

## The World Still Needs the IMF

The organization is facing serious questions about its makeup, and its purpose.

By Kenneth Rogoff  
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Sept. 25, 2006 issue - As the international Monetary Fund holds its big fall meetings in Singapore this week, it faces a financial world that has been turned on its head. Traditionally, the Fund has helped out bankrupt emerging-market governments using loan money collected mainly from Western nations. But now, the Fund is being asked, in effect, to play a much broader role in helping maintain financial stability in a world where the lenders and creditors are trading places. With the United States borrowing two thirds of global net savings and Euro-zone countries like Italy, Greece and Portugal struggling to control their government finances—while emerging markets sit on mounting foreign-exchange reserves—many worry that ground zero for the next big global financial crisis could be somewhere in the wealthy West. Given that Asia now accounts for almost 40 percent of global income, and an even larger share of its surpluses, it makes no sense that IMF voting rights and leadership posts are still dominated by the United States and Europe.

At immediate issue in Singapore is a relatively modest proposal by the Fund's managing director, Spaniard Rodrigo Rato, that would give slightly more voting power to China, South Korea, Turkey and Mexico. But this proposal is just a stalking horse for a larger reshuffling that would acknowledge the seismic shifts in global income that have taken place since the International Monetary Fund was founded after World War II. For an institution that pretends to reflect countries' relative economic influence, it is simply untenable to have China, with 15 percent of global income, own only 2.9 percent of the Fund's voting shares.

But attempts to reallocate power in global financial governance are meeting stiff resistance. True, the all-important United States stands firmly on the side of change, perhaps hoping that a more empowered Asia will feel obliged to take a less nationalistic approach to economic policy. Europe, however, is resisting fiercely, especially small, rich nations such as Belgium, the Netherlands, and the Nordic countries. They see their outsize role in the Fund—each controls more votes than China—as a key affirmation of their continuing relevance in a growing world. Curiously Asia, which ought to see the enhancement of its Fund voting shares as a milestone, is deeply ambivalent.

Many Asians, fueled by polemicists who seek to blame the Fund for the region's late 1990s financial crisis, remain deeply hostile to the IMF. Rather than seek deeper involvement in the organization, some Asian leaders are arguing for a regional alternative that would pool the trillions of dollars their economies have accumulated over the past ten years by running massive trade surpluses with the rest of the world.

Perhaps the biggest obstacle to reform are those who simply do not see the importance or urgency of revamping the IMF. Four years of rapid global growth have lulled many into thinking that the Fund is an anachronism, that nothing will ever go wrong. Sovereign debt markets, in particular, seem to have forgotten the spate of spectacular global debt crises that raced across the developing world only a short while ago. These include Mexico in 1994, South Korea, Indonesia and Thailand in 1997, Russia in 1998, and Brazil, Argentina and Turkey in the early 2000s. Each time, global financial stability stood on the brink, and each time the Fund helped orchestrate a global response, often pouring in billions of dollars in bridge loans out of its own resources.

Consider, for example, the Fund's risky and creative lending package to Brazil in August 2002, when markets were terrified that the impending election of leftist President Luiz Inácio Lula da Silva would induce Brazil to cast aside its newly stable macroeconomic policies. With market access suddenly freezing up and the country on the brink of default, the Fund stepped in with \$30 billion. The Fund's loan arguably helped avert a meltdown that

would have slammed global markets from Manila to Istanbul, and forestalled the benign period that emerging market economies have enjoyed the past few years.

Of course, not all of the Fund's programs have proved so successful. The most notable failure was Argentina in 2001, when the Fund was too slow to pull the plug even after it became obvious that the country was not willing to reform its finances in a way needed to avert default. In between these two diverse performances is the Asian crisis, where Fund intervention helped stave off default but not a deep recession. True, the root cause of the crisis was the Asian governments' attempts to rigidly peg their currencies to the dollar, even as they opened up their capital market to massive speculative flows. This was a recipe for catastrophe that I and a few other academic economists had been warning about for several years prior. The Fund, however, was too weak and inconsistent in its efforts to convince national authorities in Asia of the urgent need to adopt more sustainable policies.

For the Panglossians, who seem to hold sway now in sovereign debt markets where interest spreads are at or near record lows, all this is ancient history. Many investors have come to believe that today's newly prudent governments, backed up by newly improved monetary policies, will indeed ensure the world of at least a couple decades of financial-crisis-free living. Perhaps they are right. Maybe the world will one day look back on the sovereign debt crises of the 1980s and 1990s as mere growing pains on the path to global financial nirvana. Perhaps even today's massive U.S. current-account deficit of more than \$800 billion per year will prove a nonissue—just a reallocation of global assets, soon to be dwarfed by ever-expanding global capital markets.

If so, the rest of us may be losing sleep over prospective financial crises for nothing. But just in case, wouldn't it be a good idea to keep trying to improve the IMF, rather than to eviscerate it? Perhaps the biggest question facing the Fund today is how to assert greater influence over the big players like the United States and China, whose massive borrowing and lending activities pose risks no one can easily assess. Indeed, the Fund has already become quite outspoken in questioning China's rigid exchange-rate regime and budget deficits in the United States. But in Singapore, the finance ministers and central bankers who oversee the Fund must decide how far they are willing to go in assigning the Fund an enhanced role in surveillance of these economies, not to mention Europe's.

Speaking of Europe, one desperately needed reform is an immediate end to Europe's prerogative of choosing the Fund's leader. Although Europe's candidates have generally compared favorably with their counterparts at other international economic organizations, the practice is still a horrible anachronism. Even as the Fund board struggles over voting shares, it should immediately agree that the next managing director should be the best and most qualified candidate, regardless of nationality.

Will the Fund's leaders make any progress in Singapore on the institutions' governance and future direction? Let's hope so. In a world where global capital markets are now 10 times the size of the U.S. economy, we need a fully empowered multilateral financial institution, ready to mitigate the risk of future global financial crises, even if there is no way to completely avoid them.

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