

## **Emerging Powers in the IMF and WTO: New Alternatives or Reform?**

Laura Carsten

Two facts stand out regarding emerging powers (EPs), the International Monetary Fund (IMF) and the World Trade Organization (WTO). First, EPs have recently shown increased levels of activism within these institutions. This activism appears in three forms. First, they are active as membership applicants: Russia applied for admission to GATT in 1993 and is still negotiating its admission to the WTO. Second EPs are active as borrowers: Brazil borrowed \$18.1 billion in 1998 from the IMF in order to increase growth and improve stability. Finally, they are active as coalition builders: India, Brazil, China and South Africa formed the G20 in preparation for the WTO negotiations in 2003 to advance the agricultural interests of the developing world.

The other interesting fact about EPs is that their affiliation with these institutions has led to great benefits. First of all, IMF loans make the impossible possible: via their accompanying conditions, IMF loans have pushed through domestically unpopular reforms which leaders considered necessary but politically impractical. In India, for example, reform was attempted in the 1980s but foundered in face of popular and interest group opposition; these reforms, however, were implemented successfully in concert with the IMF in 1991 (Nayar and Paul 2003, 195-6). Second, for the EPs, WTO membership means money and justice. Since joining the WTO, China rose from being the 9<sup>th</sup> largest global exporter and 10<sup>th</sup> largest global importer in 1999 (WTO 2000, 19-22) to being the world's 3<sup>rd</sup> ranked trading nation overall (WTO 2007, 12-15). Similarly, Brazil and India are among the most active users of the WTO's Dispute Settlement Body (Hurrell 2006, 11), successfully holding other states accountable for unfair trading practices.

Since the EPs have benefited so much from the IMF and WTO, one would expect them to continue to focus their efforts on acting within these institutions. In reality, however, EPs have recently employed a variety of strategies vis-à-vis the IMF and WTO. Thus their activities can be categorized as displaying one of three basic strategies: simple institutional use, reform, or substitution. This paper will address two of these strategies – reform and substitution – in detail and then pose some questions regarding the impact of these strategies on the IMF and WTO. First, however, it is necessary to define what is meant by emerging power states.

## **WHO ARE THE EMERGING POWERS?**

Emerging powers share five defining characteristics. First, they control a variety of power resources and have the internal cohesion necessary to use these resources effectively. Second, they have global ambitions, that is, think they deserve a larger role in international society. Third, they increasingly initiate contact with each other on many different levels. Fourth, they stand on the edge of the US-led system epitomized by the WTO and IMF (Hurrell 2006, 1-3). And, finally, they often attract the followership of other states, who support both their goals and their leadership projects (Schirm 2007).

For this paper, states that fit the definition offered here include the BRIC nations identified by Goldman Sachs in 2003 – Brazil, Russia, India and China – as well as South Africa, whose economic dominance in Africa, increased South-South activism, and recent institutional activities recommend it as an EP.

## **STRATEGIES**

### **1. Reform**

A distinguishing characteristic of EP reform activities is the use of partnerships created outside of these institutions to push for reforms within them. These external partnerships are created for a variety of reasons, generally focusing on sectors which states perceive as compatible. For example, while the Shanghai Cooperation Organization links China and Russia due to security concerns, China's strategic partnership with India is primarily a diplomatic initiative. Likewise, the IBSA Dialogue Forum is based on common ideals while Mercosur – the South American trade agreement dominated by Brazil - is undergoing trade negotiations with the Arab League primarily for economic reasons.

All of these partnerships, however, share two characteristics. First, they are all underlined by pragmatism. Cooperation is perceived as a way to gain benefits the states cannot attain alone. This is reflected in both the proliferation of sector-specific cooperation as well as in the tendency for these EP states to avoid "sticky" issues when organizing their partnerships. Second, EPs characterize these partnerships as a reaction against an international system they say lacks legitimacy. For example, a joint statement from China and India claimed their partnership hoped to create "a new international political and economic order that is fair, rational, equal and mutually beneficial" (2005). Thus, these external partnerships are organized to

achieve two goals: pragmatic benefits and a more legitimate international setting. The common goals demonstrated within these partnerships build trust between EPs and allow them to overcome their differences and unite around achieving these goals via reform activities within the IMF and WTO.

One example is the G20 coalition organized for the WTO negotiations in Cancun in 2003. The IBSA states – India, Brazil and South Africa - wrote a text calling for liberalization of industrialized states' agricultural markets which implied two necessary, general reforms of the WTO. First, they wanted to increase legitimacy and accountability by creating specific rules governing agenda-setting within WTO negotiations (Narlikar and Wilkinson 2004). Second, they wanted to remove some of the exceptions within WTO regulations in order to break the standstill in the Doha Round. What is interesting about the G20 is its diversity. Member states represent a broad variety of geographical regions, levels of development, and economic power resources. It follows, then, that their specific national interests would also diverge. The trust developed through external initiatives – whether through IBSA or various trade agreements – allowed these states to overcome their differences and unite around a WTO reform which would empower them and provide tangible benefits. The states, however, did not achieve their goals. Negotiations in Cancun ended in deadlock and the WTO reform failed.

The quota reform negotiations within the IMF in 2006 show another reform attempt by EPs. Quota reform has long been an issue within the IMF as current financial obligations and voting power largely reflect outdated relative economic power positions. The 2006 proposal included three elements: immediate quota raises for the most underrepresented states, a new formula which would be used to determine future quotas, and a second round of quota raises under the new formula (IMF 2008). At issue were the variables which would be included in the new quota formula, particularly regarding whether GDP would be calculated based upon exchange rate – a move favoring the industrial countries – or purchasing power parity (PPP) – a move favoring developing countries. As Table 1 indicates, the reflected difference in economic stature is quite large, with India's GDP three times larger under the PPP than under the exchange rate calculation. For this reason, Brazil, India, Argentina and Egypt, none of whom received quota increases in the first round, were outspoken in their demands that GDP be calculated in PPP. The Brazilian minister was reported as having claimed that the IMF was in "sclerosis"

and that it was only considering the views of big states and their allies (Brown, de Rato, and Ahmed 2006). Despite organized opposition by the EPs, however, the reform passed.

**Table 1. GDP of States Opposed to IMF Reform**

State	GDP (PPP)	GDP (exchange rate)
India	\$2.989 trillion	\$1.099 trillion
Argentina	\$523.7 billion	\$260 billion
Egypt	\$404 billion	\$127.9 billion
Brazil	\$1.836 trillion	\$1.314 trillion

SOURCE: CIA World Factbook Online

Interestingly, once the new quota formula had been determined and the second round of quota increases calculated, the coalition’s reform opposition turned into reform support. Brazil and India received two of the largest quota increases through the reform process, and the new quota definition includes a proportional measurement of GDP in PPP (IMF 2008). Thus Brazil’s finance minister this time declared the reforms “an important first step toward modernizing the IMF” (IMF 2008). The EPs achieved their goals and the IMF reform was a success.

These examples provide an overview of EP reform activities in the IMF and WTO. The next section will discuss their attempts to substitute these institutions.

## 2. Substitution

Substitution strategies by EPs involve using extra-institutional means to substitute the functions EPs gain from the institutions. These strategies are diverse and numerous given that states often try to substitute only one or two different aspects of these institutions. Two general categories of substitution strategies will be discussed: bilateral and regional trade agreements, and the building-up of foreign exchange reserves (FERs).

There has been a proliferation of free (FTA) and preferential trade agreements (PTA) in the past few years. Over 200 PTAs existed in 2007 and over 400 are expected by the end of 2010 (Dadush and Nielson 2007, 25). This has led not just to trade creation between Southern states (The Decoupling Debate 2008, 74), but also an ever-higher share of global trade being dominated by emerging states (Akin and Kose 2007, 44, 12).

These agreements are increasingly initiated by EPs who are frustrated with waiting for a resolution of multilateral negotiations within the WTO. As one Indian official said, India is “happy to pursue [bilateral] deals in the absence of consensus at the WTO” (Luce 2003). This is exactly what India has done. The Indian PM initiated trade negotiations with ASEAN at the first India-ASEAN Summit (Hoong 2002), and negotiations between India and Thailand and India and Singapore are also underway. Likewise, India signed a FTA with Mercosur in 2005.

The connection between PTAs, FTAs and substituting the WTO is clear. First, because of these agreements states no longer need a multilateral agreement to experience the benefits of trade liberalization (Mansfield and Reinhardt 2003, 830). Many scholars view bilateral trade deals as the first step toward creating regional agreements, which, in turn, have the potential to move up to the international level via negotiations between regions (Henderson 1994, 192; Nakagawa 2007, 36). Further, the more successful these deals are, the more likely other states will be encouraged to “protect” themselves via new bilateral PTAs or FTAs, thus further decreasing the necessity of the WTO’s multilateral negotiations (Mansfield and Reinhardt 2003, 845). In this sense, trade liberalization can progress incrementally and avoid the power politics evident in the WTO’s consensus decision-making. Additionally, these deals threaten the WTO by undermining its principle of nondiscrimination (Ikenberry 2008). China, for example, despite belonging to WTO, signed an agreement with ASEAN which guarantees ASEAN states lower tariffs on Chinese goods before these reductions are extended to other WTO members (Ba 2003, 638). This is a clear act of trade discrimination, but simultaneously a good strategic move for China who gains not just economic benefits from increased trade with its neighbors, but also improved security by promoting an image of itself as a benevolent regional hegemon. Thus PTAs and FTAs substitute a primary purpose of the WTO – facilitating trade liberalization – and make more difficult another primary one – governing international trade (Dadush and Nielson 2007, 25).

The second substitution strategy discussed here is the tendency of EPs to build up their foreign exchange reserves (FERs). EPs now hold 70% of global FERs (The New Titans 2006, 4), or \$2.9 trillion at the end of 2005 (Porter 2006). Academics have offered two explanations for this unexpected build-up. The first and most popular explanation is that EPs, who were injured both by recent financial crises and the stringent IMF conditions which accompanied crisis management, are attempting

to create self-insurance against financial instability (Porter 2006). That is, the states are substituting the crisis prevention and stabilization functions of the IMF by building investor confidence and making sure the necessary funds are there to protect their state in a crisis. Brazil's recent behavior coincides with this explanation: despite its financial stability, Brazil drew a large loan from the IMF in 2003, which it subsequently used to increase its FERs and to build investor confidence. Once these goals were met, Brazil repaid the loan early, claiming it had made itself autonomous from the IMF (After Years of Fighting 2005).

Unfortunately for this explanation, the FERs among EPs have grown to such proportions that self-insurance can no longer explain their accumulation (Jeanne 2007, 2-3), especially since investment in FERs is causing many states to actually lose rather than save money (Porter 2006). Economically, holding FERs is expensive, since states could invest the money in other, higher-return investments. FERs are also politically expensive, as holding them, rather than relying on the IMF, weakens global economic governance and limits the amount of institutional assistance a state can receive should self-insurance prove insufficient. Thus the second explanation for EPs' accumulation of FER reads: EPs are accumulating FERs in order to prevent their currency from appreciating. This keeps their exports cheap and their profits high (Aizenmann 2007, 61; Jeanne 2007, 44). India is a good example here: as the rupee appreciated 15% against the US dollar, the Central Bank of India responded by printing more rupees to buy more dollars (The Uncomfortable Rise of the Rupee 2007). Interesting in this explanation is that FER accumulation would replace not just the IMF – for the reasons already listed– but it would also move into the realm of the WTO, regulating trade flow between markets based on currency exchange rates.

In reality, a mixture of these two explanations probably best explains EP behavior regarding FERs. What is important here is that the accumulation of reserves decreases the need for the collective financial insurance offered by the IMF and even runs the risk of making the IMF irrelevant as FER assets now grossly exceed the IMF's available resources (Jeanne 2007, 46). Thus substituting the IMF with FER accumulation seems the best of all options for EPs, who can avoid the high political costs of accepting IMF loans; reassure investors; and avoid messy crises (Kapur and Webb 2006, 10-11).

## QUESTIONS TO CONSIDER

The use of reform and substitution by EPs since 1991 does not mean that EP states have given up altogether on the IMF and the WTO: as stated, their activism within these institutions has been increasing since the early 1990s and is likely to do so as long as states continue to perceive clear benefits deriving from the system (Hoekman and Kostecki 2001, 44). Despite this, a number of questions remain to be answered. Will these states continue to perceive benefits? How can they be integrated so that they do? Is there space for these states within the current institutional frame? And if so, will the current GPs let new states occupy it? The answers to these questions will determine the behavior of EPs in the future as well as the implications of EP actions for the IMF and WTO themselves.

## LITERATURE

After Years of Fighting the IMF, Lula Turns Brazil into the Best Client of the Fund. December 20, 2005. Rede Brasil. Accessed May 28, 2008: <<http://ifis.choike.org/informes/224.html>>.

Aizenman, Joshua. 2007. Comment on Olivier Jeanne's International Reserves in Emerging Market Countries: Too Much of a Good Thing?. *Brookings Papers on Economic Activity* No. 1: 56-67.

Akın, Çiğdem and M. Ayhan Kose. 2007 (Dec.). Changing Nature of North-South Linkages: Stylized Facts and Explanations. IMF Working Paper WP/07/280. Accessed March 18, 2008: <<http://www.imf.org/external/pubs/ft/wp/2007/wp07280.pdf>>.

Ba, Alice D. 2003. China and ASEAN: Renavigating Relations for a 21st-Century Asia. *Asian Survey* 43.4: 622-647.

Brown, Gordon, Rodrigo de Rato and Masood Ahmed. 2006. Transcript of an International Monetary and Financial Committee (IMFC) Press Conference. Singapore, September 17, 2006. Accessed online June 19, 2008: <<http://www.imf.org/external/np/tr/2006/tr060917.htm>>.

Central Intelligence Agency (CIA). 2008. World Factbook Online. Accessed July 1, 2008: <<https://www.cia.gov/library/publications/the-world-factbook/>>.

Dadush, Uri and Julia Nielson. 2007 (Dec.). Governing Global Trade. *Finance & Development* 44.4: 22-25.

Henderson, David. 1994. Putting 'Trade Blocs' into Perspective. In Vincent Cable and David Henderson, eds. *Trade Blocs? The Future of Regional Integration*. London: Royal Institute of International Affairs.

Hoong, Chua Lee. November 6, 2002. India Makes Trade Offer to ASEAN. The Straits Times ( Singapore ). Accessed with Lexis Nexis online June 24, 2008.

Hurrell, Andrew. 2006. Hegemony, Liberalism and Global Order: What Space for Would-be Great Powers? *International Affairs* 82.1: 1-19.

Ikenberry, G. John. 2008 (Jan./Feb.). The Rise of China and the Future of the West. *Foreign Affairs* 87.1: 23-37.

International Monetary Fund. March 28, 2008. Directors Back Reforms to Overhaul IMF Quotas and Voice. IMF Survey online. Accessed online June 26, 2008: <<http://www.imf.org/external/pubs/ft/survey/so/2008/NEW032808A.htm>>.

Jeanne, Olivier. 2007. International Reserves in Emerging Market Countries: Too Much of a Good Thing? *Brookings Papers on Economic Activity* No. 1: 1-55.

Joint Statement of the People's Republic of China and the Republic of India . April 11, 2005. New Dehli. Accessed April 29, 2008: <<http://www.china.org.cn/english/2005/Apr/125627.htm>>.

Kapur, Devesh and Richard Webb. 2006. Beyond the IMF. Paper for G-24 Technical Group Meetings, March 2006. Accessed online June 19, 2008: <<http://www.g24.org/weka0306.pdf>>.

Luce, Edward. October 16, 2003. International Economy: India Forsakes World Trade Organisation for Bilateral Free Trade Deals with Neighbours. *Financial Times*. Accessed online June 24, 2008: <<http://search.ft.com/ftArticle?queryText=india+seeks+free+trade+with+ASEAN+in+side+10+years&y=0&aje=true&x=0&id=031016000976&ct=0>>.

Mansfield, Edward D. and Eric Reinhardt. 2003 (Autumn). Multilateral Determinants of Regionalism: The Effects of GATT/WTO on the Formation of Preferential Trade Arrangements. *International Organization* 57.4: 829-862.

Nakagawa, Juro. 2007 (Mar.). Peacekeeping and Global Business in Northeast Asia. *International Journal on World Peace* 24.1: 33-36.

Narlikar, Amrita and Rorden Wilkinson. 2004. Collapse at the WTO: A Cancun Post-Mortem. *Third World Quarterly* 25.3: 447-460.

Nayar, Baldev Raj and T.V. Paul. 2003. *India in the World Order: Searching for Major-Power Status*. Cambridge UP: Cambridge, United Kingdom.

Porter, Eduardo. April 30, 2006. Are Poor Nations Wasting Their Money on Dollars? *The New York Times*. Accessed online June 12, 2006: <<http://www.nytimes.com/2006/04/30/business/yourmoney/30view.html?scp=12&sq=india+currency+reserves&st=nyt>>.

Schirm, Stefan A. 2007. Success and Failure of Emerging Power Leadership in Global Governance: Brazil's and Germany's Bids for Structural Power, Top Jobs, and Policy

Positions. Paper prepared for delivery at the ECPR Joint Session of Workshops in Helsinki , May 7-12, 2007.

The Decoupling Debate. March 8, 2008. *The Economist*, 73-75.

The New Titans. September 16, 2006. *The Economist*, Special Section, 3-10.

The Uncomfortable Rise of the Rupee. December 13, 2007. *The Economist*. Accessed online June 12, 2008:

<[http://www.economist.com/finance/displaystory.cfm?story\\_id=10286077](http://www.economist.com/finance/displaystory.cfm?story_id=10286077)>.

World Trade Organization. 2007. International Trade Statistics. Accessed online June 28, 2008: <

[http://www.wto.org/english/res\\_e/statis\\_e/its2007\\_e/its07\\_toc\\_e.htm](http://www.wto.org/english/res_e/statis_e/its2007_e/its07_toc_e.htm)>.

World Trade Organization. 2000. International Trade Statistics. Accessed online June 28, 2008: < [http://www.wto.org/english/res\\_e/statis\\_e/stat\\_toc\\_e.htm](http://www.wto.org/english/res_e/statis_e/stat_toc_e.htm)>.