

No more tinkering at the IMF

ECONOMISTS' FORUM

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The worldwide financial crisis has shown how globalisation has linked together the fates of economies round the globe.

The benefits of multilateralism on economic matters have become evident. But so has the potential for globalisation to cause collateral damage. Even as the G7 leading industrialised economies pull back from the edge of the precipice, many emerging markets are at risk of tipping over.

This time of crisis should be the perfect opportunity for the International Monetary Fund to get its groove back. A strong multilateral institution with teeth is essential to promote international financial stability. But it will take radical changes for the IMF to fill that role. Otherwise, it may find itself at the margins of the changing world economic order and its importance fading, especially when better times return.

The IMF faces two big problems. First, its capital base is small relative to the size of global capital flows, reducing its influence. A lending capacity of \$250bn does not amount to much in a world of \$700bn bail-outs and cross-border capital flows amounting to trillions of dollars. It is not easy for the IMF to raise capital – the begging bowl has to be taken round to all member countries. One recalcitrant member such as the US can block the whole plan.

Second, the IMF has a credibility problem. It is seen as mostly taking orders from the US. The voting structure gives the US, which has a 17 per cent share, a veto over decisions that require an 85 per cent supermajority. Meanwhile, even large emerging economies such as China and India have modest shares of 3.5 per cent and 2 per cent respectively. But “governance” reforms to set right such imbalances have been painfully slow as redistribution of voting rights is a zero sum game.

Here are two ideas that, together, would increase the IMF’s capital and strengthen its role in overseeing the global economy and financial system, not just in bad times but in good.

First, proportionately shrink the voting share of existing members by 20 per cent, so the current structure accounts for 80 per cent of total voting rights. Then, auction off to sovereign governments the remaining 20 per cent, with two provisos: no country can more than double its present quota or have more than a 14.9 per cent share.

Isn’t this tantamount to selling off the IMF? Yes, economically more powerful countries would presumably pay more

and have a larger say in the IMF’s policies. But this is exactly the way the IMF was set up – with voting rights determined by economic factors rather than a one-country-one-vote principle. Moreover, the auction could entice sovereign wealth funds to contribute to the global pool of capital by offering them a safe and liquid investment opportunity with a decent yield. There aren’t many opportunities for wealth funds flush with cash, so this should provide a nice boost to the IMF’s capital.

Won’t the auction increase the imbalance of global economic power, with China and the Gulf states buying up more influence at the IMF to push their agendas? Here’s a news flash – they are already financing poorer countries, often surreptitiously and as part of Faustian bargains that may not serve the long-term interests of the recipient countries. It is far better to have transfers channelled through an open forum such as the IMF.

The second idea is to impose conditions on voting rights rather than just on loans. Each country would get a list of criteria (for example, a lower budget deficit, a more flexible exchange rate) that it would have to fulfil or have a plan for making progress towards. The IMF already jawbones its member countries but only countries that borrow from it take its recommendations seriously. The large countries routinely ignore the IMF’s advice with no consequences. Economic decisions are ultimately the result of each country’s political process but why should poorer countries be subject to harsher IMF scrutiny? After all, US or Chinese economic mismanagement can have much larger global consequences. Bringing country officials together to discuss co-ordination to forestall crises is useful but talk is cheap and the IMF needs levers to get all countries to follow through with action.

Conditionality on voting rights might make the IMF despised but that is a price worth paying for being seen as an impartial institution that doesn’t just pick on emerging markets and small states. What’s needed is to get incentives right and let a market mechanism achieve an efficient solution. Governments that take the IMF’s advice more seriously and contribute more to its capital should have a bigger role in fashioning its policies. It is time for an overhaul rather than fiddling at the margins. This, after all, is what the IMF tells its members about their economic policies.

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