

Copyright Information

From Newsweek International issues 2005 © 2005 [Newsweek, Inc.](#)

All rights reserved. Used by permission and protected by the copyright laws of the United States. The laws prohibit any copying, redistribution or retransmission of this material without express written permission from Newsweek.

Power To The Middle Guys

Future shocks: Emerging markets resent taking orders from the IMF. So let them invest their own reserves in better global governance, says the fund's former top economist.

By Kenneth Rogoff
Newsweek International

Issues 2005 - There has been a lot of rhetoric the last few years about how governance of the international financial system ought to be made more "democratic." Recent victims of emerging-market debt crises like Brazil, Turkey and Argentina are particularly peeved. They want more say over the conditions attached to vast bailout packages from the International Monetary Fund, the U.N.-family organization charged with helping to maintain global financial stability. To some extent the critics have a point. Whereas the Fund is not quite a "one dollar, one vote" organization, its governance structure certainly gives creditor nations a lot more say than borrowers. This perceived "democratic deficit" has increasingly become a serious challenge to the Fund's political legitimacy and its ability to effectively stabilize crisis situations.

Unfortunately, those who believe that the problem can be solved simply by reducing the rich countries' voting shares are either naive or hypocritical. In reality, global financial governance is a game where you have to put up money to have meaningful influence. Like it or not, right now the United States, Europe and Japan are the world's largest economies, and they put up the lion's share of the IMF's hard-currency backing. No superficial recalibration of voting power in the Fund is going to change the real balance of power. Any financial institution that doesn't worry about keeping its creditors happy isn't going to be sustainable. A purely redistributive Porto Alegre (home of the World Social Forum, where small and middle powers dominate) IMF is just not a viable alternative.

Perhaps, though, there is a better way. What if middle-income emerging-market countries assumed real power by putting up a much larger share of the capital needed to Fund each other's bailouts? Crazy, you say? Not really—not since 12 years ago, when the United States set off on a new borrowing rampage that has now reached a clip of \$600 billion per year. Courtesy of the United States' shopping spree, emerging-market central banks are awash in dollars, which they have been soaking up in part to keep their currencies from rising too much. China alone, with above \$400 billion in reserves, has more than enough to recapitalize the \$150 billion IMF twice over. Even Latin America, whose dollar reserves are dwarfed by Asia's and Russia's, could easily buy out Europe's shares in the Fund.

Now it may sound odd to have the middle-income countries actually pay for their own bailout insurance, but it isn't. In its original vision the Fund was more of a cooperative than a charity. Once upon a time, back in the 1960s, the IMF was bailing out rich countries like Britain, but that era is over. These days it doesn't have the money to bail out a United States or a Japan. Instead, it is middle-income countries like Brazil, Turkey, Russia and China that care the most about Fund bailout policies. So why not have them backstop each other?

The Chiang Mai Initiative during the late-1990s Asian debt crisis was very much in this spirit. The plan was to create a sort of intra-Asian IMF. It didn't work, and not just because of U.S. Treasury interference. You can't start a lending co-op when all your potential members are teetering near bankruptcy. Today, however, there are relatively few clouds on the short-term horizon in emerging markets, and all but a couple (e.g., Argentina, maybe Turkey) are quite solvent.

Besides, it's not that middle-income governments are earning such wonderful returns on their dollar investments. Most are held in U.S. dollar Treasuries that earn pitiful interest rates. These paltry returns are only going to look worse if the dollar collapses someday, as it may well under the strain of America's mounting deficits. International Monetary Fund credits—which are indexed to a basket of currencies and not just the dollar—seem like a good hedge, even factoring in the risk that countries like Argentina might never pay off IMF loans in full.

Would the big economies be willing to surrender some power? They should, even if global financial markets take time to adjust to a slightly smaller role for the dollar. Right-wingers in the G7 who gripe about spending taxpayer dollars to prop up spendthrift nations should be happy to shift the burden for bailouts to the beneficiaries. Sure, the rich countries might still end up having to bail out the system, but the risk of mismanagement would actually be lower than it is now. If one looks at the history of International Monetary Fund votes, no developing country ever seems to vote against a big bailout. Surely, however, such indiscriminate largesse would be cast aside if middle-income countries knew that their votes really counted, and that they were spending their own money.

Nor, once a crisis hits, would bailout policies necessarily be all that different. After all, the laws of economic gravity, not bungled International Monetary Fund crisis management, are what force spendthrift debtor countries into economic austerity. If a country that has been borrowing like crazy suddenly sees its credit dry up, it is going to be forced to tighten its belt—raise taxes or lower spending—with or without an international lender of last resort. Faced with the same economic calculus, and with their own money at stake, emerging markets would probably end up prescribing to each other policies very similar to what one sees today. Of course, with greater political legitimacy, the Fund's crisis leadership might be smoother and more credible, making crises shorter-lived and less painful.

Middle-income countries have been complaining for too long about the "Washington consensus" and their lack of power in global finance. Rich countries aren't happy about bailout costs. The solution is not to just give emerging markets a bigger voice, but to let them buy into the system.

Rogoff, the IMF's former chief economist, is professor of economics and Thomas D. Cabot Professor of Public Policy at Harvard University.

© 2005 Newsweek, Inc.

URL: <http://www.msnbc.msn.com/id/6994629/site/newsweek/from/RL.4/>