VOICES OF THE SOUTH ON GLOBALIZATION

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THE IMF GOVERNANCE REFORM

In this issue

Voices of the South on Globalization is a monthly newsletter intended to inspire a meaningful North-South Dialogue by raising awareness for global interdependences and by offering a forum for voices from the South in the globalization debate. Each edition will present short analyses or commentaries from a Southern perspective on one particular issue of the globalization process.

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'LESS BETTER THAN MORE'

Less than a fortnight ahead of the annual spring meeting of the International Monetary Fund and the World Bank, the Fund's executive board approved plans to redistribute voting power among its 185 member countries, with some emerging and developing economies gaining more influence and others losing.

The move would boost the voting shares of emerging economic powers China, India, Brazil, Mexico and South Korea. At the same time, it would reduce that of others like Russia, Egypt, Saudi Arabia, Venezuela, Argentina, Chile and South Africa.

The IMF board recommended the changes to its full membership for a final vote in April. If approved, it will be one of the most comprehensive overhauls of the IMF's voting system in 60 years.

IMF Managing Director Dominique Strauss-Kahn said the agreement was a major step forward to rebalance the voting power from over-represented countries to under-represented ones, although he acknowledged it was not perfect.

It was also a "a major step forward in the modernisation of the Fund and our efforts to adjust its structures to the dynamic and changing realities of the global economy," Strauss-Kahn said, adding: "But it is only a first step."

"No governments like to lose, but that's the cost for big countries to make it possible for small emerging countries or big emerging countries like India to have the room for an increase," Strauss-Kahn said.

With an eye on sceptics, the IMF head said: "I'm not pretending that the reform is done and that now it is perfect and that representation of the different countries is exactly what we should expect. No."

"As such, it's not enough, but without this step it would have been totally impossible to move on rebuilding the legitimacy of a multilateral institution like the Fund," Strauss-Kahn said.

Strauss-Kahn said the decision reflects members' commitment to improving the IMF's effectiveness, credibility and legitimacy. "These were not easy advances. Difficult compromise was necessary by all fund members to reach this point."

Strauss-Kahn said agreement was reached to revisit the issue every five years, which would periodically raise the voting shares of under-represented members according to a new voting formula approved on the last Friday of March.

The IMF head said: "The process goes in a good direction ... and it is an improvement in the legitimacy of the Fund but it is not enough, absolutely not, but it is an improvement," he said, adding: "The only outcome of waiting more would probably have been that there won't be any reform at all." Strauss-Kahn said that while the changes did not immediately "change the face of the world," over time, countries' shares would adjust according to their economic performances. ☑

OVERVIEW OF THE REFORM PACKAGE

The International Monetary Fund issued a 23-page document titled 'Reform of Quota and Voice in the International Monetary Fund—Report of the Executive Board to the Board of Governors. Here some excerpts from the Report published March 28:

I. OVERVIEW OF THE PROPOSED REFORM PACKAGE

3. The proposed reform package reflects extensive discussions by the Executive Board since the Singapore Resolution. It also reflects the further guidance provided by the International Monetary and Financial Committee (IMFC) at its April and October 2007 meetings, including in response to the October 2007 progress report of the Executive Board to the Board of Governors. The proposal seeks to balance the differing views and priorities of members, and agreement has required difficult compromises on the part of all members. At the same time, this agreement reflects the commitment of the membership to the Fund's future by enhancing its effectiveness, credibility, and legitimacy.

A. New Quota Formula

4. In considering the new quota formula, the Board has been guided by the request from the Board of Governors that the new formula provide a simpler and more transparent means of capturing members' relative positions in the global economy. In addition, the Executive Board has taken into account the need for the new formula to be consistent with the multiple roles of quotas; to be feasible to implement statistically; and to produce results that are broadly acceptable to the membership. While many members have reservations about aspects of the new formula, it represents a major improvement over the existing five formulas,2 and the Executive Board considers that it provides a reasonable basis for guiding the second round of ad hoc quota increases.

5. The new quota formula contains the following elements [. . .] :

• four variables expressed in shares—GDP, openness, variability, and reserves—with weights of 50 percent, 30 percent, 15 percent, and 5 percent, respectively;

• the GDP variable is a blend of GDP at market exchange rates and GDP at PPP rates, with weights of 60 percent on market rate GDP and 40 percent on PPP GDP. This approach captures the central role of quotas in the Fund's financial operations, for which GDP at market exchange rates is the most relevant, as well as the Fund's non-financial activities, where PPP GDP can be viewed as a relevant way to capture the relative volume of goods and services produced by economies; and

• a compression factor of 0.95 applied to a linear combination of the four variables. This reduces the dispersion of calculated quotas, moderating to some extent the role of size in the formula.

B. Second-Round Ad hoc Quota Increases

8. In its October 2007 Communiqué, the IMFC reaffirmed that the reform should enhance representation for dynamic economies, many of which are emerging market economies, whose weight and role in the global economy have increased. The IMFC also indicated that an outcome of the second round should be a further increase in the voting share of emerging market and developing economies as a whole.

9. In line with this guidance, the Executive Board recommends that the Board of Governors propose a second round of ad hoc quota increases totalling approximately 9.55 percent (based on an overall increase in the two rounds combined of 11.5 percent) allocated on the following basis:

• All members that are underrepresented under the new quota formula are eligible for increases, based primarily on achieving a uniform proportional reduction in the gap between members' calculated quota shares and their pre-Singapore actual quota shares (degree of "out-of-lineness"). This is consistent with the methodology used in the first round and treats the two rounds together as a single reform.

• To further reinforce the objectives of the reform, the proposed quota increases reflect three additional elements. These have been decided upon as one-time elements of the current reform:

➢ Several under-represented advanced countries have agreed to forego part of the quota increases for which they are eligible in the second round, in order to contribute to the broader goals of the reform. Specifically, the United States has indicated that it is willing to forego an increase beyond what is necessary to preserve its post-Singapore voting share, and other eligible G7 members (Germany, Italy, and Japan) have also agreed to forego increases beyond those consistent with achieving the same proportionate reduction in out-of-lineness as the United States. In addition, Ireland and Luxembourg, which are substantially under-represented, have agreed to forego part of the increases they would otherwise be eligible for (i.e., those beyond a nominal quota increase of 50 percent);

➢ To give additional recognition to dynamism by bringing forward expected future growth for those countries that are most out-of-line in terms of PPP GDP, the Executive Board recommends that under-represented emerging market *[continued on page 6]*

DISAPPOINTMENT AT OVERHAUL PROPOSALS

By Jaya Ramachandran

Developing nations have pushed for more say in how the IMF, created in the aftermath of World War II, is run. Its management is dominated by powerful industrial nations that also rank among its biggest financial supporters. The Fund is tasked with maintaining international financial stability but its finances are strained as countries increasingly turn to other sources for loans.

The proposed reform package will increase nominal quotas ranging from 12 to 106 percent for 54 countries, with some of the largest gains going to dynamic emerging market economies. The aggregate shift in quota shares for these 54 members amounts to 4.9 percentage points, said the IMF.

A rebalancing of voting rights at the six-decade-old institution was launched over two years ago at the IMF annual meeting in September 2006, in Singapore. The reforms are expected to be ratified at the IMF annual spring meetings on April 12-13 in Washington.

According to the IMF, the basic votes for each member triple under the package, the first such increase since the Fund's inception in 1944. This tripling of basic votes is important as it results in an increase in voice and representation for most emerging market and low-income countries.

But many countries expressed disappointment at the reform package.

"We're not happy about the proposal because it falls short of what we had expected, hoped for and we had strived for," said India's Executive Director to the IMF, Adarsh Kishore.

India along with other underrepresented emerging market and developing economies, whose shares in global GDP in terms of purchasing power parity (PPP) are more than 75 percent greater than their actual pre-Singapore quota shares, will receive a minimum nominal quota increase of 40 percent from their pre-Singapore level.

"We had two choices: some forward movement; the other is no movement at all," Kishore told a news agency.

His Chinese counterpart to the IMF, Ge Huayong, also agreed that the proposed reform package does not reflect the weight of the emerging markets in the world economy, while urging the IMF to take actions to raise the shares of underrepresented members.

Oxfam's policy advisor Elizabeth Stuart said the reform package represents "minimal" change for the IMF structure. "After years of debate, a proposal that gives only a small increase in quota share for a handful of developing countries -- and none for the rest -- would be more than disappointing."

"The Europeans need to give up their overly dominant position," she said, noting this is "a step, though a small one, toward the long journey of governance and credibility reform in the IMF."

A bloc of 50 emerging economies represented by Egypt, Russia, Indonesia, Iran and Kenya also rejected the proposed formula, saying it does not shift enough votes from traditional industrial nations -- the United States, Japan and Europe -- to emerging and developing countries.

Two days ahead of the agreement on the reform package, a group of influential Washington-based academics urged IMF member countries in a letter to vote against a proposed new voting formula, arguing it falls far short of what is needed to give emerging and developing nations a bigger voice in the institution.

The group of academics includes Nancy Birdsall, president of the Center for Global Development, Ralph Bryant, Colin Bradford, Homi Karas, Johannes Linn of the Brookings Institution, Ted Truman and John Williamson of the Peterson Institute for International Economics, and Jo Marie Griesgraber of the New Rules for Global Finance Coalition. Many of them have worked for either the World Bank or the IMF or previous U.S. administrations and are widely respected for their insight into global economic and development issues.

"We write to express our concern that the proposed reforms fall far short in addressing the challenges facing the IMF in its evolution toward a truly global institution with more balanced and inclusive representation and voting power," they said.

"In the absence of stronger reforms, the emerging market and developing economies will not be sufficiently engaged in the fund to help generate the energy and dynamism required to strengthen the global financial system and to renew the leadership role of the IMF in the global economy."

The academics said while progress had been made, the changes were not ambitious enough to restore the IMF's standing as a truly global organization, at a time when developed countries are the centre of global financial turmoil and emerging economies are important sources of economic growth. ☑

ASIAN FINANCIAL COOPERATION NO THREAT TO IMF

Since the 1997 financial crisis that really shook the region, East Asia has launched a number of initiatives that have attempted to improve financial cooperation among countries in the region. But the region will continue to rely on the IMF should a crisis hit again, says a new study.

The study titled *The Future Role of the IMF: Asian Perspectives* says: "If ASEAN+3 managed to speed up its process and make a bold decision regarding its framework of cooperation, ASEAN+3 would be a complement mechanism for IMF processes."

But if ASEAN+3 (ASEAN plus China, Japan, and South Korea) goes further toward achieving an Asian Monetary Fund (AMF), the IMF will be redundant for the region, says the study by Titik Anas and Deni Friawan, both from the Indonesian Center for Strategic and International Studies (CSIS).

"However, this last scenario would not be possible as member countries appeared reluctant to relinquish information regarding their financial sectors, not to mention to surrender their monetary policies," says the study commissioned by the Friedrich Ebert Foundation.

Under the ASEAN framework, regional surveillance mechanisms have been put in place. Under the ASEAN+3 (ASEAN plus China, Japan, and South Korea) framework, regional surveillance mechanisms have also been set up. In addition, swap facilities were made available and Asian Bond Market Initiatives were implemented. The Executive Meeting of East Asia Pacific Central Bank (EMEAP) has pooled resources in the Asian Bond Fund and invested in the region's sovereign bonds.

However, analysts were rather disappointed with the level of achievement in improving regional financial cooperation within this region. "There is no evidence that regional financial cooperation in East Asia has failed to achieve its ultimate objective, as it has yet to be tested in a crisis. However, if the expectation is to have a self-help mechanism that can be used in the time of crisis, basically the form of the cooperation to date is not sufficient," says the study.

The authors list six reasons for the slow progress toward achieving meaningful cooperation.

1. The region lacks leadership. After over ten years of effort, one looks in vain for the driver steering the regional financial cooperation. The leadership issue has been there for quite some time and has never been resolved. None of the ASEAN countries shows willingness to lead ASEAN in achieving significant progress in economic cooperation. In ASEAN+3, there is a historical and political barrier to having any of the Plus Three countries act as the leader of the initiatives.

2. Currently there are too many initiatives to focus on. It is often pointed out that the region, especially at the government level, lacks resources. Having too many initiatives to work on with limited resources jeopardizes the quality of the initiatives. The region needs to focus on fewer initiatives (ideally one) to make meaningful cooperation attainable, says the study.

3. Different levels of income and stages of development make the process rather complex and require a more structural effort to map out the direction. To date, no single initiative has attempted to map out a direction that will suit all member countries.

4. The urgency of having regional cooperation for crisis prevention and management no longer exists. The crisis was over ten years ago and the Central Banks of the countries hit by the crisis have already improved their capacity in preventing and managing such crisis. In addition, countries in the region are building up trade surpluses and reserves.

5. No single country is willing to provide substantial resources to make the initiatives really meaningful. Regional financial cooperation in East Asia was formed in a rather weak structure. There is no single initiative or framework agreement supported by a full-time secretariat that focuses on achieving the objective of establishing cooperation.

6. "Non-interference" policy influences economic cooperation in East Asia. Most of the initiatives in ASEAN or ASEAN+3 rely on the decision-making process of the high-ranking officials' meetings. "It appears that the meetings are basically friendly exchanges of information rather than a peer-pressuring mechanism. ASEAN+3 high-ranking officials would never challenge other high-ranking officials, and this might limit the ability of the initiatives to provide objective assessment of the respective country," the study points out.

The authors plead for a dedicated permanent institution, independent of any of the member countries, to take effective initiatives under the ASEAN+ 3 framework. "A permanent institution should be the 'kitchen' to prepare frequent analysis for the surveillance purpose, provide an early warning system for member countries, and administer disbursement of the fund when needed. Although the ultimate decision will rest with the member countries' leaders, this institution is needed for better management of cooperation," says the study. **- Ramesh Jaura** ☑

KEEP THE FUND AT ARM'S LENGTH

By Roberto Frenkel *

There is broad consensus around the idea that the International Monetary Fund is currently a problematic institution. A brief enumeration of the principal, commonly perceived problems would, at the very least, include the following:

1) the institution is no longer fulfilling the functions it used to fulfil, nor is there a clear vision of any new functions for it; 2) due to a drastic pruning of its loan operations, it is not receiving enough revenue to cover its operating costs; 3) the IMF has not played a notable role in the debate a-bout global imbalances, even though this issue is at the very heart of its institutional remit; 4) it is suffering a crisis of legitimacy, with its power structure questioned by many members; 5) there is a lack of confidence, from quite different perspectives, in its intellectual orientation and the quality of its policy recommendations. [. . .]

There is nothing new about the IMF keeping a low profile on major issues of international finance that affect the United States and the developed countries. As an institution the IMF has focussed its activities on the developing countries and been subject to the controlling influence of the United States and the developed nations, with the latter camp setting the course and defining policies for responding to the international financial difficulties of the former. If we see the IMF's silence over global imbalances as a "problem", it is because we challenge the role the IMF should be playing now, and not the role it has been playing since the late fifties. [. . .]

The Asian crises provoked concern, and the idea of redesigning the multilateral institutions or creating new ones better attuned to the new features of the globalised financial system began to take hold. Discussions about the "international financial architecture" now began, and initiatives and agreements for improving the dissemination of information and access to it began to take shape. There was considerable academic debate and a number of proposals emerged for reforms and new institutions. However, the debate and the initiatives petered out as the international financial situation stabilised again. In the late nineties, the international financial architecture was no longer a fashionable topic, basically due to a lack of interest on the part of the governments of the developed nations, and above all because of the stance of the US administration. [. . .]

The last role of significance played by the IMF in the international financial system was terminated by the government of the United States without anything new to replace it. That is one reason why the institution lacks direction. As we cast our minds back across the evolution of IMF functions, it does appear that the developed countries, and above all the United States, have lacked the motivation to propel the IMF towards renewed significance. The institution is languishing because these governments have not been confronted by any new emergencies emanating from the developing world that might require treatment under their control, using the IMF.

The fact is that, since the crises in Argentina and Turkey earlier this decade, there has not been any major crisis in the balance of payments of an emerging economy. Two kinds of factors coincide to account for this striking change in the evolution of the global financial system. First, many countries have introduced changes in the macroeconomic policies. Following the Asian crisis, a number of them entered the currency ex-change markets to preserve their competitive position and build international reserves. These competition policies took the form of "managed floating", regimes that – while reserves are accumulating – reduce vulnerabilities to volatile capital flows and other negative external shocks. Apart from China and India, other Asian countries have pursued this course in the wake of crisis. Russia joined them from 1999 and Argentina from 2002. In reality, these "managed floating" regimes combined with reserve-building are more broadly practised than competitive ex-change rate policies. Countries that have notably appreciated their domestic currencies in recent years, such as Brazil and Russia, frequently still participate in the exchange markets and have accumulated major international reserves.

Parallel to this, the present decade has witnessed the biggest change in the process of financial globalisation since it began over thirty years ago. Net flows of capital now move from developing to developed countries, reversing the former situation. The increase in oil and commodity prices that began in 2002 has combined with the ex-change rate policies of certain countries to gene-rate substantial current account surpluses in a number of developing economies. *[continued on page 6]*

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KEEP THE FUND AT ARM'S LENGTH

[continued from page 5]

Current accounts in surplus coupled with large reserves are features of external solidity, and they are seen as such by the world's financial market. Although some current accounts in major emerging market economies are still displaying deficits – including, strangely enough, Turkey, which has remained an IMF debtor – these deficits are few in number. The relative isolation of deficit economies contributes indirectly to their strength, as it reduces the risk of contagion and herd behaviour in relation to the asset "class" of emerging markets.

Briefly, the decision to deactivate the function of lender of last resort that took place in the latter nineties has not yet been put to the test due to a major, unforeseen shift in the globalisation process.

[. . .] Meanwhile, the official doctrine of the IMF does not seem to recognise the virtues of this new context for developing countries in terms of financial solidity and growth. For example, the institution continues officially recommending macroeconomic policies based on pure floating and inflation targeting. In the present context pure floating means appreciating exchange rates and ceasing to accumulate reserves, consequently reducing the current account surplus and the rate of growth. At the same time, and contrary to official doctrine, the institution's research department recently published several works covering a broad historical and geographical spectrum that show the correlation between growth, net income on current account and maintaining depreciated exchange rates. The contradictions seem worthy of an institution that cannot find its rightful place. [. . .]

It would take a revival of the Bretton Woods spirit for a reformed IMF, with a governance structure more in tune with the real weight of its members, to constitute a forum that would consider the problems of coordinating macro-economic policies as required by the globalised system. That would be desirable, but there are no signs of a will to revive that spirit in the United States or the other developed nations.

Within the above framework, the countries of Latin America are taking their place in the new context with a diverse range of economic policies. Comparative analysis would certainly be u-seful, along with debate about the various treatments accorded to macroeconomic policies, strategies for engaging in the international financial system, the development of the financial sector, inflation, tax and trade incentives. But the IMF does not appear to be the most suitable place to conduct this analysis and debate. I still believe, for the time being, that the Fund is best kept at arm's length. ☑

[continued from page 2]

market and developing economies whose shares in global PPP GDP are also substantially larger than their actual pre-Singapore quota shares (by more than 75 percent) should receive a minimum nominal quota increase of 40 percent from their pre-Singapore level; and

➢ Recognizing that the four members that received quota increases in the first round (China, Korea, Mexico, and Turkey) remain substantially underrepresented, the Executive Board recommends that these four members should receive a minimum nominal second-round increase of 15 percent. [. . .]

C. Basic Votes

11. The Executive Board recommends to the Board of Governors that, as part of the overall package, basic votes be tripled. This would represent the first increase in basic votes since the Fund's inception, and would ensure a significant increase in voting share for low income country members as a group. It would thereby make a major contribution to achieving one of the two key goals of the reform. The Executive Board further recommends that, as specified in the Singapore Resolution, a mechanism be established that will maintain the share of basic votes to total voting power in the future. [. . .]

D. Outcomes

12. The proposed reform package will result in a significant realignment of quota and voting shares. . . .

E. Future Realignments of Quota Shares

13. While the proposed reform package would achieve a significant realignment of quota and voting shares, actual quota shares for many members remain considerably out-of-line with their calculated quota shares. [. . .]

F. Additional Alternate Executive Directors

14. The Executive Board recommends that the proposed amendment of the Articles also authorize the Board of Governors to adopt rules enabling Executive Directors elected by a large number of members to appoint two Alternate Executive Directors. The Resolution further provides that, upon the effectiveness of the proposed amendment, an Executive Director elected by at least 19 members would be entitled to appoint two Alternate Executive Directors. This proposal would further enhance the capacity of the two Executive Directors' offices representing African constituencies to represent the countries in their constituencies at a higher level, recognizing their special challenges . [. . .] ☑