IMF Reform, Anew

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What's New?

- Is the case for IMF reform different today?
- Yes: this systemic crisis reminds us of Fund's key role and creates an opportunity
  - Systemic in origin, impact and response
- But the situation is dire: let us not be in denial
  - Stigma problem: IMF versus Fed and World Bank
  - Trust: IMF's "Immaculate Adjustment" Latvia Program:
- Perspective:
  - Getting bargain so that all countries are re-engaged in IMF
  - Proposed changes must respond to current imperatives but also be appropriate for the medium run
- Ambition: Greater rather than smaller
  - Incrementalism unlikely to reverse the disengagement of key actors and unlikley to facilitate bargains

Bargain

- How can the IMF regain trust of emerging market and other developing countries while also addressing disenchantment of industrial countries?

- Essentials for emerging markets
  - Better and more legitimate IMF Governance
  - More Fund resources to provide counter-cyclical liquidity: amount, automaticity, and conditionality-lite

- Essentials for industrial countries and the multilateral system:
  - A relevant agenda to include effective surveillance, including over exchange rates
  - Reduced reliance on self-insurance by emerging markets

- Other essentials
  - Intellectual openness of IMF

Outcomes and Timing

- Changes must be seen as a <u>package</u>
  - Chicken and egg problem
- April 2009 summit is important but part of a longer process
- Three types of agreements in April
- I. Agreement on concrete steps: Important symbolically
  - Agreement to issue about $150-$250 billion of new SDRs
    - Allocation?
  - Public announcement by Brown, Obama and other G-20 leaders that Heads of IMF and World Bank will not automatically go to a European and American, respectively. Commitment to merit-based and transparent selection processes

Outcomes and Timing (contd.)

- II. Agreement on principles with elaboration of specifics over 2009/2010
  - Improving governance to include:
    - Reducing Europe's chairs and shares and commensurate increase in share of emerging markets, especially China
    - Re-evaluating decision-making to make IMF more cooperative. Serious consideration of double majority rule
    - Revisiting quota formula
  - Increasing Fund resources and keeping it aligned with (gross) global capital flows
    - To $1 trillion
  - Surveillance with teeth: Global imbalances and exchange rates
    - May need IMF-WTO collaboration (Mattoo and Subramanian, 2009)

Motivation

- There can be SYSTEMIC crises not country-specific or regional but GLOBAL (something we had FORGOTTEN)

- Origin, Impact and aftermath can be SYSTEMIC requiring a systemic, multilateral response

- Origins: Global imbalances/exchange rates
  - Contributions of national policy shortcomings (US monetary policy, financial sector regulation) and global imbalances will be debated

  - But latter clearly had some role to play by increasing global liquidity and facilitating debt-financed consumption binge

Motivation (Contd.)

- Impact: Crisis has affected the world not just individual or groups of countries
  - Emergency liquidity needed for Iceland, Hungary, Latvia but also Brazil, Korea, Mexico, Singapore and others (Ireland, Belgium) have come close to needing help, and yet others (Greece, Italy) are in trouble.
  - US Federal Reserve swaps amounted to more than $600 billion but amount available was unlimited for some countries
  - Even EU needed IMF help for Hungary, etc.
  - Ex ante a new "Veil of Ignorance."* Identity of CREDITORS and DEBTORS is much more fluid and reversible

Motivation (Contd.)

- Aftermath/response: Possibility of beggar-thy-neighbor policies that can aggravate the systemic impact. A “New Mercantilist Threat?” (Bergsten and Subramanian, 2009)
  - Mercantilist response has both cyclical and structural elements
  - Cyclical: With C and I depressed, all governments (including industrial) will look to X-M to move out of recession especially if G is ineffective or has limits
  - Structural: Export-led growth and desire for reserves (self-insurance) in emerging markets could be re-inforced because of crisis

Key Reforms 1: Governance

- Key principle: Is this a truly cooperative institution or is it going to be dominated by the old powers? Will it reflect the receding realities of an Atlantic-centered world?

- Key Changes:
- Merit-based and transparent selection process of IMF head

- Reduction in share of Europe in voting by about 8-10 percentage points and in number of chairs at the Executive Board to no more than 3

- Commensurate increase in share of emerging markets, especially China.

- Elimination of veto of US and EU either through new voting system (double majority of weighted votes and number of members for key decisions including selection of IMF head)

- Greater say for the low-income members through increase in basic votes and/or double majority rule

- Codification of a quota formula that will apply over time. Formula should be simple reflecting ability to pay (GDP at market exchange rates) and economic influence (population or GDP at PPP exchange rates, Bryant, 2006)
  - Formula should not include variables for financing need.

Key Reforms 2: Size

- Key principle: An IMF based predominantly on surveillance is doomed to irrelevance.

- IMF's systemic crisis resolution role is central. Therefore size must be:
  - Such as to address systemic financial crises
  - Related to gross capital flows in world economy
  - Codified to evolve endogenously

Key Reforms 2: Size (contd.)

- Key Changes:
  - Increase lending capacity from about $250 billion to $ 1 trillion with most of the increment devoted to a quick-disbursing near-conditionality-free liquidity facility à la swap extended by US Fed
  - $1 trillion is roughly total lending by Fed, ECB and IMF in the current crisis
  - In each quinquennial review, presumption that total resources will increase in line with growth in global gross capital flows
  - Mechanism: Doubling of quota and GAB, Increased SDR allocation (see Appendix 1 for new proposal)
  - Possibility of Fund swap arrangements with large central banks to fund liquidity facility (http://www.iie.com/publications/interstitial.cfm?ResearchID=1075, Truman, 2008)

Key Reforms 3: Surveillance with Teeth

- Reforms must be politically saleable in US and EU
  - Governance reform will be difficult because US and EU will have to cede power
- Surveillance with teeth: Global imbalances/Asymmetric adjustment/Keynes problem
  - Multilateral action on undervalued exchange rates
  - Can pure IMF solution be effective?
  - Surveillance with teeth might require IMF-WTO cooperation a la Mattoo and Subramanian (2009: http://www.iie.com/publications/papers/FA-subramanian0109.pdf) or Einhorn (2009).
  - IMF provides technical evaluation, WTO provides enforcement
  - Need for more effective IMF-WTO institutional cooperation
- Reduced self-insurance: In return for easy access to multilateral insurance, less reliance on self-insurance and build-up of reserves by emerging markets which can be globally deflationary
- Capital account: Greater say for Fund on capital account issues, provided it can demonstrate intellectual openness

Reforms 4: Intellectual Openness

- Key principle: Fund must be open to alternative intellectual approaches
  - Changing zeitgeist offers an opportunity

- Two examples
  - On capital account, Fund must accept need for, and provide advice, on counter-cyclical capital account management.

  - On financial sector rescue, Fund must stress experience with nationalization

Appendix 1: Proposal for SDR Issuance for Medium Run

- Four principles
- Automatic trigger of new SDR issuance either upon declaration by IMF of global crisis or when world growth declines below x%
- Amount of SDR issuance related to magnitude of crisis
- SDRs to be allocated to countries not in line with their quotas (as currently) but according to another formula. Formula to reflect need.
- SDRs to be repaid or cancelled x years after crisis, with provision for extending “x years” to low-income countries*