SEÇÃO ESPECIAL

G20 Brasil and Reforming the International Financial Institutions

Haihong Gao

Abstract: The International Monetary Fund and the World Bank, established eighty years ago, are still functioning in the heart of the international financial system. However, they face severe challenges in the changing world. In particular, they need to tackle the issues of insufficient financial resources in low-income countries, limited liquidity access for developing economies and emerging markets, and slow pace of governance reform that has resulted in a considerable mismatch between economic importance and decision-making power.

Keywords: International Monetary Fund; World Bank; Special Drawing Rights; Global Financial Safety Net.

G20 Brasil e a Reforma das Instituições Financeiras Internacionais

Resumo: O Fundo Monetário Internacional e o Banco Mundial, estabelecidos há oitenta anos, ainda estão funcionando no coração do sistema financeiro internacional. No entanto, eles enfrentam desafios severos no mundo em mudança. Em particular, precisam lidar com as questões de recursos financeiros insuficientes em países de baixa renda, acesso limitado à liquidez para economias em desenvolvimento e mercados emergentes e ritmo lento de reforma de governança, que resultou em uma incompatibilidade considerável entre importância econômica e poder de decisão.

Palavras-chave: Fundo Monetário Internacional; Banco Mundial; Direitos Especiais de Saque; Rede Global de Segurança Financeira.

This year marks the 80th anniversary of the Bretton Woods Conference. This landmark conference established two important pillars that underpinned the post-war international monetary system: a dollar-gold parity-based exchange rate arrangement; and two international financial institutions – International Monetary Fund (IMF) and the International Bank for Reconstructions and Development (IBRD). The IMF is primarily responsible for balance-of-payments issues; the IBRD, formed as the World Bank later, is responsible for post-war reconstruction and financing for less developed countries.

The design of this post-war monetary order is based on the abandonment of the isolationist position of the United States, the reflection of countries on the lessons of the Great Depression and war, and the consensus reached by countries on international cooperation and compliance with international rules. It must be admitted that the post-war international economic structure determined the role of the United States as a leader in the creation of the Bretton institutions, and also determined the situation in which the international financial governance system was tilted towards developed countries.

Eighty years on, the Bretton Woods system is a thing of the past. The international economic landscape has also changed with the rise of emerging economic powers. Thankfully, the IMF and the World Bank, the two Bretton Woods institutions, continue to play a central role in the international financial system. And to be fair, those institutions have been reformed in many ways to catch up with the dynamic of the world economy. In recent years, geopolitical tensions have escalated, and global financial governance reform has stagnated. The G20 Brasil attached particular importance to the principle of fairness in the global financial architecture.

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This paper begins with a brief history of the reforms in the past years, followed by the discussion on current challenges faced by the institutions and the necessary reforms in the next step, including: mobilizing more financial resources for inclusive purpose, increasing access to liquidity for emerging markets, and reforming governance for balance of power. The paper concludes with the reflection of the post-war international cooperation and the role of the G20.

THE PAST REFORMS

Back in the 1960s, when the dollar-gold standard faced reserve shortage under the Bretton Woods System, the IMF members made the first amendment to the Articles of Agreement in 1969, authorizing the IMF to allocate the Special Drawing Rights (SDRs) to supplement the dollar. The creation of the SDRs has added one more reserve class in central banks' coffers, and a new crisis management tool in the IMF. Although the initial allocation of SDRs proved to be too little too late to save the Bretton Woods system, it was a path-breaking example of international monetary cooperation (Truman 2024, 13). The introduction of the SDRs has also paved the way for a multilateral reserve currency.

In 1974, the IMF established the Oil Facility amid the oil crisis, and through the facility channeled resources from oil exporters to import countries that faced severe current account deficits. Such a facility prevented competitive devaluation and trade restrictions in the first years of the floating exchange rate era. What is more, the outcome of the 6th IMF general review of quotas in 1976 was reached in the context of the oil crisis. The review, which came into effect when the IMF completed the second amendment to the terms of the Agreement, increased the overall quota of member countries by 33.6%. In particular, the quota shares of the major oil-exporting countries substantially increased. The IMF considers an increase in Saudi Arabia's quota share in the IMF to be exceptional, given that Saudi Arabia's share at that time did not reflect the importance of the country's economic size (IMF 1981, 2). The increase in Saudi Arabia's quota resulted in a substantial increase in the IMF's usable resources.

During the Asian Financial Crisis in 1997-1998, the IMF offered support but failed to meet the needs of the countries in crisis because of its hush conditionality and wrong prescription for crisis intervention. Such failure ended up with the onus for Asian countries to pursue their own regional buffer. Japan took the first move to propose an Asian Monetary Fund (AMF). But this right proposal was put forward at the wrong time. In 2000, Asian countries decided to create the Chiang Mai Initiative (CMI)–a regional financial arrangement which shared the same purpose of liquidity

support as the IMF. In a later time, the CMI was upgraded to a multilateral reserve pooling among the Association of Southeast Asian Nations (ASEAN) countries, China, Japan and Korea. Now, an institutionalized framework of Chiang Mai Initiative Multilateralization (CMIM) has US$ 240 billion funding capacity. It is not yet a regional monetary fund; but the ASEAN+3 Macroeconomic Research Office (AMRO), established in 2011, is functioning as a standard international financial organization to carry out surveillance activities. CMIM is in transformation with a new overarching legal base for conditionality, use of local currency and supplemental to the IMF as a Global Financial Safety Net (GFSN).

The IMF faced serious backlash on its stigma issue in the late 1990s and early 2000s, when financial crises frequently occurred in emerging markets and developing countries. It took a quite long time for the IMF to recognize the problems. In 2012, the IMF published an Institutional View (IV) and softened its stance against capital controls, which was a taboo in the 1980s during the Latin American debt crisis. In 2022, the IMF updated its IV, with focus on architectural design based on the Integrated Policy Framework (IPF), where both capital flow management measures (CFMs) and macro-prudential measures (MPMs) are included (IMF 2022, 2). It is important to note that the update of the IMF's view of capital flows does not represent a simple return to the idea of capital controls, as the IMF has not changed its core principle of capital flows–that capital flows bring benefits to countries, CFMs and MPMs can only be applied in certain circumstances and should not replace necessary macroeconomic adjustment measures.

The Global Financial Crisis in 2008 demonstrated that volatile capital flows and vulnerability in the financial system pose unprecedented challenges to global financial stability. The IMF, as the foremost guardian of global financial stability, needed to be better resourced to achieve its mission. However, in the wake of the financial crisis, total IMF quota has rapidly decreased in relation to the size of the world economy. Its bailout capacity faced serious challenges. The crisis also created an opportunity to reflect on the pitfalls of the international monetary system.

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It was clear that the emerging powers were much underrepresented in international financial institutions. And to rebalance the global economy, the institutions needed to bring all the stakeholders to the table.

In 2010, the IMF made overhaul reform of quota and governance. The IMF Board of Governors approved a major quota and governance reform, in December 2010, to complete the 14th General Review of Quotas. The reform package came into effect on January 26, 2016, with doubled quota size to about 477 billion SDRs (equivalent to US$ 677 billion), and shifted more than 6% of the quota share to dynamic emerging market and developing economies from overrepresented countries. The reform also protected the voting rights of the poorest countries at a fixed share of 3.2%. As a result of this reform, the four largest emerging market economies (Brazil, China, India, and Russia) were among the top ten quota contributors. The overhaul reform of quota and governance consolidated the Fund's legitimacy with a better representation of power dynamic.

In face of new challenges–especially the widening inequality, the worsening debt problem, the risk of climate change, and increased global financial instability–the existing international financial framework must be improved. It is time for the Bretton Woods Institutions to move fast and carry out necessary reforms.

In the wake of the pandemic in 2020, the IMF decided to activate the Catastrophe Containment and Relief Trust (CCRT) to provide debt relief for low-income countries. In early April 2020, the IMF increased the accessibility of the Rapid Credit Facility (RCF) and the Rapid Financing Facility (RFI), established a Short-Term Liquidity Facility (SLL) to provide up to 145% of quota share to members with better fundamentals, allocated new SDRs amounted US$ 650 billion, and created Resilience and Stability Trust (RST) as a means for re-channeling SDRs.

If history can be of any guide, the recurrent crises certainly created a sense of urgency for the international financial institutions to step up and make a change. In face of new challenges–especially the widening inequality, the worsening debt problem, the risk of climate change, and increased global financial instability–the existing international financial framework must be improved. It is time for the Bretton Woods Institutions to move fast and carry out necessary reforms.

WHAT'S NEXT?

Reforming the international financial architecture was one of the core issues of Brazil's G20 priorities. The aim was to use the G20 Summit as an opportunity to respond to new challenges and take joint action. In the context of the awareness of common challenges, it has become an urgent task for the international financial institutions to carry out reforms in the following aspects.

First, Mobilize Financial Resources for Inclusive Purpose

This is about capital allocation. While large-size capital keeps flowing to advanced financial markets, many low-income countries (LICs) need financing support to deal with poverty, debt burden and financial vulnerability. This is the case that the international financial institutions should provide more funding access, and more low-cost instruments, for LICs. Multilateral development banks (MDBs) play a leading role in addressing these issues. The G20 in Brazil attached great importance to the reform of MDBs aimed at building a bigger, better and more effective multilateral development banking system.

This should not only be done by the MDBs. The IMF is at a crossroad when dealing with new challenges. The primary function of the IMF is to solve the balance of payment problems by design. However, its mandate has to be adaptable and flexible to keep pace with time. In fact, in 2012, the approval of the Integrated Surveillance Decision (ISD) reaffirmed the built-in flexibility of the IMF's mandate (IEO 2024, 1). Recently, the IMF shows its flexibility to mobilize resources and create new tools targeted to LICs that have limited domestic fiscal space and lack of financing ability in the international financial market. One useful program is the IMF's concessional window, the Poverty Reduction and Growth Trust (PRGT). The PRGT provides

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zero interest rate loans (currently) to LICs on economic programs, and helps debt resolution in distressed countries, supported by three major tools: Extended Credit Facility (ECF) to tackle medium-to long-term balance of payments problems; Standby Credit Facility (SCF) deals with actual or potential short-term balance of payment problems; and RCF is one-off disbursement to countries facing urgent needs. The outbreak of pandemic in 2020 was a test for the IMF on how fast it could react. As a result, in the first months of the pandemic, the IMF provided concessional lending almost six times the average over the past decade.

The IMF should do more. The SDRs are the most underused resources within the IMF. They have hibernated most of the time since its birth, except for a few allocations, including two major allocations–one in the global financial crisis in 2009, the other with US$ 650 billion during the pandemic in 2021, the largest allocation in history. More importantly, as the general SDR reallocation is based on quotas, not based on needs, the RST as a means for SDR re-channeling is very useful. The creation of the RST paved the way to overcome the shortfalls in long-term tools in the IMF. Now, in face of increasing demand–three-quarters of the members are eligible for RST financing, including LICs, most middle-income countries, and all small developing members–the IMF should consider how to guarantee the sustainability of funding resources to meet the gap.

The new SDR allocation was a good example of the IMF stepping up to mobilize its own resources in response to the pandemic. With US$ 275 billion distributed to emerging and developing countries, and US$ 21 billion to low-income countries, this historically largest allocation certainly helped countries to boost their reserves and liquidity. The latest effort is that the IMF Executive Board approved the recycling of SDRs to MDBs for use as a hybrid capital aimed to overcome the constraints of MBDs' balance sheet (IMF 2024, 2). The limit amount for use as hybrid capital is no more than SDR 15 billion (US$ 20 billion), imposed by the IMF. There is still a gap compared with the potential amount needed lending power in the MDBs. This initiative is still at the stage of gathering more support from the concerned countries.

The IMF can do more, within its mandate, such as to make SDR allocations on regular bases, de-link SDR allocations from quota shares, and redesign the tools to support climate related financing for poor countries, and improve its surveillance framework in response to new risks and challenges etc. There is a concern about the IMF expanding its functions and potential duplication of other international financial institutions' work. However, IMF's coverage of broader areas reflects the institution's evolving understanding of what is critical for the achievement of its mandate (Georgieva & Weeks-Brown 2023, 1).

Second, Increase Access to Liquidity for Emerging Economies

The current GFSN is far from being able to maintain global financial stability. One problem is that the relationship between the various protection mechanisms in the GFSN is fragmented. Another problem is that the coverage of protection is uneven–some countries or regions are better protected, while many fragile countries are not.

An enlarged resource in the IMF would certainly consolidate the IMF's central position in the GFSN, where layered options coexist. However, there is no complacency for the IMF being the center, if the IMF is unable to provide access to liquidity for the countries in need. On October 10, 2024, the IMF Executive Board announced a reduction in the rate charged on loans to recipient countries borrowing from the General Resources Account (GRA), reducing the base rate by 60% and raising the threshold for surcharge payments. A surcharge is a fee charged by the IMF in addition to the interest rate on the loans. There have been criticisms over the years arguing that surcharge increases the debt-servicing burden of borrowers and reduces their fiscal space. Although the IMF's new initiative will reduce borrowing costs by 36%, equivalent to about US$ 1,2 billion a year, this reform is more targeted at middle-income countries and it is still insufficient (Stiglitz 2024).

The central bank's swap lines are increasingly important. They have expanded since the Global Financial Crisis in 2008. The size of bilateral swap lines (including limited and unlimited) accounted for 9.1% of total coverage of the GFSN by the end of 2023. Meanwhile, the IMF quota and borrowing resources combined accounted for only 5.2% of total coverage of the safety net. The Federal Reserve's unlimited dollar swap lines with other five key central banks are the most active tools in managing dollar liquidity problems in advanced markets. In fact, the Fed plays a role as a global lender of last resort, because the dollar funding market is the most influential and largest market in the world. However, as the dollar swap lines are exclusively for few key advanced markets, the majority of the emerging markets have limited choices. It should be noted that other central banks also provide bilateral swaps. For example, the People's Bank of China has signed more than 40 agreements with other monetary authorities worldwide since 2008. Although the Chinese currency–the renminbi–is not a fully convertible currency, the partners can at least utilize those swap lines as a signal to rebuild market confidence (Gao 2023, 239).

Why are bilateral swaps attractive? In the current international monetary system where few central banks have strong policy spillovers, emerging markets and developing countries have limited policy choices to defend against financial

shocks. Countries short of dollar reserves are likely to look for external help. The central banks' currency swap lines can serve as a quick buffer. For example, in the past two years, the higher for longer interest rate environment has not helped but increased borrowing costs globally. The sharp rise of the US dollar's value has also forced other currencies to depreciate. It is truly a test for the central bank's ability to defend the currency's value and prevent capital outflows in the situation that the country is short of dollar reserves. In such a context, bilateral swap lines can be used as quasi-foreign reserves with fast access and no conditions.

There are also Regional Financial Arrangements (RFAs), such as the Latin American Reserve Fund (FLAR), the European Stability Mechanism (ESM), the CMIM etc. The overall size of RFAs accounted for 6.8% of total GFSN. Those RFAs are designed to supplement the IMF, and they are in a better position to provide tailored policy recommendations and quick disbursement with flexible conditions. However, those RFAs are heterogeneous in operation and governance, and some key regions, like Africa, are not covered by such RFAs (Gallagher et al. 2021, 143).

Building on the achievements of the previous India G20 presidency, Brazil's G20 put a stronger and more effective international financial safety net on the agenda. The IMF should continue to play a central role, but allow layers of options to supplement one another, to coordinate, if possible, as there is no top-down framework for global financial stability.

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Third, Reform Governance for Balance of Power

There is a clear disconnection between voting powers and dynamic economic weights in the Bretton Woods Institutions. Since 2022, the central banks of developed countries, led by the Federal Reserve, have adopted monetary tightening policies, which have led to the tightening of global financing conditions and increase of the cost of financing in international financial markets. The evolving risks of high inflation and heavy debt pose serious challenges to the financial stability of developing and low-income economies. Against this backdrop, the IMF's increase of quota size certainly helps meet the financing needs of its member countries and enhance its ability to support the global economy. The conclusion of the 16th General Review of Quotas in 2023, with a 50% increase of each country's quota,

improves the structure of IMF resources, because it enlarged the permanent quota source and reduced overreliance on temporary funding. The new quota size will increase the amount of permanent funding to 715,7 billion SDRs (equivalent to US$ 960 billion), which is more than the total size of the two current temporary borrowed resources.

However, some core reforms have not yet been addressed, such as quota realignment, quota formula update, and governance structure (Kring et al. 2023, 1). Why is quota reform important? Under the terms of the IMF Agreement, IMF is a quota-based international financial institution. This means that the legitimacy of the IMF is based on the eligibility of member countries to pay their quotas, and that the IMF must ensure adequate resources, adequate lending instruments, effective monitoring tools, and a sound governance structure that reflects the representation of member countries. Therefore, the 17th General Review of Quotas, expected to complete in the next five years, should focus on the following issues.

First, realign quota shares in proportion to economic status of member countries. At present, there is a high level of under- and over-valuation of IMF quotas, which seriously distorts the representation of member countries. For example, there is a significant discrepancy between the quotas calculated after the Fourth General Review of Quotas and the more recent economic data. Currently, 38% of the members are underrepresented (out-of-lineness), mainly emerging markets and developing countries. Timely adjustment of quota distribution will not only improve fairness, but also lay the foundation for the adjustment of the IMF's governance structure.

Second, update the quota formula in response to changes in economic conditions and member countries' importance in the world economy. Despite the simplicity and transparency of this formula, the current formula elaborated in 2008 is outdated. It is time to reconsider the adoption of the variables and appropriate weights. The quota formula serves multiple functions in the IMF, including determining how fund resources are allocated and how member countries' voting rights are distributed. In addition, the quota formula also determines how the SDRs are allocated. Therefore, the composition of the quota formula variables should reflect changes in the economic situation, member countries' ability to provide resources, and their potential need to borrow from the IMF.

Third, the proportion of voting rights of LICs should be firmly ensured. The IMF's 14th General Review of Quotas set a good example. But in the new situation where LICs face severe economic and financial vulnerabilities, they need greater protection through better safeguard for their voice in international financial institutions.

Fourth, creating a 25th chair at the IMF Executive Board to enhance the voice and representation of Sub-Saharan Africa is a step forward to a balanced, credible and accountable decision-making in the IMF (G20 Brasil 2024, 8). In addition, there is an informal agreement that has remained unchanged since the inception of the Bretton Woods institutions–Europeans as managing directors of the International Monetary Fund and the United States as presidents of the World Bank. Such a governance model for high-level appointments is long outdated. Senior appointments based on merit, rather than on the nationality of candidates, would be a test for substantial progress in governance reform in the Bretton Woods Institutions.

CONCLUDING REMARKS

The Bretton Woods Institutions were established from the ashes of the war, with great expectations for post-war stability and recovery through multilateral cooperation. The designers also learnt lessons from the chaotic 1930s, when the gold-standard was in a disarray. The abandonment of the "rule of the game" that central banks' committed to maintain stability was one of the causes for great international monetary disorder. In the current situation where poly-crises persist, only international cooperation can prevent another disorder, and only reformed international financial institutions, that are more inclusive, effective and fairer, can save the spirit of multilateralism–the great legacy of the Bretton Woods Institutions.

The G20 countries account for 85% of the world's GDP and 58% of the world's population. G20 members own 81.2% of the IMF's quota shares and 78% of the voting rights. The G20 encompasses both developed and developing countries and serves as a platform for political consensus among the leaders of the world's major economies. The G20 has played a significant role in the past to help manage the financial crises through cooperation. It should continue to advocate the reform of global financial architecture, improve governance framework and make the governance structure reflect the relative economic strength of member countries.

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