

ENHANCING IMF GOVERNANCE

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At Bretton Woods, the management of the international monetary system was put in the hands of the Governors and the Executive Board of the IMF, with the latter exercising all powers except those which were specifically reserved for the Governors in the Articles of Agreement. Following the breakdown of the fixed exchange rate system, the Board of Governors, in 1974, established the Interim Committee(IC) as an advisory body at the political level to the Executive Board. The close collaboration between the Committee and the Board during the following quarter century enhanced the involvement of the political authorities in supervising the management and adaptation of the international monetary system, and the effectiveness of Executive Board decision making in an increasingly global environment. However, the IC was not forceful enough regarding the surveillance of the policies of the major industrial countries, which the Group of Seven (G-7) was determined to keep to itself, and it failed to give timely warning signals regarding the implications for the IMF and its members of the globalization of capital markets.

In the wake of the financial crises of the late 1990's, the Interim Committee was transformed into the International Monetary and Financial Committee (IMFC), ostensibly to strengthen the IMF's systemic oversight at the political level in the new era of global capital markets, and a new group of Deputies to the IMFC would prepare the work of the Ministerial Committee. In reality, the G-7 group of major industrial countries decided to concentrate decision making on international monetary affairs in their capitals, and set out to focus IMF work on crisis prevention and resolution, while limiting the lending function of the institution. The continued intense involvement of the G-7 interfered with the IMFC's task of improving the political oversight of the global monetary system, and weakened the authority of the Executive Board and its Chairman, the Managing Director, even though they have the legitimacy in the management of the monetary system, which the G-7 lacks. Thus it has become urgent to

¹ For the November 16-17, 2004 Consultation on Systemic Issues, organized by the New Rules for Global Finance Coalition.

strengthen the authority and legitimacy of the Executive Board, under the oversight of the IMFC and the Board of Governors. To that effect, greater equity in voting power among the IMF membership needs to be established, while the size of the Board – and, consequently of the IMFC - needs to be reduced.²

The IMF Executive Board, despite its weakened authority, remains the only global body of its kind and, in recent years, it has labored pragmatically and effectively to correct systemic weaknesses through the development and implementation of standards and codes of economic performance, and in pursuing the vast task of improving the soundness of financial systems worldwide. The Board has also updated the IMF's lending policies and the role of the institution in the fight against poverty in the low income countries. One of the most complex and innovative tasks of the Board in recent years has been the search to deal with cases of unsustainable sovereign debt. In close collaboration with the staff, market participants and legal experts, the Board developed proposals for a Sovereign Debt Reduction Mechanism. However, that task could not be brought to a successful conclusion because of the reluctance of some members to consider an extension of international law in this field. Instead, an alternative market approach was preferred involving the inclusion of Collective Action Clauses in sovereign lending; the effectiveness of that approach remains to be tested. A major decision to strengthen IMF accountability has been the establishment of an Independent Evaluation Office which is working "independent of management and at arms length from the Executive Board" and has already produced pertinent in its evaluations of IMF program design, surveillance and conditionality.

In order to strengthen the authority of the Board, the G-7 should cease micro-managing the IMF, while the IMFC should promote greater equity in the division of voting power between the industrial and the developing countries which in recent decades has remained around 60/40 per cent. The role of emerging market countries, particularly in Asia, but also in other regions of the globe, and of the developing countries as a group in IMF decision making needs to be raised. From their side, the industrial countries, who are the overwhelming

² For an earlier treatment of this subject, see my article in Finance and Development, Sep. 2004.

creditors of the IMF, insist that they should remain majority shareholders, a position which is grudgingly accepted by the developing countries.

Progress has been made in the Executive Board toward a simpler and more transparent quota formula that should comprise at most four variables, including first and foremost GDP, and measures of economic openness, variability of current receipts and net capital flows, and reserves. While confirming the majority position of the group of major creditors, the formula should not “freeze” the quota shares of the major groups, but leave flexibility for changes over time in the composition of industrial/developing countries and creditors/debtors among the membership. The use of PPP data for GDP, which would favor in particular the large developing countries, has been rejected by the industrial countries since the IMF is a financial institution and because of the continuing weaknesses in measurement of the PPP data. The small, low income developing countries which would benefit less from the use of PPP data, insist that the erosion of their voting power should be corrected through an increase in basic votes which have remained unchanged since Bretton Woods. However, action on basic votes would require an amendment of the Articles of Agreement.

Updated quota calculations, prepared by the staff on the basis of the existing formula do not produce major changes in the voting power of the principal country groups. However, for a number of developing countries, particularly in Asia, updated quota shares are significantly larger than their actual quota share. The calculations also show significantly lower updated, than actual, quota shares for the African region as a whole, for most major oil producers, as well as for a number of emerging market countries in Asia, Latin America and the Middle East.

Thus, more work is needed to construct a quota formula that would be a broadly acceptable basis for an increase in quotas including a sizable selective element as well as ad hoc quota increases to correct the main cases of “out of liness”, and an increase in basic votes. It needs to be kept foremost in mind that, to become effective, quota reviews need to be approved by a majority of 85 per cent of the total voting power. Thus, an overwhelming majority of members will need to find enough positive elements in the package to vote in favor of it. It follows that the correction of maldistribution of quota shares which involves “winners” as well as “losers”, will need to be done in stages. Moreover, the

inclusion of amendments to the Articles of Agreement will be resisted for fear of a Pandora's box of proposals for amendments that would favor the protection of other groups.

Europe's weight in the Executive Board, with 8 and sometimes 9 Executive Directors – one third or more of the total Board – who command an aggregate voting power of 36.5 to 40.7 per cent of the total, compared with 17.1 per cent for the United States, is the main distortion in the representativeness of the Board. Much of that distortion could have been mitigated if, in the 1980's and 1990's, quota calculations for the then 15 members of the European Union (EU) would have been adjusted downward for the growing "internal" trade within the Union. There is now considerable support for the idea that the EU, including 25 members today with an aggregate voting power of 32 per cent should bundle together as a single member or constituency; the elimination of intra-EU trade from the quota calculations would reduce the EU voting power to around 22 per cent; the difference would, automatically, be redistributed among the rest of the membership. However, members enjoy the protection of the provision in the Articles of Agreement that a reduction in the size of a member's quota requires its consent.

The merger of the 25 EU members into one Board seat would be a major undertaking. In recent years, coordination among the 15 EU members on international monetary affairs improved steadily but major differences on issues of substance remain which helps to explain why, despite its superior voting power, Europe has much less influence in the IMF than the United States. According to the EU Constitution, the member states would retain authority over monetary affairs, inasmuch as those do not accrue to the European Central Bank (ECB). By contrast, authority over foreign trade issues, agricultural policy, and competition policy were transferred to the EU Commission. The large EU countries who are also G-7 members may expect that decision making on international monetary issues will devolve primarily on them. Other EU members, such as Belgium, the Netherlands, and the Nordic countries who have long played important roles in the IMF, and also Spain and Poland, and perhaps others, will insist that they retain an appropriate share in decision making in the EU context. A rotating chairmanship such as was created in the EU for the Euro area, is probably among the ideas that would be considered for the leadership structure of an EU seat or constituency in the IMF. In addition to the legal and

political issues that would need to be settled in the EU context, the merger of the EU members may also require amendments to the Articles of Agreement.

A single EU chair in the Executive Board would reduce the size of the Board by 6 members, to 18 – assuming that the 17 non-EU members that are presently in the European constituencies would be absorbed by other chairs (such as the Swiss constituency). As a result, three chairs, the European Union, Japan, and the United States would hold approximately 50 per cent of the voting power. This would signal the need for consolidation of the 12 developing country chairs, (2 in Africa, 4 in Asia³, 3 in the Middle East, and 3 in the Western Hemisphere) as well as for the remaining chairs which are held by Canada, Russia, and Switzerland.

Past experience with the large number of European chairs in the Board has demonstrated the need for greater coordination in that region and the counterproductive results of many different voices. The experience of the 12 developing country chairs in the Board has also illustrated the need for more powerful and effective spokespersons. Similarly, the experience of the Intergovernmental Group of 24 as the voice of the developing countries in international monetary affairs, has been marred by weakened cohesion resulting from diverging interests of members. It is urgent for IMF members to accept and act on the need to merge Board chairs in order to produce stronger voices and stronger representation. A feasible objective would be a reduction in the size of the Board from the current 24 chairs to 14, in which the developing countries would hold the majority of the chairs, while the industrial country chairs would retain a majority, though lower than at present, of the voting power.

Vision and leadership will be required to produce a smaller and more powerful Executive Board with strengthened legitimacy through improved equity in voting power among the members. Local and regional objectives may still tend to go in the opposite direction, or to prefer the status quo, e.g with a particular stress on the importance to provide adequate services to each member in the group. That is an important objective. In an Executive Board of 14 members, only a very few would be appointed by one member, while the average

³ Where Korea now leads the chair that was traditionally headed by Australia.

constituency would include about 18 members. The agreed need to strengthen the voice and representation of the two African constituencies which serve 44 members, is a powerful illustration of the requirements and the importance for each Board chair to provide adequate services to its constituents. The size and voting power of an EU constituency, in turn, provides a clear illustration of the need for specific and transparent working methods of the constituencies, in order to clarify accountability and to ensure that the interests of all, particularly the smaller members of the group, would be taken care of.

A compact Board whose authority, legitimacy and representativeness no longer raises questions, composed of Executive Directors who are senior officials in their own countries, and are assisted by an expert staff, would create a powerful decision making instrument. It would be most desirable that, by the time of the 2006 Annual Meetings in Singapore, broad political support may have emerged in the Board and the IMFC for the achievement of these three objectives which would lay the basis for a stronger and more equitable working of the international monetary system.

Washington D.C., November 10, 2004