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International Monetary Fund: Reforming Country Representation

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Summary

Many developing countries have long argued that they deserve an increase in the influence that they wield at the International Monetary Fund (IMF). They point out that after years of sustained economic growth, their representation does not reflect their current economic position in the world economy. Proposed changes would give these emerging economies as well as poor borrowers and countries that do not significantly contribute to funding IMF operations greater say in order to enhance the perceived legitimacy and effectiveness of the institution.

At the spring 2006 IMF meetings, IMF Managing Director Rodrigo de Rato presented a loosely fleshed out proposal that would provide for a two-step process. In the first step, there would be a so-called ad hoc quota increase that would immediately raise the representation of a few select countries who it is commonly agreed are under-represented at the Fund and follow with fundamental reform of the IMF quota system.

De Rato's reform agenda was approved by IMF members at the fall 2006 IMF meetings in Singapore. At the meetings, IMF members granted four countries quota increases: China, South Korea, Turkey, and Mexico. These ad-hoc increases are to be followed by additional reforms during the next two years. Fundamental reform can take several forms. Four options are: (1) closer alignment between actual and existing quotas; (2) revising the quota formulas; (3) reorganizing the Executive Board; and (4) increasing the number of basic votes.

These reform options are not mutually exclusive. It is likely that any eventual reform may comprise aspects of several of the options discussed. Any potential reform, however, must enhance both the IMF's relevance and credibility. There is often tension between these two goals. The IMF is relevant precisely because it caters to the financial needs of the world's neediest countries. However, it is credible only to the extent that it is financially sound and is able to fulfill its mission. Increasing the representation of developing countries may only be successful if it can be accomplished without damaging the credibility of the institution and sacrificing the IMF's financial stability.

The Bush Administration has supported this proposal. In testimony and speeches since 2006, Administration officials explained that they are willing to support an ad-hoc increase for a few countries, but only if it is tied to fundamental reform of the IMF governance system. Depending on which course of action IMF members choose, action may be required by the 110th Congress. Congress must give its consent by law before the United States may agree to participate in any new IMF funding agreements that change the U.S. quota, require additional contributions from the United States, amend the IMF Articles of Agreement, or dispose of any gold currently held by the IMF.

This report will be updated as events warrant.

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Introduction

Representation at the International Monetary Fund (IMF) is linked roughly to the degree of financial support countries provide to the institution and their relative share of the world economy. Many developing countries have long argued that they deserve an increase in their representation, on the grounds that after years of sustained economic growth, their participation does not reflect their current economic position in the world economy. Proposed changes would give these emerging economies as well as borrowers and countries that do not contribute to funding IMF operations greater say in order to enhance the perceived legitimacy and effectiveness of the institution. This in turn may enhance the ability of the Fund to carry out its mission of international monetary cooperation and exchange rate stability.[1]

The IMF has introduced a two-step reform process beginning with an ad hoc quota increase for a few under-represented emerging market countries: China, Mexico, South Korea, and Turkey. These increases are to be followed within the next two years by fundamental reform of the quota system. Quota reform is at the heart of the IMF reform debate as quotas largely determine representation and voting rights, as well as financial contributions. However, since quotas are fundamental to so many aspects of a country's representation at the IMF, any change is difficult politically. Some fast-growing economies will gain voting power while others will lose. An overwhelming consensus of all IMF member nations is required for any quota reform to take effect.

The Bush Administration has expressed support for the two-step IMF proposal. Fundamental reform of the IMF quota and voting system could take a variety of forms and several options are being considered. Congressional action may or may not be required depending upon which fundamental reform option (if any) is implemented. The United States is the largest contributor to the IMF and has the largest vote in the institution. Congress is responsible for authorizing and appropriating U.S. contributions to the IMF and must give its consent to any change in the size of the U.S. quota. Although there are potential scenarios where the Bush Administration would not need to seek Congress's approval, and there is no current legislation addressing IMF reform, many of the IMF reform proposals may likely require congressional authorization and/or appropriations.

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[1] See CRS Report RL32364: *The International Monetary Fund: Organization, Functions, and Role in the International Economy*, by Jonathan Sanford and Martin A. Weiss.

This report explains how countries are represented at the IMF, discusses the reform agenda, analyzes various options to reform the quota system, and evaluates the role of Congress. It will be updated as events warrant.

Country Representation at the IMF

Broad policy is set and determinations on lending for specific countries are made by three levels of decision-making bodies in the IMF (**Box 1**). Unlike the United Nations General Assembly, which relies on a one-country, one-vote governance system, the IMF uses a weighted voting system based on a country's quota. The United States, with 17.08% of the total vote, has the largest single vote in the institution.

Box 1. Decision Making at the IMF

The Board of Governors is the highest authority in the IMF. All countries are represented on the Board of Governors, usually at the Finance Minister or Central Bank governor level. Although the Board of Governors has ultimate authority for running the IMF, it has delegated nearly all its powers to the Executive Board. The Board of Governors meets annually at the fall IMF-World Bank meetings.

The Executive Board handles day-to-day authority over operational policy, lending, and other matters. It is the main decision-making body at the IMF. The board has 24 members each representing from 1 to 24 countries (see **Box 2**) who usually meet three or more times a week to oversee and supervise the activities of the IMF. Funds cannot be raised and loans and policies cannot be approved without Executive Board agreement.

Other Groups: In addition to the official representation of the Board of Governors and the Executive Board, there are several other cross-cutting groups of countries that are actively involved with the IMF. These include the G-15 and the G-24. The G-15 was established at the Ninth Non-Aligned Summit Meeting in Belgrade, Yugoslavia in September 1989. Comprised of countries from Latin America, Africa, and Asia, the G-15 focuses on cooperation among developing countries in investment, trade, and technology. The membership of the G-15 has expanded to 17 countries, but the name has remained unchanged. The G-24 was established in 1971 and coordinates the positions of developing countries on international monetary and development finance issues and to ensure that their interests were adequately represented. The G-24 has been very active on governance reforms and has promoted several particular policies. Members meet at the IMF/World Bank spring and fall meetings and release an official communiqué.

Quotas

Quotas are the foundation of country representation at the IMF. Based loosely on each country's global economic standing, quotas specify: (1) the amount of financial resources each member is required to contribute to the Fund; (2) the amount of financing a member may receive from the Fund;[2] and (3) the amount of voting power each country has at the IMF.

Quotas are expressed as "Special Drawing Rights" (SDR).[3] Total quotas at end-September 2007 were SDR 217.3 billion (about $338.3 billion). Countries contribute to the IMF mainly in local currency. Since the currencies of many emerging market and developing countries are weak and not used by the IMF to fund its operations, only about 69% of the IMF's total quota resources are deemed usable by the IMF.[4]

Since the IMF's founding, it has been the stated intention of the IMF to base quotas on various formulas that technically deduce a country's ability to contribute to the IMF and its likelihood of drawing IMF resources. The IMF periodically calculates country quotas based on these formulas. In practice, quotas have only been loosely guided by the calculated quotas and actual quotas are determined more by political negotiations among the member countries.[5]

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[2] Over time, this linkage has weakened and several countries have been granted special access, allowing them to borrow several times their IMF quota. Argentina, for example borrowed over five times its quota in 2002. In addition, the poorest countries borrow from the IMF under the Fund's concessional facility, the Poverty Reduction and Growth Facility (PRGF). The resources for the PRGF do not come from quotas and are not restricted by any limits.

[3] Special Drawing Rights (SDR) are the IMF's unit of account. Initially defined as equivalent to 0.888671 grams of fine gold, the value of the SDR was switched to a basket of international currencies following the collapse of the Bretton Woods system of fixed parity exchange rates in 1973. The current basket includes the euro, Japanese Yen, the British pound sterling, and the U.S. dollar.

[4] See "IMF's Financial Resources and Liquidity Position, 2004 — June 2006," *The International Monetary Fund*, 2006.

[5] When the IMF was created at the Bretton Woods conference, there was debate between the United States (represented by Harry Dexter White) and the United Kingdom (represented by John Maynard Keynes) over many aspects of the proposed institution. Both the White and Keynes plans proposed fixing quotas on some type of formula that would determine a country's relative global economic standing and allocate an appropriate quota. Such a formula could include consideration of a country's reserves of gold and foreign currencies, magnitude of its balance of payments, national income, population, or any other of a host of economic indicators. Very quickly into the negotiations, it was clear that no formula would determine a quota system that would please all of the 44 new IMF member nations. Moreover, by the time of the Bretton Woods conference, the United States, Great Britain, and the other major donors had reached agreement on the total capitalization of the new institution and their contributions. Thus the United States and the other contributor nations determined the final quota structure through negotiations and then backed into a formula to give the desired result. Explaining how he came up with the quota formula, Raymond

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A 2000 study of the history and relevance of the IMF quota formula found that the formula had only an indirect influence on actual quotas.[6] The study also found that the gap between actual and calculated quotas has persisted and thus actual IMF quotas (and subsequent voting power) do not accurately reflect the current world economy. Since 1945, there have been 12 general quota reviews. Of these, seven have led to an increase in the financial resources of the institution. Of the total quota increase since 1945, less than one-third has been based on the quota formula. The remaining increase was general or "equi-proportional," each country receiving an increase proportional to their existing share. Since quota reviews have maintained the status quo, Western Europe, the United States, and the other dominant countries when the IMF was created have benefitted while emerging countries, specifically Asia, and other developing countries have quotas and voting power disproportionately low relative to their growing global economic weight.

Voting

Unlike the United Nations General Assembly, which relies on a one-person, one-vote governance system, the IMF uses a weighted voted system. The IMF's founders agreed that the voting system should combine elements of the one-country, one-vote principle with proportional voting depending on contribution levels. The voting system adopted at Bretton Woods give 250 votes automatically to every country (basic votes) and one additional vote for each $100,000 of quota. Over time, as the size of the IMF's quota increased while the number of basic votes stayed the same, basic votes have become a marginal component of the total number of votes, down to 2.1% from 11.3% initially. Many analysts agree that any fundamental reform would require an increase in the number of basic votes.[7]

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[5] (...continued)
Mikesell, an advisor to the U.S. delegation at Bretton Woods, recalled, "I had anticipated this request and gave a rambling twenty-minute seminar on the factors taken in calculating the quotas, but I did not reveal the formula. I tried to make the process appear as scientific as possible, but the delegates were intelligent enough to know that the process was more political than scientific." Since then, the quota formula has been formalized and expanded several times to include additional variables; however the quota formulas are only used as a guide for quota reviews. See Raymond F. Mikesell, "The Bretton Woods Debates: A Memoir," Princeton University Essays in International Finance, No. 192, March 1994, pp. 35-39.

[6] "External Review of Quota Formulas," *International Monetary Fund*, 2000.

[7] At the Bretton Woods Conference, the British proposed a simple voting structure where each country would have a direct vote in proportion to their quota. Mr. White however was concerned that such a system would give the United States and Great Britain too much control over the institution. On the other hand, he noted that to give all countries equal representation would be equally problematic, since the resources were not contributed equally. Mr. White proposed a mixed system that combined elements of the one-country, one-vote system and a proportional system. Mr. White proposed that each country be given 100 basic votes plus an additional vote for each million dollars of quota. Mr. White and Lord Keynes agreed on the mixed-voting system, however they compromised on a system that gave significantly less voting power to small countries than Mr. White's original proposal since countries receive one vote for each $100,000 of quota rather than Mr.
(continued...)

Constituencies

The IMF uses a voting system where the Executive Directors (EDs) can represent either a single country or several countries grouped in mixed-state constituencies (**Box 2**). A result of this constituency system is a significant power asymmetry among members on the Board. Moreover, the distribution of voting strength among EDs has become more unequal over time. The minimum voting power that the IMF allows each ED to hold dropped to 4.0% in 2005. In practice, however, this rule is waived and 15 EDs each have fewer than 4.0% of the institution's votes. The two EDs that represent 43 African countries wield 3.0% and 1.4% of the IMF's votes respectively. By contrast, the U.S. ED holds 17% of the vote, and the four other largest contributors having voting power ranging between 5% and 6%.

Box 2. The Executive Board and Mixed-State Constituencies

There are currently 24 members on the IMF Executive Board representing in varying degrees every IMF member country. Of the 24 Board members, eight represent individual countries, and 16 individuals represent the remaining members. According to Section 3 of the IMF's Articles of Agreement, the five countries having the largest quotas appoint their own executive director. This means that the United States, Japan, Germany, Britain, and France are allowed to appoint their own representatives on the Board. In addition to the five largest shareholders, China, Russia, and Saudi Arabia have enough votes to elect their own Executive Directors. All other countries have gravitated into mixed-state groupings or constituencies. These constituencies range in size from 4 countries (a South Asian constituency led by India) to 24 (an African constituency led by Equatorial Guinea). The mixed-state constituencies are flexible in their membership. Countries have periodically switched constituencies, often to a new group that will allow them to have a bigger vote or leadership role.

Unlike the eight countries that have their own ED, the influence of countries in mixed-state constituencies is not equivalent to their quota-determined voting weight. Since they vote in constituencies, very small countries can easily be sidestepped by the larger countries in the constituency.[8] For many countries at the IMF they "can at best express a divergent opinion orally but cannot bring it to bear in the form of a

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[7] (...continued)
White's original proposal of one vote for each $1 million of quota.

[8] For example, Guatemala has an 0.11% voting share at the IMF based on its quota. However, Guatemala never actually independently votes at the IMF on this percentage. As part of a constituency led by Mexico and also including Costa Rica, El Salvador, Honduras, Nicaragua, Spain, and Venezuela, Guatemala shares one executive director on the Executive Board who currently wields 92,989 votes or 4.3%. Within its constituency, Guatemala has 2.5% of the total votes. Spain has 33.1% of the intra-constituency votes, Venezuela has 28.9% and Mexico has 28.1%. Within this constituency, no other country has more than 3.0% of the constituency vote.

vote."[9] Executive Directors must cast their votes as single unit even though some of the countries they represent may disagree with their position. Of the 16 mixed-state constituencies, five have a country with a majority of the total votes, and three have countries that control over 40% of the total vote. **Appendix 1** ranks the largest member of each constituency and their percentage of the total votes within their constituency.

The IMF's Articles of Agreement set the various thresholds required for IMF decisions. The majority of IMF decisions require a 50% majority vote. However, some special matters (changes in the Articles of Agreement or approval of new quota increases, for example) require an 85% affirmative vote. Since the U.S. vote exceeds 15%, no quota increases, amendments or other major actions can go into effect without U.S. consent. The same can be said for other major blocks of IMF member countries, principally European countries.[10]

An important issue regarding voting, however, is that within the Executive Board there is a very strong institutional aversion to formal voting. Executive Board Rule C-10 states that "the Chairman [Managing Director] shall ordinarily ascertain the sense of the meeting in lieu of a formal vote."[11] Since the United States or a combination of European countries could block most policy issues if they were to actually come up to a vote, it is difficult to determine how true an Executive Board consensus often is. Thus if it appears that the United States (or other large quota holders) does not support a policy issue requiring 70% or 85% approval, it will never come to a vote, and there will be no formal record of U.S. dissent. This may have the effect of stifling debate on the Executive Board.

IMF and U.S. Policy on IMF Governance Reform

Context

The world has changed dramatically since the IMF was founded. Established in 1946 with a membership of 46 countries, the IMF now includes 185 countries and oversees a vastly different world economy with a new distribution of economic power. Unlike in 1946, emerging market economies, primarily in Asia and Latin America, play a vibrant and crucial role in the world economy. However, the distribution of quota and voting power at the IMF has changed very little to reflect these changes.

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[9] Richard Gerster, Proposals for Voting Reform Within the International Monetary Fund, *Journal of World Trade*, June 1993, quoted in David Rapkin and Jonathan Strand, "Reforming the IMF's Weighted Voting System," *The World Economy*, 2006.

[10] With a combined vote of 15.89%, Germany (5.99%), France (4.95%), and the United Kingdom (4.95%) could also block any governance reforms if they voted together.

[11] See Miles Kahler, *Leadership Selection in the Major Multilaterals*, Institute for International Economics, 2001, p. 23.

The IMF's response to the Asian Financial Crisis of the late 1990s highlighted the lack of representation of many key emerging market economies in IMF decision-making. Many countries believe that the IMF's response was heavy-handed and exacerbated the crisis.[12]

Discontent with the IMF has had tangible effects on the Fund's operations and spurred reform efforts. Several major borrowers have taken advantage of the benign economic conditions beginning in 2003 to prepay their IMF loans. In 2003, Thailand paid off its IMF debts two years early. In 2004, Russia prepaid $3.3 billion to the IMF. In 2005, Argentina and Brazil both paid their remaining IMF debt early. These early payments significantly reduce the IMF's lending activities to middle-income countries, a primary source of income for the IMF.

In addition to removing themselves from IMF lending, some member countries are also creating alternative institutions to the IMF. Under the Chiang Mai Initiative, several Asian countries are seeking to insulate themselves from the IMF by accumulating large foreign exchange reserves to remove any potential need to seek IMF lending if they run into difficulties with their international financial relations.[13] The Chiang Mai Initiative is in direct response to the perceived mishandling by the IMF of the East Asian financial crisis in the late 1990s. If developing countries continue to withdraw from IMF lending and its sphere of influence, the financial future of the institution may be in doubt.[14] Therefore, these countries' actions have heightened the pressure on the IMF to seek reform.

The IMF's Reform Effort

Responding to this pressure, IMF Managing Director Rodrigo de Rato included the need for governance reform in his 2005 Mid-Term Strategic Review, presented to IMF members at the fall 2005 annual meetings.[15] In the report, de Rato wrote, "fair weight and voice are crucial to the legitimacy of a universal institution. The current allocation puts this legitimacy at risk in many regions, for example, in Africa, where the Fund is heavily engaged, and in Asia, whose place in the world economy has grown far more than its role in the Fund."[16]

At the spring 2006 meetings, de Rato presented a loosely fleshed out reform proposal that would consist of a two-step process. In the first step, there would be a so-called ad hoc increase that would immediately raise the representation of a few

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[12] See CRS Report RL30517, *Asian Financial Crisis and Recovery: Status and Implications for U.S. Interests*, by Richard Cronin.

[13] See C. Randall Henning, *East Asian Financial Cooperation*, Institute for International Economics, October 2002.

[14] See Devesh Kapur and Richard Webb, "Beyond the IMF," Paper for the G-24 Technical Meeting, March 2006 and James Boughton, "Does the World Need a Universal Financial Institution," IMF Working Paper 05/116, June 2005.

[15] The Managing Director's Report on the Fund's Mid-Term Strategy, *International Monetary Fund*, September 15, 2006.

[16] Ibid., p. 12.

select countries that are commonly viewed as under-represented at the Fund. This ad-hoc increase would be followed in the next two years by more fundamental reforms of the IMF governance framework.

IMF member countries endorsed the de Rato proposal at the spring meetings. The Communiqué released at the meetings by the IMF's International Monetary and Finance Committee (IMFC)[17] reiterated the theme raised by Managing Director de Rato: "the IMF's effectiveness and credibility as a cooperative institution must be safeguarded and its governance further enhanced, emphasizing the importance of fair voice and representation for all members."[18] The Communiqué went on to call upon the IMF to work with the IMFC and the IMF's Executive Board to come up with concrete proposals for "fundamental reform" of the system by which countries are represented at the IMF.[19]

At the fall 2006 meetings, the IMF won approval for a more detailed reform proposal beginning with small quota increases for China, Mexico, Turkey, and South Korea. Following this increase, the IMF will work during the next two years to adjust IMF quotas through a new quota formula, a second round of ad hoc increases, and increases in the number of basic votes available to all countries. There was some resistance to the proposal at the meetings from other emerging economies including Brazil, India, and Argentina. These countries, among others, opposed the initial ad hoc increase arguing that reforms should be adopted for all developing countries simultaneously.[20]

Dominique Strauss Kahn, de Rato's successor as IMF managing director, has vowed to continue with the reform proposal. Since the beginning of his tenure in November 2007, he has invigorated the reform effort, building on the decision by the IMFC at the October 2007 Annual Meeting that, "the reform should enhance the representation of dynamic economies, many of which are emerging market economies, whose weight and role in the global economy have increased."[21]

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[17] The IMFC is the primary advisory board for the full IMF Board of Governors. The IMFC has 24 members who are Governors of the IMF. The membership reflects the composition of the IMF's Executive Board: each member country that appoints, and each group of member countries that elects, an Executive Director appoints a member of the IMFC.

[18] Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, April 22, 2006, available at [http://www.imf.org/external/np/cm/2006/042206.htm].

[19] The IMFC meets twice annually (in the spring and the fall) to consider major policy issues affecting the international monetary system and make recommendations to the IMF's Board of Governors.

[20] Gary Duncan, "China Wins Bigger Vote Share in Wide Overhaul of IMF," *The Times (London)*, September 17, 2006.

[21] International Monetary Fund, Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, October 20, 2007.

U.S. Policy

The Bush Administration has expressed support for the IMF reform agenda. For many years, it has been the policy of the U.S. government to further integrate developing countries into the global economy and its main international institutions. In his statement at the spring 2006 IMF meetings, then-U.S. Treasury Secretary John Snow told fellow IMF members that, "[t]he United States strongly supports the efforts to realign quotas and Board representation at the IMF in order to reflect changes in the global economy."[22] The Administration hopes that this ad hoc quota increase will act as a spur for broader IMF governance reform within the next two years. Moreover, the Administration would like to give China a greater say at the IMF as an incentive for them to revalue its currency, the yuan.[23] Timothy Adams is quoted as saying, "If we're going to give China or any other country ... greater weight in the IMF, then they need to take their responsibilities in that institution seriously, and they need to play by the rules as they're laid out."[24] However, giving China a substantial increase in quota may upset several Members of Congress who wish to see China appreciate the value of its currency prior to their gaining any additional representation at the IMF.[25]

Finally, the Bush Administration wants to see the IMF Executive Board better reflect the IMF's full membership. A broad consensus appears to be emerging that European countries are over-represented at the IMF compared to their share of global GDP. European countries have three full seats on the IMF Executive Board (Germany, France, and the United Kingdom), and currently chair or co-chair seven of the group constituencies. The 25 EU members appoint or play a predominant role in appointing 10 of the 24 members of the Executive Board (42%), even though as a group they have only 29.8% of the vote.[26] Among other things, this gives them a disproportionate voice in IMF discussions.

The Bush administration has expressed support for rationalization of European shares in the institution. In a speech at the Institute for International Economics laying out the Bush Administration's vision for IMF reform, Timothy Adams noted, "Consolidation of European chairs [seats on the Executive Board] would help to

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[22] John Snow, IMFC statement, April 24, 2006.

[23] Paul Blustein, "U.S. to Support More IMF Votes for China," *The Washington Post*, August 24, 2006.

[24] Michael M. Phillips, "Politics & Economics: U.S. Plots Deal Over Yuan Valuation — China Is Quietly Offered Help On Getting Bigger IMF Role If It Eases Currency Stance," *Wall Street Journal*, July 24, 2006.

[25] See CRS Report RL33762, *Congress, the IMF, and Exchange Rate Reform: Legislative Proposals*, and CRS Report RL33322, *China, the United States and the IMF: Negotiating Exchange Rate Adjustment*, both by Jonathan E. Sanford. See also CRS Report RL32165, *China's Currency: Economic Issues and Options for U.S. Trade Policy*, by Wayne M. Morrison and Marc Labonte.

[26] Edwin Truman, "Rearranging IMF Chairs and Shares: The Sine Qua Non of IMF Reform," in Edwin Truman, ed. *Reforming the IMF for the 21st Century*, Institute for International Economics, 2006, p. 203.

increase the voice of emerging market and developing country members."[27] It is unclear, however, how willing European countries are to relinquish quota or consolidate their votes.

Fundamental Reform Issues

As the recent reform discussion illustrates, it appears that IMF management, the Bush Administration, and most developing countries would like to see reform of the IMF governance system. However, three broad issues may need to be addressed before any potential reform proposals can proceed.

Should Reform Involve Amending the Articles of Agreement?

Any reform that does not involve amending the Articles of Agreement will likely be easier to gain a consensus among IMF members and easier to implement. Revising the Articles is a cumbersome process, since doing so requires the consent of the United States Congress and many other national governments and legislatures.

Will Anyone Lose Quota?

The Bush Administration has said on several occasions that it would consider a decrease in the total U.S. quota share. It is unlikely, however, that it would propose dropping the U.S. share to below 15%, that needed to block the most important votes (those requiring an 85% majority).[28] The U.S. share could be reduced without any requirement for action by Congress so long as the numerical size of the U.S. quota is unchanged.[29]

The Bush Administration has also indicated that it would like to see a voluntary rebalancing of quotas within the existing total from overweight countries to the most underweight emerging economies.[30] However, this would involve other countries, likely European, taking a more forward leaning position on reducing their quota and vote at the IMF than they have to date.

Ad Hoc Quota Increase Only

The U.S. Administration has stated that it will only support an ad hoc increase in quotas if it is tied to broader reform. In testimony to the House Financial Services

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[27] Timothy Adams, "The IMF: Back to Basics," in Edwin Truman, ed. *Reforming the IMF for the 21st Century*, Institute for International Economics, 2006, p. 135.

[28] Originally, the special majority for major IMF votes was 80%. This was later raised to 85%.

[29] For example, an ad hoc quota increase would increase the total amount of IMF quota. If the U.S. quota does not change, an increase in total IMF quota would lead to a decrease in the relative U.S. quota share.

[30] Adams, p. 134.

Committee on May 17, 2006, Secretary Snow explained the U.S. position. "We [the Bush Administration] have agreed that a first step could consist of a limited ad hoc increase for the most under-represented members. But we have emphasized that an ad hoc quota increase by itself is inadequate to resolve the quota and representation issues that are steadily eroding the IMF's legitimacy and effectiveness. *We are only willing to support a limited ad hoc quota increase at the IMF Annual Meetings in Singapore if it is credibly linked to a second step that delivers fundamental reform.*" (emphasis added)[31]

As noted earlier, IMF members agreed to an ad hoc quota increase for China, Mexico, South Korea, and Turkey at the fall 2006 IMF meetings. This ad hoc increase does not require amending the IMF Articles of Agreement and does not lead to European countries, or any other country, losing any quota though it marginally reduces their quota share.

However, an ad hoc increase does not address the broader concerns affecting the majority of developing countries at the IMF. Anne Krueger, IMF first deputy director, speaking in Tokyo on June 6, 2006, argued that such an ad hoc increase by itself would be insufficient to meet the reform goals expressed by IMF members, especially the Asian countries that appear to be turning away from the IMF. In her remarks, Deputy Director Krueger argued that to ensure that Asia's emerging economies engage further with the IMF, and support a stronger IMF role in the global economy, a new system needs to be devised that better allocates quota, representation of the Executive Board, and overall votes based on some measure of a country's economic size.[32]

Fundamental Reform Options

At the fall 2006 meetings, IMF members agreed to pursue fundamental reform of the IMF quota system within the next two years. This can take several forms. Four options are (1) closer alignment between actual and calculated quotas; (2) revising the quota formulas; (3) reorganizing the Executive Board; and (4) increasing the number of basic votes.

Closer Alignment Between Actual and Calculated Quotas. One option to boost the quota for emerging countries could be to move towards closer alignment between calculated and actual quotas. The IMF periodically calculates quotas based on a set of formulas to determine a country's economic weight and likelihood of needing IMF assistance.[33] These calculated quotas are supposed to guide IMF quota determinations. In practice, these quota formulas have only loosely

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[31] John Snow Testimony before the House Financial Services Committee, May 17, 2006.

[32] "Making the IMF relevant for Asia A revitalized Fund would help tackle global imbalances" [ASIA EDITION], *Financial Times,* June 8, 2006.

[33] Currently, the formula consists of five equations containing variables for: the overall size of the economy (GDP), capacity to contribute to the IMF (international reserves), two indicators of financial openness (current account transactions and variability of current receipts), and a measure of the potential need to borrow IMF resources (the ratio of current receipts to GDP).

guided actual quotas, which have been decided more through political negotiations. A large gap exists between the calculated and actual quotas and thus one proposal has been to move closer toward the calculated quotas.

Such a realignment could occur during a general quota review. The IMF will conclude its 13th general quota review in 2008 and could use a general increase to closer align quotas with their calculated rates (if approved by all national governments and the necessary national legislatures). This would succeed in boosting the quota share of many emerging countries. However, the increased quota would come at the expense of other developing countries in Africa, the Middle East, and Latin America. Moreover, the total quota (and vote) of developing countries would decrease while the advanced economies shares would increase (**Table 1**).[34]

Table 1. Actual and Calculated IMF Quotas

	Current Quota	Calculated Quota based on Existing Formulas (2005)
Advanced Economies	61.6%	67.6%
Major Advanced Economies	46.0%	47.9%
Of which: United States	17.4%	17.2%
Other Advanced Economies	15.6%	19.6%
Developing Countries	30.9%	27.7%
Africa	5.5%	2.3%
Asia	10.3%	15.8%
Middle East (including Malta and Turkey)	7.6%	4.5%
Western Hemisphere	7.5%	5.1%
Transition Economies	7.5%	4.7%

Source: International Monetary Fund

Within these categories, there would also be broad shifts between countries. For the industrialized countries, the U.S. share would decrease slightly from 17.4% to 17.2%, the German share would increase from 6.1% to 7.0%, the French would decrease from 5.0 to 4.3%, and Japan's share would rise from 6.2% to 7.2%. Russia and Saudi Arabia, both countries which have their own seat on the Executive Board, would see major declines in quota. Russia's share would decline from 2.8% to 1.3%, and Saudi Arabia's would decline from 3.3% to 1.0%. These changes would lead to

[34] This and the following data are from "Quotas and Voice — Further Considerations," *International Monetary Fund*, September 2, 2005.

an overall increase in the share of quota held by the advanced economies from 61.6% to 67.6% if the current calculated quota formulas are used.

More dramatic changes are seen in the quota shares of developing countries. China, most notably, would see an increase from 3.0% to 5.1%. India, on the other hand, would lose quota with their share dropping from 1.9% to 1.0%. Argentina's share would decrease from 1.0% to 0.4%, Korea's would increase from 0.8% to 2.3%, and Mexico's would increase from 1.2% to 1.9%.

The poorest countries, mostly located in Sub-Saharan Africa, would see a large quota decrease, from 5.5% to 2.3%. Since the objective of the IMF management and the Executive Board is to boost the representation of all developing countries, not just those in emerging economies, it is unlikely that IMF members would agree to move closer to the calculated quotas based on the existing five formulas.

Revising the Calculated Quota Formulas. U.S. officials have repeatedly stated their desire for a new set of formulas that closely links a country's IMF quota and vote with their GDP. Secretary Snow reiterated this point in his House testimony: "[fundamental reform] must include revising the IMF's quota formulas with GDP as the predominant variable." Administration officials note however that quotas of the poorest countries should not be decreased, a likely result if there is a greater reliance on GDP for determining quotas. The Bush Administration and most other developed countries agree that it is appropriate to "over-represent" the very poorest countries by giving them a larger quota and vote than what would be inferred from their GDP.

In the current set of quota formulas, GDP has a low percentage of weighting, while economic openness is highly weighted. A result of this is to give small, economically open European countries (such as Belgium and the Netherlands) a large quota. These formulas have guided IMF quota allocations since 1983 and have not been significantly changed since.

In 1999, the IMF convened an independent working group to discuss options to simplify the IMF quota formulas. Chaired by Harvard economics professor Robert Cooper, the Quota Formula Review Group (QFRG) evaluated the history of IMF quotas. After analyzing various options, the group recommended a single formula with two variables: a measure of the ability to contribute to the IMF (GDP) and a measure of external economic vulnerability (variability of current receipts and long-term capital flow).[35] Following the review, IMF Executive Board members agreed with the need to simplify the IMF formula, but were concerned that the QFRG formula would lead to an even greater concentration of IMF quotas among the large industrialized countries.[36] No significant action was taken.

An alternative proposal has been put forward by the G24 group of countries. Currently, the GDP figures used by the IMF for the quota calculations are calculated at market rates averaged over several years. The G24, however, proposes that the

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[35] "External Review of Quota Formulas," *International Monetary Fund*, 2000.

[36] "Quotas and Voice — Further Considerations," *International Monetary Fund*, 2005.

IMF move to a purchasing power parity (PPP) based GDP measure. In the G24's view, market-based exchange rates do not equalize prices across countries and thus understate developing countries' GDPs.[37] On the other hand, others, including the IMF, believe that market based exchange rates represent the actual cost of transferring goods between countries, and that using PPP-based calculations, which equate the relative prices of goods regardless of location to calculate GDP, would inaccurately estimate a country's ability to contribute to the IMF as well as its relative role in the world economy and possible need for IMF assistance. Prices of goods are often lower in developing countries which may allow nominal exchange rates to underestimate the size of their economy. However, in many cases prices in these emerging economies, China for example, are significantly distorted by government subsidies and price controls.

Shifting to a PPP-based GDP measure would imply major differences if the GDP measure became the dominant determinant of IMF quota shares. **Table 2** shows GDP measures for several countries in PPP and market-based figures. Moving to a PPP-based measure would significantly increase emerging market countries' quota share.

Table 2. IMF Quotas and Selected Countries GDP
(Current dollar and PPP measures)

	Current Quota %	Percentage of World GDP, 2004 (current $)	Percent of World GDP, 2004 (PPP, constant 2000 $)
United States	17.4%	28.4%	20.5%
Euro Area	25.2%	23.0%	15.3%
Japan	6.2%	11.2%	6.6%
China	2.3%	4.7%	13.5%
India	1.9%	1.7%	6.0%
Brazil	1.4%	1.7%	2.7%

Source: International Monetary Fund

As **Table 2** highlights, moving to a PPP-based GDP measure would suggest a much higher quota for several emerging economies, such as China, India, and Brazil. The Quota Reform Working Group discussed whether to measure GDP at current dollar rates or based on PPP and their debate highlighted the issues raised by moving to a PPP-based measure. A minority of the QFRG members supported moving to a

[37] John B. McLenaghan, "Purchasing Power Parities and Comparisons of GDP in IMF Quota Calculations," Paper presented to the G24 Technical Group Meeting, Manila, Philippines, March 17-18, 2005.

PPP-based rate, arguing that market exchange rates do not necessarily equalize prices of tradable goods across countries, even after allowing for quality and transport costs.

The majority of the group, however, favored the continued use of market-based rates. This is also the prevailing view among the IMF's industrialized countries. The majority members of the QFRG noted that there are significant data problems with PPP-based rates. PPP-based rates are not available for all IMF members, and many of those available are based on fragmentary data. The QFRG minority also reiterated that it is necessary to consider the cost of actually moving goods from one place to another. Market prices properly reflect these costs while PPP-based equate prices of goods regardless of the transportation costs. Although these costs are decreasing, using PPP-based measures gives, according to the QFRG, "a seriously misleading indicator of ability to contribute to international undertakings."

There is no current agreement on what a "proper" quota formula would be. Leo Van Houtvan, long-term Secretary of the IMF and Counselor to the Managing Director, wrote in 2002, "there is no quota formula that is sensible from a financial perspective and that would also solve the governance issue."[38] Although the suggestion of the QFRG to use a formula comprised of GDP, variability of current receipts, and long-term capital flow was not acted on by the Executive Board, IMF members agreed with the QFRG that a simpler, more transparent formula would be beneficial for successfully guiding quota allocations. Other possible variables that could be included in such a formula are official reserves, current payments, ratio of exports to GDP, per capita income or population, external debt, share of food and energy in imports, access to capital markets, and variability of exchange rates.

Reorganizing the Executive Board. Arguably the most controversial, and perhaps most significant proposal for improving developing countries' representation at the IMF is reorganizing the Executive Board. Quota reform is important from a fundamental framework since it determines the voting share of each member country. However, for the vast majority of IMF members, since the IMF operates on the basis of consensus among the 24 EDs, Executive Board realignment may likely be the more effective reform for boosting developing countries' representation and participation.

Currently, the power asymmetry on the Executive Board is vast. In its current configuration, eight countries hold single seats on the Board and control 48% of the vote. The remaining 164 countries are grouped into 16 mixed-state constituencies. The most powerful of these has 5.13% of the IMF vote and the weakest has 1.41%. The latter represents 24 poor African countries, many of whom have programs with the IMF. In addition to having a marginal vote in greater IMF discussions, this situation raises capability issues. Many analysts have raised concerns that it is difficult for one Executive Director to successfully represent the diverse interests and needs of 24 often IMF-dependent countries. In this situation, where many countries are spoken for by a few Executive Directors, the "voice" of many countries likely suffers.

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[38] Leo Van Houtvan, "Governance of the IMF: Decision Making, Institutional Oversight, Transparency, and Accountability." *International Monetary Fund*, 2002, p. 8.

Reshaping the Executive Board may prove difficult. Since European countries have the largest and most widely dispersed representation, any reform will likely be impossible without strong European support. In March 2006, the European Parliament released a resolution on the strategic review of the IMF. The resolution supported the idea of moving toward a single voting constituency for the EU, but no practical guidelines were offered. Originally, the document was to propose increasing the basic votes of all members, and devising some form of mechanism to increase the shares for the poorest developing countries.[39] However, both of these suggestions were removed from the final text.[40]

It is unclear to what extent European countries are willing to consolidate their representation. Although the ad-hoc increased was achieved with only a small decrease in European representation, fundamental second-stage reform would likely require much more sustained coordination among Europeans to rationalize their representation. It has been argued that the legal, political, and institutional climate in Europe may not facilitate moving toward a single EU seat.[41] EU governments have no mechanism for coordinating their policies on a real-time basis without relinquishing authority to the European Commission or some other function of the EU bureaucracy. The legislatures of the EU countries that provide funds to the IMF may not wish to cede their policy choices from national control.

Depending on how Executive Board reform occurs, congressional action may or may not be required. If IMF members agree on a voluntary shuffling of countries between the existing constituencies, no formal authorization from the U.S. Congress would be needed. Were this to occur and European countries were less dispersed among the multiple Executive Board constituencies than they currently are, EU countries may have a vote on the IMF Executive Board much larger than the U.S. vote. Further reform by consolidating several EU countries into a single IMF Executive Board seat, however, would likely involve congressional authorization as it would involve fundamentally revising the Executive Board system and would probably involve amending the IMF Articles of Agreement.

Increasing Basic Votes. At a speech to the Center for Global Development on July 31, 2006, Managing Director de Rato said that to protect the voice and vote of the poorest countries, he would like to see an increase in the number of basic votes allocated to all countries regardless of quota size.[42] The U.S. government has stated that it could consider such an increase in basic votes as part of the overall IMF

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[39] This could be in the form of a trust fund set up to help finance the purchase of quota shares for poor countries.

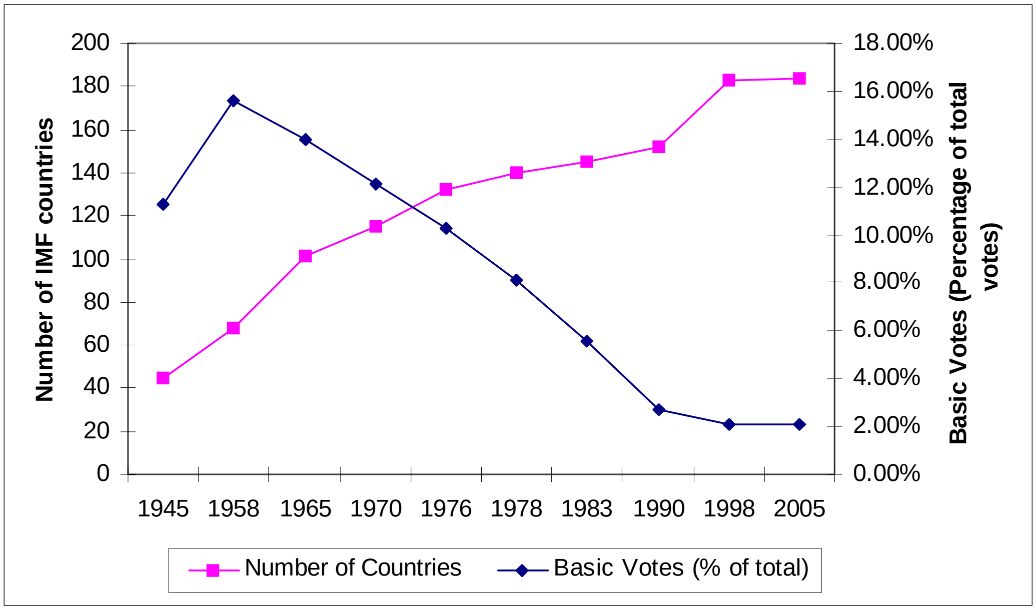
[40] Both documents are available at [http://www.globalpolicy.org/socecon/bwi-wto/imf/2006/0323euapproved.htm].

[41] Lauren M. Phillips, Lead, "Follow or Get out of the Way" *Overseas Development Institute*.

[42] Rodrigo de Rato, *Renewing the IMF's Commitment to Low-Income Countries Speech*, The Center for Global Development, Washington, D.C., July 31, 2006.

reform package.[43] As **Figure 1** illustrates, basic votes as a percentage of total votes has decreased substantially since the IMF was created, even as the number of IMF member countries (each receiving basic votes) has increased.

Figure 1. IMF Basic Votes



Source: International Monetary Fund

An increase in basic votes may not be as politically difficult as consolidation of EU chairs because no one country will gain votes at another's expense. However, any change would require amending the IMF Articles of Agreement, a difficult process requiring a broad level of support in the institution and approval by legislators.

Increasing the number of basic votes has been discussed during the past several quota reviews. One possible way to increase basic votes would be a fixed increase, giving the same amount of votes to each country. Basic votes could be reset at the original level of 11.3% of the total votes or potentially increased. Some analysts have suggested setting basic votes at 20% of the total votes. Another option would be to give only poor countries an increase in basic votes. While an increase in basic votes would raise the number of votes available to poor countries, their relative voting power would remain unchanged unless they were given a larger increase than industrialized countries.

Congressional Role

Depending on which reform approach IMF members choose, action may be required during the second session of the 110th Congress. The U.S. Congress has an

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[43] Snow, IMFC statement.

active and vital role in creating U.S. policy at the IMF. Congress must give its consent by law before the United States may agree to participate in any new IMF funding agreements that change the U.S. quota, require additional contributions from the United States, amend the IMF Articles of Agreement, or dispose of any gold currently held by the IMF.[44] Congress has also actively used its oversight role to shape U.S. policy at the institution. On many occasions, Congress has enacted legislation specifying what U.S. policy shall be in the international financial institutions (IFIs) and how the U.S. Executive Directors at these institutions shall vote and the objectives they shall pursue.[45]

Congress has also used increases in U.S. funding for the IMF (and the multilateral development banks (MDBs)) as a way to require various reforms in U.S. policy. One example is the 1998 IMF quota increase which sought numerous reforms including the increased transparency of IMF operations. Another example is various provisions in recent funding for the World Bank that tied part of the U.S. contributions to the World Bank's concessional lending facility, the International Development Association (IDA), on reforms to stem corruption in World Bank programs.

For quota and voting issues, Congress plays a crucial role. IMF governance issues are among the most important policy issues dealt with at the institution and, when voted on, require an 85% majority of members. Since the United States is the largest single shareholder, with a 17% voting share, it has a de facto veto on any possible reform proposals which involve amendments to the IMF charter.[46]

Furthermore, any change in the U.S. quota size must be approved by the U.S. Congress. The Bretton Woods Agreements Act specifies that unless Congress by law authorizes such action, neither the President nor any person or agency on his behalf can "request or consent to any change in the quota of the United States."[47] No general increase in the quota of the IMF has ever been approved without Congress consenting to the U.S. share of the increase.[48]

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[44] The Bretton Woods Act Agreement, 22 USC 286c

[45] For example, the Anti-Terrorism and Effective Death Penalty Act of 1996 (P.L. 104-132) instructs the Treasury Department to oppose any loan or other use of IFI funds to or for any country for which the Secretary of State has determined is a state-sponsor of terrorism. A list of all Congressional mandates for the IMF is included in: Government Accountability Office, *Treasury Has Sustained Its Formal Process to Promote U.S. Policies at the International Monetary Fund GAO-06-876R*, June 29, 2006.

[46] There have been numerous instances of selective quota increases for IMF member countries that did not require congressional authorization or appropriations since the actual value of the U.S. quota was unchanged. However, such increases did reduce the relative U.S. quota share in the institution but since they were all very small increases, the U.S. percentage share remained relatively unchanged.

[47] 22 USC 286c

[48] J. Lawrence Broz and Michael Brewster Hawes, "US Domestic Politics and International Monetary Fund Policy, in *Delegation and Agency in International Organizations*. Edited by Darren Hawkins, David A. Lake, Daniel Nielson, and Michael J. Tierney. *Forthcoming*,
(continued...)

The proposed quota reform may likely coincide with the thirteenth general review of IMF resources. The IMF's Articles of Agreement require that the IMF review its financial resources at least every five years. Although it is not required that the IMF seek to raise additional capital from its members every five years (the last quota increase was in 1998), quota increases have been a way for countries to adjust quotas and votes among IMF members. Like the 1998 quota increase, which sparked a vibrant discussion within Congress on the role and value of the IMF, if the Administration proposes a quota increase for the United States or puts forward a reform proposal that requires congressional consent, even if the U.S. quota does not change, such a discussion may reoccur. If the Administration sidesteps Congress, Congress could use its oversight role and *Sense of Congress* legislation to express its view of IMF governance reform.

To summarize, the actual role that Congress may need to take as the IMF pursues its reform agenda is not clear. The Bush administration has made periodic statements suggesting its preferred approach of either a voluntary exchange of quota to several emerging economies or a selective increase as a first-step toward reform. These options would not require congressional approval. Further reform, however, may likely require congressional action. **Table 3** lays out the required steps for the various proposals.

Table 3. Congressional Action Needed for Various Reforms

Option	Congressional Action
Ad Hoc Increase for selected countries	None required.
Full quota increase	Requires congressional authorization, and appropriation if the amount of U.S. quota increases.
Revise quota formula	Does not require amending the IMF's Articles of Agreement and thus only requires congressional authorization if the amount of U.S. quota increases.
Reorganize Executive Board	Does not require congressional authorization for countries to move among the constituencies. If there is reform of the total size of the board or its operations, congressional authorization is required since the Articles of Amendment would need to be amended.
Increase Basic Votes	Requires amending the IMF's Articles of Agreement and thus requires congressional authorization.

Source: International Monetary Fund

[48] (...continued)
Cambridge University Press, 2006.

Conclusion

The reform options discussed in this report are not mutually exclusive. It is likely that any eventual fundamental reform may comprise aspects of several of the options discussed. Any potential reform must maintain both the IMF's relevance and credibility. As the reform discussion has highlighted, there is often tension between these two goals. The IMF is relevant precisely because it caters to the financial needs of the world's neediest countries. However, it is credible only to the extent that it is financially sound and is able to fulfill its mission. Increasing the representation of developing countries may only be successful if it can be accomplished without damaging the credibility of the institution and sacrificing the IMF's financial stability.

For the Fund to maintain its credibility as the primary international financial institution, the industrialized creditor countries will likely need to maintain their dominance in the institution. Moreover, to increase the vote of the poorest developing countries would require increasing their quota. It is not clear whether many of these countries can afford and are willing to increase their financial contributions or to take steps that would make their national currencies usable in IMF operations. Any resolution of the governance issue will thus be a political compromise that balances the financial needs of the institution with a distribution of votes and representation that is acceptable to most members.

Appendix A. Voting Power Within Constituencies

Chair (or largest member)	Rank	Percentage of total votes within constituency
India	1	80%
Canada	2	79%
Italy	3	77%
Brazil	4	57%
Switzerland	5	56%
Chile	6	49%
Netherlands	7	49%
Belgium	8	41%
Spain	9	33%
Sweden	10	32%
Indonesia	12	30%
South Africa	13	29%
Iran	14	28%
Kuwait	15	28%
Congo	16	18%

Source: International Monetary Fund