The Orderly Resolution of Financial Crises – A G20-Led Initiative

How could a Leaders' Level G20 make a difference?

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BRIEFING NOTE

Ngaire Woods

Program on International Economic Institutions

The IMF lies at the centre of multilateral responses to financial crises. The Fund in 2005 requires political leaders to equip it to deal much better with crises. The proposed L20 could play a key role in this regard. They could start with four clear objectives set out below.

My starting presumptions are that the Fund is not a `fix-it-all'. It should not be engaged in replicating or substituting what private sector actors can or should do. It is a public, multilateral institution. Its core responsibilities are concerned with both efficiency and equity.

The IMF exists in part to ensure that markets can work efficiently. Equally vital is the Fund's role in ensuring equity, or to use words from Article 1 of the IMF's charter to ensure balanced growth, to promote high levels of employment and real income, and to shorten and lessen the impact of crises. Far too little attention has been paid to this latter duty in respect of the Fund's role in financial crises.

Let me provoke discussion by positing that the G7 countries have eroded the capacity of the IMF to fulfil its mandate in financial crises in at least four ways. Each of these signals a change the L20 could make.

stable borrowing rates for the institution which would encourage countries to approach the institution early on and enable larger deeper crises to be forestalled. Current arrangements neither provide an incentive to potential borrowers, nor confidence. Indeed some would argue that reserves being built up by Asian members outside of the Fund are a sign that the Fund is failing to give confidence to its members. The issue of charges and conditionality needs a political settlement, guided by expertise and much harder evidence as to the effects (including moral hazard) of current arrangements.

4. The G7 hold the institution tightly to account while giving borrowing members little if any incentive to participate in the governance of the institution.

At present the G7 needs hardly to consult with other members. Wielding 47.13% of the vote, it needs only persuade another Director in order to command a majority. Consider by contrast the position of Chile or Argentina. If they can persuade their own constituency of 6 countries, they will wield a total of 2% of the vote. Persuading the further 9 countries led by the Brazilian Chair in the Fund, will add another 2.47% of the vote. Further efforts might bring on board the 13 countries chaired by Malaysia, adding a further 3.18% of the vote. That's a lot of diplomatic activity in order to mobilize a voting power of less than 8%. They are still a long way from even being able to put something on the agenda.

Others advocate altering quotas or increasing basic votes. Yet neither of these measure is likely to produce the desired result – viz – creating a strong incentive for G7 members to consult more widely and build a broader coalition across the institution. Executive Directors widely bemoan a loss of the `consensual tone' of the Board. As I have argued elsewhere, this would be better recaptured by leaving voting powers as they are and simply extending the requirement for a double-majority already within the Fund's Articles (for amending them). This would require the G7 to muster a majority not just of voting power but also of members (Woods and Lombardi 2005, and Woods, forthcoming). Put simply, large shareholders would then face a powerful0.7(u T)9f.6(idel)6(l0.7()2(to buil)5.1(0w[(Woodio)-3.51.718itu)-9 to buil)dLi.6(t)1.7()hl19 TDluil a stroke it could deliver a measure of legitimacy to the organization, and a degree of participation which would help the other objectives laid out in this briefing.

Ngaire Woods

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