Analysis: Stalled IMF reforms could leave Fund on shaky ground

Wed, Oct 2 2013

By Anna Yukhananov

WASHINGTON (Reuters) - Delays in ratifying historic changes to give emerging markets more power at the International Monetary Fund have threatened the lender's credibility and raised questions about its future funding and governance structure.

The IMF's board agreed nearly three years ago to reforms aimed at giving emerging markets a greater say in the global lender, in part by making China the third-largest member and cutting Europe's representation on the board.

But the changes have been held up by the lack of approval from the United States, the fund's biggest and most powerful member, and prospects for action before year-end are slim.

The U.S. Congress has to sign off on shifting $63 billion from an IMF crisis fund to the Fund's general accounts to ratify the agreement. But some Republicans view that as tantamount to approving fresh funding in a tight budget year, and the request has taken a back seat to more urgent issues.

Emerging market nations will likely vent frustration at the lack of action when top finance officials meet next week for the annual meetings of the IMF and World Bank, peeved that their growing economic power is not recognized.

"I think there's a legitimate sense of frustration that the advanced economies made commitments and don't seem to live up to them," said former IMF official Eswar Prasad, a trade policy professor at Cornell University.

OLD STRUCTURES, NEW WORLD

Developing nations have longed viewed the IMF with suspicion for promoting disastrous privatizations that complicated the transition from communism for some emerging nations in the early 1990s, and for pushing budget cuts that exacerbated debt crises in Asia and Latin America a few years later.

That suspicion has been compounded by a power structure that dates to the Fund's founding in 1944 in the wake of World War Two. The structure was shaped by the victors of the war - the United States and Europe.

The IMF is based in Washington and is traditionally headed by a European. Under the current formula for apportioning voting power in the fund, the Netherlands' vote outweighs Brazil's, which last year had an economy nearly three times as large.

Over the past decade, the IMF has tried to rebuild its credibility with emerging markets. It has been forceful in giving policy advice to Europe, put more of an emphasis on protecting vulnerable parts of society and softened some of its prior dogmas on austerity and capital controls.

The reform of the IMF quotas, or voting shares, is part of that process. The quotas determine how much each country contributes to the IMF and how much it may borrow.

As part of the agreed reforms, emerging markets are also due to get more representation on the IMF's 24-member board, where critics say Europe is over-represented, with eight seats.

"Emerging economies are feeling a little bit betrayed by the lack of ratification of the reform package, which they saw as a base to nurture new relations with the IMF," said former Fund board member Domenico Lombardi, now with the Canada-based Centre for International Governance Innovation.

A CAPTURED IMF?

Despite its efforts to be a tougher task master for rich nations, the IMF is still viewed as giving special treatment to advanced economies. Greece was allowed to borrow 3,200 percent of its quota when it was bailed out in 2010, more than five times what countries can normally borrow. The IMF argued that a debt default in Greece could have sparked a wider crisis.

"The implication of this (delay) is that the emerging markets are still going to see the major international financial institutions as essentially being subject to political capture by the major advanced economies," Cornell's Prasad said.

The lack of progress could add more impetus to the creation of alternative sources of aid, such as a proposed $100 billion fund by the so-called BRICS nations -- Brazil, Russia, India, China and South Africa -- that is aimed at steadying currency markets. The BRICS are also working on a development bank to rival the World Bank.

Several countries expressed frustration about the reform delays ahead of a summit of the Group of 20 nations in September.

Russian Foreign Minister Sergei Lavrov said the reforms were needed to democratize the international monetary and financial system. "BRICS countries should unite to see that the G20 implements what is has agreed on," Lavrov said.

Emerging nations, which had hoped talks on a second round of quota reforms would have advanced by now, have been left waiting for the United States to act.

In January, Paulo Nogueira Batista, IMF executive director for Brazil and 10 other countries, said the Fund was approaching a "credibility cliff."

This week, he again called for action. "Without this rebalancing, the institution will not be able to retain its centrality in the world economy in the years to come," he said.

TEMPORARY CASH

The BRICS fund is unlikely to be functional for some time, as technical details must still be hammered out and the fund must be ratified by each country's parliament.

The slow process has prompted several IMF board members to question the BRICS fund as a credible alternative. They view it as akin to the Chiang Mai Initiative, a currency swap arrangement among several Asian countries that began in 2000 and has still not attracted a single customer.

"The BRICS as an acronym is far more compelling than the BRICS in practice," said Douglas Rediker, U.S. representative on the IMF's executive board until last year.

Some IMF board members have expressed concern in private that the lack of progress on reforms is weakening the basis for IMF funding.

Along with giving emerging markets a bigger slice of the pie, the 2010 reforms increased the pie's size, doubling total IMF quotas to about $730 billion. But with the reforms in limbo, so is the IMF's increased financial firepower.

This has led the Fund to rely increasingly on the so-called New Arrangements to Borrow, a temporary credit line from 26 countries set up in 1994 that allows it to borrow additional money outside the quotas in the event of a crisis.

This fund swollen ten-fold to about $568 billion from 38 contributors in the wake of the global financial crisis. In addition, 21 countries have given a total of $378 billion in bilateral loans to help the IMF deal with Europe's debt crisis.

These funds are meant as a temporary supplement, but the IMF has been forced to rely more heavily on them. That, in turn, has raised broader governance concerns.

Countries that lent to the IMF may seek to circumvent the traditional board and quota-based structure, which give all nations a say, to get their voices heard through more informal channels, such as phone calls directly to top IMF officials, said Rediker, now a visiting fellow with the Peterson Institute in Washington.

But he sees little alternative to the quota-based system.

"The other means by which you would govern the institution would be very cumbersome, would be very hard-fought, and could be very dangerous," he said.

(Additional reporting by Douglas Busvine in Moscow; Editing by Tim Ahmann and Dan Grebler)