Chapter – IV

IMF: GOVERNANCE

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4.1 Introduction

This chapter deals with the study of the governance of the IMF. All aspects of the IMF governance such as the votes and quotas of the Fund, choice of the Executive Board of the Fund, the Board of Governors and the process of choosing the managing director and the staff have been studied in this chapter. Plus, the distribution of quotas and votes for different country groups has also been explained in this chapter.

All the data collected for this chapter are secondary data. The data are collected mostly from the IMF’s database and working papers. Other sources and journals have also been used to collect data for this chapter. To understand the different aspects of the governance of the Fund, a descriptive and analytical methodology have been used.

The chapter is organized to explain the governance of the IMF. Then, the deficiencies in the system are identified. Plus, the reform efforts so far have also been studied and the scope for further reforms in the governance of the Fund has also been explained.

4.2 Governance of the IMF

The IMF is an international organization established by an international agreement that is embedded in the legal systems of each member. The institution is owned by and responsible to its member governments. Those governments, in turn, are responsible to their own citizens either in broad terms or more narrowly in the case of elected governments. Accountability, transparency, and legitimacy are at the core of the IMF existence vis-à-vis both its member governments and the world at large, regardless of how various governments or interest groups may agree or disagree on how those principles should be applied.

At the time, the IMF consists of 188 members. These countries are from different economic backgrounds, and the Fund is responsible towards each and every one of them. Each member is presented with a quota share. Quota shares are the building blocks for many aspects of the IMF and its operations. A country’s quota is directly translated into voting power because the number of votes a country has in the
Fund is based primarily on the size of its quota. Due to changes and shifts in economic power, quotas are reviewed at least every five years and new quotas are assigned respectively. The quotas are vote share of each country is shown in Annexure.

IMF assigns a Managing Director each 5 years. The Director is a European member of the Executive Board of the Fund based on the Articles of Agreement since the establishment of the Fund.

The Executive Board of the Fund consists of 24 members of the Board of Governors of the IMF that represent their own country or a group of countries in the Fund. The Executive Board of the Fund is charged with the supervision of the activities of the institution. These 24 members represent the Chairs of the IMF. Table 4.1 represents the 24 chairs of the IMF with their country grouping and their head of the constituency. Plus, the number of countries represented is also shown in the table.

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92 IMF Articles of Agreement, Article XII, section 3, Executive board (http://www.imf.org/ external/Pubs/FT/AA/index.htm#a12s3)
As it can be observed, out of the 24 chairs of the board, 8 are representing single countries and the remaining 16 are representing the other 180 members of the Fund.
4.3 Importance of IMF Governance

The Fund is an institution of global cooperation and global governance. As such, the IMF is held responsible for its policies, actions, and inactions by the International public opinion and the various groups that seek to influence or affect those opinions.

The quality and legitimacy of IMF’s governance is central to its success in carrying out its mission to promote maximum global growth and international financial stability. IMF can have a very important role in affecting the member countries practice fair economic policies that promotes the global stability. This happens only if the countries have faith that their share in the IMF is represented fairly and they have fair voice in the Fund. Therefore, in the governance and structure of the Fund is distributed according to their economic power in the world, there will be a better cooperation between the Fund and the member countries and this will result in a more stable monetary system.

The member’s quotas are also very important in the governance of the Fund, since this share represents how much these countries can borrow from the Fund in times of future crisis and since the IMF lending can play an important role in helping countries overcome their troubles. If their share is underrepresented in the Fund, the countries will not consider the IMF a legitimate organization due to defects in the governance structure of the Fund and will turn to other suppliers for help that are way riskier and costlier. This will again endanger the global stability of the International Monetary System. Hence, how the IMF is governed and how it carries its day to day actions impacts each member, whether small or big, and this affects the monetary system as a whole.

4.4 Original Governance Arrangements and Evolution in Operations

The 44 original founder countries in 1944, at the Bretton Woods conference agreed to surrender some of their monetary sovereignty to the IMF and enjoy the benefits of a rule-based monetary system in return. IMF was chosen to oversee the system. IMF started with the primary function of ensuring that the members followed policies consistent with the maintenance of the par value established for their currency. In return, IMF would provide financial support to any member state
experiencing serious balance of payments difficulties to encourage compliance with those obligations.

The operating practices and governance arrangements for the IMF were designed to support these original regulatory and financing functions. Some of their features deserve mention because of their relevance to the IMF’s current governance problems.

In the beginning, IMF’s annual surveillance on each member state focused mostly on the macroeconomic variables that influenced the ability of the country to maintain the par value of its currency, pursuant to Article IV of its Articles of Agreement.\(^93\) Given the nature of its interest, it made sense for the member states to stipulate in the Articles of Agreement, that the IMF should limit its interactions with the member state to its Central Bank and ministry of Finance.

Maintenance of the par value system influenced the conditions that the IMF would attach to its financing given to its member countries. The conditions focused on macro- economic and monetary issues relevant to the restoration of a sustainable balance of payments and par value for the currency. The nature of these conditions placed some limits on the IMF’s intrusion into the policy-making process of its member states because it left the recipient state free to choose the specific policy measures for meeting these conditions.

IMF was established to be a monetary institution and not a development one. Hence, the Fund did not classify and distinguish its members based on their level of wealth or development. So, the IMF treated all the member countries in a uniform manner since it assumed that since all states were participants in the same monetary system, that the ability of each state to maintain its par value was influenced by the same variables, and that they were all vulnerable to the same types of balance of payments problems. As a result, IMF started offering financing to all its members with the same terms and conditions. IMF’s annual consultations with each member state covered essentially the same issues. The IMF concretized this approach by adopting a principle of uniformity as one of its key operating principles. The principle made sense during the period of the par value system when many of the rich

\(^93\) IMF Articles of Agreement, Article IV, section 4, par values (http://www.imf.org/External/Pubs/FT/AA/index.htm#a4s4)
countries, including the United States, in fact, did make use of the IMF’s financing services.

In the early years of IMF existence, since the most powerful and richest countries anticipated having to use the financing services of the IMF in the future, they were unlikely to advocate policies burdensome for other member states using the IMF’s services, since they were able to understand that the policies set by the IMF could one day affect them and their own citizens directly too and the citizens would hold them accountable.

Plus, the governance structure of the Fund was built with the assumption that the Executive Board would control the IMF’s management and staff on behalf of the whole membership. In the beginning, this expectation was realistic since the original 44 members were represented by 12 Executive Directors and also the fact that the number of IMF programs was relatively small.

However, after the collapse of the Bretton Woods system in 1971, IMF lost its whole well-defined monetary mission. This led to the adoption of the Second Amendment to the IMF’s Articles of Agreement in 1978.\textsuperscript{94} Since the countries were not subjected to maintain any particular value for its currency and could choose its own exchange rate policy, then what was the IMF supposed to be monitoring in its annual consultations with the country?

Article IV of the Articles of Agreement was also amended but this also provided no clear guidance.\textsuperscript{95} It requires each member state to “endeavour to direct its economic and financial policies toward fostering orderly economic growth”; to “seek to promote stability by fostering orderly underlying economic and financial conditions”; and to “follow exchange rate policies compatible with the undertakings” of Article IV.\textsuperscript{95} The amended article also suggested that the IMF needs to look at any aspect of the member state’s economic and financial policies and policy making arrangements that could affect its “orderly economic growth”, its external balance of payments and the value of its currency. In other words, the Second Amendment has resulted in the IMF dramatically expanding the scope of its Article IV consultations. It

\textsuperscript{95} Hagan, Sean, 2006, “Article IV of the Fund’s Articles of Agreement: An Overview of the Legal Framework”
has also led to an expansion in the range of conditions that the IMF attaches to its financing.\(^6\)

After the Second Amendment, the members of the IMF were no longer uniform. They could be classified into two groups. Based on their level of wealth and access to other sources of funds, the first group was known as the supplier member states of the IMF. The members of this group have no intention of using IMF’s services in future.\(^7\) In return, they wouldn’t need to pay any attention to IMF views and controls.\(^8\) For these countries, the most important of which are the G-7 countries, the Second Amendment meant that they regained their monetary sovereignty from the IMF and escaped from its control.

The next group of members, also known as the consumer states, were those that need or know they may need IMF financing in the foreseeable future. Since these countries are influenced by the conditions and the views of the IMF, they have to pay careful attention to the views of the IMF. IMF views could also influence these countries’ access to other sources of funds.

A third group of countries have also emerged in recent years. This group consists of those that have a good access to private financial markets outside of the Fund, and they have also accumulated large reserves as a means to self-insure themselves against the risk of payments and capital account crises. Like the first group, this group is also in the verge of buying their independence from the IMF and regaining their monetary sovereignty from the IMF.

### 4.5 Changing Role of the IMF and Its Implications for Governance

After the adoption of the Second Amendment in 1978, the IMF started expanding its range of activities without making any significant changes in its governance arrangements. IMF started forcing its broader functions into the decision-making and governance structure of its mandate. This sudden change brought about distortions in the system that has questioned the relevance of the IMF since then and has undermined the effectiveness of its operations.

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\(^7\) Garritsen de Vries, Margaret, 1986, “The IMF in a Changing World”

These distortions are:

a) The relation between the IMF and the industrialized members, specially the G-7;

b) The relation between the IMF and the developing nations, those that utilize or expect to utilize IMF’s resources

c) The relation between the IMF and other international organizations.

A. The Relation between the IMF and the Industrialized Members

The industrialized members of the IMF did not use the IMF resources after the second amendment to the Articles of Agreement up until the global financial crisis of 2008. Due to their high levels of wealth and reserves, these countries relied mostly on their own resources and other private capital markets to meet their own financial needs, since IMF was not an economically or politically feasible institution to borrow money from after its expanded range of activities and controls.

Their independence from the Fund and its resources has freed them from any control and advice of the IMF in their annual consultations. They have, in fact, regained their sovereignty that they surrendered to the IMF at the Bretton Woods Conference in 1944.

However, these countries, especially the G-7 have continued to support the IMF. The reason for their actions is that through IMF they can influence poor or middle income countries that are undergoing transformations or even experiencing serious macro-economic and monetary problems. Through this system, they can compel these countries to adopt stabilization and adjustment policies acceptable to them. In short, they value having an organization that can focus on the problematic areas of the global financial system, while at the same time they were free to shape the system according to their own preferences.

Because of their wealth and their bigger quota sizes in the IMF, these industrialized countries, particularly the United States, Japan, Germany, UK, and France are the dominant forces of the decision making structure of the IMF. Their dominance is significantly enhanced by two developments that have occurred in the IMF since its formation in 1944. First, the number of IMF Executive Directors has grown more slowly than the number of IMF member states. Originally, there were 12 members on
the Executive Board to represent the original 39 members of the Fund. To represent the existing 188 members of the Fund, there are only 24 members on the Board. Originally, only the 5 biggest shareholders had their own executive directors and the remaining 34 member states were represented by the other 7 directors. This meant that each of these 7 directors represented on average slightly less than 5 states. Today, of the 24 member Board, in addition to the 5 executive directors representing the five largest shareholders another 3 directors represent single countries. Thus, today 16 directors represent the remaining 180 member states. This means that each of these directors represents on average slightly less than 12 states. In fact, some executive directors, for example the two directors representing sub-Saharan Africa represent considerably more than 11 states.99

The change in the average size of constituencies of the executive board of directors and the related power change have affected the IMF’s decision making process. The members with permanent board representation enjoy a distinctive advantage of having their views heard in the Board. A constituency including 10-11 member states is not likely to enjoy this right in the same way. Director of this constituency clearly cannot play the same role in policy issues in the IMF as an executive director of the Board.

It should also be noted that each of the G-7 countries has always a representative of their country in the Executive Board, despite the fact that only 5 of the 7 countries have appointed Executive Directors. The Euro Zone members, on the other hand, hold 6-7 seats out of the 24 seats of the Board. Plus, in 5 out of 6 cases in which an Executive Director represents both developing and industrialized countries, the Executive Director is from an industrialized country, and in the other 1, the Executive Director is usually from an OECD member state. These result in having 11 chairs from the OECD countries and 9 from the industrialized countries out of the total 24 seats.

As a result, these industrialised countries enjoy a numerical advantage on the Executive Board. Because of their powerful position in the Board, these countries are able to develop institutional memories and expertise in how to function in the IMF.

This enhances their ability to negotiate effectively and to shape the issues and the decisions around which the consensus must form.\textsuperscript{100}

The Executive Board imbalance can be seen especially in the case of European countries. These countries are clearly over-represented at the IMF compared to their share of global GDP, since they have 3 full seats (Germany, the United Kingdom and France), and chair or co-chair seven of the group constituencies. These 25 European countries have only 29.8\% of the votes, but they play a dominant role in appointing 10 out of the 24 members of the Executive Board which accounts for 42\% of the power.\textsuperscript{101}

As a result, the G-7 countries have enhanced control over the policy making agenda in the IMF. However, since these countries are independent of the IMF, they do not have to live with the consequences of the policies made by the IMF. This means that they are in control of setting policies that are of limited interest to their own citizens but on the other hand is of immense interest to the citizens of developing countries that are very dependent on the IMF. This situation of decision makers having power with accountability to people who do not have to live with the consequences of their decisions but without accountability to those most affected by their decisions is a situation ripe with potential for abuse.

The second development is related to the composition of the voting rights on the members in the IMF decision making process. Each member state is assigned 250 basic votes plus 1 additional vote for every SDR 100,000 the country hold with the IMF. The basic vote represents the principal of the sovereign equality of states. The remaining portion of the votes reflects the size and importance of that country in the world economy. The number of total votes in the IMF has been increased due to the fact that the IMF membership has also grown from just 39 members in 1946 to 188 today. However, the basic votes of the IMF have not changed since the day of the establishment. Therefore, the percentage of the role of these basic votes has decreased significantly from 1946. Basic votes accounted for 11.3\% of the total votes in 1946, where today they only account for 2\% due to the growing number of member states. Basic votes which give the smaller and weaker member states some counterweight to

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\textsuperscript{101} Weiss, Martin, 2008, “International Monetary Fund: Reforming Country Representation”, p.5.
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the dominance of the richer and bigger member states have been reduced significantly.\textsuperscript{102}

As Figure 4.1 illustrates, as of 2005, basic votes as a percentage of total votes has decreased substantially since the IMF was created, even as the number of IMF member countries (each receiving basic votes) has increased.

\textbf{Figure-4.1}

\begin{figure}[h]
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\includegraphics[width=\textwidth]{IMF_Basic_Votes.png}
\caption{IMF Basic Votes}
\end{figure}

Source: IMF, 2006

Any increase in the number of basic votes is politically very difficult, since there is a need for an amendment to the Articles of Agreement. The recent reforms have taken steps to increase the number of the basic votes, and have not received the 85\% approval to change the number of the basic votes and go on with the amendment afterwards.

\textbf{B. IMF and Developing Countries}

Before the 2008 Global Financial Crisis, most of the states that utilised IMF’s financial services were low or middle-income countries. These countries are either the emerging market economies which under normal circumstances have access to private capital financial markets. Most of these countries use IMF resources as a signal to

other private investors that they have adopted good macroeconomic policies and they are suitable for private investment. However, these countries are still dependant on IMF funding since they might be unable to raise sufficient funds from private sources.

To be able to escape from IMF’s over controlling and over sight, many of these countries have pre-paid their obligations to the Fund. Many other Asian countries in this group have also accumulated sufficient reserves to self-insure themselves against future payments crisis to escape IMF constraints.

The actions taken by these countries can be interpreted as a vote of no-confidence in the IMF and is questioning IMF’s relevance in the monetary system. The more successful these countries become in their efforts to become independent of the Fund, the more similar they become to the first group of supplier countries.

Another group of countries in here are those that are substantially dependent on official sources of the Fund because of their poverty levels and their unsustainable political conditions. These countries, not only require IMF’s financial support, but also are dependent on IMF to approve their policies so that they can receive extra financing from other sources of funding outside the IMF.

These two groups of consumer countries are more or less similar and they all share a common characteristic. Although the challenges that these countries face have a macroeconomic dimension, the primary cause of their social and economic, including macroeconomic, problems lies in the governance of their societies. In particular their problems are caused by weaknesses in their institutional arrangements and technical capacities which limit their ability to effectively make and implement policy. As part of its expanded responsibilities, IMF has attempted to address these issues. This can be seen in the policy advice and the conditionality attached to its financing. IMF is now seen addressing issues such as bankruptcy laws, legal and judicial reform, allocations of public budgets, privatization, environmental issues, social safety nets, and banking reform that are not monetary or macro-economic

103 IMF Press Release No. 05/19, Russian Federation Completes Early Repayment of Entire Outstanding obligations to the IMF (Feb. 2, 2005); IMF Press Release No. 05/278, Argentina Announces Its Intention to Complete Early Repayment of Its Entire Outstanding Obligations to IMF (Dec. 15, 2005); IMF Press Release No. 05/275, Brazil Announces Intention to Complete Early Repayment of Entire Outstanding Obligations to IMF (Dec. 13, 2005)
issues. The micro nature of these requirements has transferred the IMF into a development financing organization.\textsuperscript{104}

The issues, which the IMF is now covering in its annual surveillance mission and its funding conditions, have changed the nature of its relationship between these consumer states and the IMF. Before the collapse of the par value system, most of the IMF’s advice and conditions were limited to discrete macroeconomic variables. The member states governments were free to decide on the actual measures they would adopt to achieve the macroeconomic targets set by the Fund. This freedom does no longer exist due to the increased range of issues the IMF covers in its annual consultations and its conditions. Hence, the IMF now has become an active participant in the policy making process of this group of members. This gives the IMF the bargaining power against the governments in both the annual consultations and the negotiations with the consumer states over the policy conditions to be attached to IMF financing. Plus, due to the dominance of the G-7 countries, there is a strong probability that these countries use the IMF to impose their own economic political views on the developing countries. Hence, IMF is now seen more as a political organization biased in favour of industrialized and richer countries rather than a technically specialized and politically neutral organization.

This problem is exacerbated since this group of countries are also under-represented in the Board of Executive Directors and hence they cannot influence or limit the discretion of the management and staff in the IMF’s operation. Due to this under-representation, these countries are unable to hold the IMF accountable for their actions and discretion.

Since the IMF has recognised the unduly intrusiveness of its programs, it has issued new guidelines on conditionality that are intended to make the conditions more focused on its core areas of competence and to reduce the number of conditions to those that are essential to the achievement of the program’s objectives in recent years.\textsuperscript{105} However, although there can be seen some reduction in the average number of its conditions, these guidelines are also very unspecific and it is not clear how they

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will be effective in reducing the IMF’s intrusion. Plus, after 2002 there have been further efforts to review and reform the conditionality guidelines, but the efforts have not made much change.

C. IMF and Other International Organizations

United Nations specialized agencies were created by the assumption that each of these agencies (IMF as one), would exercise its authority within the limited scope of its specialization and the coordination of these agencies would be done by the U.N. Economic and Social Council. In order to facilitate this coordination, each agency has a relationship agreement with the United Nations. Based on the agreement, the IMF is a subordinate of the United Nations. However, IMF is declared to be independent of the United Nations and is relieved from any significant responsibilities to the UN.

The effective independence of the IMF from the UN has become a problem as the scope of the IMF’s operations has expanded beyond its original monetary function. Now that the IMF is involved in such issues as law reform, poverty alleviation, labour issues, social welfare, budgetary allocations for health and education, environment, and trade liberalization, its operations are encroaching into the jurisdiction of other specialized international organizations like the World Bank, WHO, the WTO, etc.

4.6 Anomalies in Quotas and Votes of the IMF

IMF quotas have traditionally been the main source of funding of IMF financial assistance packages. Quotas are also a determinant of a member’s voting power at the Fund. Figure 4.2 shows how IMF quota resources have changed over time relative to different measures of international economic activity since 1975. IMF quotas have fallen relative to global GDP, net capital inflows, trade, and reserves in recent decades.

This shows that as the economic integration have increased the quotas have not increased respectively. The IMF clearly needs more financial resources to remain effective in responding to economic crises.

106 UN Charter article 61-72
IMF has found alternative ways to supplement its quota resources. These alternatives account for about $367 billion. During the financial crisis of 2008-09, the IMF expanded its pool of resources through a supplemental resource called the “New Arrangements to Borrow” (the NAB). 38 member states have committed about $570 billion to the NAB.\(^{107}\) During the recent Euro Zone crisis, also, 37 countries have pledged a total of $456 billion of bilateral loans to the IMF. The United States has not participated in any of the two pledges.\(^{108}\)

However, many argue that these NAB supplemental funds are inadequate substitutes for increasing quota resources. As they argue, these large supplemental funds undermine the legitimacy of the IMF as a quota based institution, where many

crucial decisions and different aspects of the Fund are influenced by quota. Plus, since NAB resources are more difficult to use than the quotas resources, this weakens IMF’s ability to respond quickly during crises. Bilateral commitments by the member countries are also temporary and may not be a reliable source of funds. Hence, there is an immediate need for a boost in IMF quotas.

4.7 Representation of Emerging and Developing Countries

Apart from the ongoing concerns regarding the adequacy of IMF resources, some IMF members worry that the developing and emerging countries are clearly “under-represented” at the IMF. This under-representation puts into question the even-handed provision of IMF resources among crisis-afflicted member countries. Because of under-represented position in the Fund, these emerging economies are less able to influence IMF strategic policies. This undermines the legitimacy of the IMF in the views of the members.

IMF voting shares are a reflection of relative weights of the countries in the global economy, but voting shares have proved slow to change and do not fully reflect major changes in recent decades. The distribution of global growth and the diffusion of economic power have changed from the time that the IMF was founded in 1944. For example, the increasing economic influence of Brazil, India, Russia, and China is a clear evidence of such phenomenon.

Figure 4.3 compares the share of GDP and share of IMF quota (which affects IMF voting shares) for the BRICs and a group of advanced European economies. The share of global GDP produced by the BRICs started to increase in the mid-2000s, while the share of global GDP produced by the group of advanced European economies has fallen in recent years. However, IMF quota share, and hence voting power, for both sets of countries has remained relatively flat.
The dissatisfaction of the emerging and developing countries with the quota structure of the IMF, and their under-represented status is the Fund puts in danger the legitimacy of the Fund and hence, needs to be addressed.

4.8 Choice of Management and Staff

Since the establishment of the Fund in 1944, the process of choosing the managing director of the Fund has not changed and this satisfies very few observers, the exception of key senior officials and political leaders in the United States and in Europe. In practice, the existing convention is that the Europeans propose the managing director of the IMF, and the president of the United States chooses the head of the World Bank. The executive directors subsequently deliberate and elect the individuals proposed.

Asian and African country members find this process outdated and are pushing for reforms in the selection process. They call for a more transparent process in which the selection is more based on merit, and not limited to a particular country or region.
In addition, many members of the Fund complain about the lack of diversity and the senior staff and the staff as a whole. Most of these positions have been filled by people from the creditor countries, thus providing them with more undue influence over IMF policies and other decisions in the fund. The lack of geographic diversity in the Fund is an issue that needs to be addressed to better expand the diversity and technical expertise of the Fund as a whole.

4.9 IMF Governance Reform Efforts

In this section, an attempt has been made to discuss about the three rounds of IMF governance reforms. The reforms included governance reforms of 2006, governance reforms of 2008, and governance reforms of 2008. Each of these rounds has been explained in detail.

As the dissatisfaction over the governance structure of the Fund started to grow more, and as a mean to respond to the pressures from the developing and emerging market economies, IMF started a wave of governance reforms in 2005 with a statement from Rodrigo de Rato, the IMF’s managing director at the time, stating “fair weight and choice are crucial to the legitimacy of a universal institution. This current allocation puts the legitimacy of the Fund at risk especially in regions like Africa or Asia, where the Fund is more engaged than other regions.”

De Rato presented a reform proposal consisting of a two-step process, at the spring 2006 meeting of IMF. The first step, consists of a so-called ad hoc increase to immediately raise the representation of a few countries that are under-represented at the Fund. More fundamental reforms of the IMF governance framework to be executed in the next two years were part of the second round of reforms.

4.9.1 Governance Reforms of 2006

De Rato’s first round of quota increases won approval which resulted in small quota increases for China, Mexico, Turkey, and South Korea. Following this, IMF would have to work for the next two years to adjust IMF quotas through a new quota formula, a second round of ad hoc increases, and increases in the number of basic

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votes available to all countries. Brazil, India, and Argentina were among the emerging economies opposing the first round of ad hoc increases arguing that reforms should be adopted for all developing countries simultaneously. They were, however, promised an enhancement of representation of all dynamic economies in the next round of reforms.

These reforms in the form of ad hoc increases resulted to an increase of almost SDR 4 billion in the quotas of the IMF.\textsuperscript{111}

\textbf{4.9.2 Governance Reforms of 2008}

Considering the increasing importance of the emerging market economies in the world economy, the IMF aims to reform the institution in a direction to better align quota and voting shares in the Fund’s with member countries' weight and role in the global economy. Plus, the reform process aims to enhance the voice and participation of low-income countries.

The Board proposal is part of a two-year reform program approved at the 2006 Annual Meetings in Singapore. As part of the first round of reforms, China, Korea, Mexico, and Turkey went through ad-hoc increases. A country's quota at the IMF largely determines its voting power in the 185-member institution.

The reform package included the following elements:

1. The reform now takes a more transparent quota formula. The four variables in the new quota formula now include GDP, openness, variability, and reserves. The relative weights for each of these variables are 50 percent, 30 percent, 15 percent and 5 percent, respectively. For the GDP variable, 60 percent is the GDP at market exchange rates, and the remaining 40 percent is GDP at Purchasing Parity Power (PPP) rates. Some of the variables in the existing five formulas have also been updated and modernized.

2. Second round of ad hoc quota increases. First and second round of quota increases now account for 11.5 percent of increases for the dynamic countries. All under-represented members now receive a quota increase. In addition to these ad hoc quota increases:

\textsuperscript{111} Reform of IMF Quotas and Voice: Responding to Changes in the Global Economy, 2006, Report Published by IMF
• Some of the advanced economy members also forgo increases. Several underrepresented advanced countries will also be a part of the quota increase process. These countries include: the United States, Germany, Italy, Japan, Ireland, and Luxembourg.

• To recognize the dynamism completely, the underrepresented emerging market and developing economies with actual quota shares substantially below their share in global GDP in terms of purchasing power parity (PPP) will receive a minimum nominal quota increase of 40 percent under the reform.

• The four member states that have received quota increases in the initial round of the reform (China, South Korea, Mexico, and Turkey), will receive a minimum nominal second-round increase of 15 percent.

3. To ensure the continuation of the fair distribution of quota and voting shares, the quota formula and the respective quotas assigned to the member countries will be reviewed every five years.

4. The proposal also enhances the voice of low-income countries through two measures, which requires an amendment to the IMF’s Articles of Agreement:

• First ever increase of the Fund’s basic vote since the inception of IMF in 1945 to triple the current amount. This mechanism is taken in order to protect the percentage of the basic votes in the total decision making process of the Fund going forward. This tripling of basic votes is especially designed to protect the voice of smaller members.

• To enhance the capacity of the two Executive Directors offices representing African constituencies, and to recognise the heavy work load flowing from the important advisory and financial role that the Fund is playing in many of the member countries represented by these offices, the Fund will assign an additional alternate Executive director for African Chairs.
To go forward with these reforms, the Fund needed an 85% of the total voting power of the member states. Of the 185 members in 2008, 175 countries representing 92.93 percent of the total voting power in the Fund voted in favour of changes to the quota and voting share structure that will enhance the participation of emerging market and developing countries, and realign members’ shares with their relative weight and the role in the global economy.\textsuperscript{112}

This round of reforms resulted in an increase for 54 member countries amounting to SDR 20.8 billion, equivalent to US $32.7 billion. Emerging market countries are the main beneficiaries of this aggregate shift in quota shares of 4.9 percentage points. Korea has a quotas increase of 106 percent; Singapore by 63 percent; Turkey by 51 percent; China by 50 percent; India by 40 percent; Brazil by 40 percent; and Mexico by 40 percent.

These reforms, however, did not take effect until March 2011, following the ratification of the Amendment and voice and Participation to the Fund’s Articles of Agreement.

4.9.3 Governance Reforms of 2010

In October 2009, the IMF’s policy steering committee, the International and Monetary Committee, endorsed a call by the Group of Twenty (G20) industrialized and emerging market economies for a shift in quota share to dynamic emerging market and developing countries of at least five percent from over-represented to under-represented countries using the current quota formula as the basis to work from. This was the basis for the 14\textsuperscript{th} General Review of Quotas.

The 14th General Review of Quotas will include:

- Doubling of quotas from approximately SDR 238.4 billion to SDR 476.8 billion
- Shifting of more than 6 percent of quota shares to the under-represented member countries from the over-represented members.

• Shifting of more than 6 percent of quota shares to dynamic emerging market and developing countries (EMDCs).

• Realignment of quota shares. As a result of this realignment, China will become the 3rd largest member country in the IMF, and there will be four EMDCs (Brazil, China, India, and Russia) among the 10 largest shareholders in the Fund.

• Preserving the quota and voting share of the poorest member countries. This group of countries is defined as those eligible for the low-income Poverty Reduction and Growth Trust (PRGT) and whose per capita income fell below US$1,135 in 2008 (the threshold set by the International Development Association) or twice that amount for small countries.

The member countries quotas will double from SDR 238.4 billion to SDR 476.8 billion (about $755.7 billion) after the 14th General Review becomes effective. This practically doubles IMF’s principal source of financial resources. Plus, The New Arrangements to Borrow (NAB) will be rolled back as another part of this agreement.

The Board also decided that a new formula for calculating quotas should be decided by January 2013, and that the 15th Review of Quotas should be completed by January 2014.  

Dynamic emerging market and developing countries will now receive greater voting power due to the 6 percent shift of quota shares. Half of this shift comes from the advanced economies (mostly from European countries). There will be some shifts from the United States too. One third will come from the oil producers like Saudi Arabia, which accounts for 80 percent of the shifts from the advanced countries and oil producers. The other 20 percent comes from other emerging countries.

As a result, 110 countries out of 187 will see their quota share increased or maintained, out of which 102 are emerging or developing countries.

The 10 largest members of the Fund are shown in table 4.2. These countries include the United States, Japan, France, Germany, Italy, and the United Kingdom, Brazil, China, India, and Russia.

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### Table-4.2

**TOP IMF SHAREHOLDERS: CURRENT AND PROPOSED**

<table>
<thead>
<tr>
<th>Country</th>
<th>IMF Quota Share</th>
<th>Country</th>
<th>IMF Quota Share</th>
<th>Country</th>
<th>IMF Quota Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>17.69%</td>
<td>United States</td>
<td>17.40%</td>
<td>United States</td>
<td>21.57%</td>
</tr>
<tr>
<td>Japan</td>
<td>6.56%</td>
<td>Japan</td>
<td>6.46%</td>
<td>China</td>
<td>10.44%</td>
</tr>
<tr>
<td>Germany</td>
<td>6.12%</td>
<td>China</td>
<td>6.39%</td>
<td>Japan</td>
<td>8.39%</td>
</tr>
<tr>
<td>France</td>
<td>4.51%</td>
<td>Germany</td>
<td>5.58%</td>
<td>Germany</td>
<td>5.16%</td>
</tr>
<tr>
<td>UK</td>
<td>4.51%</td>
<td>France</td>
<td>4.23%</td>
<td>France</td>
<td>3.97%</td>
</tr>
<tr>
<td>China</td>
<td>4.00%</td>
<td>UK</td>
<td>4.23%</td>
<td>Brazil</td>
<td>3.57%</td>
</tr>
<tr>
<td>Italy</td>
<td>3.31%</td>
<td>Italy</td>
<td>3.16%</td>
<td>UK</td>
<td>3.48%</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>2.93%</td>
<td>India</td>
<td>2.75%</td>
<td>Italy</td>
<td>3.15%</td>
</tr>
<tr>
<td>Canada</td>
<td>2.67%</td>
<td>Russia</td>
<td>2.71%</td>
<td>Russia</td>
<td>2.65%</td>
</tr>
<tr>
<td>Russia</td>
<td>2.52%</td>
<td>Brazil</td>
<td>2.32%</td>
<td>India</td>
<td>2.61%</td>
</tr>
<tr>
<td>India</td>
<td>2.44%</td>
<td>Canada</td>
<td>2.31%</td>
<td>Canada</td>
<td>2.49%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2.17%</td>
<td>Saudi Arabia</td>
<td>2.13%</td>
<td>Australia</td>
<td>2.13%</td>
</tr>
<tr>
<td>Belgium</td>
<td>1.93%</td>
<td>Spain</td>
<td>2.12%</td>
<td>Spain</td>
<td>2.12%</td>
</tr>
<tr>
<td>Brazil</td>
<td>1.79%</td>
<td>Mexico</td>
<td>1.87%</td>
<td>Mexico</td>
<td>1.65%</td>
</tr>
<tr>
<td>Spain</td>
<td>1.69%</td>
<td>Netherlands</td>
<td>1.83%</td>
<td>South Korea</td>
<td>1.65%</td>
</tr>
<tr>
<td>Mexico</td>
<td>1.52%</td>
<td>South Korea</td>
<td>1.83%</td>
<td>South Korea</td>
<td>1.65%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>1.45%</td>
<td>Australia</td>
<td>1.38%</td>
<td>Netherlands</td>
<td>1.21%</td>
</tr>
<tr>
<td>South Korea</td>
<td>1.41%</td>
<td>Belgium</td>
<td>1.34%</td>
<td>Turkey</td>
<td>1.11%</td>
</tr>
<tr>
<td>Australia</td>
<td>1.36%</td>
<td>Switzerland</td>
<td>1.21%</td>
<td>Switzerland</td>
<td>0.95%</td>
</tr>
<tr>
<td>Venezuela</td>
<td>1.12%</td>
<td>Turkey</td>
<td>0.98%</td>
<td>Saudi Arabia</td>
<td>0.85%</td>
</tr>
</tbody>
</table>


Once all the reforms are in place, there will be further changes in the IMF’s Executive Board as well. The Advanced European countries will lose two of their seats. These seats will be transferred to the dynamic emerging market and developing countries. Plus, all Executive Directors will be elected rather than appointed. The size of the Board, which will remain at 24, will be reviewed every eight years. Last change
in the Executive Board of the IMF was in 1992, where the number of chairs increased from 20 to 24. Further changes in the Board of the IMF will require an amendment to its Articles of Agreement.

The timeline set by the Executive Board for approval of the reforms in the governance of the IMF was October 2012. The Board also emphasized on the implementation of these reforms to take place no later than the end of 2012.

The reform of the Executive Board of the IMF requires an 85 percent of total votes approval rate to become effective. As of February 25, 2014, only 142 members having 76.13 percent of total voting power had accepted the amendment.\textsuperscript{114}

To make quota increases possible, first step is the approval of the amendment to the Executive Board of the Fund. Plus, a not less than 70 percent of the total votes is required for the quota increases to become effective. As of February 25, 2014, 158 members having 78.71 percent of total quota had consented.\textsuperscript{115}

\textbf{4.10 Quota Formula Reviews}

Since the quota reforms of 2010, the focus of the Executive Board has been on the quota formula review. The Board has not offered any proposed new formula that was expected by January 2013. The new formula is expected to be in the context of the 15\textsuperscript{th} Review of Quotas rather than on a stand-alone basis.

Wide range of issues which the Board is considering to form the new formula includes:

- The role of the existing variables of the formula and their respective role
- The weights of the variables in the formula
- The scope for further simplifying the formula
- The merits of adding new variables

Although no new formula has been formed yet, the Executive Board has made some progress of identifying some major aspects which will help them move in the right direction.

The Executive Board took note of the results of updating the quota data through 2010. Based on IMF staff calculations, the calculated quota shares of emerging market and developing countries had increased by 7.7 percentage points in the 5-year period since 2005, the data used for the 2008 reform. This shift provides some evidence that the current formula adequately captures dynamic developments in the world economy and hence there is no need for radical reforms in the formula. On the other hand, others consider the formula flawed, arguing that the results do not adequately reflect the members’ relative positions in the global economy.

The board is in attempts to create a simpler formula which is more transparent and consistent with the multiple roles of quotas and more acceptable to the membership.

The following improvements have been made from the recent assessment of the variables of the quota formula:

- Since the GDP is generally seen as the most comprehensive measure of economic size, it should remain the most important variable in the formula, having the largest weight and scope for further increase. There should be further improvements in the consideration of increasing the weight of GDP in the formula. For now, it is decided to keep the current or maintain it relative to that of openness.

- There will be further discussion as to whether or not the weight of PPP GDP in the GDP blend variable should be changed. There are two broad views. One view to keep the current percentage, noting that it had been a difficult compromise that should not be reopened. Others favoured increasing the weight of PPP GDP, noting that these data will increase the share of emerging market and developing countries, including that of low-income countries.
• Openness, a measure of capturing members’ integration into the world economy, should continue to play an important role in the formula. Many believe that this variable should be maintained with the same weight in the formula while others argue that this variable is seriously flawed reflecting both conceptual and measurement issues, including its reliance on gross flows and given the challenges posed by intra-currency union trade. Several options are examined to bridge these differences, including the possible use of a cap on openness in relation to GDP, but views remain divided. Some also favour increasing the weight of financial openness, but this does not attract sufficient support.

• The reserves variable which measures a member’s financial strength and ability to contribute to the Fund’s finances is the next variable which will be preferably in the new formula with its current weight. Views are also expressed in favour of either increasing its weight to better capture members’ ability to contribute to global safety nets, or eliminating it given the concern that it could reward excessive reserve accumulation.

• There is special consideration to whether or not the current level of compression should be adjusted or not. There is no doubt that the quota formula should include a compression factor to help moderate the influence of size in the quota formula. One view is to keep the current factor, considering the difficulty to reopen it. Another group believes that by giving higher weight to this variable, greater voice will be given to the small members, and the emerging economy member countries.

• The Executive Board is considering measures to include in the formula to protect the voice and representation of the low income countries.

4.11 Incompletion of 2010 Governance Reforms

In December 2010 when completing the Fourteenth General Review of Quotas and approving the Proposed Amendment on the Reform of the Executive Board, the Board of Governors requested the Executive Board to bring forward the timetable for completion of the Fifteenth General Review of Quotas to January 2014. The Executive Board was also requested to complete a comprehensive quota
formula review by January 2013. These forward-looking elements were part of an agreed package of 2010 quota and governance reforms.

The reform of the Board of Directors has not yet entered into force. As of 25th February 2014, 158 members (requirement: 113) representing 78.71 percent of quota (requirement: 85 percent) have agreed to the Board Reform Amendment. The initiation of the work on the Fifteenth Review has been put on hold to facilitate the achievement of the required acceptance threshold for the entry into force of the Board Reform Amendment, which is one of the general conditions for effectiveness of the quota increases under the Fourteenth General Review of Quotas.

Since none of these steps have been completed, the Executive Board has not been able to complete its work in connection with the Fifteenth Review by the January 2014 deadline requested by the Board of Governors. As a result, additional time was decided for the completion of the Fifteenth Review.

The deadline for the completion of the next review was rescheduled from January 2014 to January 2015. 116

4.12 Conclusion

The Executive Board reiterates the importance and urgency of the 2010 Reforms for strengthening the Fund’s effectiveness and legitimacy. This includes ensuring that, as a quota-based institution, the Fund has sufficient permanent resources to meet members’ needs and that its governance structure evolves in line with members’ changing positions in the world economy.

The Executive Board recognizes that the immediate priority is the effectiveness of the Fourteenth Review and Board Reform Amendment. Accordingly, the Executive Board proposes that the Board of Governors adopt a Resolution expressing its deep regret that the Fourteenth Review and the Board Reform Amendment have not become effective and urge the remaining members who have not yet accepted the Fourteenth Review quota increases and the Board

Reform Amendment to do so without further delay. This step, as a part of their recent agreement should become effective no more than January 2015.

In the mean time, the Executive Board and the staff are recommended to make further progress on the new quota formula, and submit it to the Board of Governors in the context of the 15th General Review of Quotas in 2015.

Although, the process of selecting the managing director of the Fund has been considered to be dissatisfactory, there has not been much done on this issue. The Executive Board is advised to work on the adoption of a new open, merit-based and transparent process for the selection of IMF management. The process includes building a detailed qualification criteria, the establishment of a nomination process and the explicit reference to the fact that the Executive Board will consider the nominated candidates without geographical preferences.

Subject to the requirement of the Articles of Agreement to secure the highest standards of technical competence, enhancing diversity among staff by nationality, gender, education, and experience bring many benefits. The Executive Board is advised to develop list of qualification criteria for the staff and to bring more transparency to the IMF, the staff should be requested to submit progress report and staff on their responsibilities assigned to them.