6 KEEP THE IMF AT THE CENTER

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What's at Stake

A number of unrealistic suggestions have been put forward since President George W. Bush decided to convene a G-20 Summit meeting in Washington on November 15 to discuss the turmoil in financial markets, which is now producing a marked slowdown in global economic growth.

One suggestion was to combine the excess foreign exchange reserves of a few countries to create a huge global pool of money that would be used to reflate economies where growth is lagging. Another was to create a global agency to implement a uniform regulatory regime for financial institutions everywhere. A third was to start a round of global negotiations that will wrap up a bunch of contentious issues in one package, including, in addition to financial sector regulation and supervision, the Doha trade negotiations, the post-Kyoto climate change deal, and financing to achieve the Millennium Development Goals for poor countries.

What Should Be Done

The best feasible outcome for this exceptional Summit meeting could be a consensus to put the IMF back at the center of the system for managing the global economy. It was at the center from its creation in 1945 until a few short years ago when euphoria related to the global financial "bubble" made the IMF look obsolete and irrelevant. Since mid-October, however, the IMF has been re-discovered. For the first time in more than 30 years, a high-income country—Iceland—is getting financing from the IMF.

Nevertheless, three critical issues will have to be resolved to put the IMF back at the center: governance, funding, and mission. The United States is the principal obstacle to making progress in each area, and the November 15 Summit could be helpful in pointing the debate in the right direction.

The governance issue has four elements: the U.S. veto, Europe's over-representation, the role of rising economic powers such as Brazil, China, and India, and the selection of the IMF's Managing Director.

- The United States is the only one of the IMF's 185 member countries that can block decisions on fundamental matters such as amending its charter (Articles of Agreement). While the United States has rarely exercised this power openly, the threat of using it leads other members to defer to U.S. views, and it contributes materially to the image of the IMF as an instrument of U.S. policy rather than a truly global institution.

- Europe's over-representation is an historical artifact that remains because of the reluctance of smaller European countries to give up seats they have held for more than 50 years, and because the option of creating a single European Union seat seems to go too far in the other direction.

- A few steps have been taken recently to increase the voting shares of the rising economic powers, and to coordinate their positions on important matters, but these steps have not reached the point at which the systemically significant emerging market countries feel they have a meaningful ownership stake in the IMF.

- Finally, since the very beginning, the IMF Managing Director has been a European as part of a deal at which the President of the World Bank has always been an American. This deal has developed an overpowering odor, partly as a consequence of several misguided nominations beginning eight years ago.

The funding issue is less straightforward. Think of it like a dike to protect a town from flooding. The dike can be built to withstand a 20-year flood, a 50-year flood, or a 100-year flood. The higher and thicker the dike, of course, the more expensive the construction costs. Currently, the IMF's resources are large enough to deal comfortably with the last crisis, the 1997/98 Asian crisis. Clearly they are not large enough to handle the current crisis comfortably, but then there is not a strong technical case for building a war chest that will be sufficient to substitute for private capital flows. A "substantial" increase in funding (quota subscriptions) could command broad support, but the precise amount will ultimately be a judgment call, depending critically on how quota shares are re-allocated.

The mission issue is the most complicated and most problematical for the United States. Two core elements are "surveillance" of the United States and the other "old economic powers", and global financial sector regulation. The IMF is unique among global organizations in having a formal mandate to "examine" the policies and performance of the advanced industrial countries. However, for most of its 65 years, the IMF's operations have been focused on developing countries. For this and other mainly political reasons, the old powers have been inclined to dismiss the IMF's concerns about their own policy weaknesses and the alternative policies it recommends. The current financial crisis, which originated in the sub-prime mortgage crisis in the United States last year, however, has made it obvious that weaknesses with global implications do exist in the advanced countries. If the old powers now want the rising powers to take the IMF's concerns seriously, then the old powers will have to be more responsive, visibly, to the IMF. This change will require a non-trivial shift in mentality.

Regarding global financial regulation, it is inconceivable that either the old powers or the new powers will agree to grant to the IMF, or any newly created global agency, the authority to regulate and supervise financial institutions operating in their countries. Such a move would involve giving up more sovereignty than their citizens are prepared to accept. The basic choice then is between a regulatory regime that is connected to the IMF and one that is independent of the IMF. The crippling disadvantage of an entirely independent regime is that it would inevitably weaken or undermine the IMF. One attractive alternative is a beefed-up Financial Stability Forum (FSF) that remains "attached" to the Bank for International Settlements in Basel, Switzerland, but has a formal relationship to the IMF as well. In particular, through its ministerial committee, the IMF would have a say in setting the work priorities of the FSF. At the same time, participation in the FSF would be expanded to include the most important emerging market countries.

The Bottom Line

The November 15 Summit in Washington was a European initiative, but President Bush deserves credit for agreeing to host it at an awkward time politically, and for choosing as participants the G-20 coun-

tries instead of some other ad hoc group. He obviously cannot commit the Obama Administration on any of these three critical issues, but he could signal a willingness by the United States to consider new approaches. Even better would be a session, perhaps at the end of the Summit, in which President-elect Obama asks the other G-20 leaders to outline their positions on these three issues as a starting point for his reflections. His participation would also usefully underscore, for the American public, the importance of listening to other views and working in partnership with other countries to tackle global challenges.

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