Is IMF power of persuasion enough for G20?

By Lesley Wroughton – Analysis
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PITTSBURGH - The International Monetary Fund will have to call on all its powers of persuasion to steer the world's heavyweight economies toward their goal of more balanced global growth.

The IMF is keenly aware of its failure in 2006 to get exporters like China to increase demand at home and slower-growing economies like the United States to save more.

The following year, the start of the financial meltdown underscored how interwoven the global system is and the increased role of emerging economies powers like China.

Last week, leaders from the Group of 20 rich and developing nations agreed at a summit in Pittsburgh that the group would take over from the rich country G7 as the premier forum for coordinating economic policies.

Officials stressed that the G20 could not tell countries how to run their economies.

Instead, it will assess national economic policies and rely on a new process of peer review.

Under the plan, the IMF will forecast the impact of policies and report back to the G20 with suggested changes.

However, big countries have not always listened to the IMF's advice and there's no guarantee they will this time.

The United States ignored the Fund's warnings about its housing sector in 2007, shortly before a property collapse that triggered the global credit crisis.

World Bank President Robert Zoellick said on Sunday the G20 leaders made a "good start" toward increased global cooperation but added: "Peer review will need to be peer pressure.

IMF officials acknowledge their big challenge will be to provide analysis strong enough to convince countries to adjust policies, even if the changes are politically unpalatable.

IMF Managing Director Dominique Strauss-Kahn was dismissive when a reporter at the summit last week suggested that the IMF might not be able to push for the G20 rebalancing goals.

"We can't? Why? As far as economic questions are concerned, my belief is that you have to convince people," he said, recalling how the Fund was quick to call on governments to fight the growing credit crisis with huge spending plans.

The injection of nearly $5 trillion helped prevent the recession from turning into a global depression.

"We had no regulatory or legal tool to oblige countries to implement the stimulus but it was the right policy to follow and everyone understood it, so that is the real role of the IMF," Strauss-Kahn said.

SPENDING IS EASY

Urging governments to spend more is likely to prove easier than taking other measures such as raising taxes.

To date, the IMF has urged the United States not to cut taxes, given the massive U.S. budget deficits racked up as a result of the crisis-fighting spending splurge.

Many economists think it is only a matter of time before the Obama administration has to consider raising taxes.

The IMF will also find itself treading on eggshells when it comes to assessing foreign exchange rates.

China has rebuffed suggestions from the United States, notably under former President George W. Bush, that its currency was artificially weak to help fuel its export boom.

With the U.S. economy likely to recover only slowly, making it hard for a quick rebound in employment, Washington may face political pressure to turn up the heat on China to take measures to rein in its exports.

For its part, Chinese officials have urged the United States, as the guardian of the world's main reserve currency, to manage carefully the impact of its huge fiscal and monetary policy stimulus.

Chinese officials in Pittsburgh said they expected currency issues to be considered under the new peer review system.

"I'm sure the currency policies of the major currency countries would also belong under this mutual assessment," Vice Foreign Minister He Yafei told reporters, before adding: "This mutual assessment would be voluntary, not legally binding."

EVEN-HANDED APPROACH

IMF officials hope this time, the Fund will be heeded not only because the crisis revealed how the interplay of national economic policies helped cause the crisis, but also because developing countries will have more say at the IMF.

The IMF was encouraged by the G20 leaders' backing for a shift in voting power at the Fund toward emerging economies. Changes in IMF voting power are expected to be decided by early 2011 by the Fund's 186 member countries.

Such changes would improve its legitimacy for countries like China, which has seen the IMF as a pawn of Washington.

Raghuram Rajan, a former chief IMF economist and now a professor at the University of Chicago Booth School of Business, said IMF had to be seen as impartial.

"Countries have to feel comfortable that the analysis and the finger-pointing is even-handed," said Rajan.

He was the IMF's chief economist in 2006 when the IMF led a process of consultations over global imbalances with the United States, China, Russia, the European Union and Saudi Arabia.

Pledges by countries to rebalance growth went unfulfilled as governments failed to see any urgent need to act and in part because countries blamed each other for the problems, with China dismissing the IMF as a U.S. tool.

"If they see the finger-pointing over time turns out to be only in one direction, then countries will back off quickly from this," Rajan said.

"But if over the next months or years the IMF turns out to be even-handed in its analysis, then countries can use the analysis to have a legitimate discussion," he said.

"What we need to do is to push toward making the IMF structure more workable as well as more representative."

(Editing by William Schomberg)