

IMF reform Potential and prospects for change after Singapore

In September 2006 IMF Managing Director Rodrigo de Rato unveiled his Medium-Term Strategy for the future direction of the International Monetary Fund (IMF). It was a rather timid document and widely criticised for neglecting important issues such as the IMF's role in monitoring the global exchange rate system and for not putting forward concrete proposals on reforming the IMF's governance.

In April 2006, at the meeting of the International Monetary and Financial Committee (IMFC) in Washington, Managing Director de Rato released an updated version of his Medium-Term Strategy. It was more specific in its proposals and was broadly endorsed by the IMFC.

As the finance ministers and central bankers of the world gathered in Singapore in mid-September, expectations had been raised that there would be concrete progress on IMF reform. Post-Singapore, the issue is whether those expectations will be quickly confirmed, or be met with disappointment or delay. I expect delay. As a consequence, the re-emergence of the Fund in the centre of the international economy and financial system will be postponed, perhaps indefinitely, with potential adverse implications for the global economy and financial system.

Reform agenda

The IMF reform agenda consists of three principal items: (1) reform of IMF governance, (2) better policing of the economic and financial policies of the systemically important countries, and (3) a strengthened IMF role in large-scale lending to emerging market countries. The problem is that the discussion of each of these items is being addressed on a dif-



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ferent timetable. This reduces the chances of a package of reforms after Singapore, and a package approach may be required to achieve results in any of the three areas.

Reform of IMF governance is most advanced. Everyone knows what is needed: a redistribution of voting shares in the Fund – largely based on IMF quota subscriptions – and chairs on the IMF Executive Board. The accompanying chart illustrates the basic issues.

The chart shows IMF quota and 2005 GDP shares for 11 countries or groups of countries ranked by the ratio of their quota share to their GDP share. The United States, Japan, the members of the European Union, and the other traditional industrial countries account for 75 per cent of global GDP (at current dollar exchange rates) and have 63 per cent of IMF quotas.

However, the quota shares of the United States and Japan are only 60 per cent of their GDP shares while the comparable figure for the European Union and the other industrial countries are more than 100 percent. Those countries are commensurately over-represented on the IMF Executive Board.

If the combined quota shares of these latter two groups of countries were realigned at 60 per cent of their combined GDP shares, 16 percentage points of IMF voting shares could be redistributed toward the non-industrial countries. Their combined voting share

in the IMF would rise to 53 percent, roughly twice their combined 25 per cent share of global GDP.

The principal beneficiaries of increased quota shares would be the emerging market countries in East Asia, South Asia, and the Western Hemisphere. The countries of the Middle East and North Africa would be unaffected as a group because their quota share is 235 per cent of their GDP share.

Two-step process

Managing Director de Rato and the IMF Executive Board proposed a resolution envisaging a two-step process to address this issue over two years. That approach was approved in Singapore. First, agreement was reached on *ad hoc* increases in the quotas of four countries whose IMF quotas are most out of line with their economic weight. Second, a process was established to reform the traditional formula for calculating IMF quotas.

The revised formula would place greater emphasis on economic weight, which is traditionally associated with GDP. Next, the new formula would be used as the basis for a second set of *ad hoc* quota adjustments to be agreed by September 2008. Recent quota adjustments have ignored the traditional quota formula which implies a significant redistribution of quota shares involving many countries – industrial as well as non-industrial.

The Managing Director's game plan

does not address the crucial issue of the over-representation of Europe on the IMF Executive Board. It also contains two other potentially fatal flaws: First, although his resolution was passed in Singapore, a key group of countries actively opposed it. They and many others oppose elements of the second stage of the process. Second, progress is linked to the second item on the reform agenda: better policing of the economic and financial policies of the systemically important countries.

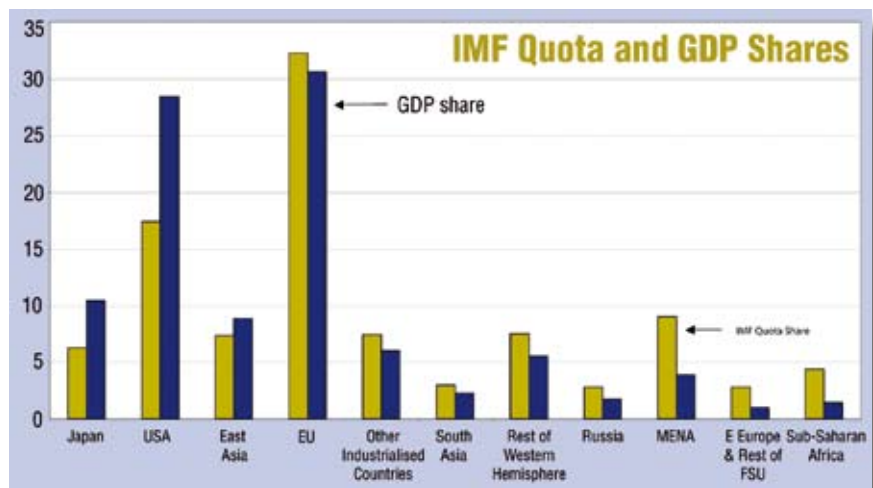
In this second area, the Managing Director at first resisted proposals that the IMF should play a more forceful role as the proactive overseer of the international monetary system as a whole, in particular, in the area of exchange rate policies that frustrate or distort global adjustment. More recently, he has initiated a multilateral consultation process involving the United States, Japan, the European Union, China, and Saudi Arabia. This is a welcome initiative, but the process will not be completed until early 2007 at best, and the results are likely to be modest.

It is crucial to the smooth unwinding of global payments imbalances that all five parties adopt economic reforms in their interest and in the interest of the system as a whole. For example, the United States should put forward concrete proposals to achieve a fiscal surplus by 2010.

East Asian exchange rate

It is also well known that as part of this process significant further adjustments in East Asian exchange rates are required. A cumulative appreciation of the Chinese yuan against the US dollar of at least 10 per cent would be appropriate as a down payment by early 2007. If that down payment has not been substantially completed, it is difficult to see how real progress can be made in reforming IMF governance.

Thus, the first two elements of the IMF reform package are tied closely together. They are also linked to the third element: a strengthened IMF role in large-scale lending to emerging market countries. Managing Director de Rato has proposed establishing a new lending facility that provides high-access financing to members contingent on their automatic pre-qualification based on their strong



macroeconomic and financial policies – an insurance facility to replace the defunct Contingent Credit Lines.

Progress on this proposal is linked to the other two elements of IMF reform. Reform of the global adjustment process requires that countries cease the rapid build up of their foreign exchange reserves, which have doubled over the past five years.

Countries will be more inclined to do so if they have larger stakes in the Fund and have greater confidence that the IMF will be in a position to lend to them if they run into trouble with today's increasingly liberalised global financial markets. Discussions of this proposal have only begun. It faces opposition from some reactionary and uninformed policymakers and critics who want to close down the IMF as a lending institution on any significant scale.

The United States is sympathetic with, but is not leading, this opposition. However, the US authorities in the end will have to accept reform in this area if they want to ensure that other elements of an IMF reform package are present.

Implications for MENA

What does all this mean for the countries in the Middle East and North Africa? Historically, these countries as a group have been relatively inactive participants in the IMF. They have not embraced economic reform, their participation in IMF reviews of their compliance with international codes and standards has been less than by countries in other regions, and they generally have resisted the publication of the annual reports on their economic and financial poli-

cies (Article IV consultations). On the other hand, many countries in the region face rapidly expanding working-age populations that can only be productively absorbed if these countries embrace economic reform and greater openness to global economic and financial forces.

To facilitate this process, the region needs a strong and effective IMF playing a central role in promoting global economic growth and financial stability. At the same time, a strong and effective IMF needs countries in the region to step up and assume greater responsibility for the functioning of the global economy, for example, as part of the new IMF multilateral consultation process. Thus, these countries along with all IMF members will benefit if significant rapid progress on IMF reform is made after Singapore, in particular because the suspension of the Doha Round of trade negotiations has cast another shadow over multilateral cooperation and problem solving. I am not optimistic, but I hope I am wrong!

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