Meeting Report
Asian Perspectives on the Future Role of the IMF

Frank Schroeder, FES New York

The International Monetary Fund (IMF) is facing an uphill battle in finding its future role in the international financial system. The crisis of the IMF's legitimacy among developing countries has led to less reliance on the Fund on policy advice and pressures are building on its prestige to serve as the guardian of financial stability in the world economy. In particular, the shift of political power is apparent in the assertiveness by which Asian governments are establishing regional financial cooperation and self-protecting mechanisms against potential future crisis. While these new mechanisms do not meet the requirements for a Regional Lender of Last Resort (RLLR) and are still linked to IMF programs, the question arises why the reform of the Fund is not a priority for many Asian governments? Is there complacency in the region about future financial crisis, due to overemphasis of liquidity in private markets, and do Asian countries have to take more responsibility in the current negotiations on IMF reform?

Against this background the Friedrich Ebert Foundation jointly organized with the Lee Kuan Yew School of Public Policy an expert meeting on "Asian perspectives on the future role of the IMF"; held on January 18, 2008 in Singapore. The meeting's objective was not only to give voice to the concerns of Asian governmental and non-governmental actors, but also to identify critical factors that are necessary to break the current stalemate on IMF reform in the Executive Board of the Fund. The event brought together a unique group of policy experts from governments, international institutions, civil society and academia and integrated the policy perspectives from low- as well as from middle-income developing countries. The discussion followed an unscripted and unrecorded dialogue (Chatham house rule) between 60 participants who were invited in their personal capacity.

This report serves a summary highlighting the conclusions and proposals put forward by the various speakers and participants. The reader should not treat the report in any way as a consensus text.

Regional Financial Cooperation in Asia

The Asian financial crisis and the sentiment that arose against the policy conditionalities attached to IMF rescue programs were clearly a catalyst for increased regional financial cooperation and many initiatives aimed at self-protecting mechanisms against future financial instability. Furthermore, the slow reform of the international system in general and particularly the limitations of multilateral official emergency lending are another reason why in Asia new arrangements have emerged. What had started as a vision for the creation of an Asian Monetary Fund is today characterized by a whole range of regional initiatives with the ASEAN+3 (ASEAN countries plus China, Japan and South Korea) framework as the main driver for financial cooperation. The sense of the discussion in the Singapore meeting was that there is currently still no relevant regional mechanism in place that could serve as a substitute for the lender of last resort function of the IMF and also, that progress so far has been too slow to overcome political impediments.

While the ASEAN+3 bilateral currency swap arrangements known as the Chiang Mai Initiative (CMI) represent the most advanced regional reserve pooling mechanism in Asia, it's actual size of $ 83 Billion is still limited. Any country in need of short-term liquidity would not only have to discuss activation with all swap-providing countries individually, moreover, any drawing above 20% of the committed fund would be placed under an IMF program. While the efficacy of the CMI in times of a liquidity crisis has not yet been tested, the lack of a permanent institution to manage the fund could have a negative impact on the response time in times of a future crisis. The ASEAN+3 countries have so far not been able to establish a more formalized and rigorous surveillance mechanism for the initiative, due to the lack of agreement on a legally binding framework for data provision and information sharing. Moreover, the existing surveillance program is seriously understaffed and the informality of the peer review affects the quality of analyses.

One reason for the slow process on regional financial cooperation in Asia is the lack of leadership in the region. There is no single country that is willing to provide a substantial amount of financial resources to further develop the regional initiatives and to provide a first step towards a reserve pooling mechanism that could meet the requirements for a Regional Lender of Last Resort (RLLR). In the ASEAN +3 framework, historical and political sensitivities between the three strongest economic players prevent any of these countries from taking on a leadership position. The cardinal principle of non-interference in East Asian cooperation and different levels of income and stages of economic development have made the process rather complex and would require more structural efforts to map out the future direction of financial cooperation.

Given that the Asian region is not in a position of independence from the IMF with respect to regional financing, it would be crucial for the Fund to focus more on the complementarity of regional and multilateral lending. The IMF could help the Asian region in developing its financing mechanisms through increased cooperation with regional forums and institutions to share information, research and policy advice, as well as technical assistance. This should also include support for the ASEAN+3 surveillance process through assistance in data provision.

Overcoming the Legitimacy Gap of the IMF

One of the major roles of the IMF is to bring about effective coordination of macroeconomic policies in the interest of global financial stability. Yet, the lack of adaptation of the IMF to the new realities in the global economy has severely undermined its ability to be up to the task. An overarching concern emerging from the Singapore Meeting was that of the IMF's legitimacy gap due to the current distribution of quotas which is viewed as not capturing the new economic dynamics in the world economy and in particular, deprives the Asian emerging market economies of their appropriate voice and voting rights in the Fund. As long as political rigidities concerning the status quo will not be tackled, the IMF will be at risk of becoming a "sunset institution". The Fund's lack of voice with regard to the subprime mortgage crisis in the United States, its muted response to global economic imbalances, as well as to the role of Sovereign Wealth Funds is raising further questions about the effectiveness of the IMF in encompassing the new dynamics in international financial markets.

Unless the legitimacy problems of the Fund will be reversed, Asian developing countries are unlikely to give priority to global solutions in support of international and regional financial stability. The perceived deficiency of political legitimacy, even in the post–Asian crisis global financial architecture, drives Asian countries to pursue self-protecting mechanisms and regional financial arrangements, such as the Bilateral Swap Arrangement under the Chiang Mai Initiative and the Asian Bond Market Initiative. The IMF could make a great contribution to the current challenges in the international financial system, but faces opposition from developing countries as long as decision-making rights are as imbalanced as they now are.

The economic landscape of the Asian region differs quite substantially today from the economic realities prior to the 1997/98 crisis. The region is financially highly integrated, holds more than 60% of the world's currency reserves and has been benefiting over the last years from robust world economic growth and ample liquidity in private markets. In these good times, Asia has been following the same approach as the developed countries by turning its back on the policy advice of the IMF and by refraining from its lending programs. However, there might be a problem of complacency in the region as evidenced by overemphasis of liquidity in good times and underestimation of the greater vulnerability of most developing countries to the vicissitudes of the global economy and business cycles. While the economic optimism in Asia might explain why the issue of IMF reform has not been a priority for most governments, this should not lead to the conclusion that the region is well prepared for future financial instabilities.

The paradox of the current debate on IMF reform is that while the public demands massive reforms, the membership of the institution has only debated decimal changes. The Fund might be well advised to establish new forms of cooperation with regional actors such as the Association of Southeast Asian Nations (ASEAN) and the Asian Development Bank (ADB). The IMF should better represent its core mandate in promoting global economic stability, by focusing on issues that are sensible for the whole membership of the organization. This should include:

- A rebalancing of the monitoring and surveillance role of the Fund

- Better IMF policy responses to the US subprime mortgage crisis and global economic imbalances

- Greater attention to supply side factors that contribute to the volatility of capital flows (e.g. Hedge Funds, Sovereign Wealth Funds, Rating Agencies)

In order to restore the credibility of the Fund the institution should carefully consider the views of all IMF member states, including domestic and regional concerns. The equal treatment of developing and advanced countries in the implementation of IMF policies would be an important benchmark, since the Fund's policy approach has been perceived as skewed towards the interests of the creditor countries of the organization.

Voice and Vote

In the 2006 IMF Annual Meetings in Singapore, member states decided on substantive reforms of the voting powers and governance structures of the Fund. The full implementation of the reform agenda will not only be crucial for restoring the legitimacy of the organization, but could also become key for the institutional survival of the Fund. In the Singapore expert meeting participants emphasized that there is a serious risk that the 2008 timetable will not be achieved.

The options that are currently under discussion in Washington for a new quota formula fall short of a meaningful transfer of shares between developed and developing countries. In order to allow for a realignment in voting power a 25-50% increase in the size of the Fund's total quotas would be necessary. The adjustment of the allocation of votes in order to adequately reflect the IMF member countries' economic weights and roles in the world economy should not be considered as a zero-sum game, since real reform will produce winners and losers. On the question of basic votes, reform would have to go clearly beyond a doubling of voting shares in order to safeguard the proportion of basic votes of low- income countries in total voting power.

The current reform efforts should also include changes to the composition of the Executive Board of the IMF. The hegemony of the European countries in occupying 8 of the 24 chairs in the organization could be reduced by modifying single country constituencies and by rearranging multi-country constituencies. A more equitable representation could be achieved by assigning member countries to constituencies according to their economic stage of development (LDCs, emerging market countries, transition economies and industrial countries). With respect to the selection mechanism for the Managing Director of the Fund a more open and transparent process would be required, since the Asian member countries are currently seeing no merit in nominating a candidate under the existing arrangements.

IMF Surveillance

The role of the IMF in surveillance of major economies and surveillance of developments in the international financial system are key tools of the Fund for crisis prevention and macroeconomic coordination in the global economy. The Singapore meeting concluded that IMF surveillance should not focus only on crisis-prone countries, but rather on the better management of the international monetary system. While the IMF is still the only institution where the developing countries have a voice on macroeconomic imbalances, a better conduct of the Fund is needed to take on the role as an honest broker in policy coordination between major economies and developing countries. Macroeconomic surveillance has to become more even-handed, so that the policy dialogue between member states can really lead to the necessary adjustments to tackle global imbalances and on market imperfections such as that revealed in the recent turbulences caused by the US subprime mortgage crisis.

The recent decision of the Executive Board of the IMF on Bilateral Surveillance over Member’s Policies against the opposition of developing countries, and in particular China, could weaken the reputation and supervisory role of the IMF. While the new surveillance framework puts exchange rate assessments at the center of IMF surveillance, the implementation of the concept of misalignments may not differentiate among countries in terms of their influence on systemic stability. Rather, it may impose undue pressure on developing and emerging economies, while failing to address the impact of key policy choices in developed countries, such as carry trades due to major interest rate differentials and the U.S. dollar policy.

In contrast to its role in the Asian crisis, the IMF has been extremely cautious and very unspecific in its policy recommendations concerning the subprime mortgage crisis that originated in the United States. While it has been argued that the IMF could have played a more active role in the in run-up to the market turbulence in mid-2007, the organization should now step up to the task to address regulatory gaps in the international financial system and convene dialogue among its member states on effective countermeasures to tackle potential and emerging issues in the future.

In contrast to the public perception in most Asian countries, the Article 4 consultations of the Fund with member states are considered a helpful instrument for structural reform. However, the effectiveness of this mechanism will ultimately depend on each country's willingness to adhere to the principles of multilateral cooperation. The ongoing reform of the surveillance process will therefore crucially depend on a legitimate process of governance and the ability of the Fund to convince, in particular, the major economies to undertake necessary policy adjustments that are in the interest of the whole membership of the organization.

Conclusion

There was a broad consensus in the Singapore consultation, that there exists no other organization that can match the resources, experience and best practices of that of the International Monetary Fund. The Asian region has a strong interest in financial stability, a well functioning global economy and an IMF that can provide global macroeconomic policy consistency. However, the adjustment of the allocation of votes in order to adequately reflect the IMF member countries' economic weights and roles in the world economy will be the crucial cornerstone for re-establishing the legitimacy and credibility of the organization. The political process for achieving this goal can not be considered as a zero-sum game and the Asian countries themselves have to take on a much bigger role and responsibility in the current negotiations on IMF reform.

While the Asian region is not in a position of independence from the IMF with respect to regional financing, and only a small number of countries in the region have established self-protecting mechanisms against future financial crisis, it would be crucial for the International Monetary Fund to focus more on the complementarity of regional and multilateral financing mechanisms. The IMF could assist through increased cooperation with regional forums and institutions by sharing information, research and policy advice, as well as by providing technical assistance for a more formalized regional surveillance mechanism.

The role of the IMF in surveillance of major economies and surveillance of developments in the international financial system are key tools of the Fund for crisis prevention and macroeconomic coordination in the global economy. Macroeconomic surveillance has to become more even-handed, so that the policy dialogue between member states can more effectively lead to the necessary adjustments to tackle global imbalances and market imperfections such as that revealed in the recent turbulences caused by the US subprime mortgage crisis.