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Reforming the International Economic Architecture

In 2006, Australia will host the annual meeting of the G20 – a group that could play a pivotal role in improving world economic governance. Will we seize the opportunity to push for substantive reform, or just "show them a good time?"

In the aftermath of the Asian Crisis of 1997-8, there were vigorous efforts to reshape a "new international economic architecture", much of it aimed at reforming the International Monetary Fund. Some progress was made, but momentum has been lost, leaving the task unfinished. What more needs to be done?

The Fund, set up to administer the fixed exchange rates of the post-WWII era (which ended in 1971), reinvented itself in ways that are still subject to disagreement: should it do *more* to police world exchange rates and international imbalances, or *less*, in a free-floating world where balance-of-payments crises are now confined to a tiny fraction of its membership? Are there areas (such as capital flows and international debt) which require more transparency and rules than exist at present? Should there be more vigorous efforts to promote uniform and consistent rules for international financial markets?

No-one is disputing the importance of a well-functioning IMF, least of all middle-ranking countries like Australia which have to operate in an increasingly globalised world, where the rules (Tom Friedman's "Golden Straitjacket") will be imposed on us all, whether we like it or not. Globalization has brought benefits and vulnerabilities, and we need good international governance, just as we need good governance at home. Good governance needs proper representation in the decision-making process, but there is a "democratic deficit" in the international financial architecture. The IMF has too much autonomy from its members at large, and the high-level decision-making is done by the G7 – which represents the immediate-post-WWII power-balance, rather than today's.

For Australia, the Fund's central weakness is its inadequate representation not just of us, but of East Asia, the region vital to our economic future. Leaving aside Japan and China, the rest of East Asia and Oceania has just two representatives out of 24-member Executive Board, where the important operational decisions are made (and the 1997 crisis was managed). Exacerbating this for Australia is the nature of the representation. Until recently, Australia sat at the Executive Board table, representing a "constituency" of Asian and Pacific nations. While some make a virtue out of this diverse constituency (arguing that it gives us a more balanced view), our voice at the executive table was inevitably fuzzed by the need to find a consensus between the views of doctrinally free-market New Zealand, dirigist Korea, and the community-oriented Pacific. To further mute our voice, the Executive Director role for this constituency has now passed to Korea. This contrasts with the dominant voices of the largest countries, and even with those homogeneous constituencies, such as the Nordic group. The European Union countries have more than 30 percent of the votes, compared with 13 percent for the ASEAN+3 countries (the ASEAN ten, plus China Japan and Korea). On the Fund's own quota formula, Asia (including Australia) should have 25 percent of the "quotas" (or more, if the formula was based on GDP), but has only 17 percent.

Nor can we bring influence to bear by moving up in the governance hierarchy of the Fund. In theory, the International Monetary and Finance Committee acts as a governing board for the Fund, determining broad strategy, but it meets only twice a year and the set speeches have all the analytical content and spontaneity of a lip-synced pop-song.

The results were clear to see in the Asian crisis. In the words of the Treasurer in Beijing a few weeks ago, the Fund and the World Bank "had not focused well on the nature of the vulnerability in East Asia (and) were not fast enough to respond to the crisis". The region was prevented from helping itself through the Japanese-sponsored Asian Monetary Fund, and was "short-changed" when it came to lending support. This reflected the absence of a regional champion: the US will always promote the interest of Latin America (Mexico, Argentina and Brazil), and Europe looks after contiguous countries. The result: two-thirds of the Fund's lending is outstanding to just three countries – Argentina, Brazil and Turkey. Of course the Fund learned much from the crisis and may do better next time. But the favoured treatment given to Argentina during the latest of its endemic crises shows that the bias remains.

The Fund governance inadequacies reflects a broader malaise. While the day-to-day operational issues are being worked out around the IMF Executive Board, the big issues are hammered out elsewhere, by the "big boys" at G7 (USA, UK, Germany, France, Italy, Japan and Canada). Their long-standing relationships determine the outcome of issues even before they come to be discussed in wider forums. To give just one example: whether or not it was a good idea for the Fund and World Bank to give debt relief to the poorest countries of Africa, Australia was not part of that decision, even though our funds are involved and there are countries of more concern to us who missed out - it was decided by the G7 at Gleneagles, who then took their decision to be rubber-stamped at the Washington meetings.

With our voice muted in Washington, and totally absent from the G7 discussions, is there any opportunity for Australia to address the "democratic deficit" in international economic architecture? Hosting the G20[1] meeting may provide that opportunity. Formed out of the Asian Crisis experience, it provided the best forum for discussion of the major world-wide issues identified in the Asian Crisis – volatile international capital flows. Its strength was the legitimacy that comes from appropriate representation, the lack of formality, and its ad hoc and non-bureaucratic processes (with single-purpose working groups formed to examine specific issues, disbanded as soon as the discussion was over). Having both the finance minister (treasurer) and the central bank governor as members brings a useful mix of politics and economics.

The Treasurer (speaking in the context of the recent G20 meeting in Beijing) said: "It is not the object of the G20 to replicate the work of the International Financial Institutions". In a narrow sense may be true. The problem, however, is that the G20 can't do the job we need it to do without taking away some power from the G7 and the IMF – it is precisely this mal-distribution of voice that makes the present position unsatisfactory for Australia. So the issue is not to replicate functions, but to *shift* them from existing groupings to ones which are more representative. Institutions characteristically do not cede power easily – we will have to fight hard to achieve this. But this is as good an opportunity as we will get. Rather than stake out some uncontroversial non-competing work for G20 to do, G20 should bid to take over some of the things currently being done in G7. It can then provide the sort of close governance that should be - but is not - provided by the Fund's own governance board, the IMFC.

If this strategy is to have any hope of success, the East Asian countries must do more to co-ordinate their views. The strength of the European position has been its ability to lobby and co-ordinate before it meets in these forums. So we should link our East Asian economic relationships firmly into the multilateral position. Now that we at least have a toe-hold in the Asian network (via the East Asia Summit - EAS), we should use it, with sensitivity (as befits a new member of a club), but playing our strong cards – our ability to function well in international forums - and form a bridge to the G7 countries. Getting G20's role on the agenda for the EAS would be a good place to start. As a reminder of the urgency of this issue, there is an alternative "reform" model on the table, in which India and China join the G7, reinforcing its dominance. That would be a poor outcome for us.

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[1] Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, UK, and USA.

All this is a big task, but not out of character with our past role in international affairs. We “punched above our weight” in the decades after WWII. We played an important role in the Bretton Woods conference that set up the International Monetary Fund and the World Bank; we have been a front-line combatant in the GAAT and its successor, the World Trade Organization (where we led the fight for a better deal for agricultural commodities in world trade); and we were a founding father of APEC. We were active members of the OECD, which played an important role in promoting our domestic reform agenda in the 1980s.

But where are we now? The current WTO negotiations at Doha are at an impasse, with trade officials putting more time into decidedly second-best bilateral trade agreements. APEC has lost its way, spreading itself thinly over so many issues as to have little or no impact. The OECD has diminished in status and importance. The current international architecture has put Australia in a pokey back room with no view.

We now have to think about these issues in a more hard-headed way. While-ever the Fund remains unable to reform its unrepresentative and dysfunctional governance, it doesn’t deserve to maintain its key role. If it is G7’s dominance that prevents reform, then we need to work towards creating the consensus to change the role of G7. Close links with our region – and a demonstrated capacity to work for the wider good of the region – will be the key to this. Hosting the next G20 meeting gives us the opportunity to make a powerful start. Will we take the risky path of trying for real reform, or the safe path of making sure there is a fat shrimp on the barbie and an Akubra for every delegate?

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