Meeting of the IMF Executive Board in 1948

Rethinking IMF Governance

A former insider advocates overhauling the IMF's Executive Board to make it more effective and representative

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FOLLOWING a string of financial crises in emerging markets since 1994, the Group of Seven (G-7) major industrial countries decided at a 1999 summit in Köln to strengthen their direct involvement in managing the international monetary system. They would do so partly through the institution that oversees it, the International Monetary Fund (IMF), but also through two new bodies—the Financial Stability Forum (FSF), which had been formed earlier in 1999 to promote international cooperation in financial supervision and surveillance, and the Group of Twenty (G-20), which was established following the summit to promote dialogue between major industrial and emerging market countries. The G-7—Canada, France, Germany, Italy, Japan, United Kingdom, and United States—apparently viewed neither the IMF's Executive Board nor the International Monetary and Financial Committee (IMFC), its principal advisory body at the political level, as being fully adequate to the task of leading the needed reforms. The G-7 leaders wanted more focus on strengthening crisis prevention and resolution in an environment increasingly defined by open capital markets. Their reform agenda included improving the soundness of financial systems worldwide, reducing the vulnerability of member countries' economies to adverse developments, fighting money laundering and the financing of terrorism, and bringing more order to external debt restructuring.

Since 1999, much progress has been made, largely through the work of the IMF, in correcting the systemic weaknesses that had become apparent. But the G-7's intense involvement in the IMF's activities has not relaxed. Its frequent contacts with IMF management on both policy and operational issues lack transparency and are perceived by many as interference with the mandate of the Managing Director and the authority of the Executive Board. As a result, the Board's authority has weakened, and the G-7 is increasingly seen as a self-appointed *directoire* of the international monetary system.

The G-7 countries are aware that their actions—including the creation of the G-20 and the FSF—and the introduction (which they inspired) of meetings of IMFC Deputies to prepare for IMFC meetings gnaw at the Executive Board's authority. They also realize, however, that the IMF Board has the unique legitimacy of being the decision-making organ of the central organization for global monetary cooperation. Meanwhile, pressure is building from emerging market countries—especially in Asia—and from developing countries more generally, for a greater say in IMF decision making. What follow are some thoughts on reforms from the perspective of someone who served the Board as the IMF's Secretary for nearly 20 years. But first, a look at how the Executive Board operates.

How the Board works

The IMF's Executive Board is responsible for conducting the IMF's business under powers delegated to it by the Board of Governors, the IMF's supreme decision-making body, which, however, retains responsibility for major decisions concerning the institution itself—for instance, quota increases and accepting new members. The IMFC, a committee of the Board of Governors, provides guidance for the Board's work at meetings held usually twice a year.

The Board is currently composed of 24 Executive Directors. Each of the five countries with the largest quotas—United States, Japan, Germany, France, and United Kingdom—appoints its own Executive Director, usually from its finance ministry or central bank. Three other countries—China, Russia, and Saudi Arabia—have enough voting power to elect their own Executive Directors. The remaining 176 members are organized into 16 constituencies of countries, each of which elects an Executive Director. For instance, the Nordic constituency comprises Estonia, Denmark, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden.

The IMF is organized along the lines of a credit union in which members may be lenders or borrowers. However, the industrial countries have long ceased to be borrowers; special vigilance is therefore required to ensure that the rules of the game reflect a reasonable balance between the interests of the lenders and those of the borrowers.

Each country's voting power in the IMF, set by the Articles of Agreement, is the sum of its 250 basic votes (the same for each member) and one vote per SDR 100,000 of its quota in the Fund. (Each country's quota also determines its capital subscription to the Fund and its access to Fund borrowing.) However, decision making in the IMF is usually done by consensus; the Board rarely takes a formal vote.

Building a strong Board

The IMF needs a stronger Executive Board. This is partly a matter of ***increasing the authority of the Executive Directors who are its members***. To this end, the major shareholders should cease their micromanaging of the IMF and delegate more authority to their Executive Directors. They should, at the same time, take the lead in ensuring that senior, highly qualified officials are appointed to the Board. The intensity of Board work also requires that Executive Directors have strong Alternates; in fact, an upgrading of both positions is desirable. Moreover, large multicountry groups in the Board, such as the two African constituencies, the European Union, and others that may emerge following consolidation of the kind proposed below, will need more expert staff to deal with their complex tasks.

Apart from the authority of individual Executive Directors and their offices, strengthening the Executive Board also calls for reforms in its size and country composition. With regard to the latter, many member countries and observers believe that the system of votes and representation is skewed in favor of the industrial countries, which are the IMF's main creditors and command about 60 percent of the total voting power. One problem is that emerging market countries such as Brazil, China, India, and Korea, whose importance in the world economy has grown enormously over recent decades, have fewer votes than many industrial countries whose economies are now smaller than theirs. For instance, Brazil's quota is only two-thirds the size of Belgium's, and China's quota is smaller than Italy's; there are similar anomalies in comparative voting power. Another problem arises from the fact that basic votes have remained unchanged since they were set in the IMF's Articles of Agreement. With the growth of quotas, basic votes, which still represented more than 10 percent of total votes in the 1970s, have declined to barely 2 percent. Thus, the voting power of countries with relatively small quotas—including many developing countries that often need to borrow from the Fund—has been significantly eroded.

To address these problems, ***member countries need to agree to a package of measures to obtain more equity in voting power***, including a new and more transparent quota formula, ad hoc quota adjustments to help resolve particular anomalies, and an increase in basic votes.

A major distortion currently is the fact that the combined voting power of the 25 European Union (EU) member countries stands as high as 32 percent. This voting power was established in the early years of the IMF when European economic integration was in its infancy and many European countries needed to borrow from the IMF. Today, the exclusion of intra-EU trade from the quota calculations, which would be appropriate for an economic union, would reduce the combined EU quota and voting power by approximately 9 percentage points, which could then be redistributed to other members.

Interestingly, the EU member countries' superior voting power has not translated into commensurate influence in the Executive Board. The aggregate voting strength of EU Board members is nearly twice as large as that of the United States, which stands at a little over 17 percent. Nevertheless, the EU's influence in IMF decision making lags well behind that of the United States because the EU has not been as effective in developing common positions.

Reforming the way the EU's aggregate quota is calculated would take care of some problems but not all. Some progress has been made toward a new and more transparent quota formula (which would include measures of GDP, economic openness, vulnerability to external shocks, and financial strength), but more work is required to reach consensus. One change that would increase the quotas of developing countries as a group would be to use GDP data converted on the basis of purchasing power parities (PPP), rather than market exchange rates, as is currently done. (PPP data use international market prices, which tend to be higher for developing countries than their own domestic market prices converted at market exchange rates.) The industrial countries resist the use of PPP data partly because of the central role of market exchange rates in the IMF's work. Further consideration of this complex issue will be required.

In the view of IMF staff, it will be difficult to develop a quota formula that is sensible in terms of both financial burden sharing and equity. Political decisions will be required to ensure very broad support within the membership for the promotion of reasonable equity in voting power while ensuring that the industrial countries remain majority shareholders to reflect their role as the predominant creditors of the IMF.

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The required changes in the distribution of voting shares can best be achieved through a package of reforms implemented in the context of a general quota review that, according to the IMF's Articles of Agreement, must take place at a maximum frequency of every five years. This package could include a general increase in quotas involving a selective element distributed according to a new quota formula, supplemented by ad hoc adjustments for countries whose quotas are most out of line, and an increase in basic votes. Because the United States and the EU have comparable GDP levels, the future U.S. and EU quotas should be similar. In fact, it would make eminent sense for the United States and the EU to have identical quotas. Such a package would require the support of countries holding at least 85 percent of the voting power. Therefore, the support of the United States is essential.

In addition, ***the size of the Board should be significantly reduced***. The present size of the Board—expanded from its original 12 members to 20 by 1964, and to 24 members in 1992 when Switzerland and the countries of the former Soviet Union joined the IMF—is too large for the institution to be fully effective. The unification of the 25 EU member countries into a single chair would represent a major step toward this objective. Currently, the EU is represented by seven chairs: France, Germany, and the United Kingdom each represent themselves, while Belgium, Italy, the Netherlands, and the Nordic group chair constituencies that include 19 EU members and 17 non-EU members. In addition, Spain holds the Executive Director position on a rotating basis in a constituency that includes a number of Latin American countries. Ireland is a member of the Canadian constituency, and Poland is a member of the group headed by Switzerland. A single EU chair in the Executive Board would, accordingly, reduce the size of the Board by 6 chairs—assuming that the 17 non-EU members in the four constituencies would be absorbed into other groups.

The merger of the EU's 25 members into one constituency would reduce the Board's size to 18 chairs. The developing countries (including Russia and the other transition countries), currently represented by 12 chairs, would then have twice as many chairs as the industrial countries, even though they would continue to hold less than half the total voting power. This would send a powerful signal to the developing countries to consolidate their chairs to strengthen their influence. The same holds true for constituencies that are led by the remaining industrial countries—Australia, Canada, and Switzerland. A feasible objective would be a reduction in the size of the Board from the current 24 chairs to 14.

A streamlined Board, represented by Executive Directors who are also senior officials from their own countries, would create a compact and powerful decision-making instrument in which developing countries would hold a majority of the chairs while the industrial countries would retain a voting power majority, albeit reduced.

Political reality check

Of course, there will be resistance to such an overhaul of the Executive Board. To some countries, the status quo may appear preferable to the uncertain outcome of reform. To others, the proposed reforms would not go far enough. In the EU, which in many ways holds the key to successful reform of the IMF's governance structure, a host of legal and political issues related to decision making within the EU itself will need to be settled first. Developing countries will also need time to become convinced of the need to merge their chairs as a means of strengthening their voice and representation. This will present a particular challenge, given that regional integration is much less advanced in the developing world than in Europe. For its part, the United States remains conscious of the fact that strengthening the global stature and appeal of the IMF is in its own interest.

In any event, the world needs an IMF that has a stronger, more effective Executive Board, and one whose country composition no longer raises questions about its representativeness and legitimacy. The action that is needed to address the Board's current shortcomings will require vision and attention to the common good to overcome regional interests and inertia. It would be most desirable that, by the time of the 2006 Annual Meetings in Singapore, broad political support of the membership will have emerged for the comprehensive strategy that is needed to strengthen decision making, enhance equity in voting power, and reduce the size of the Board. ■

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