What G20 leaders must do to stabilise our economy and fix the financial system

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Reforming global economic and financial governance

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G20 leaders should focus on global governance and should boost the IMF’s financial firepower. Global financial coordination requires a broader group than the G7 or G20. The EU should get only one chair in the ‘G20+4’ to allow broader representation. The Secretariat for this group should be a reformed IMF. The IMF’s lending capacity should be immediately increased by allowing the Fund to leverage its member quotas at a ratio of between 5 and 10 to 1.

The central problem in fostering global economic dialogue is that it is currently a ‘dialogue of the deaf’.

- Industrial countries stopped requiring financing long ago; they now believe they are responsible global citizens, and guard their policy independence carefully. It seems they view the primary role of multilateral institutions as correcting the policy mistakes and the naked mercantilism of emerging markets, and – of course – providing aid to the very poor.

- Emerging markets feel they have come of age; they believe multilateral institutions follow an agenda set by the industrial countries, and don’t see why their own policies should be under scrutiny when industrial countries show scant regard for the multilateral institutions (other than to enforce their bidding).

- Developing countries, beset with their own problems, have little time or interest in a global agenda.

Unfortunately, global problems are mounting, and the problems are not just financial. The availability and pricing of resources is, as we have realised in recent years, of critical importance. Ideally, such resources would be produced and allocated by a free market to which everyone has access. Unfortunately government action distorts the market. Decisions by small groups of countries on issues ranging from promoting biofuels to restricting investment in, or production of, oil, have enormous impact. As other countries try and adopt strategies that shield themselves from resource shocks, everyone’s access to resources is impaired. Dialogue can help us reach a better global solution.

Similarly, even though the world may have learnt the dangers of beggar-thy-neighbour strategies in trade, echoes are still seen in cross-border investment. More barriers are being contemplated in industrial countries to investment from emerging markets. Old barriers, under the guise of promoting domestic stability and security, also exist – all this while emerging markets have historically been exhorted to reduce their barriers to investment, and in some cases are doing so. It is important that we start a global dialogue on the admissible rules of the game in cross-border investment.

Finally, global financial integration, while helpful, has increased the size of the
shocks that countries are subject to, especially when private capital seizes up. The size of resources available to multilateral institutions like the IMF has not kept pace with the size of potential shocks and the needs of large emerging markets.

**Key issues for the November 15th meeting**

In the interests of space, I will focus in what follows on

- Governance, and
- The availability of emergency finance.

Progress on these two fronts, initiated by the international conference in November 2008, would be enormously beneficial.

**Governance: A G20+ with only one seat for the EU nations**

There is clearly a need for better international economic dialogue, facilitated by an impartial secretariat that lays the issues on the table. There is merit in having only a few key participants so that there is dialogue and not a formulaic restatement of positions.

- The G-7 is probably too small and unrepresentative;
- The G-20 is probably at the limit of what might work, but unfortunately, is still unrepresentative.

More thought needs to be given to constituting a group consisting of all major countries, with some representation of smaller countries and regions through rotating seats, and some special invitees based on the relevance of the topic.

One change that would help make such a group feasible is to have a single seat for the EU. The non-EU countries in the G-20 plus the EU would make 16, to which could be added 4 countries on a rotating basis, or based on topic. Let us call this the G-20+ in what follows.

**A reformed IMF as the G20+ secretariat**

The obvious secretariat is the IMF. Unfortunately, the Fund suffers the burden of history, and its objectives and governance are still not sufficiently transparent so as to make it widely trusted by emerging markets. This hampers its functioning as an honest broker. Important reforms are needed at the Fund, including:

- Broadening its mandate beyond exchange rate surveillance, which tends to put only emerging markets under scrutiny;
- Making the Fund self-financing so that it does not have to keep going back to key shareholders (which effectively gives them a veto over Fund activities),
- Eliminating any country’s official veto power over major decisions,
- Making the choice of management transparent and nationality-neutral, and
- Allowing the Fund's agenda to be set by the more representative G-20+ described above.

Even while these changes are in train, there is merit in beefing up the Fund's global surveillance unit, and perhaps allowing it to report directly to the G-20+, and to the IMFC (International Monetary and Financial Committee), without its opinions being heavily edited and filtered by the Fund's Board of Governors. The Fund's multilateral
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surveillance should focus more sharply on emerging risks – this involves strengthening macro-financial analysis and early warning systems. Also the G-20+ should focus on the identification of remedies when serious risks are diagnosed – here early coordination with other policymaking and advisory agencies would help.

**Changed role for the IMF and World Bank Boards**

There is some merit in discussing whether there is any need for the Fund and the World Bank to continue to have permanent boards, an anachronism that dates from the time when distances were large and communication difficult. Those boards could be reconstituted much like the boards of corporations, with quarterly meetings, and a focus on broad governance rather than on management details. The mid-level functionaries who now are on the board could then be replaced by high-level deputies, who fly in for meetings, and would have a greater capacity to undertake dialogue.

Indeed, in times of crisis, the boards, consisting of high-level finance ministry deputies, could easily turn into crisis management teams that coordinate any collective response, much as the G-7 deputies do today.

**Financing firepower**

The IMF has an aggregate lending capacity of about $250 billion, probably sufficient if a number of small countries are in trouble, but insufficient if a couple of large countries face problems. If the multilateral system does not have adequate firepower, countries will have to rely on bilateral arrangements, with all the difficulties that it entails. It is not that resources are not available amongst emerging markets and industrial countries. The need is to find a way to pool them.

Such resources are needed to build confidence in emerging markets (the swap arrangements announced by the Fed with four emerging markets were a powerful and welcome signal to investors). Moreover, if we do nothing to address this issue, we will set up serious problems for the future. We will emerge from the crisis with many countries attempting to build reserves through export-led strategies and managed exchange rates, aggravating the demand imbalances that are at the heart of the current crisis.

**Incremental is insufficient**

The resources at the Fund’s command, disbursable through light-conditionality facilities like the new Short Term Liquidity Facility should be multiplied by an order of magnitude. One possibility is to expand the Fund’s arrangements to borrow from countries with large reserves, or from financial markets. In order to limit the liability of member countries, while at the same time bringing transparency to the process, the current quotas of member countries could be treated as the equity capital backing the borrowing. This is simply a formalisation of the loss-sharing arrangement that currently exists. At normal financial institution leverage ratios of 10 to 1, the Fund could borrow up to 10 times member quotas of $340 billion. Even if it maintains leverage at more conservative levels of 5 or 6 to 1, this will be a sizeable expansion of potential fund resources to about $2 trillion, enough to deal with most eventualities. Ideally, this capacity would never be tapped, but it is important to create it.
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