

A Strategy for IMF Reform

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The world needs a strong and effective International Monetary Fund (IMF) as the principal multilateral institution responsible for international economic and financial stability. The IMF today is not discharging these responsibilities effectively in large measure because of a lack of consensus on its role. Rather than focusing primarily on global poverty, or on financial crises affecting a small group of vulnerable emerging-market economies, the IMF must engage all its members on the full range of their economic and financial policies. It must play a central role in shaping global economic performance. Systemically important countries, starting with the Group of Seven but extending beyond that narrow group, must support the IMF in this role.

IMF reform should encompass six components: IMF governance, better policing of the policies of systemically important countries, the Fund's role in external financial crises, refocused engagement with low-income members, capital account and financial issues, and the potential need for additional financial resources.

Progress on **IMF governance** is crucial to enhancing the Fund's legitimacy and restoring member countries' trust. Although countries generally agree on the need for such reform, the IMF has shown no movement to date. Action is needed in three areas: representation on the IMF Executive Board, realignment of voting shares, and (with somewhat less immediacy) management selection procedures. On representation, the European Union should declare its intention to consolidate its representation into a single seat or at most two (one for euro area and one for non-euro area members of the European Union). In the fall of 2006, EU representation should be consolidated into 7 seats from the current 10 seats. Second, IMF voting shares must be realigned to reflect the economic and financial weight of key emerging-market countries in the global economy. Third, the United States and the Europeans should at last surrender their monopoly of IMF and World Bank leadership, recognizing that the old order undermines the institutions' legitimacy.

The IMF needs to police better the policies of its 20 to 30 **systemically important members** and must more forcefully discharge its responsibility for surveillance over members' exchange rate policies. "Naming and shaming" should be an element of the Fund's consultations with key countries. The IMF also needs to establish a framework for its surveillance activities with respect to these countries and identify a set of reference exchange rates consistent with global economic equilibrium as a new tool. It should also embrace the triad of proposals by Morris Goldstein: issue a semiannual report on members' exchange rate policies based on the reference exchange rates, make more frequent use of its existing powers to conduct special or ad hoc consulta-

tions on these policies, and review existing guidelines for surveillance of members' exchange rate policies to see whether they need to be clarified or updated. Finally, the IMF should embark now on a collective special consultation with the major Asian economies as a group—at least China, Hong Kong, India, Japan, Korea, Malaysia, Singapore, Thailand, and informally Taiwan—about their macroeconomic and exchange rate policies.

The IMF must reassert its role in **international financial crises** and as the global lender of final resort, including through its potential for large-scale lending. It should actively explore new lending policies to give greater confidence to emerging-market countries that may have a potential need for IMF lending in capital account crises. The Fund should revert to its previous central role in all sovereign debt negotiations. In cases requiring debt restructurings, in particular those involving a sovereign default to private creditors, it should embrace the proposal by William Cline to establish publicly estimates of the resources available to a country to service its external debt on a sustainable trajectory.

The Fund should be selective and focused in its engagement with **low-income members**, ready to assist them in areas of its comparative advantage, reluctant to add to their debts, and respectful of the skills and opportunities offered by institutions centrally involved with development issues. In effect, the IMF's Poverty Reduction and Growth Facility (PRGF) should be substantively transferred to the World Bank.

Members should exploit an emerging consensus and upgrade the IMF's capacity to provide policy advice and analysis on members' external and internal **financial policies**. The Fund should concentrate on surveillance and the identification of members' vulnerabilities and leave most technical assistance in financial-sector development issues to the World Bank. Although it is not essential to clarify the IMF's role with respect to **capital account policies**, its members should accept the implicit long-run objective of full capital account liberalization.

The IMF does not face an immediate need for additional financial resources via an increase in IMF quotas, but members should lay the groundwork now. The Fund also should put in place procedures for **borrowing from the market** to guard against the possibility that it will not receive timely increases in its quota resources. A debate on this issue should proceed in parallel with a serious discussion about how to provide the Fund with a stable source of income to finance its nonlending activities.

Progress in the areas of governance, systemically important countries, and external financial crises are time critical. Concrete progress on IMF governance is necessary to underpin reform of the second two components. Reform of the remaining areas—low-income countries, the capital account and financial sector, and resources—are less time critical because how the IMF performs in these areas will not matter if the principal components of the reform agenda have not been confronted. Lest it sink into irrelevance, the IMF must be reformed immediately so it can discharge its core mission.

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