretton Woods institutions to finance long-term investments in economic development, education, healthcare, and the environment, which are beyond the present capacity of the IMF.

The **Club of Madrid** also calls attention to the fact that the economy has become global, but politics has not. Hence the importance of working towards democratic global governance to address issues as crucial as sustainable development and social justice.

Does the IMF promote democracy? Should it? Can it?

Some thoughts inspired by the deliberations of the November 2003 General Assembly of the Club of Madrid

December 2003

Moises Naim
Foreign Policy Magazine

Devesh Kapur
Harvard University

I. Introduction

The International Monetary Fund plays many roles in the global economy: it is a financial and an informational intermediary; serves a global insurance function; acts as an agency of 'restraint' on borrowing governments; is seen to act as a debt collector for international capital markets and a foreign policy instrument for some of its principals; serves as a convenient scapegoat and punching bag for most of its members. Finally it represents the unfulfilled hopes of institutional possibilities of global governance.

With the scale and scope of the Fund increasing in recent years, so have the controversies surrounding the institution. There are innumerable and contentious debates on the effects of Fund programs on borrowing countries, the conditionalities embedded in these programs, and whether any alternative policy mix would deliver better outcomes. Some leading economists vehemently argue that the Fund's policies and programs have pernicious effects on the economies of borrowing countries while other equally prominent ones defend the IMF stance. The Fund's behavior, however, not only has economic consequences but also social and political ones. What are the implications of the Fund for the politics of borrowing countries, in particular for democratic processes and institutions?

This was the spirit in which the **Club de Madrid** conceived of the conference on the IMF and Democracy in November 2003. The conference centered around three case studies, all middle-income countries. The three —Korea, Poland, and Brazil— were from different continents where a former head of government was active in the **Club de Madrid**. Notably, the agenda did not include weaker countries which have had a more difficult time negotiating with the IMF.[1] Nonetheless, the discussions were comprehensive and wide-ranging and reflected the wealth of experience of the 26 former heads of state who participated in the conference.

This essay does not purport to be a summary of the proceedings. It is instead our own personal interpretation of the discussions around a complex, multifaceted subject on which it is impossible to provide a summary that would do justice to all the opinions,

Round Table on the IMF and the Role of the G7 and Other Developed Countries. From left to right: Lionel Jospin (former Prime Minister of France), William J. Clinton (former President of the United States, Honorary Co-Chairman of the Club of Madrid), Kim Campbell (former Prime Minister of Canada, Deputy President of the Club of Madrid), Leonel Fernández (former President of the Dominican Republic) and John Williamson (Senior Fellow of the Institute for International Economics).

nuances and different views and experiences that were expressed at the Madrid meeting. Therefore, the essay is based on our own conclusions about the deliberations that took place in the formal sessions of the Club de Madrid, on the informal conversations with many of the former heads of state who attended the meeting, and on our reading of the documents prepared for the event. Obviously our own previous experience with the Bretton Woods institutions and our reading of what we feel is a significant and representative sample of the literature which exists on this subject also informs our views on these issues. While complementary to many points of the conference's Final Declaration, the opinions and conclusions of this essay have not been endorsed by the **Club de Madrid** or any of its members.

The essay is organized as follows: We first lay out a framework that identifies what are the key questions regarding the issue of the IMF and democracy. We

View of the Plenary Room.

[1] As the Final Declaration adopted by the Club members attending the conference put it, "[M]any [nations] have been less fortunate in their dealings with the international community and less successful in stabilizing their economies. Different lessons could be extracted from those cases."

then distill the principal lessons from the three case studies discussed at the meeting and build upon them to clarify the connection between the IMF programs and democracy. Subsequently we discuss what we interpreted to be central themes of the discussions in Madrid, namely the impact of global financial markets on democracy in developing countries. We conclude by suggesting six broad ideas about how to think about the IMF and democracy.

II. The IMF and Democracy: What are the key issues?

There are three principal questions about the Fund and democracy. One, what are the consequences of the IMF's activities for democracy? Two, should it become more active in promoting democracy through its principal functions, namely technical assistance, surveillance or lending programs? And three, how democratic an institution is the IMF itself?

At one level the IMF and democracy may seem strange bedfellows. The Fund is officially proscribed from taking political considerations into account in its lending decisions and any discussion of the Fund and democracy has to frontally confront the constitutional reality of the proscription.[2] But there is an elementary paradox. The IMF deals solely with governments – which are fundamentally political entities. Its programs inevitably require economic reforms, often of a sweeping nature with widespread political consequences. They often alter a country's distribution of power by, for example, changing public spending patterns or ownership structures. That is why IMF programs often excite so much opposition and have unpredictable political aftershocks.

Three central questions:

The first question concerns the impact of IMF policies and the conditions it imposes on borrowers. Do IMF conditions help or hinder democracy in borrowing countries or are they irrelevant? Are there fundamental institutional features of the Fund (i.e. its functions and organization as opposed to its governance), which shape its effect on democracy?

A key aspect of the Fund's lending programs is conditionality and it is here that the implications of the Fund's actions for democracy are more direct. Conditionality has always been one of the most contentious aspects of Fund programs.[3] Ever since the demise of the Fund as a financial cooperative and the emergence of two groups of members ("structural creditors" and borrowers and potential borrowers), the number of conditions in Fund programs rose steadily. Following the Asian Crisis, the Fund was criticized for its "Christmas tree" approach: adding conditions to its programs that had little to do with immediate program goals. There was a growing recognition in the Fund that the growth in conditionality in its programs had become self-defeating and their implementation record was patchy.[4] New guidelines on conditionality were drawn in 2002 replacing the earlier ones last issued in 1979. The new guidelines stressed that conditionality would be applied "parsimoniously" and reduced the emphasis on structural conditionality. They recognized that conditions should be tailored to the administrative capacity of borrowers and called upon the institution to focus on areas within its core areas of responsibility (namely macroeconomic policy making and implementation), while leaving other more sectoral, social, or microeconomic issues to the World Bank and other regional multilateral development banks.[5]

There is an inherent tension between conditionality and the cardinal tenet of democracy, which is that a government governs with the consent of the people. By its very nature IMF conditions inevitably smack of external imposition, rather than initiatives which emerged following debate and discussion that is the hallmark of policy making in democratic societies. The Fund has begun to recognize the limitations of conditionality for program success, and has instead started to stress the importance of borrower "ownership" for successful implementation of Fund programs. The concept of "ownership" is a recognition

[2] This proscription is interpreted from Article 4, Section 3 (b), which calls for the Fund to adopt specific principles for the guidance of all members with respect to their exchange rate policies and enjoins that the principles "shall respect the domestic social and political policies of members". This is reinforced by the language in Schedule C (on Par values): "The Fund shall not object because of the domestic social or political policies of the member proposing the par value."

[3] The original rationale of conditionality was to protect the financial integrity of the Fund by providing a mechanism to reduce the risk of noncompliance by a borrower on an agreed program. This original rationale has since been supplanted by a host of other reasons ranging from their allegedly signaling effects for capital markets to "hand-tying" vis-à-vis domestic political opponents.

[4] Average implementation rates of the set of programs covered by the IMF's MONA database show that during the 1990s, "69 percent of prior actions, 58 percent of performance criteria and 56 percent of structural benchmarks [were] fully implemented." IMF, "Structural Conditionality in Fund supported programs," February 2001, para 80.

[5] IMF, "Guidelines on Conditionality", September 2002.

of the reality that successful implementation of economic policy changes require strong input and participation of the principal stakeholders in society and cannot be parachuted from outside the country. The Fund's guidelines put it rather judiciously that it "will encourage members to seek to broaden and deepen the base of support for sound policies in order to enhance the likelihood of successful implementation [of a Fund program]."[6] Nonetheless it will always be difficult to gauge what constitutes "ownership" during crises. During a financial crisis borrowing governments face a Hobson's choice or in the case of non-democratic governments, there can be a large divergence between "government ownership" and "country ownership". Very often what passes for "ownership" in certain countries with weak democratic checks and balances is nothing more than the manifestation of the policy influence of vested interests. Should the IMF in the name of "country ownership" acquiesce to governmental demands to use public funds to bail out private banks looted by politically influential *private* shareholders? Is it "best practice" in terms of the need to respect "country ownership" to allow a government to maintain massive subsidies for higher education whose beneficiaries are mostly the children of a politically influential minority while the budget for rural primary education for a poor majority is practically nil? Should the IMF insert itself in these highly charged and inherently domestic political debates? According to its charter it should not. In practice, it does all the time. Also in practice, it is often patently ignored.

In recent years an operational focus on "governance" issues has led the Fund into subjects that are at the heart of democracy. In 1996 the Fund's Board of Governors enjoined it to "promote good governance in all its aspects. These included strengthening the rule of law, improving the efficiency and accountability of the public sector, and tackling corruption, all expressed by the IMF as essential elements of a framework within which economies can prosper."[7] Since then, according to the Fund, its "role in promoting good governance has expanded considerably" and the underlying assumption has been that this agenda is positive for the economy as well as for democracy. For operational purposes, however, the Executive Board interpreted the Governors' guidelines by emphasizing that "the IMF's judgments should not be influenced by the nature of a political regime of a country."[8] Consequently, the IMF has largely defined its "governance" role to improve the "quality of government", and in particular the reduction of corruption.

The second question is whether even if the goal of the IMF to promote "good governance" is a laudable one, does the institution have the tools to undertake this task? Indeed, among the constellation of international organizations, is the Fund the appropriate instrument for this task? Can Fund programs be procedurally more democratic and can their content and goals be constituted to promote democracy or be more "democracy friendly"? Intentions notwithstanding, there is a fundamental limitation to the Fund promoting *institutions* of good governance, since the time horizon of its programs is much shorter than the minimum reasonably needed for institution building. This is one reason why the "governance" agenda has had such limited success. All prior experience of political and social reengineering, most notably the gradual historical processes of the now advanced democracies, and previous efforts by International Financial Institutions to carry out institutional reforms, suggest that the road to better governance —and the emergence of liberal democracies— is bound to be long and uneven.[9]

Some argue that the international community has an important role to play in creating an environment conducive to democratic development and point to the European Union accession process as an example positive incentives can play in encouraging a domestic reform process. The latter exception notwithstanding, the empirical experience to date is that democracy cannot be "imported" but has to be "homegrown". Efforts by outsiders to accelerate the process are at best of minimal impact and can even end up retarding the emergence of the domestic dynamics that lead to the strengthening of democratic practices and institutions. Nonetheless, external pressures to adopt practices like the obligation to make governmental expenditures more transparent, while surely not a magic anti-corruption wand, do make the most extreme forms of public thievery harder to sustain. However, giving the impression that the Bretton Woods institutions have the knowledge, the "experts" and the resources to wage an

[6] Ibid, para 3.

[7] http://www.imf.org/external/np/exr/facts/gov.htm.

[8] See "The Role of the IMF in Governance Issues: Guidance Note," approved by the IMF Executive Board, July 25, 1997.

[9] For a skeptical view of outsiders trying to jump start democracy in developing countries see Thomas Carothers, "The End of the Transition Paradigm," *Journal of Democracy* 13 (1), January 2002 and critiques in *Journal of Democracy* 13 (3), July 2002.

effective battle against corruption in their borrowing countries may be a laudable pretense and a goal worth keeping; but it is important not to lose sight that it is more a pretense, than a reality.

It was evident in the Madrid meeting that much of the worry about the IMF's impact on democracy was related to its actions during financial crises of the type that in recent years have occurred at immense speed and with grave consequences. The implicit hypothesis seemed to be that the most important impact of the IMF on democracy occurs during international economic and financial crises, since that affects the participatory aspects of democracy. Crises inevitably strengthen centralization in decision-making within a government (mostly in the central bank and finance ministry). In the IMF, crises concentrate decision making within the G-7 (especially the U.S. but also some European nations and Japan), further muting the voice of borrowing governments and even more that of its domestic constituencies. During financial crises the involvement of creditors [typically banks or large bondholding financial institutions] domiciled in the IMF's largest shareholding countries means that the Fund's autonomy from such shareholders is particularly constrained.[10]

In addition, the severe asymmetry in the speed with which reversals in capital account and speed of change in confidence on the one hand compared with the time it takes for consensus building on the other hand point to the inevitable consequences of crisis for democratic decision making. While money now moves across borders at the speed of light thanks to globalized electronic fund transfers, governments continue to move at the slow speed of inter-agency meetings and consultation with multiple domestic and foreign constituencies. This means that the only hope for governments is to minimize their vulnerabilities to international financial swings and undertake greater efforts at consensus building ex ante – underlying the importance of the surveillance mission of the Fund. We have learnt that once money starts to move out of a country there is little its government can do to reverse the situation in the short run. Preventing these panics and minimizing its vulnerability to such runs against its currency, its banks or its stock market is the only prudent course of behavior for a government. As we know, it is the role of the IMF to help the country by alerting its authorities to such vulnerabilities and working with them to eliminate or reduce the risks before its too late. Unfortunately, one of the lessons of the crashes of the 1990s is that governments in the path to financial crash develop a special kind of "learning disability" that blinds them to the lessons of experience and fatally pushes them to repeat the errors that are known to have led other countries to crash. There seems to be a consensus that, in some cases, the IMF has failed to act appropriately before, during and after such financial crises. Such denunciations however, have clouded the fact that placing in the shoulders of the IMF most of the blame for the economic damage and human pain associated with these disasters is like blaming firefighters for damaging a home in the process of dousing a fire. The IMF is seldom responsible for the policies that made a country vulnerable to a financial fire that requires blunt emergency interventions where, tragically, collateral damage can rarely be avoided.

William J. Clinton, former President of the United States and Honorary Co-Chairman of the Club of Madrid, addressing the 2003 General Assembly.

The third question concerns the central dilemma of the Fund's governance: the relative balance of power (as reflected in quotas and voting power) bet-

[10] For instance speaking of the IMF (and World Bank's) role in the Latin American debt crisis, Stanley Fischer was candid, "So long as the United States was not free to move, the IFIs [International Financial Institutions] were not willing to speak…" If they were unwilling to even *speak* independently during times of crisis, then they are even less likely to exercise agency by undertaking actions without a green light from the U.S. Quoted in Devesh Kapur, John Lewis and Richard Webb, *The World Bank: Its First Half Century*. Volume 1: History. Washington D.C.: The Brookings Institution, 1997, p. 647.

ween the few countries who provide the funds for the institution's operations and the many borrowers (and potential borrowers)[11]. Since the 1970s the share of developing countries in the IMF's quotas and voting share has been roughly constant (around 37.5 and 40 percent respectively) while they account for 85 percent of the membership today. There is no quota formula that would simultaneously resolve the imbalance between financial and voting power in the institution. Moreover in one fundamental sense the IMF —or for that matter any international organization— cannot be democratic, at least in so far as popular control over decision-making is a key aspect of democracy. Structurally, international organizations are doomed to face a democratic deficit in this sense. As Robert Dahl has argued, even in countries with deep-rooted democratic structures, it is "notoriously difficult" for citizens to exercise effective control over key decisions on foreign affairs; their influence on international institutions is likely to be much less.[12] One country one vote (as in the UN) might seem more democratic than one dollar one vote (as in the Bretton Woods Institutions) but both violate the notion of democratic equality inherent in one person, one vote. And, for a financial institution, democratic decision-making is inherently problematic – which borrower would not like to control the terms of its loans? Also the proposition that the vote of a tiny island nation has the same weight as that of China or the US, continues to haunt the search for global governance rules that recognize the need to balance democratic principles [one nation-one vote] and the realities that actually guide the behavior of nations. Economic and military might, size, geopolitical calculations and national interests too often overwhelm justice and equality as the forces that drive an international system where might and size still matter more than treaties. Designing institutions on the base of principles that fly in the face of reality is always problematic and leads to artificial arrangements that while admirable in principle are irrelevant in practice. This of course is not a problem that just bedevils the IMF but all institutions of global governance.

However, there are other institutional features of the Fund that exacerbate the democratic deficit: a selection process for its leadership which is ad hoc and lacks transparency, designed simply to suit the largest shareholders (the US and Europe); an Executive Board where European countries who hold one-third of the seats are obviously over-represented; and despite the skewed deck, the frequent by-passing of the institutional structures of governance —the Executive Board and the International Monetary and Financial Committee (IMFC)— by the G-7 who often gives marching orders to the Fund at its periodic summits.[13] As Leonel Jospin, France's former Prime Minister put it at the Madrid conference, "developed countries themselves do not always follow the rules which they have a tendency to want to impose indiscriminately to [sic] others."

The financial realities of the IMF imply that one cardinal principle of democracy, namely equality of participation, cannot occur in practice. This, however, is not a fatal weakness as long as the asymmetric distribution of power is offset by a system of checks and balances that protects the interests of weaker members along with mechanisms that hold those that have the power accountable. And if there is any aspect of the Fund's governance that violates the basic tenets of democratic governance it is not the asymmetric distribution of power in the voting structure but the imbalance between those who have the power and their accountability. It is facetiously easy to blame the agent —the IMF— for a lack of accountability, when the real issue is the accountability (or lack thereof) of the key principals, the major shareholders. The limited accountability is the main reason why members perceive increases in quotas to have a much greater net benefit and hence explain why they fight so hard to retain or increase their quotas.[14]

[11] Each member of the IMF is assigned a quota whose size depends on the country's weight in the world economy as well the size of its initial quota when joining the Fund. Quota subscriptions generate most of the IMF's financial resources. A member's quota determines its voting power and the maximum financial commitment to the Fund. It also affects the size of the country's access to IMF financing. Total quotas at end-August 2003 were SDR (Special Drawing Rights) 213 billion (about $296 billion).

[12] Robert A. Dahl, "Can international organizations be democratic", in Ian Shapiro and Casiano Hacker-Cordon (eds.), *Democracy's Edges*. Cambridge: Cambridge University Press, 1997. Dahl's skepticism of the possibility of designing democratic international organizations is shared by James Tobin, "Comment on Dahl's Skepticism". Ibid.

[13] The Executive Board is responsible for conducting the day to day business of the Fund, exercising the powers delegated to it by the Board of Governors. In 1999 IMF's Board of Governors established the International Monetary and Financial Committee (IMFC) to replace the "Interim Committee", which had been in place since 1974. The change was designed to strengthen the role of the primary advisory committee of the Board of Governors. Like its predecessor the IMFC advises and reports to the Board of Governors on issues broadly within the institution's mandate. The IMFC has 24 members.

[14] Contrary to general perceptions, a country's subscriptions to the IMF's quotas do not have any direct budgetary implications for taxpayers. They imply contingent liabilities which, given the extremely low default record to the Fund and the institution's balance sheet reserves, are modest. The low direct cost to taxpayers ––and the many benefits— leads to excess demand for quotas.

III. What have we learnt from the three case studies?

The three cases discussed at the Madrid conference —Brazil, South Korea and Poland— present a common set of issues. During the period under analysis, all three countries were democratic. All three are middle-income countries, with relatively competent bureaucracies and reasonably robust civil society. In all three countries, there was significant "government ownership" of the reforms required to deal with the crisis and all three governments went beyond what the IMF was asking of them. It should be emphasized that these set of conditions are uncommon among the large number of current and foreseeable borrowers of the Fund. And, in all three cases the Fund programs were relatively successful, again a not common occurrence. Further studies are needed to examine the experience of smaller, weaker states and the impact IMF programs have had on their democratic politics.

Money was a constraint in the Fund's initial program in all three cases. Relative to the magnitude of the crisis the Fund's major shareholders tried to get away on the cheap in the initial stages. The initial programs were severely underfunded, resulting in their breakdown and necessitating a new, better funded, program. But this delay prolonged and amplified the crisis.

The Korean case is interesting in that, in general, Korean democracy came out stronger post crisis. The analysis of events leading to the crisis and its aftermath might lead to the following conclusion based on backward induction:

- No reforms, no improvement in democracy.
- No crisis, no reforms.
- No capital account liberalization, no crisis.
- No pressure from the US, no capital account liberalization.
- No pressure from Wall Street, no pressure from the US.

Hence if true the widely suspected and particularistic influence of American private financial interests [Wall Street] on the US Treasury to push for changes in South Korea unwittingly helped improve democracy. Perhaps Wall Street pressures on the US Treasury and in turn its influence on the IMF and its conditions helped weaken the grip that a few, large South Korean business groups traditionally had on the government and thus open the door for more competition. The Korean case highlights the para-

Working Group on Poland. From left to right: José Manuel Romero (FRIDE), Bolívar Lamounier (Member of the Advisory Board and Rapporteur), Mary Robinson (former President of Ireland, Moderator of the Working Group), Fernando Henrique Cardoso (former President of Brazil and current President of the Club of Madrid), Ilan Goldfajn and José Roberto Mendonça (Experts), Montek Ahluwalia (Director of the IEO of the IMF).

Working Group on Korea. From left to right: Daniel Zovatto (IDEA), Walter Wells (IHT), José María Figueres (former President of Costa Rica, Moderator of the Working Group), Lee Hong-Koo (former Prime Minister of Korea), Soogil Young (Expert), Byung-Kook Kim (Rapporteur), Belisario Betancur (former President of Colombia).

Working Group on Poland. From left to right: R. Sudarshan (UNDP), Antonio Guterres (former Prime Minister of Portugal, Moderator of the Working Group), Hanna Suchocka (former Prime Minister of Poland), Hanna Gronkiewicz-Waltz (Expert, Vice-President of EBRD), Jerzy Osiatynski (former Minister of Finance of Poland, Rapporteur), Valdas Adamkus (former President of Lithuania).

dox that a little less democracy in one part of the international system might result in greater democracy in another part and even base intentions can have virtuous outcomes.

In general however an important insight from the three case studies is that democracy proved surprisingly resilient and indeed it could be argued that five years after the crisis in all three countries democracy was stronger than before. This is *not* meant to be prescriptive – the economic pain inflicted on ordinary citizens renders that untenable. However, it does suggest the complex, and often unpredictable, relationship between the IMF, economic crisis and democracy.

The case studies also suggest that one of the original purposes of the Fund, "the promotion and maintenance of high levels of employment and real income," has a direct bearing on democracy. There are few events as threatening to democratic order as economic crisis, and in so far as the Fund's efforts in these cases limited the downside effects of economic and financial crises, they undoubtedly contributed to shoring up democracy in these countries. The Fund is often critiqued for the limited positive consequences of its programs but the counterfactual, namely that its actions often limit the negative consequences, is perhaps underestimated, even though in some cases (as in Indonesia, Argentina or Russia) critics allege that its actions amplified the crisis. The lessons, at least from these three case studies, suggest that the IMF reprised a *raison d'etre* of international organizations: their global insurance function (or role as a safety-net) that can limit the downside for countries facing crises.

Another conclusion is that in all three countries discussed in Madrid there was a shift in the government's position *ex ante and ex post* elections, which inevitably eroded democratic credibility. Political parties that were elected on the basis of specific platforms and promises changed course after elections and ruled on the basis of a commitment to macroeconomic adjustment programs. Unsurprisingly, voters become more cynical about political leaders and the role elections play in determining public policies. The paradox of government ownership going hand in hand with voters cynical of politics presents a conundrum. What would be better for democracy, improved economic prospects or an electorate disengaged from politics?

There is, however, a major limitation on the lessons that can be drawn from the three case studies. Countries where the challenges to a democratic order are greatest, and which are also some of the poorest countries, are also those where the Fund's dominance vis-à-vis borrowing governments is most asymmetric. They were barely represented in the *Club de Madrid* studies, and hence the deliberations and lessons from the case studies apply principally to emerging markets – largely middle-income countries. In all likelihood, if the case studies had been low-income countries, the conclusions would have been quite different. It is thus important to bear in mind that any conclusions about this subject are highly sensitive to the sample of country experiences and national programs that is selected.

IV. How can the Fund's role in democracy be enhanced?

From our perspective, the discussions examined two separate but interlinked strands that could enhance the Fund's support of democracy: improvements in the governance of the Fund itself, that make the Fund's decision making more congruent with democratic principles of governance. And second, changes in what the Fund does (and can do), so as to bolster democracy, both globally as well as in the borrowing countries.

The first issue is important not just as a matter of principle but has important instrumental utility as well. The democratic deficit in decision-making in the IMF means that even if a correct decision is taken the perceived lack of legitimacy vitiates public trust in the Fund thereby creating the possibility of undermining its long-term effectiveness. To the extent that democracy reflects the sovereign will of the people, it is important to emphasize that democracy is about process and not just about outcomes. Therefore, even "good" outcomes based on processes perceived as illegitimate can have inimical long-term consequences for public trust. The importance of popular participation for the success of poverty-oriented programs is now well recognized. Just as participation is crucial for the success of programs aimed at poor people, it is also important for programs aimed at poor countries.

The problem with Fund programs is not that it has a one size fit all or cookie cutter approach but that decision making is a black box. As the report of the IMF own Office of Independent Evaluation has pointed out, the Fund often does not explain the precise reasons for its conditions or transparently state its assumptions (and doubts) underlying pro-

gram design, especially the financing needed to restore external viability[15]. This allows for greater discretionary intervention by major shareholders, leading the Fund to a forced optimism in program design, in turn adversely affecting the quality (and effectiveness) of its programs. In some sense this is a reprise of the old debate of "rules versus discretion". The former results in greater perception of technocratic credibility but the resulting "one size fits all" is inherently problematic in a highly diverse world. The latter, if done credibly, can be more effective but if the institution's governance is skewed, it can result in greater political malleability, eroding the Fund's reputation and therefore its long-term effectiveness. Consequently, if and when the Fund shows flexibility (as it often does for the best of reasons), the lack of trust in its actions creates doubts whether the decision reflected technocratic judgments or the pressures stemming from particular interests. Sadly, assessing how much of the IMF posture and conditions on specific cases rests on technocratic merit and how much results from political pressures and calculations has become a normal exercise among governments, academics, journalists and politicians. Decreasing such perception through deeds and increasing the perception that the IMF is an objective, fair and competent institution is an indispensable goal that will naturally add to its legitimacy.

V. The IMF and Democracy: What should be done?

The deliberations suggested to us several changes in the governance and operations of the Fund, that could enhance the institution's effectiveness and its positive impact on democracy. Perhaps it is worth reiterating that *the policy suggestions that follow, while informed by the discussions in Madrid, are our own opinion and should not be read as reflecting some consensus view or the view of individual members of the Club of Madrid.*

1. **Governance**: We detected a general inclination to reshape the IMF's governance by reallocating quotas and seats in the Executive Board even though there was less agreement on what precisely this might entail. It might appear somewhat odd that even today Belgium (population 10 million) has more votes in the Fund than Brazil (population 175 million) or Netherlands (population 16 million) more than India (population 1048 million), or that Europe holds a third of all seats in the Fund's Board. The need for an additional chair in the Executive Board for the beleaguered African constituencies is widely shared (especially if it is in addition to, and not substitute for, a European chair). Increasing the voting rights of developing countries is a more formidable challenge and the suggestion by Lionel Jospin of France, a former prime minister of a G-7 member, arguing for an increase in the basic voting rights of member states (which would increase the relative voting share of smaller, poorer countries without affecting their quotas), could be the most viable option in this regard.[16] There is also some legitimate debate about whether the Fund needs to improve the sensibilities of its staff on the political implications of its actions on democratic politics.

2. **Leadership selection**: While many lament the "democratic deficit" in the IMF, there can be little doubt on the need to strike a careful balance between the resources that key members provide and the legitimacy of greater representation. As important as equitable representation is for both symbolic and substantive reasons, a democratic system of purely popular control over decision-making would impair the effectiveness of most international organizations. However, this unavoidable tension is severely exacerbated when the institution's leadership is chosen through an ad hoc and opaque process that inevitably erodes the legitimacy and credibility of the IMF and indeed that of the World Bank. How can these institutions go around preaching transparency and meritocracy and denounce crony capitalism when their own leaders are selected through a medieval, opaque process that is completely at odds with even the most simple practices of corporate governance, let alone democracy?

In the case of the IMF, an undisclosed yet decades-old "gentlemen's agreement" guarantees the top job at the institution to a European [while the top job at the World Bank always goes to a US citizen]. In both cases the search and selection procedures are either merely symbolic, and domestic political considerations and indeed unabashed cronyism often prevail. A closed-door selection process based on domestic political compromises hardly seems an ideal way to choose the leader of an organization ostensibly serving a broad, global constituency. The selection process of the Fund's leadership remains inefficient

[15] Statement of Montek Singh Ahluwalia, Director Independent Evaluation Office of the IMF at the General Assembly of the Club de Madrid, November 1, 2003.

[16] Statement by Lionel Jospin, former Prime Minister of France at Club de Madrid.

at best and is the result of backroom deals centered on the requirement that the job goes to a European. This flawed method undermines trust in the institution and amplifies the democratic deficit. Moreover, it also creates an acrimony that weakens the authority of the incoming managing director, strains relations in the Executive Board and, in so far as debts are incurred in getting a candidate through, they have to be settled through similarly awkward compromises (often in other international organizations) down the road. The situation in the World Bank and other international organizations is equally appalling.[17]

The IMF had initiated a high-level review of its leadership appointment processes and a report of a sub-committee of the Executive Board had proposed transparent methods of selection. However, this was "noted" by the IMFC at one stage but there is no record of its acceptance. It is imperative that the IMFC take a decision on this report rather than allowing discretion to reign again. The selection processes for the Fund's leadership should have clear, transparent rules with standing selection committees to screen and shortlist candidates; term limits for leaders of international organizations; and periodic independent performance appraisals of those leaders to reduce the chance that they will use their positions for partisan ends. Nonetheless, a simple set of rules for leadership selection would not solve the problem. International organizations face an unavoidable dilemma that forecloses easy options. Rules allowing international institutions to choose leaders opposed by key members would only leave these institutions exposed to the risk of losing the financial support of the major players. At the same time, an unrepresentative process in which a few rich nations dominate the selection process and exercise their power in unacceptable ways only undermines the legitimacy and sustainability of multilateral organizations like the IMF or the World Bank.

3. **Resources**: The speed and ferocity of "new style" financial crises has thrown into stark relief the limited resources of the Fund compared to the resource challenges posed by these crises. Rebuilding market confidence either requires extremely large upfront resources in very short periods of time, or some sort of standstill procedures. In the absence of either, countries pushed to the wall may be tempted to bite the bullet and simply default, or face political instability. Capital markets have repeatedly found the Fund lacking resources relative to the magnitude of the challenge. This has undermined the credibility of the Fund in global financial markets, requiring even greater resources in every subsequent crisis. While issues related to the changes in the global financial architecture go beyond the Fund (and are discussed in the next section), members felt the Fund's resources needed to be augmented, and in particular poor countries need greater access to low conditionality resources through periodic issues of SDRs.

From left to right: William J. Clinton (Honorary Co-Chairman of the Club of Madrid, former President of the United States), Fernando Henrique Cardoso (President of the Club of Madrid, former President of Brazil), Diego Hidalgo (President of FRIDE), Antonio Álvarez-Couceiro (Secretary General of the Club of Madrid).

4. "**Ownership**": The shift in the Fund's stance from conditionality to "ownership" by the borrowing country is a welcome change. One reason for the success of the Brazil program despite elections and a change in the head of state, was that opposition candidates were also indirectly involved in discussions with the IMF. However, it still leaves a large unsettled terrain on what constitutes ownership, and by whom. This problem is particularly acute in democracies with weak checks and balances, where the whims of a deputy minister for example become the "wish of the client." Moreover, to the degree that increasingly 'ownership" is seen to be a sine qua non of successful Fund programs, the operational implications of "ownership" makes IMF intervention even more

[17] For a more detailed analysis see Devesh Kapur, "Who gets to run the world?", Foreign Policy, November/December, 2000; Miles Kahler, *Leadership selection in the Major Multilaterals,* Washington D.C.: Institute for International Economics, 2001.

problematic in the case of non-democratic borrowing countries. Should the procedural requirements of Fund programs be different in democratic countries versus non-democratic ones? In these cases, it may be tempting to suggest that the Fund needs to engage in greater "due diligence" to ensure that the borrowing government's commitment is not simply a matter of expediency. In practice, such highly political, subjective –and very consequential –assessments are routinely made by the IMF staff in deciding the scope, size and timing of their programs. Conversely, and quite naturally, all borrowing governments are keen to persuade the IMF of their commitment to the reforms needed to secure its funding and approval.

5. **Surveillance**: It is imperative that the IMF sharply upgrade the quality, frequency and intensity of its surveillance mission. This had been one of the key functions of the Fund when it was created. However, this function of the Fund has waned in recent years. Its surveillance reports lack candor and in part reflect a self-perception in the Fund of its importance as a confidential advisor. As the report from the IMF Independent Evaluation Office argues, this role of the Fund has not been effective and should be given a quiet burial. We concur with this judgment. The tenor of the reports also violates a key aspect of democratic decision-making: procedural equality of its members. In the United States and Europe, reducing the fiscal deficit by a fraction of GDP over several years has proven to be extremely politically contentious and difficult. Yet, the same shareholders – and the IMF -- have little hesitation in insisting that far poorer countries slash their fiscal deficits by a few percentage points in a year. The Fund has avoided even pointing out these enormous double standards in its surveillance reports – a testimony to the seriousness with which it takes this function.

In addition to candor the Fund's surveillance missions need to engage with a wider cast of stakeholders in the borrowing country, especially parliaments, academics, selective civil society organizations and the media. Indeed it is perhaps very important that in the course of its surveillance mission dialogue the IMF team should meet, discuss and present its concerns to the relevant parliamentary committees. A substantially greater effort to engage key stakeholders in surveillance missions is likely to increase ownership if or when a program does occur.

Stronger surveillance can also promote an important facet of democracy, namely transparency. This is especially true with regard to government policies, budgets and expenditures, and their distributional implications. In addition the Fund needs to be less guarded with respect to its analysis of the international system and its effects on poor countries. The last has been a particular weakness of the Fund in recent years. For instance even as evidence mounted of serious shortcomings and malfeasance in global financial companies and internal incentives within these firms, the Fund has judiciously avoided casting a critical gaze on their functions and their effects on poorer countries. This avoidance simply erodes the Fund's credibility and undermines trust in its usually correct advice on the importance of open economies for prosperity. On the other hand the improvement in the Fund's transparency policies over last few years is a welcome change.

VI. Globalization and Democracy: Is the Fund a critical actor or a bit player?

In so far as democracy is about process and not simply outcomes, there is no more troubling issue about international financial crises than that elected governments have to cater to, and answer, not to the people who have elected them, but to external actors and enforcers. The heart of the matter in the deliberations of the **Club de Madrid** (as interpreted by us), was the dilemma faced by leaders in democratic developing countries in how to steer between the Scylla of global financial markets and the Charybdis of the demands of their own citizens. The platforms they run on to get elected are ones that are rarely approved of by the Fund and global financial markets. Once they are elected, they change course (as was the case with Kim Dae Jung in Korea). This change in course is usually good for the country's economy and improves its standing in global financial markets. But as we have already noted, it increases cynicism amongst the people about politicians and political parties and is corrosive to their trust in democracy and democratic processes. On the other hand, it is the case as the Korean example suggests, that the volte-face in economic policies helped democracy in one important way by weakening the business-politics nexus. The reforms strengthened markets by limiting state interference and concomitant rent seeking behavior, especially in the corruption ridden financial sector.

The Fund has important signaling and gatekeeper effects on capital markets. However, it has been their cheerleader rather than an impartial referee, let alone a partisan for the weaker countries in the global system. The Madrid discussions were categorical on two

issues. One, in general global capital markets have much greater impact on emerging market democracies. And second, when a crisis takes place the US Treasury is by far the most important actor and the Fund is just the agent. If as the former US Treasury Secretary Robert Rubin says in his new book "future financial crises are almost surely inevitable and could be even more severe" it is unclear if the Fund has the capacity to deal with this inevitability.[18] The discussants stressed the importance for major shareholders to be proactive in endowing the institution with the capacity to face the next crisis, rather than simply react to the past ones.

A central concern at the conference was with regard to the weak decision making mechanisms on global issues. Globalization has proceeded asymmetrically with much greater movement in financial markets and product markets, while it has proceeded slowly in those areas that benefit LDCs, namely labor on the factor market side and agriculture products and textiles in product markets. At the International Conference on Financing for Development at Monterrey in 2002, it was agreed that the main responsibility for development lies within developing countries themselves but if their policy space and autonomy is restricted then this responsibility becomes moot. It was also agreed at Monterrey that the governance structure of multilateral institutions in anachronistic, but while the former continues to be stressed the latter is not.

There is an increased recognition that markets need a regulatory framework – one that states need to be involved with. Nonetheless, it is at least the case in the United States that when these firms do engage in malfeasance they can be fined severely. To argue that these firms have only behaved in this fashion in the one market that they care most about but not so in emerging markets would stretch credulity. The discussion highlighted the need for a stronger international regulatory framework that can exercise a similar discipline.

Since its inception the IMF has transformed itself from an institution whose primary goal was to facilitate international monetary cooperation to an instrument facilitating the development of capitalism in developing countries. The resulting proliferation of goals has been criticized, although the Fund argues that given the complex interrelationships among a host of economic, structural and institutional variables, there are good reasons for the mission creep of the IMF. The widening agenda of the IMF, however, has had a negative impact for democracy. Observers of government bureaucracies have long recognized that multiplicity of missions impairs bureaucratic incentives and erodes institutional autonomy by rendering them more vulnerable to politicization. The IMF's skewed governance structure and lack of competition make it more vulnerable to these threats.

In many ways the Fund's predicament reflects the penchant of the global community to critique it, and then ask it take on more tasks without backing them with additional financial resources and then critique the IMF even more for failing to deliver. One solution to this problem that emerged from the discussions was the need to strengthen other international organizations, to distribute the "burdens of the Fund" so to speak to other organizations, both regional and international. For instance while the discussions revealed that the Fund did have a positive role to play in middle-income countries, it left open the question whether it was the appropriate institution for the small, structurally weak, low-income countries where the problems are of much longer term nature and where democracy is also usually weakest. By insisting that the Fund be all things to all members, it is hardly surprising the institution fails to live up to expectations – but that may be as much the result of unreasonable expectations than weaknesses in the Fund per se.

VII. Conclusion

Many of the heated debates on the Fund reflect the reality that with the passage of time, the mismatch between the antiquated structures of multilateral institutions and their larger global environment has increased – and so have tensions. In reflecting on the discussions at the **Club de Madrid** we offer six mo-dest conclusions.

1. There is no doubt that despite the Fund's technocratic persona, its actions are highly political – they have significant political consequences and may often be driven by geopolitical calculations. The bureaucratic dynamics, internal politics and narrow organizational interests that normally exist in any organization also erode the IMF's ability to avoid inconsistencies and double standards.
2. The Fund is not an independent actor and decision making in the institution reflects its gover-

[18] Robert Rubin and Jacob Weisberg, *In an Uncertain World. Tough Choices from Wall Street to Washington New York:* Random House, 2003.

nance. The criticisms of the Fund appear to reflect a frustration with larger forces that the Fund itself is buffeted by, namely global financial markets and its largest shareholders.

3. The Fund's own decision-making is not always transparent and its emphasis on speed and centralization in policy-making in the borrowing countries tends to short-cut democratic processes. The Fund also needs to be more aware of the implications of its actions for democratic governance. An increased awareness, might lead the institution to adhere to a form of "Hippocratic oath" and become more conscious about any negative consequences of its procedures and programs for democracy.
4. There is little evidence that in the three cases (Brazil, Poland and South Korea) discussed by the former heads of state economic crisis undermined democracy. If anything, five years later, it has proved to be stronger. By engaging the principal presidential candidates (particularly in Brazil and South Korea) during the crisis, the ensuing Fund programs had wider political acceptance, and in that sense were helpful to democracy.
5. Democracy promotion is not a science – we know very little about how to do it and the Fund certainly does not have either the mandate or the skills to undertake this enormously challenging task. It would not just be shortsighted but dangerous to ask the Fund to undertake this role. At the same time the Fund can support democracy indirectly by promoting transparency in a country's economic policies and budgetary practices and by increasing consultation with key democratic institutions.
6. It is important to keep in mind that there are intrinsic reasons why international organizations cannot be democratic, and there are no Solomonic governance solutions to this dilemma. If the IMF cannot be more democratic (although it can certainly be less undemocratic) it is important to ask whether it can do more for democracy by doing less. May be a "narrow", technocratic Fund with a very limited scope of intervention is better for democracy in that it ensures that a country's citizens take decisions about their future and not an outside "do gooder." On the other hand it is also true that in the face of an imminent financial crash both the country's government and other affected parties are bound to continue to force the IMF to intervene. In many ways one of the paradoxes coming out of the debates in Madrid is that the IMF is far less powerful and can do far less than most observers seem to assume.

Summary of the Reports of the Working Groups' Rapporteurs and Concluding Remarks by the Academic Coordinator

Report from the Working Group on Korea, by Byung-Kook Kim[1]

We had a very constructive, lively and productive discussion over the last two days. Let me summarize our major points of agreement and also of disagreement.

To the question of the original crisis, there was a wide consensus among the leaders and experts that the Korean case was close to what we call a "capital account crisis," which is different from an "old-style current account crisis." As for the economic variables that caused the crisis, three critical factors were identified. The first one was panic and a liquidity crisis that caused massive capital flight. The second one was a combination of domestic structural causes like, for example, the close relationship between banks and corporations and the lack of any regulation on capital flows combined with the previous liberalization of the capital accounts. The third critical factor in bringing about the crisis was the impact of the uncontrolled and highly volatile speculative financial capital flows.

On the political side, three important variables were also identified. The first one was a sense of complacency. Korea was a country that had gone through a successful economic modernisation and that success had created a sense of self-complacency that affected the reform policies before 1997 and also the management of the crisis in 1997. Crisis was something that was not considered possible in South Korea. At the same time, there was an emphasis on the importance of the experience of partial reforms, most of which had failed before 1997. The third critical variable to explain the cause of the crisis was the failure of presidential leadership during 1997. Those three critical factors did contribute to precipitate the economic and financial crisis together with what could be described as a certain failure of democratic politics. For instance, Korea had had the opportunity to reform its financial system before 1997, tried to do it but failed to do so because the National Assembly was weak and because the political parties did not function as institutions of agenda setting, coalition building and education of the public.

On the question of ownership of the IMF programme, there was a consensus among participants in the Working Group that Korea quickly became a core owner of the IMF programme, and that this was mainly due to independent domestic political factors and less due to what the IMF did or did not do. Among those factors: a) President-elect Kim Dae-Jung became a core owner of the IMF programme because he saw it as an opportunity to consolidate his political role; b) the state bureaucracy also supported the IMF programme because they saw it as an opportunity to implement many of the reforms that could not be implemented between 1981 and 1997; and c) NGOs and civil society groups also became core owners of the IMF programme because they saw in it an opportunity to shift the balance of power towards the progressive sector and towards the reformist intelligentsia.

Our discussion also emphasized the fact that Korea was very lucky too. The financial crisis came when both the Korean democracy and the Korean economy were becoming mature . Both factors eased the implementation of the IMF programme: on the political side, the cooperation between the South Korean government and the IMF representatives was made easier and, on the economic side, the vitality of the Korean economy – which had joined the Organization for Economic Cooperation and Development (OECD) in 1996 - allowed the state to adopt comprehensive reform measures. Korea was also lucky in the sense that it had a close alliance with the United States and U.S. assistance helped very much in assembling the second IMF package.

The group came to the conclusion, however, that one has to be very cautious when trying to draw general lessons from the South Korean case. One has to be cautious not to overestimate the role of the IMF programme in the suc-

[1] Member of the Advisory Committee of the Club of Madrid. Professor of Government, University of Korea; Visiting Professor, Kennedy School of Government, Harvard University.

cessful recovery of the Korean economy as well as in the consolidation of the Korean democracy after 1997. Structural reforms to increase transparency and accountability had their intended effect in South Korea because democratisation had proceeded further in South Korea than in other Asian countries and because the Korean democratic institutions, in spite of their limitations, were stronger than in other crisis-struck Asian countries. Those structural reforms could be implemented because Korea had a professional state bureaucracy, active NGOs and civil society groups and a competitive business sector. The same structural reforms would not have produced the same effects in other less developed crisis-prone countries that may not have these features. So, one has to be careful because adding conditionalities to include structural reforms may not be a good thing for all countries.

The second lesson that we could draw from the Korean case is that there should be some reforms in the IMF governance structure to allow the developing countries to air their interests to the international community.

The third lesson that we drew from the Korean case is that in spite of the successful overcoming of the crisis, the crisis itself shows that some capital account control measures are needed.

Report from the Working Group on Brazil, by Bolívar Lamounier[2]

The group on Brazil, as the others, had a very rich discussion. We focussed our discussion on the 2002 programme and on the crisis that developed during that year.

The crisis was diagnosed as having been caused by three sets of factors: lingering fiscal and current account problems not officially solved over the previous years; some external influences, particularly the contagion from the Argentine situation; and third, and perhaps more importantly, the electoral process itself.

The prospect of a left wing candidate winning the elections was very clear. The financial markets saw that as a danger to existing market-friendly economic policies and badly miscalculated and underestimated the strength of the Brazilian institutions. The fear of the election's result then caused the beginning of a panic with substantial capital outflows and other damage to the Brazilian economy.

The agreement with the IMF was very significant and can be regarded as a successful instance of crisis management. It certainly helped the transition to the new Lula administration. It truly helped avoid a significant crisis after the elections and it also helped the administration to implement sensible policies. I think they would have carried out sensible policies anyway, but the IMF programme was certainly a strong inducement for the government to adopt sensible and realistic economic policies during that period. Thus the Brazilian case is generally regarded as an example of a successful and well- managed case of IMF involvement in a crisis-struck country.

Some important lessons were drawn. First of all, during that period there was in Brazil a very significant mutual learning going on, a dialogue between the administration and the opposition candidates and of both with the IMF through the administration. There was a sharing of information, a certain sharing of responsibilities represented most significantly by the fact that three of the four presidential candidates accepted the agreement with the IMF during the campaign. All this represented a mutual involvement in a programme that was regarded as necessary at that point in time. From this Brazilian example, the Working Group considered that some steps could be taken in the future in other countries to increase this kind of dialogue before a crisis takes place. In other words, instead of just jumping in when a crisis has already occurred, this process of mutual learning, mutual information and more informal talking can be useful in view of preventing crises and not simply managing them after they have taken place.

The Working Group also discussed the important issue of ownership. In the Brazilian case it can be said that the level of ownership was very high and so clearly there was no question about the Brazilian ownership of the pro-

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[2] Member of the Advisory Committee of the Club of Madrid. Director, Augurium Consultores, Sao Paolo.

gramme. Brazil had had some previous experiences with the development and implementation of economic programmes with the IMF and so there was some experience with this.There also were technical teams, Brazilian technical teams, that were involved in offering solutions and preparing the plans from the very beginning, even before the IMF came into the picture.

In this respect, when thinking about the relationship between the IMF and different countries at different levels of development, of different sizes and so on, one has to bear in mind the importance of the issue of each country's domestic capabilities – both of a technical and of a political kind - so that solutions can be offered, solutions can be debated, recipes can be debated, and even eventually rejected, as indeed they were in Brazil in previous years.

Having stated that we had in Brazil a successful instance of crisis management, members of the Working Group made however the sobering observation that it is too soon to celebrate. We do not have in Brazil or in the international community the answer to problems such as how to attain and maintain a sustained rate of growth compatible with poverty reduction and an increase in equity. And without sustained growth, without equity and social justice, there is no guarantee that democracy is fully consolidated. So a clear distinction must be made between a specific instance of crisis management that can be regarded as successful and the broader question of growth, reform, equity and so on. This leads us to the need for a broader debate on the international financial architecture and specifically about how to improve the IMF .

Finally, the consensus of the group was that we need a stronger IMF, not a weaker IMF. We need an IMF with more resources and with more capabilities. In other words, the IMF's resources should grow in proportion to worldwide financial flows. On the other hand, this does not mean that the IMF should come into the picture when it comes to institutional or political aspects in a direct way. We need reforms in the public service, we need reforms in the judiciary, but this is a scenario where the IMF should not go in directly, rather it should take into account the direct and indirect consequences of what it does. From the concept of ownership, from the concept of the local autonomy of each country, it follows that these aspects belong to the governments and to the societies in question, not to the IMF as such. Within the reform of the international architecture we will all have to discuss the need to promote and strengthen more growth-oriented economic organizations and the need to minimise the eventually detrimental effects of short- term capital flows.

Report from the Working Group on Poland, by Jerzy Osiatynski[3]

The difference of the Polish case with respect to the other two cases that have been considered is that, when we talk about Poland or about countries in transition in general, we have to deal with a much broader project. It is not just a business or a financial or banking crisis; it is an issue of moving from a political dictatorship to a parliamentary democracy. It is a problem of constructing a civil society, it is a problem of restructuring a whole economy, it is an issue of having to face an institutional vacuum. And, on top of that, there is also the problem of achieving and maintaining a short-term economic equilibrium.

In Poland we had to undergo a "shock therapy" because there were huge imbalances in all markets. Some other countries in transition, like Czechoslovakia or Hungary, where the rate of growth of wages was far better controlled in relation to the rate of growth of productivity, also needed liberalization and all the rest of the standard "IMF-Bretton Woods package," but they did not need, as we did in Poland, a shock therapy in their economies.

An important element that one could see in Poland and, with a varying degree, in other countries in transition was the mutual commitment of both the countrys' governments and of the international financial institutions and other institutions and stake-holders. In fact, nobody really knew how you, if I may say so, "transform a scrambled egg back into an egg." There was a lot of ignorance of how to achieve this systemic transformation and, in fact, it was

[3] Member of the Parliament and former Minister of Finance, Poland.

this general ignorance that in many ways helped the success of the process. Nobody wanted to admit their own ignorance, neither the governments nor the international financial institutions and there was also a feeling of mutual trust. International institutions were cautious and, therefore, on a number of grounds, we were given leeway to implement some measures that were then seen as "unorthodox." We, in Poland, for instance, decided to introduce some tax instruments to control wages and we also declined to implement a programme of mass privatisation, a controversial measure that, with the benefit of hindsight, everybody admits now that it was a sensible solution. On the less positive side, however, it soon became clear the lack of understanding and coordination between the two Bretton Woods institutions. You cannot possibly maintain short-term macroeconomic stabilization without well- advanced structural reforms. And I think we can still see this problem today.

Another key factor was that both the IMF and the rest of the international financial community helped Poland in its transition from the very beginning. Even before the first non-communist government came to power, the Fund was already working on the Polish Stabilization Fund, which was designed to provide a cushion so that the new rate of exchange and the new reforms would have a chance to succeed. Before the Mazowiecki government came to power, the Group of Seven also developed the so called "PHARE" program, which was set up to assist Poland and Hungary to reconstruct their economies. We also received debt reduction from both the Paris and London Clubs . So we were extremely lucky and the Fund was supportive and forward looking. Having said this, however, the expenditure on debt servicing plus local government plus social expenditures like pensions - many people took early retirement because of a huge rise in unemployment in the early stages. These costs added up to something between 85% or more of the total Polish budget, which means that we only had around 10% to 15% of the budget upon which we had some flexibility to decide on what to spend, and that is a very small amount to carry out a whole systemic transformation of the economy.

So, if we want to be forward instead of backward-looking, the first one of the conclusions that we can draw from the Polish case is that, although we benefited both from Paris and London Clubs' debt reductions, the Fund and other institutions should be much more courageous in debt reduction. Debt reduction is essential in order to provide room for restructuring the economy and, in our own case, for instance, to provide room for generating funds for European Union participation if we want to take advantage of cohesion funds, structural funds and so on.

A second conclusion concerns asymmetrical liberalization. Yes, we did liberalize, we had to liberalize and we knew why we were liberalizing. But it was a very expensive decision to take in political terms. Asymmetrical liberalization is in fact very critical, not only, I believe, to countries in transition. And again when you look at Cancun and what is happening with the World Trade Organization (WTO), this is a total disaster. We do need a global agenda on this particular issue.

Now I think I should come to the final point, which relates to the IMF agenda and the democracy agenda. The IMF is not in the business of political democracy. Whatever the Fund does has an impact on political democracy but there are others, perhaps more important players in the stage, like the United Nations Development Programme (UNDP), like the World Bank whose mandate is closer to promoting democracy, institution building, fight against poverty and so forth. So we need to be careful here.

So what could we do? What sort of leverage could we use to be able to better synchronise the operations of both the Bretton Woods institutions and other agents? I think we do have the instrument of the Millennium Development Goals (MDGs), which have been subscribed to by a great number of both developed and developing countries but which are, at present, ignored. If one looks into the country assistance strategies of many of the international development institutions, they almost fully overlap with the MDGs. Why not use them as leverage for the governments to implement this particular widely supported agenda?

I conclude with an issue over which there were some differences of opinion within our Working Group. While some participants suggested that perhaps an "umbrella organization" might be necessary to improve the coordination among the IMF and other international financial institutions such as the World Bank in their democracy promotion efforts, I personally believe, with some other members of our Working Group, that perhaps it would be sufficient and more effective if we used properly the coordination mechanisms that already exist and that we do not use.

Concluding Remarks by Andrés Velasco[4] – Academic Coordinator

Let me try to put together my own summary, which will not necessarily be a reflection of what has been said but which, I hope, takes into account the discussions over the last two days and also the materials prepared for this meeting. I will make five points of which the first one is a caveat.

The caveat is that these interesting cases are not necessarily representative of all the cases one could study. Clearly they might be representative in the sense that they cover the three continents on which these issues are highly relevant, but I think they are not representative in three key senses, which we should keep in mind when drawing any conclusions.

First of all, these are countries with strong states and fairly strong political leadership. Number two, these are countries with very able technocrats. Brazil and Korea have a long tradition of this, and Poland managed to create a new generation of technocrats quite quickly after the demise of the previous regime. And thirdly, and this is perhaps the most important, these are cases in which the final economic outcome was good. By that I do not necessarily mean that sustained growth has been attained in any of these countries but that, certainly, the immediate goals of the IMF have been met. There are many other instances in which that is not so and therefore we want to keep that in mind when generalizing from these three case s.

Let me move now to my more substantive points. Point number one. Even if one loves the IMF, I think all leaders here would agree that it is much better to live without the IMF. That is to say, it is better not to wait until the IMF comes knocking or one has to invite the IMF in. This raises the big question of whether countries and the international community are still doing enough on crisis prevention. My reading of the discussions this morning provides me with a fairly clear answer: no, we are probably not doing enough on crisis prevention. Crisis prevention today is a very different business than it was 25 years ago and what we heard this morning, again and again, is that this difference is capital flows. Capital is highly mobile across countries, it comes very quickly, it goes even more quickly and most countries, even the most advanced of the emerging market countries, are ill-prepared for this sort of thing. What can we do about it? Two kinds of ideas were thrown around today and yesterday. One is capital controls of one kind or another and here my own country, Chile, is often mentioned as the paramount positive experience. My own feeling is that this is possibly a correct reading. Nonetheless we should remember that in Chile these controls were: a) on inflows and not on outflows and b) they were a complement and not an alternative to good and sound economic policies. Chile could impose them precisely because it had tight money, a credible central bank, etc.. So capital controls help if you've got everything else right. They do not help otherwise.

The other idea thrown around as a way to enhance crisis prevention has to do with IMF surveillance. The IMF goes around and looks at countries but the truth of the matter is that it does not have a very good record in predicting crises and does not have a very good record in pointing its finger at nascent or preliminary signs that a crisis is building up in a country. The reason for this is two-fold. First of all it is very hard to do. As a practicing macroeconomist I can tell you, most of the crises are a surprise for me too. Secondly, even if you see it coming, you cannot say it publicly because financial markets will panic. So the question here for IMF policy making is: how to make this disclosure of information systematic without making it a source of panic? If you never do it and you suddenly do it, it becomes a big deal. If you do it regularly, it is less of a big deal and therefore we should move to a greater regularity on that.

Point number two, and here I quote President Hurtado from Ecuador, "the best thing for democracy is to have good economic policies and therefore to be on the road to economic prosperity." That is to say, when we think about the connection between IMF and democracy we have to begin by asking: how do we ensure that the outcome of this interaction is sound economic policies? The conventional wisdom on this matter in the international community over the last five years is that you need institutions, accountability and transparency. And I think we all pray at the altar of these three things. The problem is that we do not know how to attain that because these

[4] Sumitomo Professor of International Finance and Development, Kennedy School of Government, Harvard University.

three things emerge from political processes. Koreans, educated Koreans, I am sure they got quite clear that their country had an arrangement, let us say, between business and government that was probably not conducive to long-term economic stability. But changing that was, of course, very hard because that situation was the outcome of a political equilibrium.

So how to change these institutions? I think there are two answers that I heard mentioned this morning. The first one is very particular and very relevant for the case of Poland and it has to do with the IMF and the international community more broadly. As givers of advice we tend to forget that building institutions often requires know-how. Transparency is a political decision but it is also a technical achievement. And the IMF in the Polish case seems to have played a rather important role in helping the process along. I suspect the IMF could do the same thing, and so could the World Bank and the EBRD in many other countries.

Second thing we heard from our Brazilian friends was that this is a slow process and that it is mostly domestically-driven. Perhaps Brazil did well coming out of last year's crisis because the IMF and the presidential candidates were able to engineer an agreement. But perhaps more important, over the previous three or four years, Brazil had instituted a prestigious and fairly independent central bank, a good inflation-targetting regime, a fiscal responsibility law, etc. Those are domestic processes, processes that take time and about which, I suspect, the Fund cannot do a great deal.

Three more brief points . Financing remains absolutely key, that is the other thing that I heardagain and again. Something which is quite striking of the three cases is that money was a problem. The Korean programme was severely under-funded. In fact, it is quite striking that the IMF came in and as soon as the programme was announced, the currency collapsed. Ex-post, we all know that the money was insufficient. In Poland, our Polish friends tell us that was also the case.The inability to meet fiscal targets which were excessively tight was a source of discontinuing several programmes and also a source of political instability in Poland. The Brazilian case, in which money seems to have been sufficient, was also a case in which Brazil was treated very specially, in which Brazil got more money than the IMF was initially allowed to loan. Clearly, we cannot generalize from the Brazilian experience to other experiences around the world. This suggests that we have to be thinking about the levels of IMF financing and about the question of whether the IMF, with its current resources, can, in fact, perform this role of world policeman and world lender of last resort that we seem to be assigning to it.

Point number four concerns ownership of policies. Conventional wisdom is that the IMF comes in and imposes policies on governments that governments do not want. What we have learned in these three cases is that, at least in Poland, Brazil and Korea, that was not at all the case. In fact, what we have seen here -and the papers are quite clear on this- is domestic governments that chose to take the reform and stabilization agenda beyond what the IMF was asking for. So ownership in these cases is not an issue. But there are two issues that remain in this domain. One is whether these sudden changes of position by domestic governments are good or bad for democracy, because they represent false advertising. What we have, more or less in all three countries, was candidates that said "a" and upon coming to office did "b." "B" happened to be an embrace of the IMF. Ex-post, from an economic point of view, that was probably the right thing to do but, from the point of view of democratic credibility, that is an issue, and an issue we have to think about. Also regarding ownership, we have the issue of ownership by whom. The fact that policies have been made their own by governments does not mean that they have been made their own by the voting public. There is something quite striking in this respect and, as President Figueres from Costa Rica, said: " I suspect most of us around this room could not get elected by advocating policies that are the right policies." This suggests there is an issue of socialization of wisdom, of knowledge, of learned experience of the right policies, that has yet to take place in most countries.

I conclude with the following. If we think about democracy and the IMF we should be thinking about democracy inside the IMF. I see two major issues. Number one, the representation of countries within the IMF is the outcome of a political equilibrium that is now half a century old. There are some European countries that have a larger voting power than large emerging democracies. And secondly, the selection process for the heads of the IMF and the World Bank is still, in the words of one conference participant, "medieval." It is certainly not transparent and it is certainly not accountable and that is probably something we also want to be thinking about.

What is the Club of Madrid

Formally constituted on May 13, 2002, the Club of Madrid was born out of the Conference on Democratic Transition and Consolidation that was held in Madrid in October 2001. The Conference united 35 Heads and former Heads of State and Government from Europe, America, Asia and Africa and over a hundred experts from all over the world. The objective of the Conference was to contribute to strengthening democracy through an in-depth debate of the challenges and difficulties facing democracies involved in processes of transition and consolidation, as well as to propose practical solutions to those problems that may arise during the process in order to develop a democracy that delivers.

The Club of Madrid is a permanent body, international in character and vocation, that was created to actively contribute to the strengthening of democracy worldwide, by drawing on the experience of its members, who are all former Heads of State and Government of democratic countries (see list for details). It also has the advisory expertise of a prominent group of experts from all over the world, politicians, practitioners and academics, on questions related to the process of democratic transition and consolidation Its main aim is to help emerging democracies in their efforts towards the consolidation of their democracy, as well as to help those countries already in a process of democratic transition.

Mission

The Club of Madrid is an independent organization whose main purpose and priority is to contribute to strengthening democracy in the world. To this effect, it will promote, stimulate, support and carry out initiatives and activities and participate in projects seeking this objective. Specifically, it will act as a consultative body and support group for those countries involved in a process of transition to democracy. The personal and practical experience of its members, former Heads of State and Government, in processes of democratic transition and consolidation is not only a distinctive characteristic of the Club of Madrid; with the cooperation of high level experts, it is also a working tool to convert ideas into practical and feasible recommendations and action plans for implementation.

Second General Assembly: IMF and Democracy

The Second General Assembly of the Club of Madrid took place on November 1st and 2nd 2003 in Madrid with the attendance of twenty-six of its members, former Heads of State and Government (see list). The central theme of debate was the role of the International Monetary Fund and its contribution to the democratic governance of countries in which the Fund has intervened.

The debate was all the more interesting given that many of the political leaders who, at some time, had to negotiate with the IMF and implement its recommendations, are now members of the Club of Madrid. Their privileged opinions are therefore based on personal experience. A group of experts as well as representatives from the IMF and other multilateral bodies also participated in the debate. The discussions were carried out in three Working Groups, which considered the specific cases of Brazil, Poland and Korea. The debates on the Working Groups were then followed by a round-table discussion on the IMF's relations with the G7 and other developed countries and their influence on the definition of IMF policies and programmes.

"All documents from the 2001's Conference on Democratic Transition and Consolidation and from the 2003's General Assembly on the topic of the IMF and Democracy can be downloaded from the Club of Madrid's webpage on www.clubmadrid.org <http://www.clubmadrid.org>".

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• Ahthisaari, Martti	Former President of Finland
• Al-Mahdi, Sadig	Former Prime Minister of Sudán
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• Aylwin, Patricio	Former President of Chile
• Betancur, Belisario	Former President of Colombia
• Calvo-Sotelo, Leopoldo	Former President of the Spanish Government
• Cavaco Silva, Aníbal*	Former Prime Minister of Portugal
• Delors, Jacques	Former President of the European Commission
• Fernández, Leonel**	Former President of the Dominican Republic
• Figueres, José María*	Former President of Costa Rica
• Frei Ruiz-Tagle, Eduardo*	Former President of Chile
• Gaviria, César*	Former President of Colombia
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• Gorbachev, Mikhail	Former President of the Soviet Union
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• Hurtado, Osvaldo	Former President of Ecuador
• Jospin, Lionel	Former Prime Minister of France
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• Lee, Hong-Koo*	Former Prime Minister of Korea
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• Mascarenhas Monteiro, Antonio	Former President of Cape Verde
• Masire, Ketumile	Former President of Botswana
• Mazowiecki, Tadeusz	Former Prime Minister of Poland
• Meidani, Rexhep	Former President of Albania
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• Paniagua, Valentín*	Former President of Peru
• Pastrana, Andrés	Former President of Colombia
• Pérez de Cuellar, Javier	Former Secretary General of the United Nations. Former Prime Minister of Peru
• Quiroga, Jorge Fernando	Former President of Bolivia
• Robinson, Mary	Former President of Ireland
• Roman, Petre	Former Prime Minister of Romania
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Members of the Club of Madrid that participated in the 2003 General Assembly

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