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The IMF bargain

Europe must get beyond seeing the head of the International Monetary Fund as part of the spoils from Bretton Woods

In the grand European political reshuffle of 2019, it turned out that Christine Lagarde was the answer to the conundrum of who should replace Mario Draghi at the European Central Bank. But her move opens another question. Who succeeds Lagarde at the International Monetary Fund?

The question is a European question because, as part of the founding compromise of the Bretton Woods institutions in 1944, the United States nominates the head of the World Bank and the position of managing director at the IMF is taken by a European. America's interest at the IMF is secured by its blocking position as the largest individual shareholder and since the 1990s by the nomination of the first deputy managing director. Today that role is occupied by David Lipton, who is currently filling in for Lagarde.

So far, even in an age of growing international tension, that basic distribution of spoils has held up. When Jim Yong Kim abruptly announced his departure from the World Bank in January 2019, the Trump administration nominated David Malpass as his successor. Despite his reputation as a critic of the bank, in April Malpass was elected unanimously and unopposed. No one wanted to add to the simmering tension with the White House.

Now, having rolled out the red carpet for Lagarde, the Europeans are mobilising to complete the reshuffle by nominating one of their own for the IMF.

Indefensible and anachronistic

Though they have tradition on their side, the fact that the Europeans feel entitled to proceed in this way is indefensible and anachronistic. It is bad for the legitimacy of the IMF and unhealthy for Europe as well. The eurozone crisis created a toxic codependency between the eurozone and the IMF which needs to be dissolved once and for all. The fact that the Europeans are treating the leadership of a global institution as a bargaining counter in an intra-European political deal — involving the presidency of the European Parliament, the European Council and the European Commission — adds insult to injury.

Faced with the bullying of the likes of Donald Trump and Vladimir Putin, the European Union preens itself as an upholder of multilateral order and co-operation. And such institutions as the World Trade Organization and the IMF do embody general principles of global governance. But the acceptance of those rules in turn depends on the acceptance by the key players of an underlying distribution of power. Given the huge shift in the balance of the global economy in recent decades, the power-sharing agreement hashed out between the Europeans and the Americans in the final stages of World War II looks increasingly threadbare.

The fact that the emerging-market economies of Asia should have more voice in the Bretton Woods institutions has been acknowledged at least since the Asian financial crises of the late 1990s. In the wake of that crisis, the manner in which the IMF had dealt with countries such as Indonesia and South Korea triggered a major legitimacy crisis. In political terms, borrowing from the IMF became toxic.

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By 2007, when the Spaniard Rodrigo Rato casually resigned from the managing directorship and handed the job to the ambitious French socialist Dominique Strauss-Kahn, the fund was in freefall. Its client list had shrunk to Turkey and Afghanistan. Without the fees it earns from lending, the fund's budget was contracting and 'DSK' began his term in office by downsizing its team of economists.

Some would of course wish the IMF good riddance. But the financial crisis of 2008 put paid to that idea. The fund's client list rapidly expanded, led by desperate eastern-European economies such as Hungary, Latvia and Ukraine. The initiation of the G20 leadership meetings in November 2009 created a new global forum in which the emerging-market economies had more adequate weight. And it was the London G20 meeting in April 2009 which agreed to adjust the balance of IMF voting rights and to raise its funding to over USD 1 trillion. This restored the IMF as a 21st-century crisis-fighting organisation.

Confidence shaken

But where and how should that firepower be directed? In 2010 global financial confidence was shaken by the outbreak of the eurozone crisis. The thought of involving the IMF in the affairs of the eurozone horrified both the Sarkozy government in France and the ECB.

But Europe's own crisis-fighting apparatus worked painfully slowly. To stabilise the situation, a bargain was struck between the German chancellor, Angela Merkel, and the US president, Barack Obama, supported by the ambition of DSK. The IMF became deeply embroiled in both the national crisis programmes for Greece, Ireland and Portugal and the overall backstop to the eurozone. In May 2010 no less than €250bn of the fund's resource were earmarked to complement the European Financial Stability Facility, the hastily improvised predecessor of the European Stability Mechanism.

Over the protest of several non-EU members of its board, the IMF's involvement in the eurozone forced the fund to override the basic principles of crisis-fighting it had developed since the 1990s. From 2010 to 2015 it found itself underwriting debt-restructuring programmes, which the fund's own economists knew were inequitable and unsustainable. When DSK's career began to unravel in 2011, via a series of accusations of alleged sexual offences (charges were eventually dropped or he was acquitted), the Europeans even had the effrontery to argue that his successor must be European because the IMF was now existentially entangled with the eurozone. And the Obama administration insisted the IMF had to remained involved, for fear that Europe might trigger another 'Lehman moment'.

To be instrumentalised in this way by its two largest shareholders was bad for the legitimacy of the IMF as a global institution and it was bad for Europe. Not only did the fund, as part of the 'troika' with the commission and the ECB, underwrite Europe's disastrous management of the eurozone debt crisis. The ability to call on the fund meant also that Europe could drag its feet over building its own safety net.

It is to Lagarde's credit that she has gone a long way towards extricating the IMF from the eurozone, refusing to sign up to its third bailout for Greece in 2015. But the experience only confirms that the fund is not safe in Europe's hands.

Matter of contention

Meanwhile, the argument for an increase in emerging-market-economy influence over the IMF is stronger than ever. Today the EU27, excluding the UK, has a voting share of 25.6 per cent, compared with 16.5 per cent for the US, China's 6 per cent, 5.3 per cent for Germany, 4 per cent for France and India's 2.6 per cent. How exactly quotas should be revised is a matter of contention.

Is the relevant criterion the size of foreign exchange reserves or of gross domestic product? If GDP, then is to be measured at purchasing-power parities or current exchange rates? In PPP terms China is the largest economy in the world; at current exchange rates it still a long way behind the US. And how should the closed nature of much of the Chinese economy weigh in the balance?

Picking the formula is itself a highly political exercise. But even if one takes the formula for IMF quotas agreed by the existing dispensation, the implications are stark. China's voting share should double to 12.9 per cent. The voting share of the EU should fall to 23.3 per cent and that of the US should be adjusted down to 14.7 per cent. The latter change is critical because it would push the US below the 15 per cent of the vote it needs to exercise a veto over the decisions of the board, which require an 85 per cent majority.

We are in a fragile moment in global politics. America is erratic. Tensions with China are mounting. The EU has decisions to make about where it stands.

There is no chance of America accepting such a change. Indeed, there is no realistic prospect of Washington signing off on any quota adjustment. Under Obama, the Republicans in Congress took until January 2016 to approve the modest shift in the balance of voting rights accepted by the US administration in London in the spring of 2009.

For the Europeans to take advantage of this deadlock to once again appoint one of their own to the managing directorship would be a blatant demonstration of bad faith. If Europe is serious about securing the international order by means of progressive accommodation of the legitimate demands of rising powers, it could send an important signal by opening Lagarde's replacement to well-qualified candidates from emerging markets. There are several obvious possibilities.

Front runners

The three most commonly mentioned front runners would be: Augustin Carstens, formerly of the Mexican central bank and currently running the Bank for International Settlements in Basle; Raghuram Rajan, formerly chief economist at the IMF, head of the central bank of India and now kicking his heels at the Booth School of business at the University of Chicago; and Singapore's former finance minister Tharman Shanmugaratnam, who was the first Asian to chair the IMF's key policy steering group, the International Monetary and Financial Committee.

The fact that these men come from emerging-market economies does not make them advocates of heterodox views — all are *habitués* of the Davos circuit. Rajan is the highest profile in intellectual terms. But his preferences run in the redirection of ordoliberalism. Rajan was one of the fiercest critics of the unconventional monetary-policy measures pursued by Ben Bernanke's Federal Reserve.

Nevertheless, for any of them to head the IMF would be an acknowledgement of the fundamental shift in the balance of the world economy. And any of them would be a stronger candidate than the short list that the Europeans have so far come up with.

Mark Carney, the (Canadian-born) head of the Bank of England, is the only 'European' who could match up to these three in terms of standing in the world of global finance. But, despite his Irish passport, he has been ruled out as insufficiently European. And given its need for support over Brexit, Dublin is not going to force the issue.

Regrettably, the decisive voices in Europe are determined that a representative of the eurozone should have the job. And at this point the familiar European squabbling begins. The southern Europeans have two candidates in the ring: Mário Centeno of Portugal, the current head of the Eurogroup, and Nadia Calviño, the Spanish economy minister and a former senior EU official. Both lack profile and would struggle to find the support of northern Europe.

Deeply implicated

The two candidates who would attract the support of northern Europe are deeply implicated in the disaster of the eurozone. Olli Rehn, the governor of the Finnish central bank, was widely thought of as an alternate for Jens Weidmann in the ECB stakes. He would no doubt attract support from the new 'Hanseatic League', with all that implies: between 2010 and 2014, as commissioner for economic and monetary affairs and the euro in the Barroso commission, Rehn vocally advocated the austerity line.

But even worse would the man who is apparently the front runner, Jeroen Dijsselbloem, the former finance minister of the Netherlands. As president of the Eurogroup from 2013 to 2018, he personified the combination of populist northern resentment and fiscal narrow-mindedness that dictated eurozone policy towards Cyprus and Greece. If he were to emerge as the IMF's managing director, it would be a truly horrible twist in the saga of the fund's entanglement with the eurozone.

We are in a fragile moment in global politics. America is erratic. Tensions with China are mounting. The EU has decisions to make about where it stands. In the UN and Bretton Woods institutions, created in the final stages of World War II, it has an anachronistic over-representation. There is a risk that Europe's preoccupation with its own problems will undercut the legitimacy of those institutions.

Instead Europe should put what leverage it retains to good use. It should start by inaugurating a new era at the IMF.

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