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Reform of IMF Quota Shares and Voting Shares: A Missed Opportunity

The Executive Board of the International Monetary Fund approved on March 28th a recommended set of reforms for IMF quotas and voting shares and asked the Governors of the 185 member nations to vote by the end of April 2008 to approve the resolution embodying the proposed reforms.[1]

The Managing Director of the IMF, Dominique Strauss-Kahn, described the proposed reforms as "a very important step." The package does contain modest improvements in existing governance procedures for the IMF. But the improvements fall very far short in addressing the challenges facing the IMF in its hoped-for evolution toward a global institution with more balanced and inclusive representation and voting power.

The most serious failing of the proposed reforms is the omission of any changes in the composition and size of the IMF's Executive Board. Throughout the discussions leading up to the March 28th agreement, all questions about the size of the Executive Board and the disproportionate dominance of European "chairs" were taken off the table completely. Yet the composition and procedures of the Executive Board are the aspects of IMF governance most in need of reform.

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[1] See IMF Press Release No. 08/64, March 28, 2008; and the document "Reform of Quota and Voice in the International Monetary Fund – Report of the Executive Board to the Board of Governors." March 28, 2008. Both documents are available on the IMF website.

The proposed revised formula for calculating the presumptive quota and voting shares of members is an especially weak component of the proposed package. Taken on its own, the formula generates changes in shares that move away from rather than toward a closer alignment of voting power with economic realities. The proposed package as a whole achieves its very modest improvements only because the formula is overridden with one-time, ad hoc adjustments that mask the unpalatable consequences of the formula and because the basic votes allocated to each member are tripled. The new formula, despite assurances to the contrary, is not a viable basis for making future adjustments in quotas and votes that will adequately reflect changes in relative positions in the world economy.

This note identifies the positive and the disappointing aspects of the recommended reform package and assesses the package in the light of further, more ambitious reforms that will be required in the future.

IMF Credibility and Legitimacy Depend on Good Governance

A prosperous, stable world economy is in the self interest of every nation—large and small, rich and poor. The IMF is a worldwide institution that can facilitate that prosperity and stability. The value to each nation of an effective IMF increases as the world economy and financial system become more integrated.

The needed functions of the IMF have become more complex through time. In today's and tomorrow's world, it is especially important that the IMF become more active as an adjustment referee and a cooperation catalyst (a function sometimes labeled as "multilateral surveillance"). Such roles can help prevent the emergence of economic and financial crises. If crises do occur, especially if they spill across national borders, the IMF can help to organize the international cooperation required to manage them. The IMF can play a central role in developing and monitoring international rules of the road. The IMF's role as an intergovernmental lending intermediary remains important; but IMF lending and borrowing operations are less significant than they were in the past.

Because every nation has a stake in the world economy, each should participate in the IMF's governance and operations. For the IMF to be viable and effective, its governance procedures must adapt to changed circumstances. In particular, the quota shares and voting shares of members need to be adjusted from time to time to better reflect changes in the relative positions of countries in the world economy and financial system.

Existing Governance: Flawed

After more than 60 years since the IMF's creation, existing governance procedures are seriously flawed. Most notably, the current distribution of quota and voting shares in the IMF is unbalanced and inappropriately reflective of nations' relative status in the world economy and polity. Similarly, the composition of the Executive Board is inadequately representative of current economic and political conditions in the world. The IMF is – and to an even greater extent is perceived to be – an institution excessively dominated by the interests of transatlantic nations. The proposed reforms, unfortunately, fall very far short of remedying this unbalanced situation.

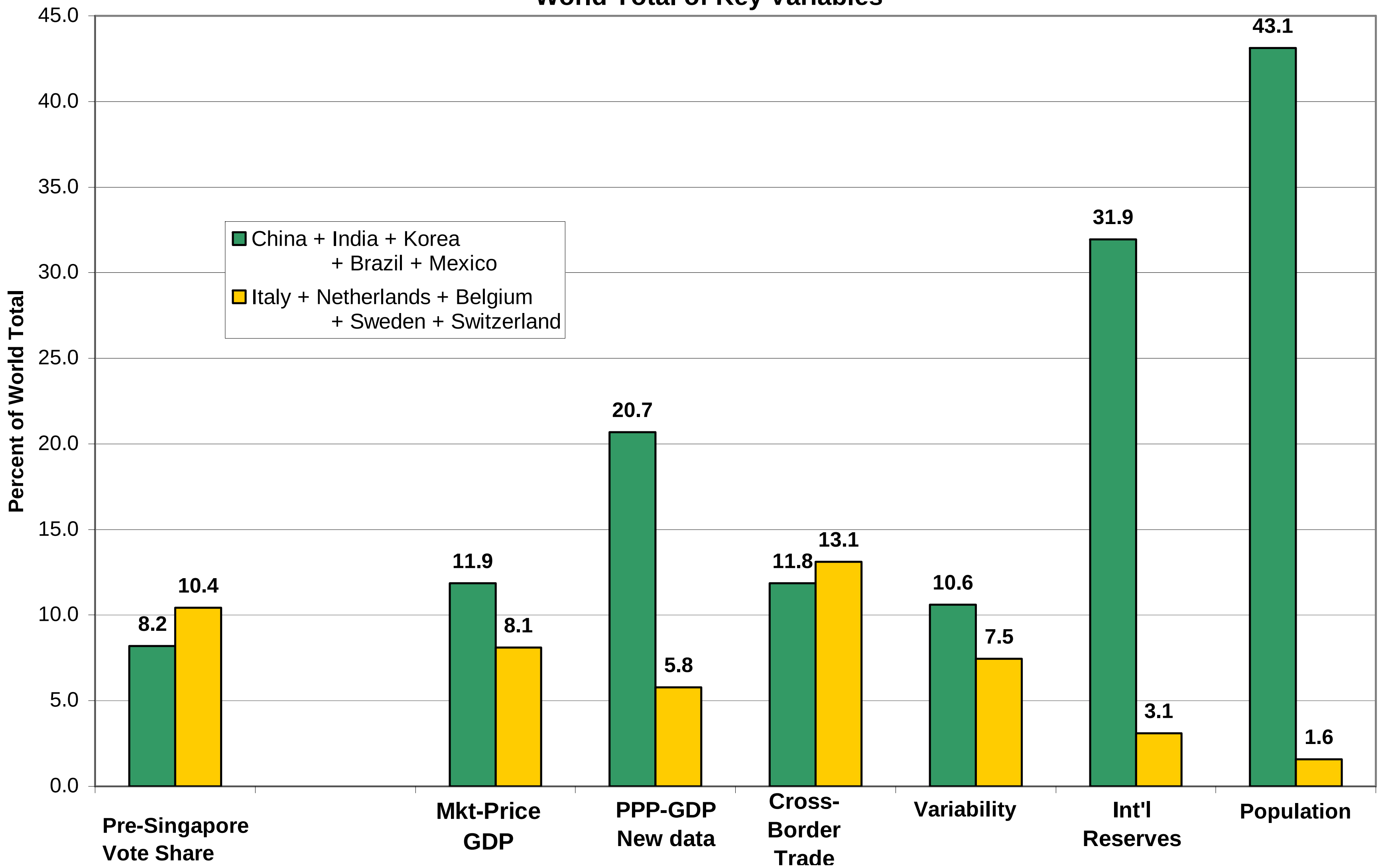
The unbalanced governance can be illustrated with a single comparison. Consider the five European countries Italy, the Netherlands, Belgium, Sweden, and Switzerland (the first four of which are members of the European Union). Contrast those countries with five of the largest emerging-market nations (LEMs): China, India, Korea, Brazil, and Mexico. Prior to the limited "first-round" changes made for four countries in Singapore in September 2006, each of the two groups of IMF member nations had very roughly one tenth of the total voting power. But the five European members had the significantly larger vote share, 10.4 percent versus only 8.2 percent for the five LEMs. For a graphic comparison, see the left-most columns in the bar chart of Figure 1.[2]

The five European economies have a significantly *smaller* share of world GDP—only 8.1 percent versus 11.9 percent for the LEMs—if GDP is measured at market prices and exchange rates. And if one compares shares of GDP measured at purchasing-power-parity prices (PPP-GDP) instead of market prices, the European countries have only 5.8 percent of the world total, much less than the 20.7 percent world share of the LEMs.[3] One indicator of relative status, world shares in the gross value of cross-border trade, shows the European nations with a slightly greater share than the emerging-market economies—13.1 percent for the Europeans versus 11.8 percent for the LEMs. That measure of cross-border trade, however, includes all intra-trade within common currency zones, most notably intra-trade within the Euro zone of the European Union countries. If one were to make an adjustment to exclude intra-trade within common currency zones, the five European countries' share of world trade would be significantly less than the share of the five LEMs. The five European economies account for a smaller share than the five LEMs of the variability of trade and capital flows (using the measure of gross variability preferred by the IMF staff in its background papers). The LEMs have a much higher share of the world total of reported foreign-exchange reserves held by central banks and governments; the Europeans' share is only one-tenth that of the five LEMs

[2] The aggregated voting share for the five emerging-market countries is shown on a "Pre-singapore" basis, that is prior to the September 2006 upward adjustment in quota and vote shares for the 4 countries China, Korea, Mexico, and Turkey. (India and Brazil, who opposed the September 2006 changes, did not get a "first-round" upward adjustment in September 2006 in their quota and vote shares.) The share data for other variables used in Figure 1 are taken from IMF staff data used in the current international discussions. The data typically refer to an average of recent years.

[3] These figures for PPP-GDP shares reflect the most recent data based on revised World Bank ICP data for PPP-GDP, made available at the end of 2007.

Figure 1. Five Emerging-Market Economies versus Five European Economies, Shares in World Total of Key Variables



(3.1 percent versus 31.9 percent). The contrast between the groups is most dramatic of all for population: the five European countries have only 1.6 percent of the world's population whereas the five LEMs account for more than 43 percent!

The comparison in Figure 1 is not misleading. Numerous other examples documenting unbalanced governance could be given. Voting shares for many IMF members as of 2006 could not be justified in terms of the member nations' relative positions in the world economy, measured in virtually any plausible way. Determination of quota shares and voting shares also, of course, dominantly influenced the number of IMF Executive Directors and the composition of their constituencies.

The degree of imbalance was so severe that, in September 2006, IMF member governments promised that they would agree on a simpler and more transparent formula for rebalancing quotas and voting rights. That formula was then to be a basis for a comprehensive "second round" of rebalancing, to be achieved no later than the annual meetings in September 2008.

Unfortunately, the rebalancing proposed in the reform package announced on March 28 after many months of international negotiations is pallid and inadequate. Judged against the goals and promises of the September 2006 resolution in Singapore, the outcome is a major disappointment. Progress has been so limited that IMF governance will remain seriously flawed for at least several more years.

The Agreed Formula Points in the *Wrong* Direction

The formula for determining quota and voting shares underlying the March 28th reforms is very far from being satisfactory**.** The most troublesome aspect of that formula is its inadequacy as a foundation for reviews of quota and voting shares for the medium- and longer-run future. The agreed changes in quota and voting shares embodied in the compromise reform package override the underlying formula with a variety of gimmicks. The essential purpose of the gimmicks is to offset and mask the unpalatable results emerging from the underlying inadequate formula. The September 2006 goal of designing a revised formula that could be sustained as an appropriate foundation for periodic reviews over the longer run has been effectively demoted, if not abandoned altogether. In the absence of the papering-over gimmicks, the underlying formula produces an outcome that is *markedly less acceptable* than the quota and voting shares already in force prior to the proposed reforms.

This point, not even mentioned in the official announcement of the proposed reforms, is illustrated in Table 1. The first column in the table shows the voting shares of IMF member countries as of September 2006, grouped into advanced-higher-income members and emerging-market-developing-transition members (following a classification used by the World Bank). The table also reports three memorandum groupings of members: 58 of the lowest-income countries, the 27 European-Union countries combined, and 26 "advanced economies" using the definition of "advanced" favored by the IMF staff.[4] The second column in the table reports the results of applying the agreed formula in an ***unadulterated*** way, in other words *before* the application of any massaging to override the results generated by the formula and *before* the agreed tripling of basic votes. The third column in the table reports the results from the unadulterated formula in an alternative way by including rather than excluding the effects of the tripling of basic votes. For ease of comparison, the figures shown in the second and third columns are *incremental changes*—calculated share minus "pre-Singapore" 2006 share.

Consider the figures in the second column. On its own, prior to any masking gimmicks, the agreed formula would *increase* the aggregate voting share of all advanced and higher-income countries by 3.4 percentage points (and hence of course correspondingly *reduce* the voting shares of all emerging-market/developing/transition economies). For advanced countries as defined by the IMF staff, the increase is a still larger 4.3 percentage points. If China, India, Brazil, Mexico, and Russia are excluded from the aggregate of non-advanced economies, the voting share of the remaining 144 non-advanced countries would *decline* by the very large amount of 7.3 percentage points. The 58 lowest-income countries would experience a decline in voting share of almost 3 percentage points.

The figures in the third column of Table 1 modulate the unadulterated effects of the formula by incorporating the effects of the tripling of basic votes. But those figures

[4] The IMF staff definition of "advanced" includes 10 fewer IMF members than the row in the table for 36 "Advanced & Other Higher-Income" countries using the World Bank classification. The 10 countries included in the World Bank classification but excluded from the IMF staff definition are six higher-income oil producers (Saudi Arabia, Kuwait, United Arab Emirates, Qatar, Brunei, and Bahrain), Korea, Singapore, and two members of the EU Eurozone (Slovenia and Malta).

Table 1.
IMF Vote Shares in September 2006 ("Pre-Singapore") and Share Increments Resulting from Application of Unadulterated Formula

		Vote Share as of Sept. 2006 ("Pre-Singapore")	Calculated Vote Share from Unadulterated Formula less "Pre-Singapore" Vote Share *WITHOUT ANY INCREASE IN BASIC VOTES*	Calculated Vote Share from Unadulterated Formula less "Pre-Singapore" Vote Share with a tripling of basic votes
		% of world total	difference in percentage points	difference in percentage points
World Total (All IMF Members)	(185)	100.00	0.00	0.00
Advanced & Other Higher-Income	(36 members)	66.378	3.41	1.56
G7 -- "Major Advanced"	(7)	45.127	4.43	2.75
United States		17.023	3.55	2.82
Japan		6.108	2.21	1.93
Canada		2.928	-0.41	-0.49
Germany + France + Italy + UK	(4)	19.068	-0.92	-1.51
Germany		5.968	0.40	0.19
France		4.929	-0.91	-1.04
Italy		3.242	0.07	-0.04
United Kingdom		4.929	-0.48	-0.62
Other EMU/Euro Area (excl UK)	(12)	8.944	0.90	0.78
Australia + New Zealand	(2)	1.915	-0.42	-0.44
Other Industrial & High Income	(7)	4.765	-0.65	-0.66
Korea + Singapore	(2)	1.166	1.99	1.91
Saudi Arabia + 5 Other High-Income Oil Producing	(6)	4.461	-2.84	-2.78
Other Emerging-Market/Developing/Transition:	(185 - 36 = 149)	33.626	-3.41	-1.57
China		2.928	3.62	3.40
India		1.916	0.02	-0.04
Brazil		1.402	0.25	0.21
Mexico		1.196	0.71	0.66
Russian Federation		2.734	-0.75	-0.80
All Other "Non-Advanced"	(144)	23.450	-7.26	-5.00
Memo: Lowest-Income Countries (< $825 GNI per capita)	(58)	7.446	-2.94	-1.96
Memo: European Union, total	(27)	32.547	-0.36	-1.01
Memo: Advanced Economies, IMF Staff definition	(26)	60.575	4.28	2.42

Source: IMF; author's calculations.

nonetheless underscore the same conclusion. The agreed formula, taken on its own, generates changes in shares that move away from, not toward, a closer alignment of voting power with economic realities. For the developing countries apart from China, India, Brazil and Mexico, for example, the unadulterated formula still mandates a *reduction* in shares of 5.0 percentage points.

Unambiguously, therefore, the results of the formula by themselves are unpalatable. The formula does not achieve the stated goals of the 2006 Singapore resolution.

If a formula produces results that are widely understood to be undesirable, one might assume, the formula would be rethought? Surely, negotiators would change focus to design a formula that generates more acceptable results? Unfortunately, that logic has not been the approach at all. Rather, the idea has been to override the formula with gimmicks that mask its unpalatable results.

The amusing euphemism used in the official report is that "one-time elements of the current reform" were decided upon "to further the objectives of the reform."[5] In plain words, a compromise outcome was envisaged that was judged, independently of the formula, to be minimally acceptable. Then gimmicks, largely unrelated to the formula, were invented to produce that outcome.[6] The first gimmick applies a "compression factor" to the formula results; that factor is a purely mathematical device that reduces the calculated shares of the very largest IMF members without altering the rankings of calculated shares. Another gimmick, known to the internal discussions as the "booster," selectively raises the quota and voting shares of a few of the largest countries whose GDP measured in purchasing-power-parity terms exceeds their pre-Singapore quota shares by 75 percent or more; the countries benefiting from this selective booster are China, Korea, Turkey, India, Brazil, Vietnam, and Mexico. Not coincidentally, those countries are the ones that, if they had taken the lead in opposing the reform package, would have had sufficient voting shares in the aggregate to prevent a compromise package from going

[5] "Reform of Quota and Voice in the International Monetary Fund – Report of the Executive Board to the Board of Governors." March 28, 2008, paragraph 9.

[6] The formula is used to identify IMF members that are "underrepresented" according to the formula and those members are then deemed eligible for a quota increase (and hence vote increase). The gimmicks are then required to correct the unacceptable results of the formula calculations (see again the figures in Table 1).

forward. In addition, the four countries receiving a first-round increase in 2006 – China, Korea, Mexico, and Turkey – are granted further selective treatment to ensure that they receive a minimum nominal second-round increase. The single most important gimmick overriding the unacceptable results of the inadequate formula is a "foregoing" adjustment: major advanced countries voluntarily forego part of the share increases to which the unsatisfactory formula would otherwise entitle them. The countries agreeing to this foregoing device are the United States, Germany, Italy, Japan, Ireland, and Luxembourg. (These gimmicks are discussed in more detail in an earlier paper.[7])

The door has now been temporarily closed on re-consideration of the formula itself. But the international community will certainly have to reopen the discussion sometime in the future (as the official document announcing the reform package acknowledges). At that future time, when there is greater willingness to adopt an improved formula, there will be three main ways to achieve improvements. First, the formula could include shares in world population as an additional variable, with population shares being assigned only a modest weight. Second, somewhat more weight could be given in the formula to PPP-GDP with less weight to cross-border trade. Third, the variables in the formula for the variability of international transactions and for cross-border trade could be redefined and measured more appropriately; in particular, those variables could appear in a form scaled to the size of economies (in other words, as ratios rather than gross measures).[8]

The last eighteen months of negotiations have ignored almost completely the possibility of allowing population shares into the formula with a small weight. Essentially, there has been no meaningful discussion. Of course, population should not be the primary variable in the formula. Of course, the IMF is a financial institution, and the ability to contribute resources to it needs to be taken into account in the formula. Yet the

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[7] Ralph C. Bryant, "Reform of Quota and Voting Shares in the International Monetary Fund: 'Nothing' Is Temporarily Preferable to an Inadequate 'Something'" (January 2008, available on the Brookings website at http://www.brookings.edu/papers/2008/01_imf_bryant.aspx).

[8] For example, trade "openness" would be defined, not as the gross amount of cross-border trade, but rather as the ratio of cross-border trade to GDP.

case for giving population a modest role in the formula deserves, but has not received, serious consideration.[9]

Proposed Changes in Quota and Voting Shares Are Very Modest

Table 2 on the following page displays the changes in voting shares embodied in the IMF Executive Board decision of March 28th, 2008. For convenience of analysis, the table repeats the columns of Table 1. The additional column reports the difference between the proposed new voting shares and the pre-Singapore 2006 shares.

The changes in voting shares from the pre-Singapore shares are very modest. One is tempted to say *exceedingly* modest. By construction (because of the one-time "foregoing" element), the voting share of the United States remains identical to its *post*-Singapore value of 16.73 percent; the reduction in its share from the pre-Singapore level of 17.02 percent is thus 0.29 percentage points. Japan has a very small increase of 0.12 points from its pre-Singapore level. Germany and Italy have miniscule declines (0.16 and 0.08 respectively). The United Kingdom and France, insisting on a continuation of their past exact parity in shares, experience declines slightly larger than half a percentage point. The twelve members of the Eurozone other than the three largest (that is, other than Germany, France, and Italy) experience a miniscule decline in voting share (0.06 points). China has an increase in its pre-Singapore share of only 0.88 percentage points (the figure includes the first-round increase of 0.72 points). India and Brazil, which did not receive a first-round increase in 2006, experience share increases of 0.42 and 0.30 points. Mexico receives a small share increase of 0.27 points.

Overall, the 36 advanced and higher-income IMF members experience a reduction in aggregate shares of only 2.2 percentage points. That modest decline reduces their share from 66.4 percent pre-Singapore to the proposed 64.2 percent. The corresponding modest increase of 2.2 percentage points in non-advanced countries' share can be described as an increase of 2.65 points if one uses the IMF staff's more restricted definition of advanced countries (last row of Table 2).

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9 This issue is discussed in detail in an annex to Bryant, "Reform of Quota and Voting Shares in the International Monetary Fund: 'Nothing' Is Temporarily Preferable to an Inadequate 'Something'" (January 2008).

Table 2.
IMF Vote Shares in September 2006 ("Pre-Singapore"), Share Increments Resulting from Application of Unadulterated Formula, and Share Increments Agreed in March 28, 2008 Executive Board Decision

		Vote Share as of Sept. 2006 ("Pre-Singapore")	Calculated Vote Share from Unadulterated Formula less "Pre-Singapore" Vote Share *WITHOUT ANY INCREASE IN BASIC VOTES*	Calculated Vote Share from Unadulterated Formula less "Pre-Singapore" Vote Share with a tripling of basic votes	Proposed New Voting Share less "Pre-Singapore" Vote Share (includes a tripling of basic votes)
		% of world total	difference in percentage points	difference in percentage points	difference in percentage points
World Total (All IMF Members)	(185)	100.00	0.00	0.00	0.00
Advanced & Other Higher-Income	(36 members)	66.378	3.41	1.56	-2.22
G7 -- "Major Advanced"	(7)	45.127	4.43	2.75	-2.08
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Germany + France + Italy + UK	(4)	19.068	-0.92	-1.51	-1.53
Germany		5.968	0.40	0.19	-0.16
France		4.929	-0.91	-1.04	-0.64
Italy		3.242	0.07	-0.04	-0.09
United Kingdom		4.929	-0.48	-0.62	-0.64
Other EMU/Euro Area (excl UK)	(12)	8.944	0.90	0.78	-0.06
Australia + New Zealand	(2)	1.915	-0.42	-0.44	-0.22
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Source: IMF, "Reform of Quota and Voice in the International Monetary Fund – Report of the Executive Board to the Board of Governors." March 28, 2008; author's calculations.

Notice, however, that the aggregate of all 144 developing/emerging-market/transition countries other than China, India, Brazil, Mexico, and Russia experience a very modest share increase of only 0.68 points. The 58 lowest-income countries taken together have a very modest increase of only 0.87 points. It should also be emphasized that the modest voting share changes for developing countries other than the very largest are the result of the tripling of basic votes; the modest increases in voting shares do *not* stem from increases in quota shares.

Putting the Proposed Changes in Perspective

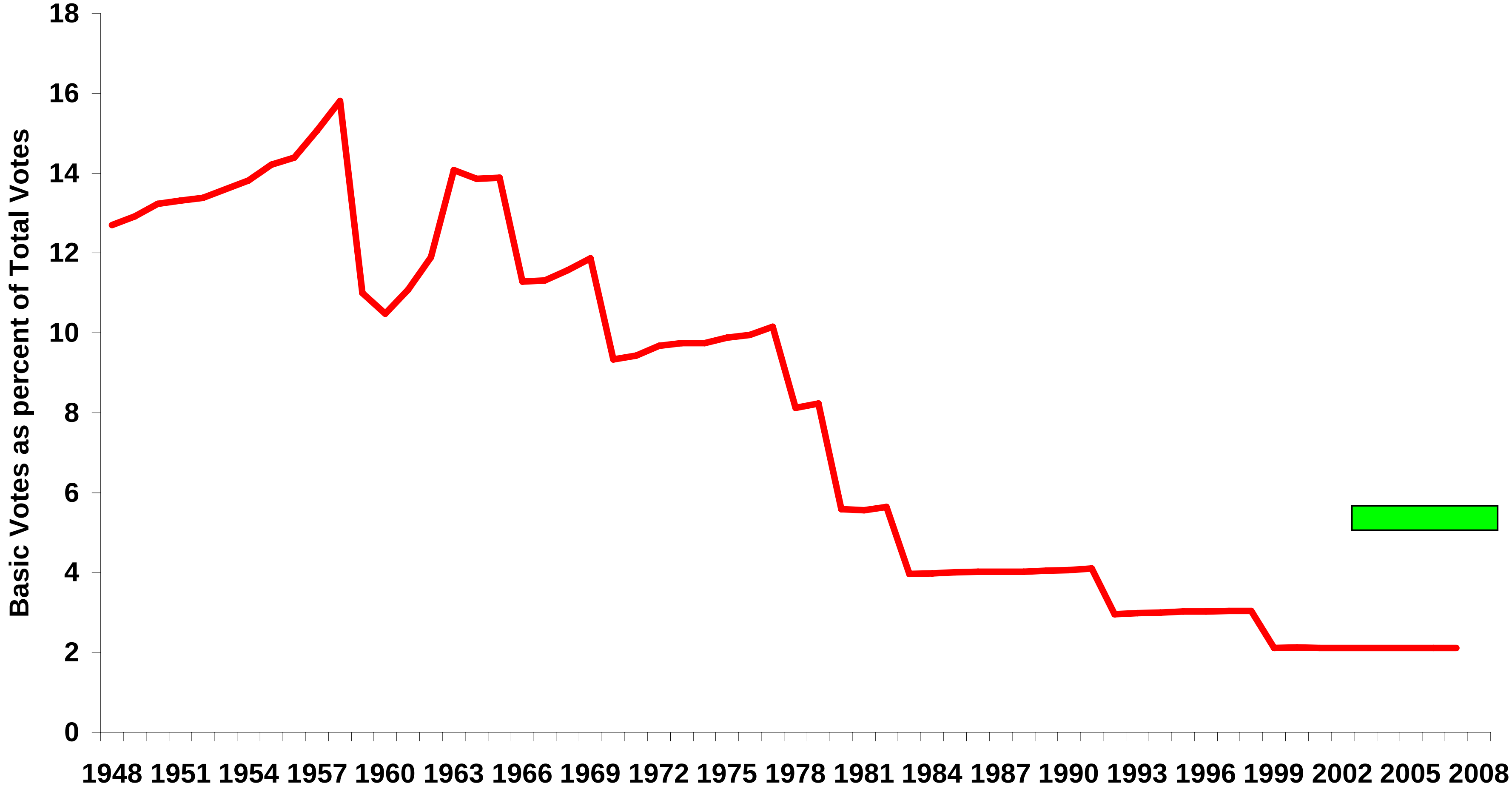
There are some positive things that can be said about the March 28th package of reforms.

First, the number of basic votes allotted to each member country will be tripled (from the current 250 to 750). That change is a significant reform. It will raise the proportion of total votes accounted for by basic votes to about 5-1/2 percent from the very low current level of 2 percent. From the perspective of history, a basic-vote fraction of 5-1/2 percent is not generous. As Figure 2 on the following page reminds, a fraction of 5-1/2 percent is nowhere near as high as the fraction that prevailed in the earliest decades of the IMF. Nonetheless, the proposed change in basic votes does move in the right direction. Furthermore, a proposed amendment to the Articles of Agreement will prevent the basic-vote fraction from falling again in future decades if and when aggregate quotas are increased further. These basic-vote changes genuinely raise (modestly) the political influence of smaller IMF members.

For reasons already explained, the substance of the quota formula itself is deeply flawed. On the positive side, however, it should be observed that the *structural form* of the quota formula has been improved from the old Bretton Woods formulas. Variables appearing in the formula are now expressed as shares in a world total rather than as nominal amounts. This change is a genuine improvement, albeit just in structural form.

Another positive development has been the agreement that PPP-GDP can play a role in the formula. Several months ago, even that modest change was in doubt. For the next two decades, the battle to include PPP-GDP as well as market-price GDP will not have to be re-fought.

Figure 2
Share of Basic Votes as a Percentage of Total Votes
All IMF Member Nations, 1948-2007



The reform package includes a genuflection to further change of the formula in the future. The official announcement indicates: "the Executive Board considers that further work will be needed in the following areas: the scope for measuring openness on a value added rather than a gross basis, the appropriate treatment of intra-currency union flows, the appropriate way of capturing financial openness, and how to improve the measure of variability to adequately capture members' potential need for Fund resources….The Executive Board has decided to consider these issues based upon additional staff analysis before the formula is used again to guide a further realignment of quota shares." These words could turn out to be a relatively empty promise. The Fund is not required to consider a further realignment of quota shares until the next (Fourteenth) quinquennial review, which does not have to be completed until 2013. But paying weak lip service to the need for future changes is preferable to utter silence.

An additional positive element in the reform package, albeit again modest, is the agreement that Executive Directors elected by a large number of members will be authorized to appoint two rather than just one Alternate Executive Directors. This change will benefit especially the two African constituencies.

Unfortunately, one has run out of positive things to say after making the preceding points. If one appraises the proposed package of governance changes against what was promised in the 2006 Singapore resolution and what is needed to enhance the legitimacy and credibility of the IMF, the package is a major disappointment. The past several years of negotiation were an important opportunity. That opportunity has been missed. More ambitious needed reforms have been put off still further into the future.

Managing Director Strauss-Kahn, the Executive Board, and many government spokesmen have all taken the upbeat line that the package should be seen just as a first step in a sequence of further reforms. Yes, the package is a step – a baby step – in the right direction. But the achievement is modest indeed.

One can strain to put a positive spin on the overall outcome by observing that the gimmicking that has overridden the underlying inadequate formula has at least resulted in a situation in which the medium-sized and smaller developing countries are not being forced to accept an actual diminution in their voting shares. Nor have the lowest-income countries been forced to accept an actual decline in their voting shares. But as Table 2 shows clearly, the increases rather than declines experienced by these countries are so modest that they merit a label such as minimal or notional.

To grasp just how pallid and inadequate the proposed changes in voting shares really are, consider three further charts structured in the same general manner as Figure 1.

Figure 3 compares the pair of countries China and India with the pair France and the United Kingdom. The pre-Singapore voting shares of China and India together were 4.8 percent of the total; the reform package raises their share to only 6.1 percent. Most objectively-based formulas for quotas and voting shares would assign significantly larger shares to China and India. If variables such as PPP-GDP and international reserves were assigned sizable weights in a formula, and especially if population were assigned even a small weight, China and India combined would receive a significantly larger voting share than France and the United Kingdom. The reduction in voting shares for France and the United Kingdom combined is a mere 1.3 percentage points (from 9.9 pre-Singapore to the proposed 8.6). At their insistence, France and the United Kingdom each still have identical voting shares that are much higher than the share allocated to China.

An analogous comparison is made in Figure 4 between the three emerging-market Latin American countries Brazil, Mexico, and Chile with the trio of European countries the Netherlands, Belgium, and Switzerland. The three Latin American countries will have a very modest increase in voting shares from 3.0 to 3.6 percentage points. The European countries will see a modest drop in their combined voting share from 6.1 to 5.3 percentage points. The three European countries will still have a much larger vote share than the three Latin American countries -- despite the facts that the Latin American countries account for a larger share of world GDP measured even at market prices, a much larger share of PPP-GDP, a much larger share of global reserves, and a population that is close to 10 times larger than the European countries. This change in relative voting shares is not only modest, but many will – and probably should -- see it as laughable.

A final illustration is provided in Figure 5, which compares the five developing countries Indonesia, Thailand, Malaysia, Egypt, and South Africa with five smaller European countries Sweden, Denmark, Finland, Austria, and Greece. For the next several years, as in 2006, the five European countries will have a combined voting share marginally larger than the combined share of the five developing countries. The five

Figure 3. Two Largest Emerging-Market Asian Economies versus Two Larger European Economies, Shares in World Total of Key Variables

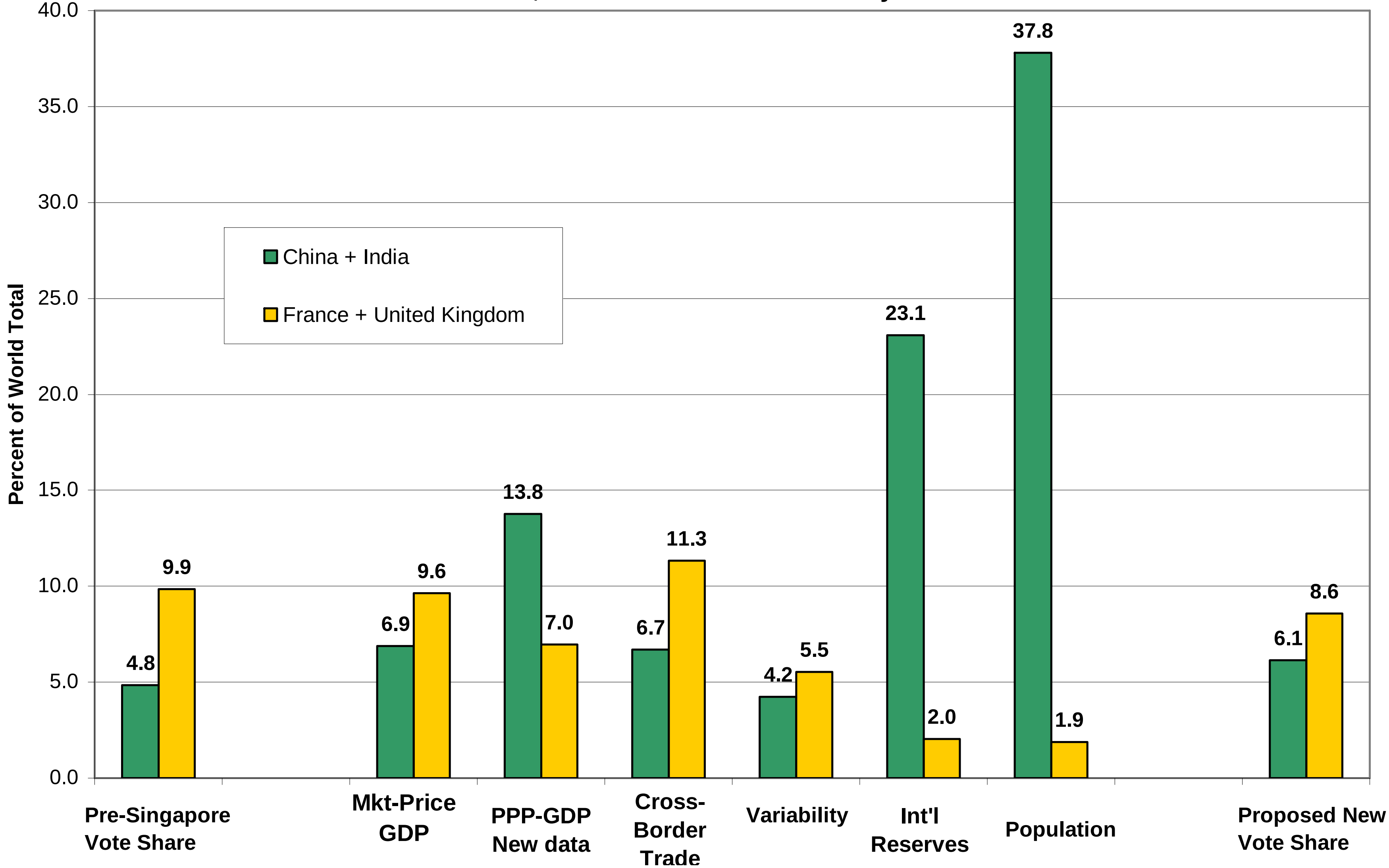


Figure 4. Three Emerging-Market Latin American Economies versus Three Smaller European Economies, Shares in World Total of Key Variables

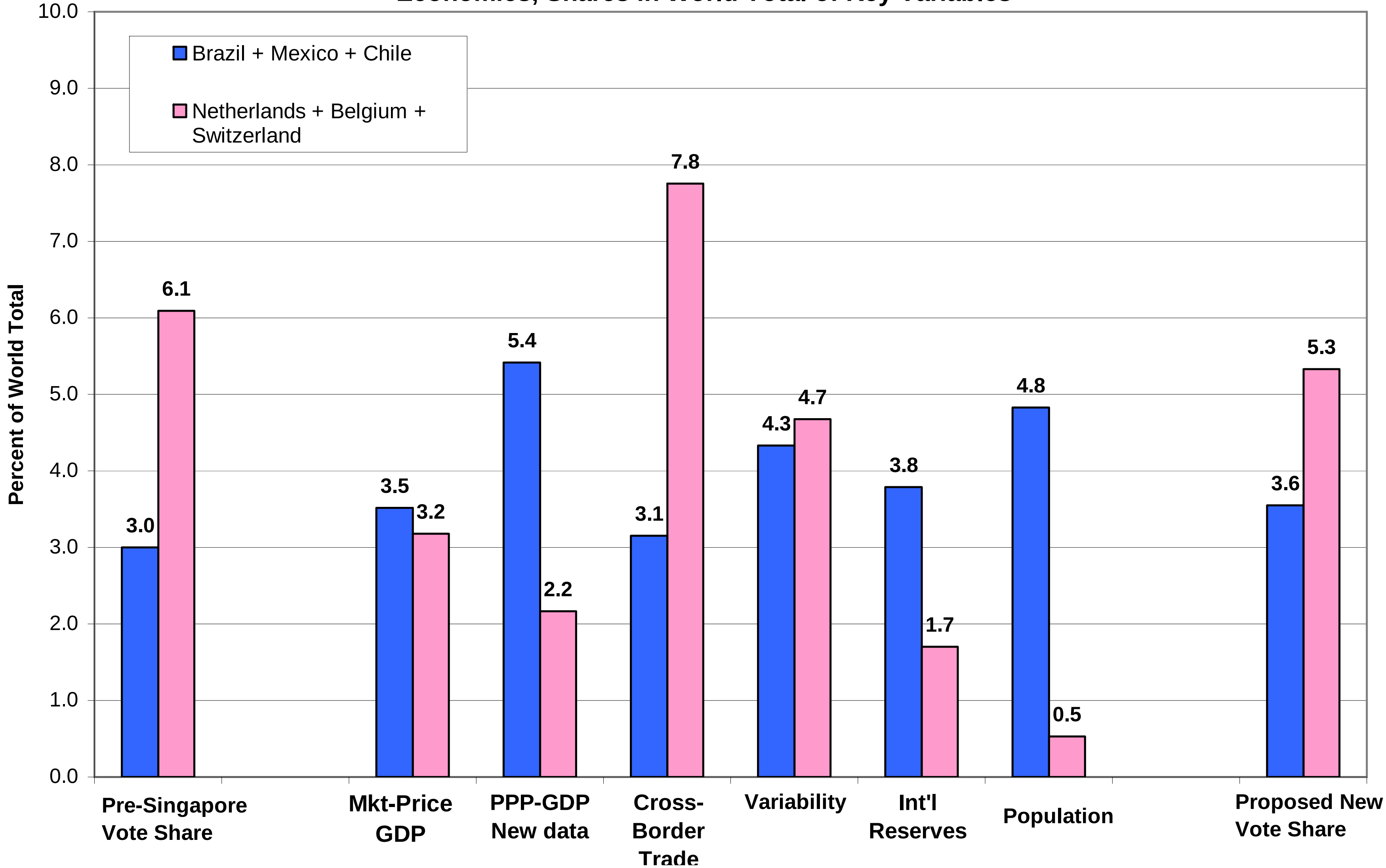
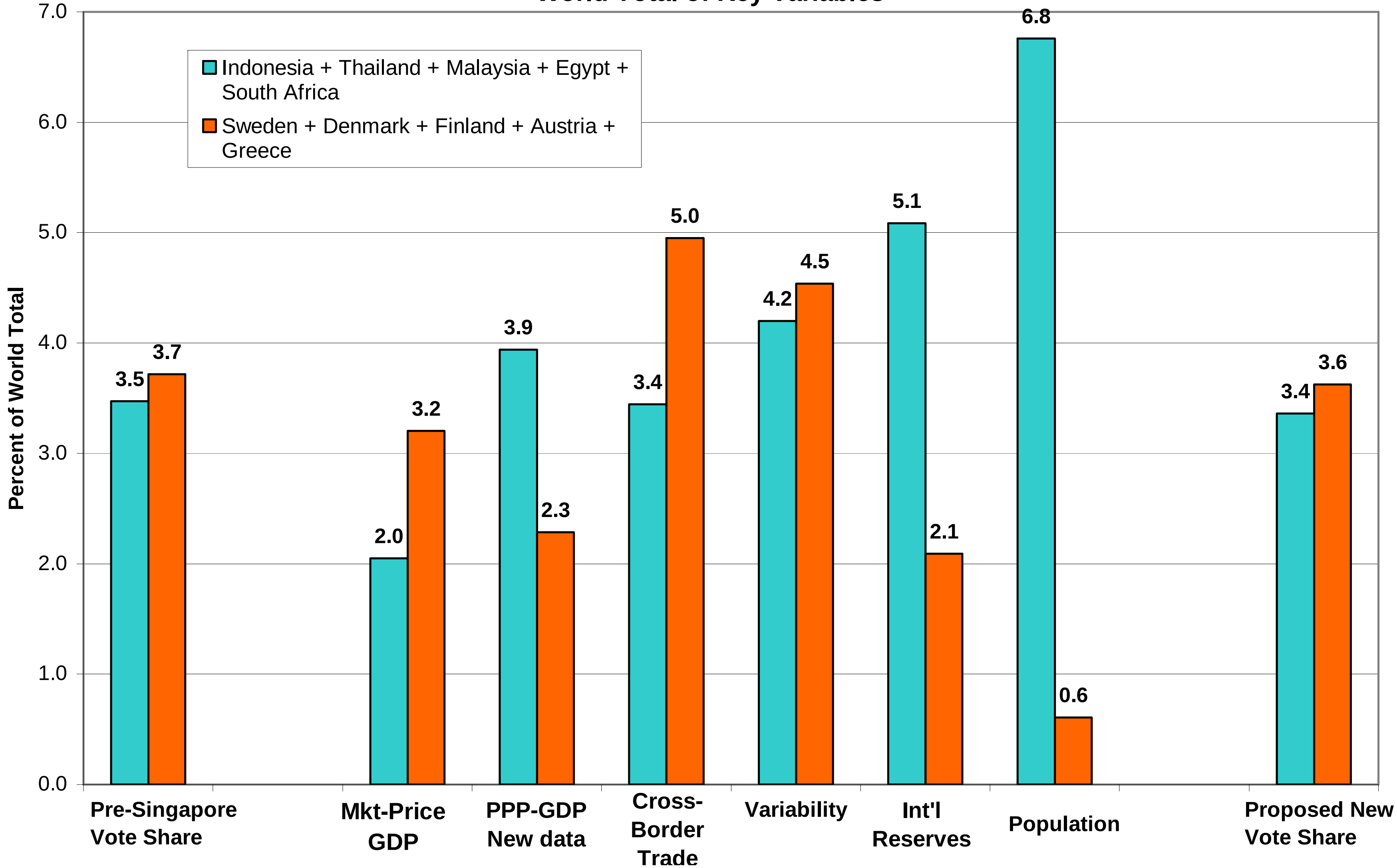


Figure 5. Five Developing Economies versus Five Smaller European Economies, Shares in World Total of Key Variables



European countries will experience a combined diminution in voting share from 3.72 to 3.63 percentage points (the share of the five developing countries falling from 3.47 to 3.36 points). These changes are *extremely* modest.

Any bolder reform would certainly have lowered the voting shares of European countries by significantly large amounts than the changes shown in Figures 3, 4, and 5.

The most glaring failing of the proposed package of governance reforms, as stated at the outset, is the complete omission of any consideration of changes to the composition and size of the Executive Board. The organization of member nations into constituencies, the selection of Executive Directors for the constituencies, and the size of the Board itself are issues integrally related to how quota and voting shares should be determined, and how the operations of the IMF should be conducted. No whisper of these larger issues appears in the official description of the package. The tacit agreement in the last two years to place these issues off the table is a discouraging clue to how little genuine willingness has existed to consider major governance reforms. It is a mystery to me why most G-24 member countries have been willing to separate all the Executive Board issues from the discussion of quotas and voting shares and to postpone serious debate about reforming the Executive Board.

Looking Ahead

What metaphor is most appropriate to characterize the March 28th package of governance changes? An optimistic assessment, which is the view that official participants in the negotiations are encouraging, sees the package as a first small step in an entire future sequence of reforms. For example, Managing Director Strauss-Kahn has described the package as a very important initial step that "will allow us to have a more legitimate Fund." By itself, he has acknowledged, the step is not enough. "But without this step it would have been totally impossible to go on rebuilding the legitimacy of a multilateral institution like the Fund." "It shows the institution is likely to evolve and to adapt." The news agency AFP on March 28th even quoted Guido Mantega, the finance minister of Brazil, as welcoming the package as "a victory for developing countries" [sic]; "this was the first step, but not the last one."

All supporters of a strong and effective IMF can hope that such an upbeat assessment proves a sound forecast for the evolution of IMF reform. But a skeptical view is likely to be more appropriate.

I have not been able to suppress a pessimistic metaphor, the image of a decades-old building that is in need of major repairs and renovation. The plumbing is ancient and needs updating. The roof is leaking in places. Termites have been found in the joists in the basement. Yet the building owners recommend, as a first step in renovation, merely a fresh coat of paint in the entrance hallway and the fixing of some broken glass panes in the windows facing the street. The March 28th package of IMF governance reforms, I fear, is only a little more bold than a fresh coat of paint in the entrance hallway.

The strongest grounds for pessimism about the future is that the reform package now being adopted will remove governments' feet from the fire. Pressures for subsequent substantial reform will now dissipate. Further significant steps may not be seriously debated until the time of the next quinquennial review of quotas. That review is some 3-4 years away.

I would like to believe that the current reform package will be seen as enhancing the IMF's legitimacy and effectiveness. But I doubt that, upon reflection, many friends of the IMF will really hold that view. My conjecture is that, when looking backwards a decade or two from now, historians of the IMF and the world financial system will view the recent episode of negotiations as a serious failure of international cooperation.

The largest IMF member nations—most notably the United States, Canada, Japan, the European countries in the G-7, and the largest emerging-market countries such as China, India, Korea, Brazil, and Mexico—have the greatest self interest of any countries in supporting a viable and effective IMF. But they do not seem to be adopting a farsighted view of their interests. In effect they seem to be treating the international negotiations about quota and voting shares, and IMF governance reform more broadly, as a zero-sum game. Member nations who would experience a decline in quota and voting shares are perceiving the declines as an unambiguous loss, and vice versa for those who would receive share increases.

But a fundamental truth is underemphasized, if not ignored completely, when such attitudes prevail. Reforming IMF governance is in fact a *positive-sum* game.

Individual member nations badly need to rise above the perception that IMF governance reform is a zero-sum game and instead emphasize features of the reform that advance the collective interest of all members.

Sadly, a more far-sighted attitude has been little present in the round of negotiations that has just been completed. Let us hope that, for the next steps in the reform process, the world community can do better. And let us hope that the next steps will not be long postponed.