

A Special lunchtime meeting with Michael Deppler, Director, European Department,
International Monetary Fund.

New Dimensions in IMF Surveillance

Summary: The prospects for improved international economic policy coordination and the role of the International Monetary Fund (IMF) in fostering progress in this field were the focus of a Special Lunchtime Meeting with **Michael Deppler** at Bruegel on 15th May 2006. Michael Deppler chaired the Fund's task force on multilateral surveillance.

The lunch took place in the shadow of the Spring meeting of the IMF where the Group of Seven (G7) advanced economies and the wider International Monetary and Financial Committee (IMFC) had reaffirmed their concern about global economic imbalances and asked the Fund to examine how it could play a more effective role in promoting coordination.

It quickly emerged during the discussion, however, that, in the wake of the IMF meeting, there may be too much optimism in the media about the immediate prospects for policy adjustments designed to promote a rebalancing of the global economy. Not only are there fundamental disagreements amongst important IMF members about the urgency with which global imbalances need to be addressed, the issue of policy adjustments by systemically important players has become entwined with the no less complex questions of the role of the IMF itself and of its internal governance.

Michael Deppler made clear that a formal restructuring of the balance of power within the IMF is needed to take account, in particular, of the much bigger role which major emerging market countries such as China and India, are playing in the world economy. Such a rebalancing is seen in Asia as a quid-pro-quo for participating in IMF discussions on economic policy adjustment and global imbalances. This is a particular challenge for the European Union.

Gridlock ?

Jean Pisani-Ferry, Director of Bruegel, said that it was evident that the system of multilateral surveillance of the global economy by the International Monetary Fund was not achieving its full potential. In part this reflected the rapid and far reaching changes in the structure of the global economy in recent years.

Mr. Deppler opened his presentation by placing the issue of multilateral economic policy consultation/coordination within the framework for IMF reform which IMF Managing Director Rodrigo de Rato has put forward. The elements of this framework include not only strengthening international economic surveillance, but also the effort to develop IMF-based arrangements designed to try to insure emerging market countries against financial crises. Questions about how to tackle the linked problems of the governance of the Fund itself and its budgetary and income problems also fit in to this wider framework.

Turning to the issue of economic surveillance, Mr. Deppler said that already the Fund itself is trying to focus and streamline its Article IV bilateral surveillance activities. Hitherto it had tended in Article IV consultations, to try and address too many macro-economic and structural variables. The Managing Director believes that you achieve results in dealing with politicians if you only have a very narrow range of topics on the agenda, he said.

This streamlining process was already having an impact on IMF relations with the euro area where the IMF team is now paying a lot more attention to the financial sector and the interaction of the real economy with financial markets. Stemming from this approach, there would also be a greater effort to analyse and discuss with the large, systemically important IMF member countries, the economic impact of their performance on their neighbours and on the global economy.

This would involve paying more attention to exchange rates, including, now, key emerging market exchange rates, and trying to assess international exchange rate consistency within the framework of the global economy. For some time, the Fund has been willing to let its estimates of Fundamental Equilibrium Exchange Rate for the major industrial economies be known, it would from now on do the same for major emerging economies.

Turning then to the question of where the world currently stands in terms of the international economic policy dialogue, Mr. Deppler said that the imbalances are getting worse - the US current account deficit of around 7% of gross domestic product, is still widening .

The most inclusive forum for debate, the International Monetary and Financial Committee of the IMF, is too large to be effective, he said. Up to 250 people may be sitting in the meeting. For an effective discussion on global imbalances you would need to get around five main, systemically important, players to engage in detailed negotiations.

As for the substance of the debate, Mr. Deppler dismissed the “euphoria in the press,” about improved multilateral cooperation as “overblown”. Why nothing is being done, even though all sides worry about the risks associated with global imbalances, must reflect in part the fact that countries feel that it is not in their best (domestic) political interests to act and also that they do not agree on the imminence of these risks. He pointed out, too, that there is also an “asymmetry” in the global adjustment process. Just as in the 1960’s and 1970’s, countries with current account surpluses feel that they are not under such time pressure to act.

Another problem is that the economic imbalances are now so huge “standard policy tools” for tackling them are not adequate. As for devising a process through which a cooperative approach could begin, the official said discussions are at a “very delicate stage.”

Jean Pisani-Ferry intervened to highlight the paradox that although global economic imbalances are getting worse there is no sense of urgency about how to tackle them.

André Sapir of Bruegel added that, based on his recent experience at the annual meeting of the Asian Development Bank, there is certainly a sense of urgency amongst many Asian countries, not only about the imbalances but also about the role of the IMF itself. “For ‘Asians’,” he suggested, “this debate (about the role of the Fund and global imbalances) amounts to a last attempt to keep the IMF (as an international financial institution) relevant in the eyes of Asia.”

Mr. Deppler agreed that Asian countries see the issue of IMF quotas and their influence at the Fund as very important and link it to the issue of how to resolve global imbalances. The IMF is also concerned about its legitimacy given emerging market under-representation at the Fund.

The particular problems faced by the European Union in participating in discussions about imbalances when not all its members are in the single currency and when there is no efficient economic policy coordination structure in place in the EU triggered a lively debate. Mr. Deppler pointed out that to be a credible partner in discussions with a small group of systemically important countries, the EU had to be able to put credible proposals on the table, adding that the G7 was no longer a satisfactory forum.

One participant drew a comparison between the unproductive way in which the Ecofin Council works, with too many people in the room and too many interests represented, and Mr. Deppler’s comments on the inadequacy of the IMFC as a forum for discussing global imbalances. He wondered how the EU might set about improving its own surveillance processes in order to become a credible player.

Mr. Deppler pointed out that, as well as addressing this issue, the EU also had to try and work out how it is represented at the IMF, not least because the Fund itself sees its own international legitimacy called into question by the under-representation of emerging market countries on the board and the over-representation of Europe. He suggested that the EU could have more influence at the Fund if its representation was rationalised.