A case for reform

Stephen Grenville and Greg Maughan

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Any United Nations institution, purporting to represent the universality of the world, will have formidable challenges of governance, decision-making and reform capacity. The diversity of vested interests, cultural chasms and differing mind-sets ensures that the status quo is always the default option.

Functions are added in response to new problems, without old structures being stripped away. The International Monetary Fund showed a tenacious capacity to re-invent itself after the decline of its original purpose, and to broaden its mandate. It was created as part of the United Nations group of organisations. It was given the job of avoiding a repeat of the pre-war competitive devaluations (today a non-issue). Now it provides lender-of-last resort facilities to countries in balance of payments difficulties, offers technical assistance, develops and monitors rules for international financial transactions and policy, provides commentary on the world economy and implements surveillance of the economies of its 184 member countries.

There is a widely held appreciation that there has been mission-creep and that the time has come for trimming and refining the Fund's remit. Australia's interests (and those of our Asian neighbours) would be well served by active participation in that debate. The IMF has the same inherent governance problems that other UN institutions have - created out of the back end of a simpler post-war world, now well into a century characterised by emerging middle-class economies, new regional alliances, and crumbling ruins in once great superpowers.

In one sense, the IMF might have a better chance of defining a proper role because its mandate is narrow and more technical - to foster international flows of goods and capital by making international payments and finance work better. So the starting point for reform is to put aside the vexed issues of governance that dominate the debate (voting shares, selection of management, size of committees and so on), and focus on the technical functions the Fund should perform.

First, there is the traditional role of lending to help balance of payments problems. It seems most unlikely that any of the major industrial countries will draw on this facility again: floating exchange rates have removed this need. But financial globalisation has introduced a problem not present when the Fund was formed - large flows of international capital. There are 20 or 30 emerging countries, sufficiently integrated with international financial markets to receive large and volatile foreign capital flows, that may experience the same sort of capital reversals that affected Mexico in 1994 and East Asia in 1997. Just as domestic policy makers keep the instrument of lender-of-last resort to cope with systemic banking crises, the international world benefits from this kind of in extremis insurance and the IMF is well positioned to provide it. If it doesn't provide adequate crisis insurance of this type, vulnerable countries will attempt to provide self insurance through excessive foreign exchange holdings, which is inefficient. The large foreign exchange reserves built up by the East Asians (notably China) and the attempts to pool their reserves through regional arrangements reflect, in part, lack of confidence that the Fund will be there to help them if needed. But what should the Fund do about the chronic balance of payments problems of the poorer countries (by far the majority of membership)?

Under its policies, these countries are eligible for cheap loans and are subject to debt-forgiveness when these loans prove too great a burden. Is this the IMF's role - to act as an aid agency? What is the division of responsibility with the World Bank?

The Fund also provides technical assistance, basically on demand. Some of these reflect the Fund's accumulated skills and comparative advantage, but some could be better done by others - for example, the Fund provides central banking and monetary courses at its regional training institute in Singapore, in competition with the region's own central banking training centre in Kuala Lumpur. The IMF's deep pockets enable it to attract participants away from these other facilities. It conducts annual "missions" (the quasi-religious terminology is revealing) to assess how each of its member countries is performing. These may be resource-intensive overkill. Some argue that these examinations should be confined to the 20 or so systemically important countries, and that these should be the vehicle for far more intrusive and prescriptive pressure to adjust or co-ordinate policies (particularly those relating to the exchange rate). Others argue that the visits to developing countries are an important source of technical knowledge transfer. There may well be merit in both these arguments.

The visits to Australia, however, are a waste of time, not just for the Fund staff, but for the officials who interact with the mission. Even the Fund's managing director, Rodrigo de Rato, has called for a different style: "less cover-the-waterfront reporting on economies, more incisive analysis of specific weaknesses and distortions that risk crises and contagion or hinder adjustment to globalisation, and more active Fund engagement in policy debates that shape policy opinion and policy choice."

Finally, there is a function the Fund has tentatively explored, but could be enlarged. The globalised world needs rules to supplement and co-ordinate the national rules: how relationships should be governed when they are largely beyond the reach of any one sovereign government. The opportunities for beneficial international rule convergence are very wide - ranging from telecommunications to terrorism. The Fund's patch is international capital flows and the stability of the international financial system, and its particular speciality might be how to sort out the systemic problems that arise when volatile flows overwhelm the capacity of the market adjustment process. The Fund has come a long way in its thinking on this topic since the Asian crisis. Before the crisis, the general view was that capital flows were, like trade flows, a good thing that should be encouraged, and that the free market would sort it all out. The Asian crisis suggested that more structure was needed (including international debt resolution when things go wrong).

There has been too much emphasis by the Fund on macro-economics and too little on the micro-requirements for well-functioning capital markets and capital flows, especially in emerging economies. The attempts at rebuilding the "international architecture" after the Asian crisis showed just how hard this is to do. All 184 countries can't agree on much. The job, however, can't be left to the Fund's own staff.

In a recent lecture, former managing director Michel Camdessus left no doubt that self-managed reform of a largely self-satisfied organisation will result in an enlarged role and a bigger establishment. The debate is taking place among the Fund itself and the largest players - the G7 countries. It is inevitable that the biggest countries will dominate the discussion, but it might be possible to broaden the dialogue by shifting it into a more representative body. The G20 group (which Australia is hosting in Melbourne in November) might provide the opportunity. This group, formed during the Asia crisis, is small enough to provide a forum for serious debate, yet represents almost 80 per cent of the world in terms of gross domestic product. Australia should aim to have Fund reform as the major agenda item, not a mere formality. To succeed, we will need allies, and our interests will coincide with many others, especially our Asian neighbours. We should look for common ground (and coalition) among the dozen countries that are in the G20 but not part of the G7.

Here are some possible issues that might be explored: Like other medium-sized countries with strong global links, Australia should regard the Fund as vital in ensuring that the international economy works well, and this needs rules and an umpire. These rules tend to be made by the

biggest countries - principally the USA. We should be able to find allies in arguing that these rules should be drawn up and enforced in a more objective and universal way, and a well-functioning Fund will be a vital part of that process. The Fund has made a good start, with its codes and standards covering a variety of issues. But there is further to go: The Fund's quasi-aid function might belong more logically to the World Bank. No matter how the voting shares are divided, there is no permutation which gives Australia an effective voice in IMF governance. The interests of medium-sized countries would be better served by devolution of some of the Fund's functions to the G20, and by more emphasis on regional solutions where global answers are not necessary. The central idea should be subsidiarity - getting the decisions down to the smallest group possible and delegating rule-making to experts rather than fitting all issues into the procrustean bed of universality. The Fund has not been able to stake out any significant territory in international policy co-ordination. It has not, for example, had much impact on the debate on large international external imbalances. Its influence on the major countries' policies is small, and when the major countries want to get together to discuss international policies, the big players do this principally in the G7 grouping. When the big countries needed to do some serious international policy co-ordination, they did it in the Plaza and Louvre agreements, with the Fund a bystander. Rather than persist with the failed efforts to shift this debate to the Fund [as suggested by Camdessus], these debates should take place in the G20. Countries in the Asian region might note how the Fund's resources have gone disproportionately to countries with a clear "champion". Mexico in 1994 fared better than Thailand or Indonesia in 1997. So America's interests in Latin and Central America will be well looked after, as will Turkey and Eastern Europe (supported not only by the USA, but Europe). Asia is without such an effective champion, and was short-changed in the crisis of 1997-98.

The stultifying effect of universality constrains what can be done in many of the family of UN organisations. The opportunity exists to do better with the IMF, partly through internal reform, but also through devolution to other organisations. For the sake of its trading partners, its region and the efficient functioning of the international monetary system as a whole, Australia should seek to promote a more radical agenda, initially through the forthcoming G20 meeting. Australia is a minor player in the consideration of such issues, but if it can influence events towards fundamental reconsideration rather than further sluggish incrementalism, it will be to the benefit of the financial system as a whole (which, in turn, promotes specialisation, trade and wealth creation), and especially to our newly emerging trading partners.

Stephen Grenville is visiting fellow at the Lowy Institute for International Policy and a former deputy governor of the Reserve Bank of Australia. Greg Maughan is a former commonwealth Treasury official.