

PROGRESS ON IMF REFORM

Introduction

The International Monetary Fund (IMF) at age sixty is in need of reform to increase its legitimacy and relevance, according to many in the international financial community. Many reform proposals have been advanced, but leading governments are in disagreement over the need for bold and quick action. The leading proposals call for:

- ◆ Changes to IMF governance, reallocating vote share and board seats to reflect economic and political changes;
- ◆ More effective policing of the policies of systematically important countries and their impact on others (so-called "multilateral surveillance");
- ◆ Restoration of the Fund's role as lender of last resort;
- ◆ Refocused engagement with low-income members;
- ◆ Increased attention to capital account and financial sector issues;
- ◆ Addressing the need for added IMF financial resources.¹

Expanding the Fund's Watchdog Role

At the spring meetings in April, the IMF announced progress on two major reforms. First, there will be an expanded "watchdog" role for the Fund. The IMF will begin organizing *multilateral* consultations with major countries that focus on the impact of their economic policies on other countries. Major features such as the U.S. fiscal deficit or China's currency policy should receive more pointed attention in the future. Similarly, European countries could be reminded of the need to implement structural reforms to regain competitiveness.

IMF Managing Director Rodrigo de Rato said, "Of course the responsibility affecting government action is on governments, not international institutions," but he contended that by holding meetings at which "spillovers and linkages" of countries' policies are highlighted, "we can provide a framework in which consequences of actions can be seen more clearly, and also consequences of inaction."

A second change involves the reapportionment of some voting power among IMF members. Vote shares will be increased for a few, large and fast-growing developing countries, including China, South Korea, Mexico and Turkey. The details of the increased voting shares have yet to be worked out. The difficult part is determining from whose share they will be taken. The Fund's policy-setting committee asked de

¹ List adapted from a speech by Edwin M. Truman of the Institute for International Economics called "Progress Report on IMF Reform," Washington, DC, April 20, 2006.

Rato to propose specific changes by the time of the Annual Meetings of the IMF and the World Bank in Singapore in September.

Under the current quota formulas, China has about 3 percent of the vote share, and South Korea about 0.75 percent, far below their relative proportions of the global economy. At the same time other countries have a disproportionately high vote share, including several European nations. In addition, seven of the 24 seats on the IMF executive board are now held by Europeans, and the case for this is not as strong as it once was.

A third reform initiative involves the Managing Director's proposal to create a new instrument to provide high access contingent financing for countries that have strong economic policies, sustainable debt, and transparent reporting but remain vulnerable to shocks. The Fund's policy making body suggested this proposal deserves further examination.

However, many questions were left unanswered by the Fund's recent announcement and there was little progress on other reform measures. And, a major fight now looms over efforts to revamp the voting rules. Europeans are generally lukewarm about reform. They appear loath to give up vote share and board seats. In contrast, the United States has advanced an aggressive reform agenda and need a comprehensive agreement to keep the U.S. Congress from punishing China over the currency issue.

However, senior Fund officials appear satisfied with modest reforms at this stage and have promised more fundamental reforms in the future. When and how this would be achieved is not clear. In addition, some predict that smaller countries could block any agreement in the end, unless there is something specific in it for them. In many ways, this division of views is reminiscent of the polarization seen at the Doha multilateral trade negotiations and could produce the same kind of gridlock.

Other Reform Proposals on the Table

A number of individuals and groups have proposed more sweeping IMF reforms. Bank of England's Governor Mervyn King has suggested that the IMF should withdraw from lending altogether and rely on private capital markets to fill the gap. The Fund would be left with the role of surveillance. King also argues that the proliferation of "G groups" – the G-5 that became the G-7 or G-8, the G-22 that morphed into the G-33, etc. – has lessened the legitimacy of the Fund.

Lawrence Summers, former U.S. Secretary of the Treasury, called for the IMF to be more innovative in helping smooth out imbalances. He suggested the IMF could manage a share of surplus countries excess reserves on their behalf and take a one-percent management fee to invest in public goods, make grants or provide debt relief to benefit poor countries.

International bankers generally believe the Fund should rely more on market signals and advice from market actors in setting their policies. A recent position paper released by the Institute of International Finance notes that the fall-off in Fund lending programs (from 21 programs in 1998 to 6 in 2006) has diminished the IMF's influence on policies of emerging market countries. Bankers are also often outspoken in their complaint that the IMF should stay out of debt renegotiations.

Outlook

Many IMF reform discussions are taking place at think tanks and among governments, within various "G" groups and among IMF officials. Under the auspices of the Bretton Woods Committee and in conjunction with the Federal Reserve Bank of New York, a high level discussion will be held June 27, assessing the need for additional reform and evaluating what is needed to achieve it. Some experts remain concerned that the Singapore Annual Meetings could come and go without a final agreement. Since IMF management appears content with modest reforms at this stage and European and American negotiators are working for dramatically different outcomes, failure is a real prospect.