

IMF Reform: An Unfinished Agenda

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Op-ed in *VoxEU.org*
January 28, 2009

The central question for the leaders of the G-20 countries in the run-up to their second meeting on April 2 in London is whether to reopen the meager package of International Monetary Fund (IMF) reforms that was agreed a year ago. Their answer should be bold: They should reopen the prior package and commit to completing the unfinished business of IMF reform.

The world economy and financial system face the worst crisis since the IMF's founding in 1944. The Fund was established to promote cooperative solutions to common problems and to prevent a global meltdown of the type experienced from 1929 to 1939. Unfortunately, in recent years, its promise has been damaged by the pursuit of narrow national interests and a lack of appreciation of the dark side of globalization and its impact on weaker economies and societies. Consequently, the IMF is starved for legitimacy, financial resources, and relevance.

The task for the G-20 leaders is to drive a process positioning the IMF to play its assigned role in the current crisis and to set the Fund on the right course for the 21st century by completing a long-overdue IMF reform agenda. In the current context the leaders should focus on two types of actions: (a) those to be implemented by the end of 2009 to contribute to the restoration of confidence and to meeting the pressing needs of the world economy and (b) those to be implemented by the end of 2010 to restructure the Fund's role as the principal institution of global economic governance. The necessary actions are grouped below in three broad categories: (1) legitimacy, (2) resources, and (3) relevance.

Legitimacy

For too long, the IMF has been perceived by leaders and citizens of most of its member countries as the tool of the United States and Western Europe. In particular, its governance has been locked into a framework that was devised at the end of World War II with only minor adjustments in the ensuing six decades. It is imperative to change this perception if the IMF is to regain the relevance and role envisioned by its founders.

To this end, at the G-20 meeting in London, President Obama and leaders from the Western European countries should agree to a robust reform of the management selection process in the IMF and World Bank that ensures that all qualified candidates receive consideration regardless of their nationality. The G-20 leaders should endorse an amendment to the charters of the Fund and the World Bank to require a double majority of weighted votes and number of members to elect or to reelect a managing director of the Fund or a president of the World Bank.

The G-20 leaders should also support an immediate replacement of the IMF quota formula that was adopted last year with one that points decisively toward reducing the voting power of the traditional industrial countries.¹ The new formula should be employed immediately in augmenting the IMF's quota resources as outlined below to redistribute at least 5, and



preferably 10, percentage points of voting power in the Fund from the traditional industrial countries to other members.

For the somewhat longer term, the G-20 leaders should endorse an amendment of the IMF Articles of Agreement to reduce from 85 percent to 80 percent the voting majority needed to approve or to enact certain IMF decisions. This would eliminate the potential, so-called US veto of such decisions. As part of this bargain in London, along with accepting a substantial reduction in Europe's combined voting power to something much closer to that of the United States, the Europeans should commit to a consolidation of their representation on the IMF executive board from the current 7–10 out of 24 seats to two seats. Finally, the G-20 leaders should endorse a revamping of the role of the executive board from one of day-to-day engagement with the operations of the Fund to one of broad oversight of the decisions of IMF management.²

Resources

The scope of the current crisis reflects the harsh reality of today's globalized economy and financial system. Every country has been affected; those with the weakest policies and in the most precarious financial circumstances have been affected most and first. We have learned that countries can run but they cannot hide from the effects of such crises. In the future, the incidence and virulence of crises may be reduced but will not be eliminated. Over the past several decades, the leaders of the advanced countries have failed to recognize this trend. One consequence has been that they have starved the IMF of resources to lend. In London, the G-20 leaders should take immediate and longer-term corrective actions.

When the simmering financial crisis boiled over in September 2007, the Fund's estimated forward lending capacity was \$200 billion from regular quota resources and an additional \$50 billion from established borrowing arrangements. Since September, the IMF has made more than \$50 billion in lending commitments and set aside \$100 billion for a new short-term lending facility. At the same time and outside the framework of IMF lending, the Federal Reserve has advanced more than \$600 billion in short-term credit to 14 other central banks, and the European Central Bank and Swiss National Bank have advanced smaller amounts within Europe. These facts illustrate the need to augment immediately the IMF's lending capacity and to provide it with the resources and instruments so that permanent, multilateral arrangements replace ad hoc bilateral operations in the future.

For the period immediately ahead, the G-20 leaders should agree to support at least a doubling of IMF quotas and borrowing arrangements.³ They also should agree to support the establishment of a mechanism so that the IMF can borrow up to \$50 billion in private capital markets. Finally, they should call for a special allocation of at least 50 billion special drawing rights (SDR), or about \$75 billion. This last component is intended to boost confidence in the coordinated actions of governments to address the crisis, to signal that the primary global concern at present is deflation not inflation, and to provide a significant amount of unconditional financial resources to countries with a potential near-term financial need. A conservative estimate is that \$18.75 billion of the \$75 billion would go to such countries.⁴

Looking further but not too far ahead, the G-20 leaders should commit to establishing a presumption that in each quinquennial general review of IMF quotas, total quotas will be increased in line with the expansion of the global economy, trade, and financial system over the



intervening period.⁵ This would help to ensure that the IMF's lending capacity expands with the continued globalization of the world economy and position the Fund to support its members continuously in times of crisis instead of relying on ad hoc measures. The leaders should also commit their governments to the positive consideration of annual, substantial SDR allocations to meet members' demands for international reserves without exacerbating global imbalances that distort the adjustment process. Finally, in London President Obama should commit his administration to support congressional approval of the fourth amendment of the IMF Articles of Agreement, under which SDR 21.9 billion would be issued principally to those countries that joined the IMF after one or both of the prior issues of SDR in 1970–72 and 1979–81.⁶

Relevance

Without enhanced legitimacy and adequate financial resources, the IMF will not be relevant to the needs of the globalized economy. With enhanced legitimacy and adequate financial resources, the Fund will be positioned for a restoration of its relevance. The G-20 leaders meeting in London on April 2 should endorse the following set of actions.

For the period immediately ahead, the G-20 leaders should support the management and staff of the Fund in vigorous surveillance over the exchange-rate policies of members and in policing members' exchange-rate obligations under the IMF Articles of Agreement. This is essential to ensuring that the global recession does not trigger a mutually destructive, cascading sequence of competitive depreciations.

The leaders should also support a comprehensive rethinking and updating of IMF lending policies. The international financial needs of members can no longer be met solely by IMF lending designed to meet the traditional, narrow balance-of-payments test. In the interests of global economic recovery and international financial stability, the objectives of IMF lending operations should be expanded to include support for members' sound fiscal policies and for the international operations of their financial institutions.

Taking a somewhat longer perspective, the G-20 leaders should support consideration of an amendment to the IMF Articles of Agreement to permit the Fund to enter into short-term arrangements with national central banks to swap SDR for national currencies that are central to the functioning of the global financial system, principally the US dollar but also the euro, yen, pound sterling, Swiss franc, and possibly others. The currencies would be used to fund the IMF's short-term lending facility. That facility would replace the bilateral international lending operations of national central banks, centralizing the responsibilities and risks involved.⁷

In light of experience in the current crisis and calls for a more active role for the IMF on financial-market issues, the G-20 leaders should also support reconsideration of an amendment of the IMF Articles of Agreement with respect to the capital account policies of members. The objective should not be to compel all member countries to open their capital accounts. That would only be the ultimate goal. Meanwhile, the Fund would be provided with an updated mandate to assess and guide progress toward that goal, including the judicious use of restrictions on capital flows.

Finally, the G-20 leaders should endorse a strengthened surveillance role for the Fund in several key areas: signaling the emergence of global imbalances, policing of exchange-rate



obligations under the IMF Articles of Agreement, assessment of the stability of national financial systems (including implementation of existing, strengthened, and new international standards and codes in the wake of the crisis), and the complex nexus of microprudential and macroeconomic policies under the heading of macroprudential policies. Each of these activities is central to the Fund's relevance in the 21st century.

Conclusion

The G-20 leaders' meeting in London on April 2 should not only act to implement the unfinished IMF reform agenda that I have outlined here but should also endorse those items in the 2008 package that have not been superseded: the tripling of basic votes, the expansion of the Fund's investment powers, and the sale of 12.5 percent of the IMF's gold to provide an endowment to finance the nonlending activities of the Fund, which are likely to increase in the future. Taken together, these elements of the earlier package and those unfinished items on the IMF reform agenda that I have outlined are essential to supporting the restoration of economic growth and the stability to the global financial system and to positioning the IMF to play an enhanced role at the center of the world economy and financial system in the future.

Notes

1. The formula that was adopted last year implies that the share of the 26 traditional industrial countries should increase by 2.2 percentage points relative to their actual share.
2. Under the heading of governance, some observers favor replacing the International Monetary and Financial Committee (IMFC) with a Council as provided for in the Articles. I do not attach major importance to such a cosmetic change, but it should be included on the agenda if it receives the endorsement of a significant majority of G-20 members.
3. Consideration should also be given to the participation of additional countries in the New Arrangements to Borrow (NAB) beyond the current 26 participants and to a realignment of NAB lending commitments.
4. SDR are allocated on the basis of IMF quota shares. The combined quota share of G-20 countries is about 66 percent, but a number of these may need external financial assistance over the next year. Although a number of non-G-20 industrial and oil-exporting countries may not need such assistance, a rough estimate is that countries with at least 25 percent of current IMF quotas fall into the category of countries with a potential need. 25 percent of \$75 billion is \$18.75 billion. The combined quota share of the 105 smallest and mostly poorest members of the Fund is about 8 percent, implying \$6 billion in ready assistance to these countries from an SDR allocation of \$75 billion.
5. A qualified majority vote should be required to overturn that presumption, though acceptance of the proposed increases would also continue to require a qualified majority.
6. The amendment was approved in 1997 with strong US support and has been ratified by members with 77 percent of the voting power in the Fund, but the US Congress must ratify the amendment before it can go into effect.
7. An additional advantage would be that the SDR swapped, for example with the Federal Reserve for US dollars, could be transferred, for example to the European Central Bank for euros if there were downward pressure on the US dollar at the time in foreign exchange markets and US authorities needed euros to support the dollar.