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De Rato's summer to-do list

Lauren Phillips

'Paradoxically, De Rato's resignation may provide new impetus for finishing a deal on IMF representation quickly rather than undermine the process.'

Just weeks after the leadership debacle at the World Bank seemed to have finally faded from front page news, the uncertainty spread across H Street to the Bank's sister institution, the International Monetary Fund (IMF). Rodrigo de Rato, Managing Director of the IMF, announced his intention to resign from his post much earlier than expected. Most of the discussion since his announcement has focused on the chance that his resignation provides to right the wrongs of the antiquated 'gentleman's agreement' that dictates the nationality of the leaders of both institutions. But while the selection process is important, the more fundamental concern that De Rato's resignation has highlighted is the urgency to settle a deal on the still nascent process of IMF governance reform.

Last year, major momentum built both within and outside the institution for reform. The IMF was at risk of losing relevance in a world of high liquidity, staggering levels of foreign exchange reserves and soaring commodity prices. This prompted some soul-searching, and resulted in the beginnings of a process of governance reform for the IMF, which was supported by large member states such as the US and, critically, the Managing Director.

Perhaps paradoxically, his resignation may provide new impetus for finishing a deal on representation quickly rather than undermine the process. The members' initial self-imposed deadline to determine a new formula for so-called quota votes was the October 2007 annual meetings, which coincides with De Rato's planned departure just after the meetings. His upcoming resignation will give him the freedom to act strategically, and indeed, to consider his legacy in the post. This may provide an extra incentive to help personally mediate a deal amongst coalitions of developed and developing countries, where important differences still lie on issues such as whether GDP should be measured using market exchange rates or purchasing power parity (PPP) and whether the quota votes formula should somehow take population into consideration.

The conditions for an outcome in the coming months look even better when one notes that the Managing Director of the IMF is not the only actor set to change after the autumn meetings. The body which has become a negotiating forum between developed and large developing countries on IMF reform, the G20, has a rotating leadership. At the end of 2007, leadership will pass from South Africa – the current chair – to Brazil. Under the leadership of Trevor Manuel and the Ministry of Finance, South Africa has made good progress on bridging the gap among G20's members expectations on what a new quota formula should contain. Thus, the country is likely to be eager to capitalise on this positive momentum by hammering out a fair and equitable deal in time for the annual meetings as well. The combined effect of the departure of these two critical players to the reform process might just give the push needed to make sure that the reform circle is squared before Ministers of Finance descend on Washington for the annual meeting.

Despite this confluence of positive conditions, there remains a risk that the reform deal could become sidelined by debates over the leadership succession process. Despite the fact that European states have rallied around French socialist and former finance minister Dominique Strauss-Kahn as a candidate for the post, his appointment as Managing Director is not secured because serious discontent remains amongst both developing country members and selected developed countries (notably the UK) who want to see a contested nomination process instead of a 'coronation'. The Board of Director's recent decision to extend the nomination period until the end of August and consider all candidates that have emerged in September, while welcome, may

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indeed distract from the issue of quota vote reform.

Focusing attention on IMF representation in the coming weeks and months appears to be even more critical when one looks ahead at the minefield of risks that loom if the autumn 2007 deadline is missed and negotiations spill over into 2008. First, 2008 is the year of the US presidential elections, and as American attention is diverted to presidential politics, the likelihood that the US Treasury can continue to support a delayed IMF reform process will probably decline. Additionally, as the US Congress is required to approve any deal on IMF reform and as elections loom legislators will be unlikely to vote in favour of such a package given competing priorities and scarce political capital. Lack of US support for a deal would sound an immediate death knell for the reform process.

A second risk is more technical than political. As mentioned above, the decision on whether to utilise GDP figures measured in market exchange rates or PPP remains outstanding. Developing countries generally support the latter, as it tends to show their economic weight in global terms as much higher. One of the key arguments against using PPP has been the lack of reliable data, but a new and more complete PPP dataset will be published in late 2007. There is some chance that this dataset will show increased GDP for large developing countries such as China, India and others, and therefore imply that their representation should be higher. This would make a formula based on PPP unpalatable to the G7 and other developed nations unless the developing countries agreed not to revise quota votes for some time.

In the longer run, coming to a deal on IMF reform while the conditions are ripe matters because of the risk that after several years of high growth and low inflation, the global economy could face a serious downturn. Because Asian (including Chinese), North American and European economies are now so closely intertwined, a re-adjustment in one of the three major economic zones would have a major impact on economic conditions globally. If the reform process is not made a priority in the coming weeks, the IMF may lack the credibility to serve as a legitimate lender of last resort in the case of a downturn. The implications of this on developing economies, which have different levels of domestic and regional crisis 'protection', are unclear.

De Rato's resignation provides both opportunities and risks for the reform of IMF representation. If the IMF Managing Director and the G20 secretariat together focus their efforts on helping members to decide the last critical pieces of the new formula in the months before October, risks to the reform process looming at the end of 2007 and start of 2008 could be avoided. Most importantly, an equitable deal on representation would serve the global economy, and developing countries, well in the longer run.

Written by Lauren Phillips, ODI Research Fellow
l.phillips@odi.org.uk

odi

Overseas Development Institute

111 Westminster Bridge Road, London SE1 7JD

Tel: +44 (0)20 7922 0300

Fax: +44 (0)20 7922 0399

Email: publications@odi.org.uk

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