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IMF REFORM: AN AGENDA FOR THE G20 SUMMIT

THOMAS A. BERNES

KEY POINTS

- The G20 should state unequivocally that they will implement their prior commitments on IMF quotas, SDR allocations and putting in place the strengthened New Arrangements to Borrow.
- The leaders should confirm the October 23 finance ministers' agreement in principle to undertake further reforms on quotas and executive board seats as an essential first step toward rectifying the unbalanced representation of emerging markets and many other countries.
- The leaders should start to address the fundamental governance issues of institutional oversight, the role of the executive board and the IMF's relationship to the G20.

The global financial crisis coincided with and was preceded in some degree by a legitimacy and governance crisis in the International Monetary Fund (IMF). The G20 leaders need to address this crisis or it will fester again.

The G20 has described itself as the premier forum for international economic cooperation. The IMF sees itself as the premier institution for international economic cooperation. What is the difference between them? The G20 was born out of the recognition that the G7 industrialized countries no longer reflect economic reality. The G20 is a self-appointed informal group with no permanent secretariat or legal framework. By contrast, the IMF is a treaty-based formal organization with a membership of 187 countries that have obligations to it.

In the period before the financial crisis, a debate was already under way about the future role of the IMF. Many observers saw the IMF as ineffective and lacking in even-handedness, in part due to the role that the G7 countries played behind closed doors, and in part because most of the IMF's membership felt they had no say in its management and policy work. G7 countries regarded the IMF as not particularly relevant to their economies (an irony, in retrospect, given the origins of the global financial crisis), while they saw a role for the Fund supporting the emerging markets. The emerging economies, on the other hand, saw the Fund as biased and questioned its policy advice. There was no agreement on what the role of the IMF should be.

Since the global financial crisis broke in 2008, the two groups with the least amount of time for the IMF — the emerging markets and the G7 countries — have been working together in the G20, which became the principal coordinating body, whereas the IMF has simply implemented what it has been asked to do. We have seen through the G20-led "mutual assessment process" to promote macro-economic cooperation that, due to the tensions around its role and even-handedness, the Fund's role has been limited to that of a technical adviser. Where, then, does this leave the IMF as an institution, and where does it leave the countries outside the G20?

Thomas A. Bernes is executive director of CIGI and a former director of the IMF's Independent Evaluation Office (2005–2009).

In 2008, two reports — one by the IMF's Independent Evaluation Office[1] and another[2] by the Committee on IMF Governance Reform chaired by Trevor Manuel, then South Africa's finance minister — strongly identified the challenges of effectiveness, efficiency and legitimacy facing the IMF.

Dominating the debates have been the issues of quotas[3] (country shares) and representation on the IMF's executive board (chairs or seats).[4] On quotas, there was agreement two and a half years ago to bring about a 2.5 percent shift to dynamic emerging market and under-represented countries, and a subsequent agreement in principle on a further 5 percent shift, but with no agreement on distribution. Even the 2.5 percent shift has not been implemented because the required legislation has not been passed in the individual countries.

Europeans currently hold one-third of the seats on the executive board, but given that Europeans represent far less than one-third of the membership, this clearly is an issue to be addressed. On both quotas and chairs, it is obvious to most observers that the current situation is inequitable and seriously undermines the legitimacy of, and support for, the IMF. It is time for this situation to be changed.

At the meeting of the G20 finance ministers on October 23 in Gyeongju, Korea, agreement was reached in principle to further adjust quotas (by 6 percent) and chairs (with Europe giving up two seats), with details to be worked out by 2012.[5] Assuming the details will be worked out successfully (not a given), one has to question whether this is too little, too late. Europe will still retain six seats (25 percent of the board) and many observers have questioned whether a board of 24 can ever be effective. A truly historic agreement will need to go much further, and this papering over may simply make the current unpalatable situation only slightly less so.

Even if these long-standing issues can be resolved, not much is likely to change unless there is a clear and widely shared view on the role and functioning of the Fund. It is the absence of such agreement that makes the current stalemate so tolerable — countries are unwilling to make the necessary political choices because it is unclear why they should do so.

What can be done, particularly at the upcoming Seoul summit? The G20 needs to:

- State unequivocally that its member countries will implement what was previously agreed to concerning putting in place the new NAB, quotas and SDR allocations;
- Confirm the agreement in principle of the G20 finance ministers on further quota reform and on executive board representation, but only as a first step on truly reforming the board — this is a sine qua non for addressing current perceptions about the unbalanced representation of many emerging and other countries at the IMF; and
- Start to address the broader, more fundamental governance issues of institutional oversight, including whether to have a ministerial council, whether G20 finance ministers should constitute this body and determining the role of the executive board — what reforms are necessary to make it much more effective in holding management and staff accountable, rather than being marginalized as is now the case.

This is the agenda required of the G20 going forward if it is to clarify the role of the IMF and its relationship to it. Countries must decide what role they want the IMF to play. It can be done, but some tough decisions will be required.

ENDNOTES

1 See "Governance of the IMF: An Evaluation." Available at: www.ieo-imf.org/eval/complete/eval_05212008.html.

2 Available at: www.imf.org/external/np/omd/2009/govref/032409.pdf.

3 A member's quota determines the amount of its subscription, voting weight, access to IMF financing and allocation of Special Drawing Rights (SDR).

4 The IMF's executive board is composed of 24 directors and the managing director, who serves as its chair. Five (US, Japan, Germany, France and Britain) of the 24 directors are appointed, and the rest are elected by member countries or by groups of countries. Available at: www.imf.org/external/np/sec/memdir/eds.htm.

5 See "Communiqué" at: http://online.wsj.com/public/resources/documents/g20communique20101023.pdf.