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IMF's Governance Reform in the Shadow of Current-accounts Balance Debate

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Meeting in Gyeongju, G-20 finance ministers and central bank governors achieved a compromise on a reform of the IMF's governance model, including a shift of decision-making powers towards the emerging and developing economies. While institutional reform constitutes a major breakthrough in a decades-long debate concerning the overrepresentation of industrialised countries, a lack of understanding in respect of current-account balances spoils the moment.

Governance Asymmetry. The need to reform the IMF's system of governance has been acknowledged by virtually all member states. So far the problem has to some extent been dealt with on an ad hoc basis: the IMF's Articles of Agreement stipulate that the Executive Board consists of 20 directors, but every two years the states agree to assign four additional directors by way of exception. It was thus that Saudi Arabia, China and Russia acquired their own executive directors not foreseen in the statute.

It has been commonly agreed that the industrialised countries, Europe in particular, are overrepresented in terms of the weighted-voting power and the number of representatives on the Executive Board, but no country has been prepared to surrender its privileged position. Earlier this year the United States adopted a very firm stance on the matter: playing for into the hands of the developing and emerging markets, the U.S. rejected a resolution to maintain the 24-seat Executive Board unless the Europeans were to agree to give up some of their posts. With no agreement reached by 1 November, the Board was to return to its statutory 20-seat composition. Given that the executive directors are elected within separate constituencies, that would have amounted to a loss of four directors for the already underrepresented states. U.S. blackmail meant putting the EU partners under considerable pressure, as they alone would have been blamed for worsening the unjust ratio.

On 23 October the ministers of finance and central bank governors met in Gyeongju, South Korea, to prepare an agenda for the G-20 summit in Seoul on 11 November. According to the official communiqué , the states reached an agreement on a set of institutional reform proposals that follow up on the arrangements of the 2009 G-20 summit in Pittsburgh. These include: (1) over 6% quota shift to underrepresented countries (while protecting the voting share of the poorest), which means a shift of balance in the weighted-voting system towards Brazil, China, India and Russia. Hence the accepted quota shift is even greater than the one foreseen under the Pittsburgh arrangements. This shall be formally accomplished by the IMF-World Bank Annual Meeting in October 2012; (2) enhancing the representation of emerging and developing economies through a comprehensive review of weighted voting by January 2013 and subsequent review of quotas by January 2014; (3) surrender of two European chairs to underrepresented states and possibly a second alternate for all multi-country constituencies; (4) introduction of an all-elected Board, along with states' commitment to maintain its 24-seat composition; (5) following the 14th General Review, prolongation of the Board's term from two to eight years.

It has also been agreed to double quotas, with a corresponding roll-back on the borrowing contribution (under the New Arrangement to Borrow, NAB).

Global Financial Management. States present at the Gyeongju meeting reiterated the recent developments in lending facilities, including a considerable increase in resources through General

Arrangements to Borrow (GAB) and New Arrangements to Borrow (NAB), which supplemented the quota subscription of member states. The IMF's financial assistance programmes have lately been reviewed as well to introduce procedural simplifications and a more lax approach towards conditionality[1].

A greater lending capacity, technical consultancy services provided to the member states and a more equitable distribution of power within the IMF's institutional framework are bound to enhance the Fund's international authority. The need to cooperate stems from an observation that states cannot achieve economically sustainable growth while acting in isolation. As the IMF is not entitled to apply financial sanctions, coordination of financial policies may be achieved through a peer review process and consultations. Readiness to undergo such a review depends upon confidence in the IMF's analytical potential and, more generally, in the policy endorsed, so the institutional reform seems indispensable to strengthen the IMF's status.

In terms of financial cooperation the outlook is somewhat uncertain. Growing tensions over exchange rate policies and accusations of alleged manipulation practices have been observed in recent months. In particular states with a significant foreign trade deficit and weak currencies, most importantly the U.S., have been exerting pressure on their commercial partners, such as China, Japan or Germany, to appreciate their currencies and thus harness the outflow of financial resources from the already highly indebted economies. States represented at the meeting declared their intention to adopt certain domestic policies, such as structural reforms enhancing sustainable global demand and increasing growth potential, or monetary policies preventing prices volatility; although important, these do not yield any surplus value when it comes to policy coordination.

As reads the communiqué, States expressed their readiness to implement "growth-friendly medium-term" fiscal consolidation plans, "mindful of the risks of synchronised adjustment on the global recovery and of the risks that failure to implement consolidation, where immediately necessary, would undermine confidence and growth". This is precisely the international context of domestic policies which calls for coordination measures.

To defuse international tensions, the U.S. called on the largest industrialized economies to cap current account imbalances (whether a surplus or a deficit) at a 4% share of domestic product. The idea gained the support of such countries as Great Britain, Canada and Brazil, but was not backed by Japan or Germany, which is hardly surprising. China did not formally weigh upon the matter. Eventually States declared their willingness to strengthen multilateral cooperation to promote external sustainability leading to a reduction of excessive imbalances and maintenance of current account imbalances at sustainable levels, yet no precise number on imbalances cap reflects a political deadlock.

Although the communiqué calls for the adoption of guidelines for a Mutual Assessment Process of large imbalances and the French finance minister declared that combating imbalances might become a goal during the French G-20 presidency, the adoption of any substantial decisions on the matter during the Seoul summit seems highly unlikely.

Institutional-financial Interplay. While the IMF announced a historic achievement, vaguely mentioning its dedication to strengthening multilateral cooperation in other respects, the majority of experts remained sceptical, reiterating that institutional reform only confirmed the split in terms of financial policies cooperation. Both approaches seem clearly one-sided.

The institutional reform cannot be reduced simply to mere window dressing. The emerging and developing markets have been calling for a readjustment of decision-making powers for decades, and it seems unlikely that the recent agreement reveals a sudden change of hearts of the EU and U.S. decision-makers. Also even though formal decisions were deferred until 2012, it seems politically impossible to go back on those promises now.

The communiqué's general terms and its lack of legally binding force make celebrations premature. It remains unclear, for instance, how the 24-seat composition of the Executive Board will be maintained (perhaps through Articles of Agreement amendment) or how the new constituencies will be constructed (the actual share of votes). Also the efficiency of the IMF's monitoring over accounts imbalances will largely depend upon the approach of the member states, which have historically been reluctant to cooperate. While the political motivation behind the reform and prospects for further cooperation within the IMF framework may raise concerns, the Breton Woods architecture is about to experience one of its most significant reconstructions.

[1] The Gyeongju Communiqué recalls in this context the establishment of the Precautionary Credit Line and enhanced availability of the Flexible Credit Line; on PCL and FCL see: M. Menkes, *International Monetary Fund Reviews Its Anti-Crisis Package*, *PISM Bulletin*, no. 118 (194), 20 September 2010.