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# RSIS COMMENTARIES

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## **IMF: Next Head will not be from Asia**

By Pradumna B. Rana

### **Synopsis**

*Despite a compelling case, the next IMF Head will not be from Asia. Asia has to wait a bit longer, but it is only a matter of time.*

### **Commentary**

THE CASE for appointing a new International Monetary Fund chief from Asia is compelling. This is because of the growing economic and political clout of Asia. The Asian continent had accounted for the largest share of the world economy since ancient times until the advent of the Industrial Age. However, the last four decades have seen its "re-emergence" with an unprecedented rate of Asian economic dynamism. The global economic crisis of 2008-2009 which originated in the West has further accelerated the shift in the world's economic centre of gravity to Asia. As Asia continues charging ahead, the West is likely to remain stuck in a jobless recovery for some time.

### **Asian economic dynamism**

The much-quoted 2003 Goldman Sachs study had forecast that by 2050, three of the four largest economies in the world would be in Asia: China, US, India and Japan in descending order. An update of that study has forecast that India would overtake the US even earlier and become the second largest economy in the world by 2050 after China. Several forecasts including those from the Asian Development Bank (ADB) suggest that Asia could, once again, account for the largest regional share of world GDP well within the next 30 years.

The next IMF head will, however, not be from Asia. This is because despite Asia's growing clout in the global economy, its voting power at the IMF is low. For example, China accounts for 13.6% of the global economy (in terms of purchasing power parity) but its voting power is only 3.8%. The IMF is an international club whose governance system -- charter, quotas, voting rights, and procedures to select its managing director -- was designed in the interest of the 44 like-minded core countries. These core members were invited by the United States, the hegemon of the day, to participate in the 1944 Bretton Woods conference.

The original core members of the IMF are reluctant to give Asia a greater role in IMF governance. As predicted by the theory of clubs, the IMF is an inflexible organisation whose governance system is difficult to change in response to expanding membership -- now 187 -- and shifts in the global economy. Governance reform of the IMF has, therefore, proceeded at a glacial pace.

## Slow governance reform at IMF

It is not that attempts have not been made to improve the governance of the IMF and make it a more equitable organisation in terms of power-sharing. For example, at its Pittsburgh Summit in 2009, the G20 had pledged to increase the quota and voting power of large emerging markets by 5%, which was increased to 6% at the Seoul Summit last year. However, even the more modest pledge made five years ago when the IMF annual meeting was held in Singapore in 2006, has yet to be implemented as the required support of 85% of IMF membership has not been obtained.

Therefore, European countries continue to hold just over 30% of the votes, and the US another 17%. The US also has a veto power in the IMF. These two countries together continue to dominate decision making at the IMF and will decide who the next IMF Head will be. An American is ruled out because of the traditional division of labour is that he/she should head the World Bank and get the number two slot in the IMF.

Officials from Europe, which has provided every head of the IMF so far, have already started to argue that because of the difficulties in Western Europe the tradition should be continued. Somebody familiar with intra-European intricacies should be appointed. This has made the French Finance Minister, Christine Lagarde, the favourite for the job.

Several years ago, when the IMF was busy bailing out Eastern European countries but had little business elsewhere, Arvind Subramanian of the Peterson Institute in Washington DC had commented that the IMF was risking being labelled a "Euro-Atlantic Monetary Fund". This label will surely be used if the new head were to be from Europe. What the IMF now needs is a non-European head with a more detached perspective. This would be good for the IMF, for the world, and for Europe.

Although the G20, at its Pittsburgh summit, had agreed to an open selection process, it will be very difficult to break the nearly 70-year-old tradition at the Fund. Ms Lagarde's chances are also being improved by lack of common voice in other regions as countries have their own agenda. ASEAN and the ASEAN+3 (which includes China, Japan and South Korea) have been very silent over the issue of leadership of the IMF. It is, therefore, almost certain that Ms Lagarde will get the job.

### So what should Asia do?

Asia should wait for the next opportunity. The difficulty in reforming the governance of the IMF has led to the evolution of a more flexible decentralised global monetary architecture. Under this architecture, the IMF as the "senior" global organisation will be linked to monetary funds in various regions of the world in a complementary manner. The Arab Monetary Fund, and the Latin American Reserve Fund have already been established, and the probability of a European Monetary Fund is high.

Asia should accelerate the on-going efforts to establish an Asian Monetary Fund (AMF). This requires the merger of the recently established ASEAN+3 Macroeconomic Research Office (AMRO), which is to be an independent surveillance unit, with the \$120 billion crisis fund under the Chiang Mai Initiative Multilateralisation (CMIM). Leadership role in the AMF by the large emerging countries in Asia would position them well to eventually take leadership of the IMF.

Increased regional cooperation together with its continued economic dynamism would also strengthen Asia's clout and voice in global affairs. Asia cannot be ignored forever in the IMF.

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