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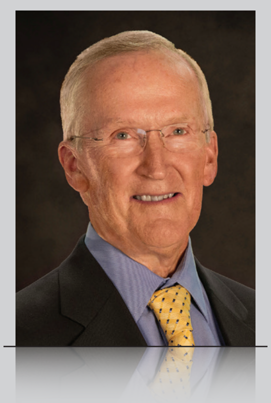
## KEY POINTS

- The IMF has a key role in the world economy, and the institution's credibility and legitimacy depend on governance reform.
- All that is needed to complete the implementation of the reform pakage is for the US Congress to approve the administration's budget request for fiscal 2014, including the proposed changes for the IMF.
- Sadly, in the dysfunctional political environment that prevails in Washington, sadly, approval is highly unlikely until the US national interest in it is even more forcefully explained.



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# WHY WE NEED (BUT WILL NOT SOON GET) IMF REFORM

James M. Boughton

Reforming the IMF is one of the most important challenges for international financial policy in 2013. The IMF is the world's premier multilateral financial institution, but its effectiveness as a manager of global crises and protector of global financial stability is threatened by the failure of the international community to complete the reform package that was agreed upon in Seoul in November 2010. That failure lies squarely at the feet of the US Congress, and the key to overcoming it is in their hands.

### What Is the Reform Package?

One element of the reform package is a doubling of the IMF's financial resources. The ongoing global crisis that erupted in 2008 and then exploded into the heart of the European Union has stretched the ability of the IMF to lend as much money as affected countries need. A patchwork quilt of temporary loans and other financial commitments from a number of countries and central banks was sewn together in 2010, but a permanent and more balanced solution is needed.

A second element is a reshuffling of voting power through an adjustment of IMF quotas, along with a modernization of the formula that underpins the allocation of quotas across the IMF's membership of 188 countries. Almost every expert or policy maker acknowledges that inertia has kept the distribution of voting power from keeping up with the dynamic changes in the world economy in the decades since the IMF was set up at the end of World War II. Getting to an agreement on how to change it has been more difficult.

And third, the IMF's charter — its Articles of Agreement — needs to be amended to permit all countries to band together in groups to elect their representatives to the institution's executive board. At present, the 17 countries using the euro as their common currency are limited in their ability to speak and act as one entity, because the two largest members — Germany and France — are required to appoint separate executive directors. Governments have agreed to eliminate that requirement, but the amendment has not been ratified.

### Why Does Reform Matter?

In one important sense, reform should scarcely matter. A change in the distribution of votes will have little or no effect on decision making at the IMF, since votes are seldom taken. Whenever possible, the executive board acts by consensus. On the few occasions when the managing director cannot forge a consensus, a vote is tallied, but the result is rarely so close that a redistribution of voting shares would alter the outcome. Another, more fundamental, reason is that the dynamic emerging market countries that stand to gain shares from the reform do not have systematically different views about Fund policies than the aging powers that will be giving up shares. In situations where national interests prevail, such as the Fund's advice on China's exchange rate policy, it is extremely unlikely that a shift in voting power would change either the advice or its reception.

Reform matters because the IMF's credibility and legitimacy depend on it. IMF policy advice is not limited to technical matters such as the Fund's overall stance or mix of monetary and fiscal policies. It often touches on matters of deep social and cultural significance: wage policy; distribution of income; prices of commodities that

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are basic to life and well-being; and the ability of residents to buy goods from abroad. It is essential for the IMF to demonstrate that it has each country's best interests in focus when it gives such advice, especially (though certainly not only) when acceptance of the advice is a condition for the Fund's financial support. That assurance cannot be credible unless influence within the IMF is fairly distributed.

Is the IMF an independent referee when it judges what policy reforms are needed in Europe, when the head of the institution is and always has been a European? Was the IMF objective in asking Indonesia, Korea and Thailand to undertake painful structural reforms in 1997-1998 as a condition for international assistance, when US and European officials were frequently present and looking over the shoulders of IMF advisers? Regardless of how reasonable and well suited policy conditions are in such circumstances, it is not reasonable to expect a citizenry to accept them if their governments are not fairly represented in the process.

## What Are the Prospects for Completing the Reforms?

All elements of the reform agenda are interlinked. Quota shares cannot be adjusted without a large increase in total resources, because the IMF does not have the power to require a country to accept an absolute decrease in its quota. An overall increase will not be approved without an acceptable revision in the formula, to ensure that future revisions will be fair. Without an amendment to the articles providing for an all-elected executive board, it will be impossible for Europe to move toward a single and more effective representation.

All that is effectively needed to complete the reform agenda is the approval by the US Congress of relevant provisions in the Obama administration's proposed fiscal budget. Senior US Treasury officials have testified repeatedly before congressional committees to explain the rationale and ask for approval. As a practical matter, however, there is no debate. The political stalemate in Washington has nothing to do with the IMF, and it will not be broken by the need for IMF reform. "Hopeless" would be too strong a word, because approval of the reforms would not add to the current American financial commitment to the IMF. Even so, only an inveterate optimist would venture a favourable guess for action this year or next.

The lesson from history is clear. Congressional approval of IMF quota increases has come only when the US national interest has been clearly evident and clearly explained. In 1983, for example, in the midst of the first wave of a massive debt crisis in Latin America, the Reagan administration was able to win approval only after President Ronald Reagan publicly called the IMF "the linchpin of the international financial system" and argued that a quota increase was "necessary to a sustained recovery in the United States" (Reagan, 1983). In today's poisonous atmosphere, testimony by Treasury officials will certainly not suffice. It remains to be seen whether even a strong public presidential plea could sway minds.

## Work Cited

Reagan, Ronald. 1983 (speech given at the Annual Meetings of IMF and World Bank Governors, September 27). *Summary Proceedings*. IMF. Pages 4-5.