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Introducing "Grassley-Baucus"

Forget Schumer-Graham. This new U.S. legislation has already spawned a strange new renaissance of IMF reform proposals. Can protectionism be cured?

BY CRITON M. ZOAKOS

The crude protectionist method of the Schumer-Graham bill that called for a 27.5 percent tariff on Chinese imports has been replaced by the comprehensive globalization approach of the Grassley-Baucus bill, named after the bipartisan leadership of the Senate Finance Committee, Chuck Grassley (R-Iowa) and Max Baucus (D-Montana). Two hours after Senators Grassley and Baucus announced their bill on March 28, Senators Chuck Schumer (D-NY) and Lindsey Graham (R-SC) responded by shelving their bill for the time being. This episode may yet come to symbolize how easy it can be to turn raw protectionist sentiment into enthusiastic support for greater economic globalization—if it is done right.

Grassley-Baucus ("The United States Trade Enhancement Act of 2006," or S. 2467) opens the way for a fundamental reform of the International Monetary Fund. It provides the first elements of a legislative framework that would turn the IMF into a facilitator for market solutions and, in this way, into a tool for the accelerated globalization of the world economy. The fact that this is proposed by the bipartisan leadership of the Finance Committee of the U.S. Senate should get the attention of America's trading partners—and that doesn't mean only the Chinese. The fact that its announcement was made right before the spring meeting of the IMF suggests that it was meant to get the attention of these trading partners: IMF reform was the agreed agenda of the Fund's spring meeting.

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IMF Reform Plans: The Big Five

At one end of the spectrum is the reform vision associated with C. Fred Bergsten and the Institute of International Economics, which calls for the creation of a "New Steering Committee for the World Economy" to replace the "illegitimate" G-7—currently the failed, de facto steering committee of the world economy.

C. Fred Bergsten
Director, Institute for International Economics

At the other end of the spectrum is the U.S. vision of IMF reform presented by Treasury Undersecretary Timothy Adams. This views the IMF as irrelevant unless it engages in aggressive exchange rate surveillance, including questioning member governments' choice of exchange rate regime.

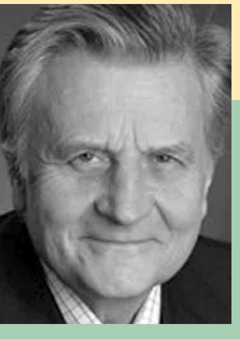
Timothy Adams
U.S. Treasury Undersecretary for International Affairs

A third version of IMF reform, somewhat close to the U.S. view, comes from Mervyn King and David Dodge, the governors of the Bank of England and the Bank of Canada, respectively. According to this, the IMF should be transformed into an impartial umpire, detached from the interests of its member government and, in its capacity as umpire, preside over the globalized economy with the aim of facilitating "market solutions"—basically by calling out fouls if the players violate market rules.

Mervyn King
Governor, Bank of England

David Dodge
Governor, Bank of Canada

A fourth version of IMF reform is suggested by the European Central Bank, which wants to take a seat at the IMF in place of the Eurozone IMF members by taking over their voting shares. This view would accept the impartial umpire model if and only if the ECB-reinforced IMF would have the authority to tell the United States what the rules of the game are.



Jean-Claude Trichet
President, European Central Bank

Finally, there is the IMF's own version of IMF reform, as presented by Rodrigo de Rato, its Managing Director. He wants to upgrade the IMF's Executive Board and its International Monetary and Finance Committee into a more effective "Steering Committee for the World Economy," in C. Fred Bergsten's ambitious phrase. Why is the IMF not irrelevant, Rato rhetorically asks? Because the "global imbalances" will not dissipate gradually on their own. They will require coordinated the efforts of policymakers from all sides, Rato replies. The new, improved IMF will be there to do this coordinating—in a market friendly way, of course.

Rodrigo de Rato
Managing Director, IMF

The important stuff happens in Title II, Sections 204, 205, 206, and 207 of the Grassley Baucus bill.

First, the bill repeals the Plaza Accord-era legislation that controls U.S. exchange rate policy (Subtitle A of Title III of the Omnibus Trade and Competitiveness Act of 1988). This was the law that mandated the orderly depreciation of the U.S. dollar, coordinated central bank interventions in the foreign exchange market, and offered provisions for identifying "currency manipulators." The familiar legal props for international economic coordination of the 1980s and 1990s are repealed. What is put in their place is the U.S. version of IMF reform.

Second, a seven-person committee of private sector financial and economic experts will work with the Secretary of the Treasury and the Chairman of the Federal Reserve to submit to Congress a report every six months that will determine which countries, if any, have a "fundamentally misaligned" currency; will identify the macroeconomic and other causes of the "fundamental misalignment" (including monetary and financial conditions, capital controls, levels of investment, trade restrictions, and export dependence for growth); and will propose remedies that the offending country or countries need to take to remove these causes.

Third, following submission of the report to Congress, the Secretary of the Treasury will try to engage the offending country bilaterally and also to enlist the IMF and other multinationals to pressure such governments to adopt the kinds of economic policies that will eliminate the fundamental misalignment.

Finally, if the offending country fails to conform under such multilateral pressure, the U.S. representative at the IMF will oppose any new financing for any project in that country. Moreover, the United States will demand that the Managing Director of the IMF advise the offending country that it may be found in violation of its obligations under Article IV of the IMF Articles of Agreement, and report the matter to the IMF Executive Board for further action.

Evidently, the Grassley-Baucus bill envisages an IMF reform that will transform the Fund into an agency that deals with the problem of "fundamental misalignment" of currencies. Without such a reform of the IMF, the bill would be meaningless. There are, however, rival versions of IMF reform proposals.

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"Global imbalances" are the reason behind this veritable renaissance of IMF reform talk. What Rato thinks is important about global imbalances—the excess U.S. investment and consumption over savings and the excess savings over investment and consumption in China, Japan, and others—is that neither of the two counterparties of these imbalances ought to dare proceed unilaterally to correct them. Therefore, both sides need to deliberate together and act only in coordination, and that's what the new, improved IMF will do.

To prove his point, Rato says that the counterparties to the global imbalances should be careful what they wish for when they wish that the other side act first to redress the problem. He correctly points out that if the United States acted unilaterally to increase its personal savings or otherwise reduce its domestic demand, then Europe, China, and the rest of Asia that depend on U.S. demand would go into recession and other downside risks would have to be faced. But he concludes from this, incorrectly, that the counterparties to the global imbalances cannot act one-sidedly. Not so. If Europe and Asia were to act unilaterally and increase their domestic consumer demand, free up investment opportunities, and so forth, there would be no downside risks.

There is an asymmetry to the global imbalances that neither Rato, nor Bergsten, nor the ECB spokesmen see: If the United States acts unilaterally to remedy its side of the imbalances, the rest of the world's export-driven, stagnant-domestic-demand economies could tumble. But if Europe, or China, or Japan acted unilaterally to remedy their side of the imbalances, the world economy would prosper.

Therefore, unilateral American demands that Europe and China adopt domestic pro-growth policies pose no risks for the world economy.

But unilateral European and Chinese demands that the United States curb its domestic demand pose enormous risks for the world economy and especially their own economies.

This brings us back to the version of IMF reform argued by Treasury Undersecretary Timothy Adams and the Grassley-Baucus bill. Both envisage two possible ways of beginning to remedy the global imbalances: either the United States unilaterally pressures and demands that its trading partners adopt pro-growth, market-based, anti-protectionist domestic economic policies, or the United States and its trading partners work jointly, with help from the reformed IMF, to promote these same policies.

Reforming the IMF's representation and voting rights would help promote these pro-growth, market-based policies. Among the specific U.S. proposals for IMF reform is reallocation of voting rights according to each country's relative GDP weight. In today's arrangement, the Eurozone accounts for 21 percent of world GDP and has 23 percent of the IMF vote. The United States accounts for 29 percent of world GDP but has only 17 percent of the IMF vote. Similarly, Korea's vote is 66 percent underweight relative to its share of world GDP, Mexico's 35 percent underweight, Turkey 32 percent, etc. If IMF voting rights were rebalanced according to each country's share of world GDP, the major English-speaking economies would increase their share of the vote from 29.5 percent today to 40.5 percent—a commanding plurality. If these English-speaking economies were to forge a policy alliance with Japan, they would command an absolute majority of 51.14 percent of the IMF vote. ◆