Emerging Powers and IMF Reform: Where Multipolarity in the World Economy is Leading the Fund.

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Abstract: This paper examines the impact of increasing global economic multipolarity, reflected in the rising influence of emerging markets in global economic multilateralism, on IMF reform. We explore the extent to which the Fund's recent revival, as evident in commitments made at the G20 summits and in the governance reforms passed by the Fund's Executive Board in the Fall of 2010, is indicative of a multilateral consensus between emerging and status quo powers. Specifically, this consensus would imply a revival of a legitimate and effective IMF. We argue that the recent reforms passed by the Fund are certainly a reflection of increasing multipolarity in the global economy, but conclude that that the path to accommodating emerging powers is far from clear. In particular, the recent changes to the Fund's governing structure provide only a superficial enhancement of the Fund's legitimacy and effectiveness as an IFI. Indeed, the foundations of IMF reform remain fragile and hinge on whether the both the Fund's governance structure *and* its mandate, which are mutually constitutive, will ultimately be perceived as legitimate by emerging and status quo powers alike. Governance reforms are certainly an important part of this equation but internal reforms (those affecting its broader mandate and technical capacity), which affect the Fund's function as an independent and effective IFI, remain unsettled. To illustrate our case we evaluate the recent governance reforms and proposals, including quota share reallocations and the consolidation and reshuffling of seats at the Executive Board, as well as the recent proposal to expand and institutionalize the use of Special Drawing Rights. Based on recent surveys by the Fund's Independent Evaluation Office, we provide appraisal of the ways in which both the emerging and advanced countries view the Fund and conclude by discussing some limitations in our analysis.

This paper examines a recurring theme in the debate surrounding international financial institutions (IFIs): the ability of the IMF to be perceived as a legitimate and effective institution by its members. We focus specifically on its powerful emerging market members, or emerging 'powers' as they are increasingly being called. Since the global financial crisis, we have seen a revival of multilateralism at the global level.

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Today, it appears that a financial crisis of global proportions seems to have provoked a truly global response. While regional monetary arrangements like the Chiang Mai Initiative in East Asia have failed to produce financial rescue packages in their respective domains, economic multilateralism appear to flourish. The IMF, in particular, has come out on top, with a renewed mandate and resources from the Group of Twenty (G20) club of advanced and emerging economies to provide financially stressed countries with balance of payments financing. Moreover, on November 5, 2010, the International Monetary Fund (IMF or Fund) agreed to a doubling of members' quotas a large realignment of quota shares toward emerging powers, ending a decade-long stalemate on the debate surrounding the Fund's governance structure. Thus, it may be tempting to conclude that the crisis has effectively revived the once ailing IMF and restored its fading legitimacy. In this paper, we aim to explore the extent to which the Fund's recent revival is indicative of an emerging multipolar bargain between emerging and status quo powers and whether this bargain restores Fund's legitimacy and effectiveness as an international financial institution (IFI). To put it another way: do the recent IMF reforms and reform proposals satisfy the ascent of emerging powers in the global economy and do these reforms, thereby, make the Fund a more legitimate and effective IFI? Notwithstanding the significance of other actors to the debate surrounding IMF reform (namely, the low-income developing countries), we limit our analysis to the interaction between emerging and advanced economies—those that have the most influence over how the Fund distributes loans and carries out its surveillance functions.

It has been suggested shortly before the global financial crisis that the Fund reached a milestone of insignificance or even obscurity.[1] We examine how the decline of IMF legitimacy in the last decade has seen a reverse via the G20 commitments of enhanced resources and (recently enacted) governance reforms, and whether these commitments reconstitute the Fund to the prideful place it once held in the international financial architecture. We then outline the recent development with respect to governance reforms, including the recently implemented quota and voice reforms and discussions surrounding the Fund's Board of Governors. A great volume of literature has been devoted to proposing advocating governance reforms that would make for a more legitimate and representative IMF, including rebalancing Executive Board votes toward emerging powers, changing the operative logic and size of the executive board, and shrinking European representation therein.[2] We show how recent implemented reforms fit with these proposals and what this means for enhancing IMF legitimacy. Next, we explore the proposals for making the IMF a more responsive IFI through expanding the use of the Fund's Special Drawing Rights (SDRs). The proposed expansion is a relatively novel but potentially the most far-reaching reform proposal affecting the Fund's effectiveness in global monetary governance.[3] Lastly, drawing on new survey data

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[1] Eric Helleiner and Bessma Momani, "Slipping Into Obscurity? Crisis and Reform at the IMF," Centre for International Governance Innovation, *Working Paper No. 16* (2007); Leonard Seabrooke, "Legitimacy Gaps in the World Economy: Explaining the Sources of the IMF's Legitimacy Crisis," *International Politics* 44, No. 2/3 (2007): 250–68. Similarly, just as the crisis was beginning to unfold, some were quick to point out a significant contrast between the IFI's leading role in the East Asian and Argentine crises and the recent crisis. See Mark Beeson and Andre Broome, "Watching from the Sidelines? The Decline of the IMF's Crisis Management Role," *Contemporary Politics* 14, No. 4 (2008): 393-409.
[2] Ariel Buira, "A new voting structure for the IMF" (Washington, DC: Group of 24, 2002) http://www.g24.org/newvotig.pdf; Edwin M. Truman (Ed.), *Reforming the IMF for the 21st century* (Washington, DC: Institute for International Economics, 2006); Ngaire Woods and Domenico Lombardi, "Uneven patterns of governance: How developing countries are represented in the IMF," *Review of International Political Economy* 13, No. 3 (2006): 480-515.
[3] Eric Helleiner, "The Politics of the New Global Reserve System," *Journal of Globalization and Development* 1, No. 2 (2010); Barry Eichengreen. *Out of the Box Thoughts About the International*

produced by the Fund's Independent Evaluation Office (IEO),[4] this paper also explores how the Fund is perceived by the two groups comprising its most powerful members: the advanced industrialized countries and the large emerging markets economies (the emerging powers in global finance). It has already been suggested that effective IMF surveillance along with other internal functions—such as the training, hiring, and professional predisposition of Fund staff members—are crucial components of the Fund's function as a legitimate and effective institution of global macroeconomic management, and thus must be reformed.[5] This fourth section of the paper will illustrate why this is crucial from the perspective of IMF lenders.

We argue that the recent IMF reforms and reform proposals are certainly a reflection of increasing multipolarity in the global economy, representing a significant culmination of efforts to give emerging powers a greater stake in the way that the Fund is governed. But we caution that it may be premature to infer from these reforms the restoration of Fund's legitimacy. In particular, the recent changes to the Fund's governance structure provide only a superficial enhancement to its legitimacy and effectiveness as an IFI. The foundations of IMF reform remain fragile and hinge on whether the Fund's governance structure *and* its mandate, which are correlated and not exclusive, will ultimately be perceived as legitimate by its most powerful members. Governance reforms are certainly an important part of this equation but internal (those affecting its broader mandate and technical capacity), which affect the Fund's function as

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Financial Architecture, IMF Working Paper WP/09/116, May (2009). www.imf.org/external/pubs/ft/wp/2009/wp09116.pdf.

[4] The IEO is an internal organ of the IMF, but it is an independent auditor of the Fund's activities.

[5] Andre Broome, "The Importance of Being Earnest: The IMF as a Reputational Intermediary," *New Political Economy* 13, No. 2 (2008): 125-151; Bessma Momani, "IMF Staff: Missing Link in Fund Reform Proposals," *Review of International Organizations* 2 (2007): 39-57.

an independent and effective IFI, remain unsettled. Unless these reforms are addressed, the IMF's global macroeconomic management role—its function as a 'ruthless truth-teller' and policy coordinator for weak and powerful member alike—will remain an ideal rather than fact.

1. What kind of IMF? The Legitimacy of an IFI

After the Argentine financial crisis and before the global financial crisis, the IMF had been declared all but completely irrelevant to managing the global financial order, manifest in the diminution of its operating budget (including very significant staff downsizing), the dwindling of its revenue from lending operations, a lack of legitimacy in the eyes of its key emerging market members in Asia and Latin America (traditionally, its most significant pool of borrowers), and lack of enthusiasm for the Fund's global economic governance role from key lenders like the United States.[6] Following the East Asian financial crisis in the late 1990s, the emerging markets economies of East Asia—some of whom later came to form a less than cohesive grouping, called 'emerging powers' by international relations literature—had decided that the Fund's policy advice was ill-conceived; that it reflected the ideational and policy goals of American policymakers rather than their own, and that it was unsuitable to their domestic economic contexts and their development strategies. As the crisis subsided, East Asian governments opted to insure themselves against future financial crises by building up foreign currency reserves, promptly paying back their IMF loans and refusing to turn to the Fund again for balance of payments financing. Other emerging markets like Russia in Eastern Europe and Brazil in Latin America also followed suit.

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[6] Eric Helleiner, "The Strange Story of Bush and the Argentine Debt Crisis," *Third World Quarterly* 26, No. 6 (2005): 951-969.

To be sure, the logic behind the self-insurance motive was not, at its core, a direct response to IMF advice (although this notion is a useful bargaining chip in pushing for more voting rights at the Fund). Past experience with financial crises, coupled with domestic political economy considerations, had led emerging markets to conclude that the level of their reserve ratios—that is, the international currency assets held by national central banks—did not meet their needs in responding to financial crisis and in mitigating the volatility of global capital markets more broadly. Indeed, the policy of accumulating large volumes of reserves was not unprecedented. Both Japan and Germany—formerly 'emerging' (or perhaps re-emerging) economies as well—employed similar tactics and continue to do so. Moreover, self-insurance cannot account for all the motivations for reserve-accumulations. Changes in exchanges rate-regimes, as well as trade-motivated factors have all been cited and debated as rationales behind the drive to accumulate reserves. For example, China is often accused in this regard of employing neo-mercantilist tactics in keeping its exchange rate low to gain export-oriented competitiveness. Some have pointed to a variety of other related economic and strategic motivations.[7] However, the IMF's role in the East Asian financial crisis did *contribute* to a marked re-orientation of macroeconomic policy among large emerging markets. Contrary to IMF advice, emerging market policymakers concluded that crises were exacerbated not by inadequate convergence to 'best-practices' in domestic financial market and banking structures (i.e. wrong microeconomic policies), but by a lack of adequate liquidity; by a lack of available lines of credit to cover balance of payments needs or to defend the domestic currency without having to draw on external credit.

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[7] See, for example, Gregory T. Chin, "Remaking the Architecture: the Emerging Powers, Self-Insuring and Regional Insulation." *International Affairs* 86, no. 3 (2010): 693-715.

Another key turnaround in IMF fortunes was an increase in hostility toward the Fund by conservative voices in the US leadership and legislature. Enthusiasm for the Fund's role in helping to steer the global financial architecture waned on the part of Washington under the Bush administration, as long-standing conservative reservations about the 'moral hazard' of financial rescue packages—those that proliferated both in East Asia and Latin America—asserted themselves in the White House and in the US Congress and Senate alike. By 2006, a cottage industry of reform proposals was developed by think tanks, independent evaluation offices, academics, central banks, world leaders, and the IMF itself to address the decline in its legitimacy. At that time, many emerging market economies developed macroeconomic indicators and policies and were able to turn to private capital markets and private commercial banks for their financing needs, further sidelining the IMF's role as lender of last resort.

When tremors in global capital markets reached crisis proportions in the second half of 2008, the IMF's role as an international lender of last resort was uncertain. The rise of China and the rest of the Goldman Sachs' study-designated 'BRIC' countries (Brazil, Russia, and India) had implied that the Group of Seven (G7) advanced industrialized countries could no longer steer a global policy consensus, and the IMF could hardly be seen as a vehicle for orchestrating a global rescue as such. But the Fund's fortunes shifted as multilateral responses to the crisis did eventually materialize. The organization was seemingly restored to its former glory by both the status quo powers of the G7 and their emerging power counterparts in the crisis-prompt Group of Twenty (G20) summit of leaders. In their London leaders' statement on 2 April 2009, the G20 leaders promised:

> …to treble resources available to the IMF to $750 billion, to support a new SDR

> allocation of $250 billion, […] to ensure $250 billion of support for trade finance, and to use the additional resources from agreed IMF gold sales for concessional finance for the poorest countries, constitute an additional $1.1 trillion programme of support to restore credit, growth and jobs in the world economy.[8]

Indeed, this sudden cascade of support for IMF lending and its operating budget came unexpected to many (including perhaps to the IMF staff itself), as the most powerful economic actors displayed a sudden appreciation for multilateralism, and for the IMF's role therein. Seemingly overnight, countries once again started to borrow from the Fund—not only developing countries, but the developed world as well; countries such as Iceland, Ukraine, Romania, Latvia, and Greece.

Nevertheless, closer examination of the details surrounding this reinvigoration of the Fund does not reveal a return to business as usual for the organization, nor does it signal a broad-based consensus among the states that provide the Fund with implicit and explicit support. Unlike the IMF of the 1990s, whose policy prescriptions, technical assistance, and lending conditionality were backed up by a relatively close-knit group of advanced industrialized countries (i.e. the G7), the IMF's mandate today rests on much shakier foundations. Beneath the surface of the appearance of solidarity among the G20 on the IMF's role in the global economy, the degree of support for the organization was relatively ambiguous. The new financing announced at Pittsburgh is not an expansion of the IMF's resources per se. Rather, it was largely a commitment to make available to a collective stream of credit lines (more than $600 billion) from various advanced and emerging economies, in the form of a crisis-contingent loan to the Fund (See appendix for the latest breakdown of the distribution to the IMF). Moreover, this lending was largely funneled through a facility known as the New Arrangements to Borrow (NAB).

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[8] G20, "The Global Plan for Recovery and Reform, 2 April, 2009," *G20.org* (2009). http://www.g20.org/pub_communiques.aspx. Accessed on 4 October, 2010.

The NAB does not provide the IMF with new permanent resources and, unlike the more significant General Agreement to Borrow (GAB), does not require a reshuffling of IMF voting rights based on contributions. Not surprisingly, the BRIC countries, along with other emerging economies, did not agree to participate in the NAB directly and only took part in lending to the Fund by agreeing to purchase the newly created IMF bonds, which was later rolled into the NAB as part of a further promise to redistribute IMF quotas away from advanced economies.[9]

To be sure, the recent realignment of quotas and voting shares (discussed in the next section), are certainly legitimacy-enhancing in this respect. But it should not obscure the fact that while the IMF was certainly the vehicle for coordinating lending to small emerging and developed economies, the multilateral response to the crisis was carried out through the informal channel of the G20; not through the formal institutionalized channels of the Fund itself. As such, we are currently witnessing, through the lens of IMF reform proposals, an attempt by the G7 to bring emerging powers into existing global governance structures. The G20 commitments show that the IMF has become an important bargaining chip between emerging and advanced economies as they try to address the problem of global macroeconomic coordination; the legitimacy of the Fund remains an uncertain and ambiguous issue.

What kind of IMF is emerging from the crisis? Borrowing a framework developed by Naigre Woods,[10] a useful way to understand the IMF's evolving role is to distinguish between its three competing roles, which include a Fund responsible to its borrowers (i.e.

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[9] For a more detailed discussion of the NAB and its role in the Pittsburgh summit contribution to the IMF see Woods, "Global Governance After the Financial Crisis," 2010.
[10] Naigre Woods, "Global Governance after the Financial Crisis: A New Multilateralism or the Last Gasp of the Great Powers?" *Global Policy* 1, no. 1 (2010): 51-63.

dependent on revenue from its lending operations); a Fund responsible to its lenders (wherein it is beholden to the wealthy members who lend it money); and an independent Fund (one that relies on its own resources and stands on its own mandate). As Woods, explains, the IMF is emerging from the crisis as a heavily lender-dependent institution, which takes away from its function as an independent IFI. As we explain below, this lack of independence is very much reflected in the reform process; not least, in the latest enacted reforms wherein most of the changes are set to increase the leverage of IMF lenders without any commitment to enhance the Fund's function as an institution independent of the immediate interests of global economic powers. In short, will the Fund assume a mandate independent of the G20's communiqués? Will it be able to provide effective surveillance functions and balance of payments lending without relying on informal bargain between emerging and advanced industrialized economies (which take place outside of the Fund itself)? The answers remain unclear. As the following sections will show, while the latest round of reforms may be a step in the right direction, it certainly does not guarantee a more legitimate and effective IFI.

2. Governance Reforms

The global financial crisis has certainly sparked a revival in the IMF reform process, and the speed with which governance reforms have been adopted has been a surprise to many. The G20 agreed in Pittsburgh in 2009, reiterated in Toronto in 2010, and detailed further in the finance ministers' meeting in Gyeongju, South Korea to adjust IMF quotas to better reflect members' contribution to the world economy. China and the remaining BRICs then proposed that the IMF transfer 7% of traditional powers' quota

share to the rising powers.[11] As a compromise, the negotiations leading up to the Pittsburgh G20 meeting instead produced a proposal to shift 5% of quota shares by January 2011. In this respect, the recent reforms adopted at the IMF annual meeting on November 5, 2010 are quite significant. The IMF Executive Board agreed to double its members' quota contribution and to realign the voting shares at the Board by 6 percent—an even compromise between the two proposals. The Fund promised this realignment in the form of a shift from "over-represented to underrepresented members," with "dynamic emerging market and developing countries,"[12] with Brazil, Russia, India, and China making significant gains at the Board. This does appear to be a major acquiescence in the demand of rising economic actors, putting an end to an almost decade-long debate on a key aspect of IMF reform.

However, it is important to approach this achievement with an air of caution. First, over half of the realignment in voting shares to emerging markets will come from various developing countries, with the voting share of advanced economies falling by only 2.6%. Emerging market member like South Africa and Argentina are actually losing rather than gaining shares.[13] Moreover, the purported rebalancing of quota shares at the Fund in order to better reflect member's position at the global economy (a legitimacy-based argument) remains fraught with caveats and contradictions. For instance, it remains a fact that if global economic significance is taken as a broad measuring stick for representation the United States is actually under-represented at the Board, as are most low-income countries. As such, the latest reshuffling of quota shares is more about

[11] *Reuters*, "China wants moves on IMF voting at G20- officials" (15 September 2009).
[12] International Monetary Fund, "Factsheet: IMF Quotas," (March 3, 2011). http://www.imf.org/external/np/exr/facts/quotas.htm
[13] The Brretton Woods Project, "Implementing IMF Governance Reforms: Baby Steps in Slow-Motion" (November 29, 2010). http://www.brettonwoodsproject.org/art-567219.

balancing the interests of IMF lenders than about broad based legitimacy, per se. To be sure, the claim of large emerging market lenders to have better representation at the institution is an important component of IMF reform; but it remains an insufficient (albeit necessary) component to enhancing the Fund's legitimacy and effectiveness as an IFI.

Further contributing to these outstanding issues is the size of the Executive Board itself. Bretton-Woods Institutions (BWI) designers have always intended to keep the size of the Fund Executive Board small in order for it to be effective. The IMF Executive Board is currently comprised of 24 seats, however only 20 seats are actually mandated by the IMF Articles of Agreement. The top strata of IMF Board seats go to the 5 appointed members with the largest quota share. Currently, the seats are occupied by United States, France, Britain, Germany, and Japan. While the Articles of Agreement mandate that the top five quota holders appoint five Executive Board seats, these appointed seats are actually 'on-loan,' as quota allocations are reviewed every five years. These quota reviews give members a chance to make their case for enhanced quotas and to potentially unseat other Executive Directors. Making the case, however, is a highly politicized process, regardless of the economic merits for change. Japan experienced this most clearly in 1970, when it finally unseated India and received a seat at the Board.

Since the start of reform discussions in Singapore 2006, and through the 2010 G20 summits, the Executive Board debate has centered on shuffling Board seats among the Fund's members. Most significantly, negotiations and discussions have centred on how to reallocate seats from European countries—who are in practice overrepresented at the Board with 8 chairs out of 24 seats—to the emerging powers. This remains a key, intractable issue of legitimacy in IMF reform. In recent years, the United States has

joined the BRIC countries to pressure Europe to decrease and consolidate its IMF representation. In August 2010, the United States publicly stated that it would use its de-facto veto power at the Board to ensure that the 24 seats would be reverted to the mandated 20 seats. In practice, this would have unseated Brazil, India, Argentina, and Rwanda, which hold the bottom 4 seats with the lowest amount of pooled quotas. Instead, Americans hoped that the Europeans would succumb to peer pressure at the Board and forgo its seats; eyes were particularly set on Belgium, Netherlands, and Denmark, all of whom represent a multi-constituency group at the Board.

The focus of reforming the Board as such has centred on consolidating quotas within the Eurozone. After all, the IMF is technically a monetary organization and European countries that share the euro currency should, by definition, only have one seat at the table. This, however, would put pressure on France, Germany and many other European countries to consolidate their seats, leave the United Kingdom (as a non-Eurozone member) seat untouched. To the benefit of the Europeans, this move would create one of the largest and most powerful single chair(s). However, the European project of centralization and consolidation of political and constitutional authority has hit a number of obstacles, and national authorities therefore remain sceptical of combining their IMF representation. In other words, the IMF reform process hinges, in part, on whether the European integration project can be made acceptable to the individual European domestic constituencies, who prefer to keep national authority and representation at the BWIs.

The Europeans have proposed in G20 summits to contribute an additional permanent $75 billion to the IMF lending facility in order to prevent a decrease in their

influence in the BWIs and to augment their voting strength to 35% of the total votes. Nevertheless, the BWIs system of weighted voting means that one country's gain in quota must correspond to another country's loss of quota. Because of this apparent zero-sum game, the Europeans are worried that the emerging markets' increased strength at the Board could result in a loss of their respective power. For example, if China were to increase its quota to reflect actually its GDP size, its rank as the world's second largest economy would then unseat both the British or the French at the Board. Recently, the G20 finance ministers agreed to keep Board composition to 24, while increasing emerging market economies' representation at the Executive Board by deleting two European chairs—most likely Belgium and Denmark But while the G20 members agreed to these reforms among themselves, the challenge will be to implement these changes and to put pressure on those set to lose from diminished power at the Fund, as the losing parties are not members of the G20. To this end, Belgian Finance Minister Didier Reynders stated that his country might be able to consolidate with the Netherlands but called for his state and other small EU states be given a place at the G20. Clearly, political bargaining and informal diplomacy on this issue will likely continue despite the apparent clarity of the G20 commitments

In short, the resolve of the BRICs and the United States to see a change in the IMF Executive Board composition through European consolidation continues to be tested and, as such, the latest stage of reforms by no means represents an end to governance reform debates. Perhaps more significantly, it should be noted that recent changes to the Executive Board do not represent the full range of governance proposals that have animated the IMF over the past decade and prior. Beyond governance reforms, it is

important to remember that the IMF's legitimacy deficit since the Argentine financial crisis stems not only the inadequacy of its representational structure, but from its perceived effectiveness as an international organization. Effectiveness does not simply imply imposing policy conditionality on borrowing members; it applies equally (at least in principle) to the IFI's ability to (1) be of use to, and (2) to have sway over, its powerful members. The recent proposal to institutionalize the Fund's management of global reserve assets via the expansion of the use of SDR applies to the first of these abilities. In the next section we examine the prospects and plausibility of this proposal.

3. Special Drawing Rights

While governance reforms create winners and losers no matter what the outcome, there is one significant reform proposal that promises to lift all boats: the proposal to effectively elevate the Fund to of something approaching a global central bank. That is, the reintroduction of the five-decades-old idea of an IMF-based substitution account. The idea calls for the widespread disbursal of an IMF-based accounting unit (already in existence but not widely utilized) called the Special Drawing Right (SDR), with the intention that countries would multilaterally manage their national currency reserves at the IMF. Indeed, traction on this proposal has already been made with the G20 commitment of $250 billion in SDR resources—a not insignificant start, but ultimately just a gesture with respect to the herculean task of effectively institutionalizing the use of this reserve currency at the global level.

The idea behind the SDR is quite simple but its implementation—its potential to supplant currencies like the dollar and the Euro in the reserves of national central banks—is unavoidably complex and fraught with political uncertainty. Much of the

renewed enthusiasm surrounding SDRs materialized as the global financial crisis raised the profile of the widening global imbalances in current and capital accounts, which resulted in part from the accumulation of currency reserves at the central banks of many large emerging countries, as well as advanced ones. As described above, whatever the motives of this accumulation (self-insurance, neo-mercantilism, or others), they had hitherto claimed the IMF as a victim, as the Fund found itself losing its most prolific borrowing clients. And whereas the imbalances are increasingly seen as a global problem of collective action, with the potential to provoke what the Brazilian finance minister in October 2010 called a global "currency war,"[14] the IMF is increasingly seen as a solution.

Many, but not all, of the reserve assets have been accrued in U.S. dollars, making diversification out of the currency by large dollar holders like China and Japan counterproductive, as such a decision would cause a sharp devaluation of their dollar portfolios. Recently, Chinese, Russian, Brazilian, as well as other policymakers, proposed that the IMF be used to help the world diversify out of U.S. dollars by issuing SDRs in exchange for dollars. Instead of depressing the value of the dollar, official holders could deposit their unwanted dollar assets in this special account at the IMF in exchange for SDR (which have nominal dollar, Euro, Yen, and sterling values). They would be credited with SDR-denominated certificates, which could principally be used at any time to finance balance-of-payment deficits, to conduct monetary policy, or in other transactions. These certificates could then be exchanged at the IMF or for any other

[14] See Ambrose Evans-Pritchard, "Capital Controls Eyed as Currency Wars Escalate," *The Daily Telegraph* (29 September 2010). http://www.telegraph.co.uk/finance/economics/8031203/Capital-controls-eyed-as-global-currency-wars-escalate.html.

currency, or be transferred to other countries with shortfalls in their national balance of payments.

Details notwithstanding, this is the simple part of the proposal. The difficult part is making it work for everyone involved. In principal, the proposal would allow countries to diversify their national reserve assets as they see fit. Indeed, large emerging markets stand to benefit from this proposal because of their overreliance on currencies that they have no direct control over. Nevertheless, monetary policy is never fully de-politicized even at the national level, and some outstanding questions will have to be worked out if countries are to allow the IMF to take on this unprecedented global role. Would SDR be issued through the approval of the Executive Board? At the present moment an 85 percent voting threshold is required to approve any and all issuances of SDR. Given the potential for politicization of Executive Board decision-making, it is not clear how efficient an effective an SDR-based monetary system will be. To what extent would an SDR-based monetary system allow the IMF to have discretion over the quantity and timing of reserve-currency issuance? In other words, will the IMF be able to issue SDR as a form of global monetary policy? This would effectively make the IMF into a world reserve bank akin to national central banks, but we are yet to see if IMF members would be willing to grant it this responsibility. Moreover, if SDR are to replace the dollar, they would need to comprise liquid financial markets of their own, and we are yet to see a willing actor take on the burden of creating such liquidity.[15]

[15] A move to create such markets on the part of a large emerging or status quo power would effectively constitute a real vote of confidence in the IMF. For a discussion on obstacles to the SDR proposal see, for example, Barry Eichengreen, "The dollar dilemma: the worlds top currency faces competition," *Foreign Affairs* 88, no. 5 (2009): 53-68.

These issues remain unresolved, and cannot be resolved until key IMF members agree to commit to strengthening global multilateralism through the Fund and to make good on this commitment by granting significant powers to the IFI. However, there are currently real obstacles to such a commitment; namely, the lack of influence that the IMF currently yields with policymakers in both emerging and advanced member countries. To be sure, the current enthusiasm for the SDR proposal seems to be reflected on both sides of the advanced-emerging country divide. But there are reasons to be skeptical that the major advanced and emerging powers would so eagerly allow the Fund to assume the independent role that such a scheme requires. In the end, such a role would entail that the BRICs and the G7 alike be willing to accept IMF appraisals of their economies—to fulfill a role of a 'ruthless truth teller,' as envisioned by one of its chief architects John Maynard Keynes.

4. An Effective IFI? The Fund's Interaction with Non-Borrowing Members

With respect to the second function of effectiveness mentioned above—the IMF's ability to have sway over its lenders—the outlook is no better. There is little evidence that the Fund has been an effective institution of 'ruthless truth telling' with respect to its most powerful members. And presently, there is little to suggest that the latest round of reforms will make a substantial impact in this area. Since the East Asian and Argentine financial crises the Fund's surveillance-based interaction with many large emerging economies declined in part because the latter perceived the former's technical advice to be flawed and biased against them. In addition, in recent years, it has become equally evident that advanced economies are equally unwilling to acquiesce in the Fund's independent surveillance practices and policy prescriptions. Currently, the IMF's ability

to 'name and shame' members that receive poor macroeconomic appraisals is very limited. Recent IEO evaluations have revealed that rather than valuing the IMF's key macroeconomic surveillance function, both the advanced and large emerging market economy (EME) members of the Fund have been rather unwilling to accept the Fund's evaluations and policy advice.

In principle, given the current status of reform, one might expect the IMF to be most closely aligned—strategically, and on policy issues—with large advanced economies and with large emerging markets. In fact, recent IEO surveys show the IMF staff-country official interactions were actually least effective between the IMF staff and advanced country officials. The surveys found that the staff's desire to avoid confronting or displeasing advanced country authorities was a clear obstacle to the Fund' independence as an international organization. The incentive to avoid 'speaking truth to power' was, the IEO also found, reinforced by the Fund management. Advanced economies simply did not see much value added in interacting with the Fund, and Fund staff, in turn, reported that the former only acquiesced in their advice when the advice was deemed favourable to existing national policies.[16] Given the traditional assessment of the IMF as an agent of large advanced countries' interests, these survey results are perhaps surprising. But given the IMF's declining legitimacy in the past decade, the results are broadly reflective of the reality that we outlined above: the Fund may be endowed with new resources and a new mandate to stabilize debt-stricken members, but the questions surrounding its perceived legitimacy are far from settled.

Not surprisingly, large emerging markets were classified as the second to least satisfied grouping in Fund staff-country official interactions. The main complaint from

[16] For a detailed outline of the results see IEO, *IMF Interaction with Member Countries*, IMF (2009).

this group was the lack of trust on the part of emerging country officials in the evenhandedness of the IMF staff's approach to surveillance activities. Namely, the general perception among large emerging economies was that surveillance was carried out in the interests of the largest IMF shareholders—namely, US and European countries. On the whole, as large emerging economies transferred to a surveillance-only relationship with the Fund in the 2000s, little value was attributed to the Fund's services.[17] The focus on IMF quota and vote reform could therefore be seen as a direct response to such perceptions. But more than giving a voice, the Fund needs to regain respect from emerging country authorities in conducting policy dialogue; surveillance activities, in particular, need to be seen as useful by the respective country authorities.

Until this happens, it is hard to see how the IMF could be considered to be an effective IFI. If its ability to extract policy concessions (e.g. naming and shaming) is only limited to weaker member—namely, the borrowing members—then its role as global macroeconomic policy coordinator cannot be considered fully adequate or legitimate. We are thus presented with a peculiar paradox: IMF reforms have focused striking a deal between them and advanced industrialized members, neither of which will be affected by the IFI's policies and neither appears ready or willing to grant the Fund an independent role vis-à-vis themselves. To be sure, the G20 has reinvigorated the IFIs and especially the IMF. With a renewed mandate, funding, and interest in reform, the G20 has placed a lot of faith the IMF. But without the kind of internal reforms that will renew Fund members' trust of the competence and necessity of technical advice and surveillance we could see the G20 more frequently assume the informal role of global macroeconomic manager, and sideline Fund to assume a secretariat role.

[17] For a detailed outline of the results see IEO, *IMF Interaction with Member Countries*.

Conclusions and Limitations

The IMF is yet to regain its once-privileged position in global economic governance. The recent round of reforms is certainly accommodating of the interests of emerging economies, and a reflection of increasing global multipolarity. In order for the Fund to become an influential and independent international financial institution, it must be seen to be legitimate by its most powerful members, and an important step has been taken in this direction. But even significant governance reforms, by themselves, are unlikely to accomplish this task; there needs to be a deliberate and concerted recognition and acceptance of the Fund's authority on macroeconomic policy coordination. And in this respect, the IMF reform process faces an even greater array of obstacles, not least of which are internal reforms to that would make the Fund's lending policies, mandate, and day-to-day activities more acceptable and authoritative to its members.

One of the limitations of our analysis is our focus is our explicit focus on large emerging economies. While the discussion of the Fund's relationship with low-income countries and small emerging markets, such as various South American countries and the European 'periphery', is beyond the scope of this paper, it is worth remembering that the Fund's borrowers are most strongly affected by the Fund's policies. At the same time, they are perhaps least represented in the reform process. The 1.1. Trillion in loans contributed to the institution by the G20, tied as it were to the recently-passed governance reforms, went to rescue struggling economies in Eastern Europe and East Asia. It remains to be seen what impact, if any, the rebalancing of power at the executive board will have on the policy prescriptions these countries have and will adopt in repaying these loans.

Similarly, while we explored the perceived effectiveness of IMF staff and emerging and advanced country officials in the area of IMF surveillance and technical advice, we have left out the views expressed by the low-income country members. The greatest irony of the reform process is that, according to the IEO surveys, this group cares most about the effectiveness and quality of Fund staff expertise. Indeed, the low-income countries are neither dismissive (as is the case with large emerging economies) nor indifferent (as is the case with advanced economies) about the dimensions of the Fund's policy advice. Yet, they remain in the background of much of the present discussion surrounding IMF reforms. Indeed, governance reforms at best have a muted effect on much of the Fund's borrowing members and at worse disadvantage them, especially when we take their technical *over*representation at the Executive Board. Now that significant governance reforms are out of the way, it is time for a greater discussion of how to reform the function and mandate of the organization.

Appendix

Breakdown of Lending Capacity
Funding Committed to the IMF, by Country

Country	**Amount Committed in US Dollars**
Japan	$100 Billion

European Union	$178 Billion
Norway	$4.5 Billion
Canada	$10 Billion
Switzerland	$10 Billion
United States	$100 Billion
Korea	At least $10 Billion
Australia	$5.7 Billion
Russia	Up to $10 Billion
China	Up to $50 Billion
Brazil	Up to $10 Billion
India	Up to $10 Billion
Singapore	$1.5 Billion
Chile	$1.6 Billion