

Restructuring the International Monetary Fund for the 21st Century

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Abstract

In the absence of a *Westphalian* voting system in the International Monetary Fund (IMF or the Fund), power tilts excessively towards creditor countries resulting in skewed crisis analysis and resource distribution. Consequently, exploring the *democratic deficit* within the governance structure of the Fund reveals needed changes in the quota regime and voting system of significant import. As the governance structure of the Fund is a product of the political and economic agreements embodied in the quota regime, addressing the quota bias will provide one means for a Fund in tune with the growing contiguous democratic consensus. Quota adjustments alone prove insufficient, therefore we will explore: reassessing the Fund size given the pressing need for a larger Fund as the present size is too small when compared to the global Gross Domestic Product (GDP); readjusting access to the resources of the Fund in accordance with the gross financing need of the concerned country; reexamining the voting system and the veto market; restructuring the Executive Board so that every member of the Board is an elected member; and the establishment of an Economic Security Council as a body within the Fund.

Restructuring the IMF for the 21st Century

Viable international institutions reflect the historical necessities of a particular period. The strength of any institution lies in its ability to adapt and serve the changing economic and political forces. Frustration in the developing countries about the skewed distribution of global power has seldom been greater. Developing and emerging market country members need a unified, coherent and pragmatic platform from which their voices can be heard and incorporated into crisis prevention, management policies, and overall institutional governance at the Fund.

New Challenges

The decline of global institutions and the imminent alternative, the resurgence of regional economic blocs, would represent a threat to international peace and security. A crucial lesson of the Second World War that guided the architects of the Bretton Woods institutions was the precedence of the international monetary order to other spheres of international intercourse. Chronologically, the breakdown of the monetary order preceded the breakdown of international trade and the commencement of war. In actuality, the proper organization of the monetary order is fundamental to the workings of international relations. A stable monetary system is the foundation for international peace and prosperity. International financial institutions that promote stable, cooperative, and growth-oriented economic policies provide an essential global public good. While the international community rhetorically recognizes the growing global interdependence, global policy has yet to conform to the pressing needs of this reality. Thus, it is important and urgent for politicians and policymakers to undertake reforms of global institutions before another major crisis materializes.

The governance of the global political economy requires global institutions that reflect the changing distribution of economic power in the international system. There are seven economic forces currently shaping the global economy that are profoundly altering the global economic map and power centers. First, the world economy is now riding a new

technological wave lifting up economies with faster growth in productivity, which has led to an increase in international economic exchange with an expanding knowledge-based economy and intensified competition as the drivers. Second, the global demographic of the aging populations in the OECD countries, as compared to the working populations in developing countries, are rising to even higher levels. This means that international capital flows are going to increase at an even dizzy pace given the divergence in the productivity of capital and in the growth rates between these two divergent demographic transitions. In other words, the coming years will see further expansion in global capital flows and in economic growth rates, which expands the economic potential of developing countries. Third, the rapid growth of transnationals in production and finance means that private capital flows dominate the global economy. These international capital flows are: banks led short-term capital flows, portfolio flows led by the mutual and pension funds, and foreign direct investments (FDI) by transnationals and other actors. This aspect of globalization is fueling the engine of global capitalism where an increasing concentration of economic decision making, particularly relating to capital flows, challenges the market. The concentration of economic power transforms business cycles' turning points into tipping points, magnifying the scope of economic crises in the global economy. Fourth, the rise of emerging market economies in the global economy. The share of these economies in the global output and trade has grown significantly and is projected to increase further in the first half of the 21st century. Fifth, the rise of Asia in the global economy. Presently, three of the four world's largest national economies in terms of Gross Domestic Product (GDP), valued at Purchasing Power Parity (PPP) terms, are from Asia. They are Japan, China and India and this is going to be the global economic trend for sometime. Of course, if the European Union is seen as a single economy its GDP would exceed that of India, Japan or China. Sixth, the inability of the IMF to restructure itself has initiated a new kind of debate for regional monetary arrangements. For example, the twenty-nine year old Arab Monetary Fund and the ongoing argument made for establishing an Asian Monetary Fund (AMF). Such proposals have a potential of being counterproductive to the interests of global as well as regional economies and therefore global security.

Finally, all these economic factors are accompanied by a growing international consensus amongst policy makers, politicians, and other elites that emphasizes the critical importance of democracy, human rights, transparency. Unless Fund sponsored program's political legitimacy is defined by openness and access to information and officials, democracies will fail to successfully carry out decisions executed by the Board. How should the Fund adapt and transform itself to this new global political economy?

The IMF: Present & Future

The ability of the Fund to carry out its mandate has been recently called into question due to a series of financial crises that threaten to shred the economic, social, and political fabric of several emerging markets in Asia, Africa, and South America. The Fund will only lose relevance if it continues to ineffectively meet the needs of all its constituents.

The IMF is attempting to enhance surveillance and harmonize rules related to member countries' banking and financial systems to strengthen the international financial architecture.¹ The efficacy of these initiatives is dependent upon the level of participation by the Fund's member countries. Democratizing the Fund will make the organization's initiatives more effective as decisions produced by a democratic process have greater legitimacy and credibility amongst participating members. Concerns for global governance move the IMF reform debate beyond arguments about the proper size and scope of the Fund. Realistic changes in the governance of the Fund will be achieved by rationalizing the Fund's quota regime, or the framework for the organization's decision-making process and the basis for allocating resources. Reforms based on broadly accepted principles will enhance the Fund's legitimacy and accountability as a forum for global economic policy decision-making.

In addition, the IMF needs to undergo institutional reforms so that its structure reflects the aforementioned underlying major economic forces and to ascend the established preeminent role of geopolitics. The following agenda proposes an improvement in the functioning as well as the governance of the IMF. A transformed IMF will bolster much

needed economic cooperation, enhance economic security, and promote globalization that will benefit all, not just any particular region or group of countries. Although the need for reform is urgent, it is important that reforms are principled and transparent.

Regional Responses

The Fund's institutional reform deficit has created a rather legitimate debate as the IMF has failed to represent all of its 184 constituent members. A failure to reform the Fund, coupled with the recurrence of financial crises in the emerging market economies hinders the growth of the global economy. As processes of production are subordinate to the flows of financial capital, financial crises have direct impacts on "real" economic activity. Even though most financial crises are short lived, they exert detrimental, long-term and asymmetric economic and social consequences on the lives of the most vulnerable members of the global economy. Recent financial crises and global economic trends have already mobilized non-governmental organizations, students, and workers around the world to protest the perceived inequities in the operation of the global economic system and the policies of global institutions such as the IMF.

Recurrent crises may also lead to the proliferation of regional international financial institutions and ultimately the marginalization of global economic institutions. This scenario is possible to the extent that emerging market countries, particularly in Asia, believe they are underrepresented in the decision-making bodies of international financial institutions relative to their role in the world economy. The Asian central banks have accumulated more than \$2 trillion foreign exchange reserves. The institution's governance in the hands of the G7 has led some to believe it is time to create an Asian Monetary Fund (AMF). Asia contains almost 55 percent of the world population. According to one author, the region of East and South Asia contains the most dynamic economies, fastest-growing trade, highest saving rates, and biggest current account surpluses. As a result, scholars point out that there is no reason for these countries to depend on the Fund and the United States. In order to reduce vulnerability they suggest the creation of an AMF. Although the case for an AMF seems legitimate, such a Fund

would probably lead towards the proliferation of regional financial institutions and eventually may prove to be counter productive for the global economy.

The most recent move toward the formal creation of a regional equivalent to the IMF occurred at the 1997 Asia-Pacific Economic Cooperation (APEC) meeting of a group of ministers. The Japanese introduced the proposal for a \$100 billion “Asian Monetary Fund” to protect regional currencies from speculative assaults. US & IMF opposition effectively terminated the proposal in 1997.² Nevertheless, the 2001 Chang Mai Initiative (CMI), signed by the ten members of the Association of South East Asian Nations (ASEAN), has created an informal regime that could serve as the basis for an Asian Monetary Fund. The CMI permits bilateral swaps and repurchase arrangements amongst the ASEAN-10, China, Japan, and Korea thereby providing short-term financial assistance to member countries. Currently, any member country can access 10 percent of the entire credit line in time of emergencies. For the facility to be 100 percent available, the country has to be under an approved loan program from the IMF.

The Shanghai Cooperation Organization, founded in 2001 by China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan, should also be noted here. The pact provides for regional collective security arrangements focused primarily on borders as bilateral trade has eased tensions in the region. The Shanghai group is headed by the Secretary General Zhang Deguang. In November 2003, at an international conference on Kazakhstan’s financial reforms, representatives of the IMF and the World Bank noted that the governor of the People’s Bank of China was the most sought-out guest.³ Analysts find Uzbekistan and Turkmenistan also look to China as opposed to Western-dominated international financial institutions. The article’s author notes China’s central planning, economic and political, resonates with many of the former Soviet republics in the region. A dangerous conclusion as perhaps this is true of the elite in these respective countries, but this has yet to be demonstrably proven with respect to its citizenry. The international community should also take note of the rail project that is taking form which will link China with Western Europe. So to should they note that the entry qualifications for Forbes magazine

annual list of China's richest was \$6m in 1999 and \$100m in 2004. Davidoff, the leading Swiss cigar maker, restricts the sale of its Millennium brand, the most expensive cigars in the world, to two markets: the US and China.⁴ These trends will have consequences, and if they are not matched by a search for just status then a regional response will follow.

Reforming the Fund

In an increasingly integrated world economy the distribution of power within the Fund must adapt to reflect the growing weight of developing and emerging market countries in order to make the Fund more effective as an institution. Giving voice and ownership to member countries will increase the legitimacy and efficacy of global governance.⁵ The volume of world trade flows has increased by six percent annually over the past two decades, twice as fast as world real GDP; this is one testimony of the deepening of economic integration. Developing countries as a group have achieved the fastest expansion of trade and now account for one third of world trade, up from one quarter in the early nineteen seventies. The developing countries' share of global GDP valued at Purchasing Power Parity (PPP) has increased from 31.86 percent in 1992 to 37.56 percent in 2001, while the European countries' share has declined from 34.20 percent to 29.04 percent over the same period.⁶ The growing contribution of the developing countries to world output and trade is not reflected in the distribution of power in international financial institutions such as the IMF. A great disparity exists between the economic strength and voting power of the emerging market economies and smaller European countries on the IMF's Executive Board.

An increase in the effective participation of developing and emerging market countries is desirable in promoting the success of IMF crisis prevention and management policies. What is more, as the IMF increasingly seeks to harmonize and coordinate strategies for crisis prevention and management, the Fund is becoming a rule making institution whose decisions impact international as well as national economic policymaking. The legitimacy of a rule making process can be enhanced through the use of a polyarchic

framework for governance.⁷ A polyarchic process of governance, characterized by the diffusion of power and networks of reciprocal influence, will also better resemble the process of governance among the growing number of democratic states on the Fund's membership roll. These reforms will permit the Fund to act more effectively in times of crisis, as its decisions will hold greater legitimacy amongst the politicians and bureaucrats who will need to monitor and implement Fund programs. Moreover, the diffusion of decision-making power should help to prevent the blind acceptance and application of universal models of macroeconomic management.⁸

Size Matters

The central role of the Fund should be to manage the new wave of intensified globalization in such a way that it promotes a stable growth in the global political economy, offering security to all. Towards this, the foremost requirement is to strengthen the resource base of the Fund (see section on Quota). The size of the fund today is too small when compared to the global GDP, or the levels of global trade, or international capital flows, or to any other comparable indicators for global liquidity.

No precise formula for an optimal Fund size exists, but what needs to be recognized is that the loss function in this regard is asymmetric. The size of the Fund in relation to any of the relevant parameters has shrunk significantly over time. There was no general increase in quotas since the Eleventh review of 1998. Traditionally, the size of aggregate quotas is assessed in relation to key economic indicators that are included in the quota formula. Though the size of the Fund increased from SDR 61.1 billion in 1978 (Seventh Review) to SDR 212 billion in 1998 (Eleventh review), between these two reviews, the size of the Fund significantly reduced from 8.5 percent to 3.7 percent in relation to current payments, from 1.4 percent to 0.9 percent in relation to GDP, from 33 percent to 18.4 percent in terms of reserves, and in relation to world imports from 9 percent to 6 percent. Because of further expansion in all economic variables since 1998, the present size of the Fund at SDR 212.794 billion (US \$ 312.4 billion) stands very low at 1.8

percent of current account transactions, 0.8 percent of GDP, 9 percent of reserves, and 4 percent of world imports.

The Fund size could be substantially increased. In addition to an increase in quota size, the Fund should, by exploiting the provisions of Article VII, create over time a pool of tier II capital through market borrowings, of course not to exceed the quota size. This would promote capital markets' monitoring of the Fund, and such market discipline may not be a bad thing for an international financial institution. Yet another instrument that the Fund can deploy to fulfill its most critical role as the lender of last resort, is the creation of self-liquidating temporary SDRs to meet expeditiously liquidity needs. This also means the Fund would need to revise the access policy and strengthen bilateral and multilateral surveillance. The access to the Fund facilities, whether by Stand-By Arrangement (SBA), or Supplemental Reserve Facility (SRF), will need to be guided by the financial needs of the member country and not determined by its quota size per the present policy.

Contribution –Share of Global Output

A member's contribution to the Fund's resources should be based on a member's stake in the global economy as well as ability to pay, which is a function of its share of global output. The Fund's major potential contribution towards global stability and balanced growth is its crisis prevention and management role. In periods of economic crisis the Fund acts as a catalyst for private sector involvement and as a de facto international lender-of-last-resort. The Fund also carries out extensive economic surveillance and helps to set uniform standards and rules for monitoring the global economy. Members need to support the global public good the Fund provides, consistent with the size of their economies. As a larger economy uses greater resources and has a greater systemic impact in the event of a financial or currency crisis, larger economies ought to contribute more to the resources of the Fund than smaller economies.

With economic integration, a country is now susceptible to contagion even though it may adopt sound economic policies. Developing, emerging, and industrialized countries are likely to be affected. These negative spillover effects, which include the ‘financial globalization hazard’ of rapid capital flow reversal, put a country’s stake in the globalized system at risk.⁹ A country’s stake in the global economic system or its “value-at-risk” is its Gross Domestic Product, i.e. its national income. Therefore, a members’ contribution to the Fund is best determined using that country’s value-at-risk as a basis.

If the quota regime was only used to determine members’ contribution to the Fund resources, one variable could suffice: GDP valued at PPP. The transparency of a single variable would redress the current mismatch between calculated and actual quotas.

Access - Gross Financing Need

Access to the resources of the Fund should be based on gross financing need. Quotas need to be officially de-coupled from the determination of access policy. Access to Fund resources should be on the basis of gross financing need, subject to two prudential norms. First, the Fund should supply only a limited percentage of the gross financing need, thus confirming the role of the Fund as a catalyst for private sector involvement in crisis management.¹⁰ Second, a prudential norm should be in place to limit the individual borrower; such as limiting access beyond 10 percent of the Fund’s total resources. These illustrative numbers are based on a much larger Fund size, a requirement for an access policy based on gross financial need.

Currently, access to Fund resources is supposed to be limited to 300 percent of a member’s quota. However, as nearly 70 percent of the Fund’s outstanding credit is currently confined to five borrowers, who are borrowing much more than 300 percent of their quota, it is apparent that the present access policy is not observed.¹¹ Access to resources is well beyond the present access norms, e.g. Turkey exceeded 2900 percent of its quota in 2002.¹² It is evident that the rules concerning access to Fund resources were not used as a factor in determining access limits for these large borrowers. By approving

large facilities to these countries based on need, the Fund has recognized de facto the limitations of the present quota based access limits.

It should be recognized de jure and the link between access and quotas should be broken. Moreover, the Fund facilities created to deal with capital account crises, i.e. once the Contingent Credit Lines (CCL) and now the Supplemental Reserve Facility (SRF) implicitly recognize that financing should be based on need rather than quota. The SRF has, and the CCL had, no general access limits linked to a member's quota.¹³ Uncoupling the quota formula from access considerations would have the added benefit of effectively addressing the pressing need for equality of treatment, an issue raised in recent years by some of the smaller borrowing members.

The Quota Regime

The governance structure of the Fund is a product of the political and economic agreements embodied in the quota regime. While the Fund recognizes a basic number of votes for all members, relative voting power in the Fund is determined by the size of a member's quota.¹⁴ The IMF's quota regime is the basis for (1) determining a member's required contribution to the Fund and thus the overall size of the Fund; (2) the level of access to Fund resources for each member country; and (3) the distribution of voting rights within the organization¹⁵, including the right to a "permanent" or elected seat on the twenty-four member Executive Board.¹⁶

The quota regime is not an abstract formula; it is the basis of power relations between member states of the Fund. Therefore any proposed reform of the IMF quota regime must adhere to three basic guidelines. First, reform must be simple and transparent, as an infinite number of permutations are possible through minor manipulation of the quota formulas. Countries whose relative power within the Fund will be diminished can be expected to resist any changes. For this reason, an excessively complex quota reform program will only encounter opposition from members who will have their voting share reduced. A proposal that lacks sound economic criteria for change will inevitably

succumb to charges of “politicization.” Second, as a financial institution, creditors need to have a decisive voice in policy making otherwise they may lose confidence in the institution’s lending decisions. Third, any proposed reform of the quota system must not seek to remove the veto power of the largest individual creditor, the US, as such a proposal would be politically stillborn.

Current quota formulas are composed of five components:

- A country’s gross domestic product at current prices for the recent year converted at market exchange rates;
- The twelve-month average of gold and foreign exchange reserves, including reserve positions in the IMF;
- The annual average of current payments (goods, services, income, and private transfers) for a recent five year period;
- The annual average of current receipts (goods, services, income, and private transfers) for a recent five year period;
- The variability of external current receipts for a recent thirteen-year period.¹⁷

With the exception of the last item, these components are intended to measure a member’s economic “strength” as well as its “openness” to trade.¹⁸ The five formulas use essentially the same set of economic variables, but combine them in different ways with different weights. Members may use whichever formula they prefer to generate higher calculated quotas. Large, closed economies tend to prefer the revised “Bretton Woods” formula in which GDP is the most heavily weighted variable. Small, open economies tend to prefer one of the four “derived” formulas in which trade and openness has greater weight, and GDP holds relatively less weight. One simple formula, GDP at PPP, would, in part, redress the problems that arise from this inconsistent policy.

In addition, as the Fund’s quota regime comes to reflect the economic weight of emerging market and developing countries, more staff will be selected from developing

countries. A diverse staff may help shape program designs that reflect the concerns of developing countries. At the very least, a diverse staff might help to eliminate "standardized" solutions that characterized some Fund structural adjustment programs for developing countries in the nineties. While there is a remarkable homogeneity in the Economics discipline, a diverse staff might introduce heterodox approaches to economic crisis management, enhancing legitimacy for proposed reforms.

Quota Regime: A New Approach

The use of market exchange rates in converting GDP expressed in national currency obscures the relative strength of the economy at the global level for the purpose of international comparison. A country's GDP converted at PPP rates better reflects the real value of total output produced by a country. Global trade distortions have an asymmetric impact on the measurement of output if calculated at market exchange rates, as the consequent undervaluation of the output of developing countries is much greater compared to the overvaluation of the developed countries.¹⁹ PPP raises developing countries' GDP figures because it relies on international market prices to value countries' output and international market prices tend to be higher than domestic market prices in developing countries. Differences between these two methods are sizable for individual countries, in particular for large, relatively closed, developing economies, where PPP-GDP can be more than four times higher than GDP at market prices.²⁰

Changes in the quota distribution often reflect pressing economic developments and political needs of the international community as defined by the dominant voices within the Fund. It is noteworthy that in 1976, the Executive Board decided to increase the liquidity of the Fund by doubling the quota share of the major oil exporting countries. A stipulation was added that the collective share of all the developing countries should not fall, lest their access to resources decline in a period of balance of payments instability. Quota formulas did not play any role in deciding which countries should receive selective increases. In the most recent General Review in 1998, the Executive Board sought to realign calculated and actual quotas. Ten percent of the total quota increase was

distributed selectively to those countries whose ratio of calculated to actual quotas was considered to be most “out of line”.²¹

Critics of the PPP approach sometimes argue that this method may not always correctly indicate a country’s ability to contribute to Fund resources. Also, accurate data for all countries is not readily available.²² The first objection overlooks the point that a large number of developing countries are now in a position to supply liquidity needs to the Fund as they have reasonably stable currencies, large reserves and comfortable balance of payments positions. Countries that have difficulty in meeting their contribution can be handled on a case-by-case basis. Thus, a quota increase will not create a significant barrier to contribution by such countries. Issues of data quality and availability can be resolved through a determined effort to replace estimates by actual price surveys. By providing technical assistance, countries can be motivated to support price surveys and suitable transitional arrangements can be worked out in the interregnum. It should be noted that over 95 percent of world output is currently available through the PPP technique, although there is some variability in the quality of the data.²³

Voting – Proportionality & Sovereignty

At the Bretton Woods conference in 1944 two alternate formulas were proposed for determining voting power. In the first formula voting power would be related solely to members’ quota contributions (i.e., one dollar – one vote). The second formula related voting power to the Westphalian principle of the equality of states (i.e., one country – one vote). The Fund settled on a system that combined “basic votes,” which are distributed irrespective of quota size, and “proportional votes” based on a member’s quota contribution. The basic votes were designed to increase the voting power of those members whose quotas were below the average quota for Fund membership as a whole. However, a constitutional mechanism was not created to maintain the ratio of basic votes to proportional votes if the size of the IMF’s membership fluctuated.

The relative importance of basic votes decreased substantially from 1944, when basic votes constituted 11.26 percent of total votes for the forty-five member countries, until the late fifties as a result of the growth in new Fund members with smaller-than-average quotas. The relative importance of basic votes has declined considerably since then. In 1958, basic votes constituted 15.61 percent of total votes but by 1995 basic votes share reduced to only 3.02 percent. This decline occurred along side an expansion in the number of Fund member countries from 68 in 1958 to 181 in 1995.²⁴ The decline in the relative importance of basic votes reflects, in part, the effects of regular quota increases since 1965, and more recently the marked slowdown in the new membership of relatively small members. The result of this decline is that smaller countries have very little voice in the governance of the Fund, even if they are able to form a united front.

Voting rights should balance a member's financial contribution with the principle of sovereign equality. Maintaining a strong link between a member's financial contribution to the Fund and its voting power is necessary to inspire confidence among creditor members and financial markets. However, there remains the need to balance the capitalist norm with the principle of sovereignty in order to improve the governance of the Fund.

The principle of sovereign equality can be advanced by enhancing the weight of basic votes in the determination of voting power. This is necessary as the share of basic votes has steadily declined over the past, and with near universal membership of the Fund, this trend is likely to continue with every further quota increase. It is important to note that basic votes continue to be important for countries with small quotas. In 2001, out of 183 members there are 25 members for whom basic votes comprise more than half of the member's individual voting power, while basic votes make up at least 30 percent of total voting power for 34 members, and 20 percent of total voting power for 60 members. The aggregate voting power of these 25, 34, and 60 members is 0.406, 0.699, and 1.919 percent of the total membership's voting power respectively.²⁵ If basic votes were simply doubled to 500 basic votes per member while maintaining the existing formula for voting

rights, the voting power of these countries would increase to 0.678, 1.064, and 2.548 percent of the total membership's voting power respectively.²⁶ If the proportion of basic votes to the total number of votes had been kept constant since 1945, these countries would constitute 1.659, 2.379, and 4.820 percent of the total membership's voting power respectively.

It is apparent that any increase in the size of voting power of these relatively small members, nearly all of which are non-oil producing developing countries, would have an effect upon the highly skewed distribution of voting power within the Fund. In order to prevent further erosion of voting power amongst the poorest members, it is necessary that basic votes be determined on an ad valorem basis. The Fund's Articles of Agreements should be amended to ensure that basic votes would constitute 11.3 percent of total votes regardless of future quota changes.

Restructuring the Executive Board: Legitimacy and Accountability

The appointment of the Managing Director and the first Deputy Managing Director is the exclusive and unchallenged preserve of the European Union and the United States. In view of this fact, the agreement to objective criterion for filling these posts has yet to be followed. Presently, Europe has ten chairs on the Fund's Board while Asia has six and Africa has even fewer. The Western Hemisphere has five chairs. Today Europe's share in the global GDP valued at PPP basis, an appropriate measure for international comparisons, is 29 percent while that of Asia is 32 percent. With the present trends in growth rates, this difference between Asia and Europe will only grow in Asia's favor.

Merely changing the quota shares or reallocating chairs will not be enough to improve governance. The Fund needs to fully empower the Board by making it truly independent as envisioned by Lord Keynes. The Fund requires a fully independent Board to better manage the global economy just like the parallel demand for independent central banks to better manage national economies. How can this be achieved?

One approach is that every member of the Executive Board should be an elected member, elected by their respective parliaments. In other words, no one should be nominated to the Board even if he or she represents a single country constituency. The tenure of the Executive Board members should be fixed and it could be for six years with every two years one-third of the Board is elected, providing continuity of the Board. To ensure the independence of the Board members there should be a single term limit. Enhancing the Board's independence will attract eminent professionals; this would increase objective bilateral and multilateral surveillance and improve crisis management.

Simultaneously, one needs to ensure the Board's accountability, but for now the Board has little accountability for implemented Fund programs. For instance, there could be a set of benchmarks or a Memorandum of Understanding by which shareholders will measure the Board's performance, providing for a corresponding structure of rewards and disincentives. Another way of enhancing the Fund's accountability is by actively engaging parliaments, including those of creditor countries. After all, the Fund's accountability has to be to its shareholders, who in turn represent their parliaments. Just as the Chairman of the Federal Reserve appears regularly before the US Congress, the Managing Director, or his deputy, should brief annually the parliaments of major economies on the IMF assessment of the global economy, and the implications of this assessment for the respective country. Equally the IMF would brief the parliament about the impact of Article IV Consultation on the concerned country and the impact of that country's policy towards the global economy. The added advantage of engaging the parliaments could be improved policies and policy coherence.

The Democratic Deficit: The Veto Market and the Westphalian Contradiction

The redistribution of voting power would not only redress the Fund's current imbalance amongst industrial, emerging, and developing countries, it would also create a more contestable "veto market." Veto power as determined by different coalitions of states will enable cooperation, which could empower states to prevent policies with which they disagree. A highly contestable veto market would encourage greater dialogue between

member countries, as coalitions of member countries would be able to effectively block the approval of programs that influence their interests. This increased pluralism need not lead to deadlock due to the growing global interdependence. As a political institution, the prescribed quota regime reforms would enhance participation and legitimacy, creating dialogue on the governance of the global economy.

Second, despite periodic changes to the quota regime, developing and emerging market countries have argued that the distribution of voting power within the Fund does not adequately reflect their importance in the world economy. This “democratic deficit” results from three factors: (1) the decline of basic votes in the Fund’s quota regime, reducing the voice of smaller countries in the governance of the Fund; (2) biases in the calculation of economic strength, causing the IMF to neglect the strength of emerging market economies; and (3) the needless complexity and opacity involved in the calculation of quotas. As the legitimacy and representativity of the organization is in question, the Fund will have to address this growing “democratic deficit” if it wishes to address global civil demands for improved governance and a greater role for the developing and emerging market economies.

Economic Security Council

Since the early 1990s there have been strong recommendations for the creation of an Economic Security Council (ESC). One key recommendation from the Commission on Global Governance was a new institution to address this need as “the international community has no satisfactory way to consider global economic problems in the round and the linkages between economic, social, environment, and security issues in the widest sense.”²⁷ Later on in 2001, the Zedillo Report made a similar suggestion for the creation of an apex institution in the form of an ESC.²⁸ Both reports suggest the creation of the ESC within the United Nations (UN). Currently the UN is not only fighting for its

political legitimacy, but also it is involved in a serious debate as to the restructuring of the Security Council. Given this situation, expecting an active and effective role on the part of the UN to create a viable new institution is unreasonable, and hence why we turn to the Fund.

The Fund's institutional reform deficit has created a rather legitimate debate as the IMF has failed to represent all of its 184 constituent members. In the absence of effective surveillance on G-8 Countries, this debate could bring about hazardous consequences. The Asian central banks have accumulated more than \$2 trillion foreign exchange reserves. The institution's governance in the hands of the rich nations has led to the belief that it is time to create an Asian Monetary Fund (AMF). Asia contains almost 55 percent of the world population. According to one author, the region of East and South Asia contains the most dynamic economies, fastest-growing trade, highest saving rates, and biggest current account surpluses. As a result, scholars point out that there is no reason for these countries to depend on the Fund and the United States. In order to reduce vulnerability they suggest the creation of an AMF. Although the case for an AMF seems legitimate, such a Fund would probably lead towards the proliferation of regional financial institutions and eventually may prove to be counter productive for the global economy. The spread of multiple financial institutions would create greater instability in the international system with respect to effective crisis management. To avoid proliferation of regional financial institutions the IMF ought to develop an ESC.

The central role of the Fund as an ESC would be to manage the present wave of intensified globalization in such a way that it promotes stable growth in the global

economy as the *universal* lender of last resort, providing economic security to all with an enhanced resource base. The ESC is an extension at the global level of the role of the state at the national level of providing economic security with better risk management through socializing risk, as recently argued in Moss's work, "When All Else Fails."²⁹ Through this, the Fund will reduce global political tensions, providing security for smaller countries.

In Conclusion

It is high time for a new Bretton Woods Conference to undertake the needed transformation of the global financial architecture. Notably, the conference ought to address the concerns raised by the IMF's present *assignment problem*: one instrument achieves many objectives. Jan Tinbergen finds there should be one instrument for each policy objective.³⁰ This is one reason why the three objectives of the quota regime, contribution, voting, and access, in our proposal are determined by three separate instruments: GDP at PPP, basic votes at the historic 1945 level plus GDP valued at PPP, and based on need, respectively. Current voting shares for the advanced economies would drop from 62 percent to 51 percent, a mere eleven percent.

The Fund should go through fundamental changes in four additional areas: the Fund size has to be increased substantially; the Fund governance structure, in terms of voting and number of chairs in the Board, requires a major rebalancing if the Fund is to reflect current needs; the members of the expanded board should not only be elected, but also held accountable to their Parliaments; and the central role of the Fund should be to manage the new wave of intensified globalization in such a way that it promotes a stable growth in the world economy, offering economic security to all (ESC).

¹ See Stanley Fischer "On the Need for an International Lender of Last Resort," (3 January 1999) paper prepared for delivery at the joint luncheon of the American Economic Association and the American Finance Association, New York, NY.

² (See *Straits Times* 24 September 1997; *Business Times (Singapore)* 22 November 1997; *Los Angeles Times* 7 November 1997; *Washington Post* 19 November 1997; *Times* 20 November 1997; *Financial Times* 16 December 1998; *Guardian* 22 April 2000; *Hindu* 7 May 2000; *New Straits Times (Malaysia)* 24 April 2002). In the Middle East, the Arab Monetary Fund, which was founded in 1976, is headquartered in Abu

Dhabi, United Arab Emirates. Presently, there are twenty-one members, and it is devoted to providing short and medium-term assistance to members experiencing balance of payments difficulties.

³ French, Howard (28 March 2004). China Moves Towards Another West: Central Asia. *The New York Times*.

⁴ Fenby, Jonathan (17 October 2004). Big Money in Modern China. *The Sunday Times*.

⁵ Birdsall, Nancy. Why it Matters Who Runs the IMF and the World Bank, Working Paper 22, Center for Global Development, January 2003. See also Devesh Kapur and Moises Naim, "The IMF and Democratic Governance," *Journal of Democracy*, January 2005.

⁶ IMF staff calculations. Complete calculations available upon request from V. Bhaskar, vbhaskar@msn.com

⁷ Dahl, Robert A. 1991. *Modern Political Analysis*, 5th ed. (Englewood Cliffs, NJ: Prentice Hall, 1991). pp 71-80. "Polyarchy" literally means rule by the many. The term is intended to provoke self-reflection among democracies, to right the historical tendency of classifying regime types in terms of extremes.

⁸ Eisuke Sakakibara (22 January 1999) "The End of Market Fundamentalism," speech at the Foreign Correspondents Club, Tokyo, Japan. The "constitutionalist" design of the Fund and World Bank, in which duties and actions were carefully prescribed by the Articles of Agreement, were originally intended to keep these institutions from imposing far-reaching structural reforms on sovereign members. However, in the wake of major financial crises particularly since the 1982 Mexican debt crisis, the industrialized members of the IMF and World Bank have cast these institutions into the role of correcting weaknesses in domestic financial systems to ensure growth and poverty alleviation. As the IMF has stated, conditionality has evolved substantially over the history of the Fund. Some element of policy conditionality has been attached to Fund financing since the mid 1950s, but the scope of conditionality has expanded particularly since the 1970s.

⁹ Calvo, Guillermo A. Globalization Hazard and Weak Governments in Emerging Markets. Unpublished manuscript.

¹⁰ Sources for bridging the financing gap outside of the private sector could be (a) domestic adjustment effort; (b) multilateral banks; (c) bilateral country assistance; and (d) loan restructuring.

¹¹ The five borrowers are Turkey (SDR 14,510.5 million or 28% of the Fund's General Resources Account - GRA), Argentina (SDR 10,849.8 million or 21% of the GRA), Indonesia (SDR 6,884.9 million or 13% of the GRA), Russia (SDR 5,515.5 million or 11% of the GRA), and Brazil (SDR 3,249 million or 6% of the GRA). IMF July 2002, pp 24--25.

¹² Although Turkey's quota in the IMF is small, the commitment of IMF loans at almost ten times the normal limit is unprecedented in the history of the IMF. Michael Mussa Forthcoming, 2002, p 12.

¹³ By enabling countries that are "basically sound and well managed" to secure precautionary financing in case a crisis should occur, the CCL aimed to prevent the spread of a financial crisis. The SRF was established in December 1997 to provide assistance to members experiencing balance of payments difficulties resulting from "a sudden and disruptive loss of market confidence" reflected through pressure on the member's capital account and reserve holdings. IMF 2001, *Financial Organization and Operations of the IMF*, 184, 196.

¹⁴ The quota regime also determines allocation of SDRs as a reserve asset. A decision to allocate SDRs has only been reached twice. In 2001, SDRs accounted for less than one half of one percent of members' non-gold reserves. IMF 2001, *Financial Organization and Operations of the IMF*, p 89.

¹⁵ Countries with the five largest quota subscriptions (i.e., US, Japan, Germany, France, and the United Kingdom) are allowed to appoint an Executive Director to the Fund's Executive Board. All other members are organized into regional groups and elect an Executive Director to represent their constituency. China, Russia, and Saudi Arabia form separate single member country constituencies, thereby effectively retaining a separate and independent seat on the Executive Board.

¹⁶ The Board of Governors, whose members are usually ministers of finance or heads of central banks, normally meets once per year. It is the highest policymaking body of the IMF and it holds the Executive Board accountable.

¹⁷ IMF 2001, *Financial Organization and Operations of the IMF*, p 57.

¹⁸ The variability of the current receipts is the only need-based indicator; it takes into account the financial problems that countries are likely to face.

¹⁹ Quota Formula Review Group 28 April 2000, p 58; Quota Formula Review Group 27 September 2001, p 13; IMF Treasurer's Department and IMF Statistics Department 3 May 2002, p 4.

²⁰ IMF Treasurer's Department and Statistics Department 3 May 2002, p 6. A compromise formula or hybrid exchange rate based on a combination of PPP and market exchange rate is also possible.

²¹ IMF 2001, *Financial Organization and Operations of the IMF*, p 58, p 62.

²² Quota Formula Review Group 28 April 2000, 57--58; Quota Formula Review Group 27 September 2001, 13--14; IMF Treasurer's Department and Statistics Department 3 May 2002, p 4, p 6

²³ Ibid. p 58.

²⁴ The number of countries included in the 1995 tally includes Brunei Darussalam, Sudan, Zaire (whose voting rights had been suspended), South Africa (which did not participate in the 1994 regular election of Executive Directors), Bosnia & Herzegovina, Iraq, Afghanistan, and Liberia -- for which data was not available to make quota calculation under the Eleventh General Review.

²⁵ East Timor became the 184th member of the IMF on July 23, 2002.

²⁶ A member's voting power is equal to 250 basic votes plus one additional vote for each SDR 100,000 in quota. IMF 2001, *Financial Organization and Operations of the IMF*, p 55.

²⁷ Commission on Global Governance, *Our Global Neighborhood* (Oxford, Oxford University Press, **1995**), **153**.

²⁸ High-level International Intergovernmental Consideration of Financing for Development, June 26, 2001, The United Nations. Ernesto Zedillo, Chairman, **67**.

²⁹ Studies show that for modern market based economies to perform well, one of the most important roles of the government is the effective management of risks at both the macro and micro level as an integral part of its public policy framework. In this age, international organizations will have to play a role in risk mitigation and risk sharing to provide for global economic security. The Meltzer Commission has already proposed far-reaching reforms; it has suggested that the Fund must focus on short-term liquidity crisis assistance and eliminate long-term loans for structural reforms.

³⁰ Tinbergen, Jan. *On The Theory of Economic Policy*, 2nd ed. (Amsterdam: North Holland, 1952).