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IMF Reform Needs a Serious Push

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During the IMF and World Bank Annual Meetings in Singapore in September 2006 , a first modest step was taken to rebalance the weights of under-represented developing countries by increasing the shares of the four most under-represented countries, China, South Korea, Mexico and Turkey. Since quota shares determine votes at the board of the IMF, as well as obligations to pay in and rights to draw on the IMF's resources, this move has been billed as a first step towards making the IMF a more representative and legitimate global institution. A second and more far-reaching package of reforms of shares and hence votes in the IMF is currently under discussion, with the hope that significant further action will be taken by no later than the Annual Meetings in 2008. This progress in governance reform of a premier global institution is a signal that movement is possible in what appeared to be a frozen state of global governance reform, where institutions that were created 60 years ago or more, no longer reflect the dramatic shifts in global population, economic and political power, especially as regards the rapid rise of Asia.

Member governments, and especially the members of the G20 forum of finance ministers of the most important economies of the globe, should make sure not to miss this unique opportunity for making a meaningful change in the distribution of IMF shares and votes. However, we believe that a more far-reaching package of governance reforms is needed for what has become an ailing global financial institution. In our view the following five steps would comprise an action program that would make the IMF significantly more representative and effective:

1. Go back to basics. Since the creation of the IMF the proportion of so-called “basic shares” – allocated to each country irrespective of size has dropped from over 12 percent to about 2 percent. The proportion of votes of the small countries, many of them among the poorest and most dependent on the IMF, has dropped accordingly. The IMF should increase the "basic" quota allocations for all countries - unrelated to economic weight – not just to 4-5% currently being considered, but back to at least the level at the creation of the institution. While real influence at the IMF would still be wielded by the bigger economic powers, this simple step is an important one towards more equitable representation of the smallest and poorest countries and to giving them better access to IMF finance.

2. Rebalance the scales. A second potential, though more difficult, step would be to alter the criteria for allocation of shares of the IMF so they reflect the reality of changing economic and financial weights of countries by allowing not only for GDP at current exchange rates, trade and reserves, but by also including GDP adjusted for purchasing power, financial flows and especially population. This step would shift governance power in the IMF further to the emerging economic powers that deserve representation commensurate with their growth and their rapidly rising weight in the world economy, global finances and geo-politics. For this to happen, many European countries will have to reduce some of their currently over-weighted shares.

3. Streamline and rebalance the Board seats. A third step for meaningful

IMF reform would be to reduce the number of IMF Board "chairs" to 20 (from the current 24) by consolidating and streamlining the European seats on the Board. Currently, European countries occupy lead positions on the IMF Board in eight out of 24 chairs. A partial step to rectify this imbalance would be for the Europeans to unify the Euro-Zone members into one Board seat, since the creation of the Euro currency and of the European Central Bank in any case means that the members of the Zone have no longer independent monetary systems. But ultimately, a single EU chair should be the goal. This would free up seats even if the overall size of the Board is reduced. One or two of these could be offered to African countries as a way to increase their voice in the international financial institutions.

4. Give merit a chance in leadership selection: A fourth and long overdue step would be to make the selection of the IMF's Managing Director transparent, merit-based and unrestricted by nationality. This would require the Europeans to give up their customary claim to select the Managing Director.

5. Look for a grand bargain: Taken together the first four steps would amount to a real change for the better in IMF governance by making it into a more representative, effective and hence legitimate global institution. But most of the steps involve a reduced role for the European countries individually and as a group. To get them to agree to this painful, although justified change most likely will require a grand bargain under which the U.S. would also yield some of its traditional, but exceptional prerogatives in the international financial institutions. For one, the U.S. should give up its claim to select the World Bank's President. For another, the U.S. could boldly give up its veto right at the IMF and World Bank boards, which it at the moment holds exclusively among members. This could be done by lowering the minimum threshold of votes required for key decisions from the current 85% level to a level, say 75 or even 80%, which would in effect eliminate the veto of the US. Finally, the customary tight link between IMF and World Bank governance structures should be abandoned. The Bank also needs to revisit it shares and chairs, but since it has a very different mandate from the IMF, and a very different financing structure, especially in IDA, it does not make sense to tie reforms in one institution narrowly to those in the other.

A combination of steps such as those outlined above would represent significant progress in the governance of the IMF and we believe if they are taken as a package, they could also be politically feasible. Failure to move now boldly towards such a governance structure will likely mean a progressive weakening of the IMF, and would also represent a signal that other global institutions, including the World Bank, the WTO and the UN are beyond repair. In their stead we would see the possible rise of competing power centers and regional institutions that would leave a fractured world at a time when the growing global threats of financial imbalances, of health and environmental risks, and of insecurity if anything require more inclusive, effective and cooperative global institutions.