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DP 13/05

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IMF Quotas: Constructing An International Organization Using Inferior Building Blocks

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ABSTRACT

The International Monetary Fund's structure and rules are based on the quota system that was constructed when the Fund was set up in 1946. Quotas affect contributions and resource availability at the Fund, access to resources, the distribution of Special Drawing Rights, and voting rights. Despite periodic reviews and modifications, the quota system has gradually been eroded and undermined. The fundamental problem is that a single system is attempting to serve four separate and incompatible functions. We illustrate how this erosion has taken place, and how an unreformed quota system will compromise the future operations of the IMF and the international monetary and financial system. Although the difficulties associated with reforming quotas are myriad and complex, the legacy of an unreformed quota system may be profoundly undesirable. We argue that a refined IMF structure must accommodate a clearer separation of a member's contributions to the IMF, its access to IMF resources, and its voting rights at the institution.

1. INTRODUCTION

Among the most fundamental issues currently facing the International Monetary Fund (IMF) are its role as a financing and adjustment institution, its economic crisis management duties, and its own internal governance. All of these issues have featured prominently in recent discussions about the IMF and have resulted in lively, if not down right heated, debate. Reports such as that of the Meltzer Commission (IFIAC, 2000) have received close attention not only amongst policy-makers and academics but also within the media. Critical commentaries of the Fund's role in crisis countries have generated wide interest and have been latched onto by those opposed to certain aspects of globalization. [1]

One central element of the Fund's operations, however, has avoided this upsurge in public interest and inspection. Despite its pivotal role in determining the IMF's governance structure, resource capacity, and lending behaviour, membership quotas have attracted little attention outside of the Fund's own formal internal review process. It has been only relatively occasionally that the topic has cropped up in the academic literature, (see, for example, Bird, 1987.) More recently, however, and particularly in the context of governance, IMF quotas have received closer inspection (Buira, 2002, Kelkar et al, 2004, and Kenen et al, 2004). Obscured by seemingly complex equations and often mired in important but technical debates about the merits of different measures of aggregate income or balance of payments variance, it is easy to see how the topic would test the attention of even seasoned IMF watchers. And yet quotas are presented by the Fund as its 'building blocks' (IMF Survey, 2002). Are IMF quotas good or bad building blocks?

[1] Bird (2001) provides a summary and discussion of the principal issues involved in the current debate about the IMF.

This paper focuses on the practical and political economy dimensions of IMF quotas and their reform. As indicated by recent experience with the Twelfth General Review of Quotas, in which a consensus for change failed to emerge, the question of quotas is at the heart of institutional reform at the Fund, and consequently it is politically highly charged. Central to the debate over quotas is the fact that they attempt to play multiple roles, requiring any reform to strike a balance between conflicting ideals and opposing constituents. We examine the various roles played by the quota system, identify some of its deficiencies, and illustrate how the linkages between its functions both necessitate and confound the reform process. We then examine whether and how the reform impasse may be overcome, arguing that it is necessary to contemplate fairly profound changes to the Fund's institutional structure.

The lay out of the paper is as follows. By way of background, section 2 provides a brief history and summary of IMF quotas. Section 3 examines two of the three key roles for quotas: determining the Fund's resource base and its members' borrowing capacities. It also briefly discusses the role of quotas in allocating Special Drawing Rights (SDRs). Section 4 investigates the implications of quotas for the governance of the IMF. Section 5 examines the linkages between these functions and the implications for reform from a political economy perspective. Section 6 offers a few concluding remarks.

2. IMF QUOTAS: THE BACKGROUND

Quotas are significant to the Fund's operations because they affect voting rights, subscriptions, the size of ordinary drawing rights and access to special facilities, as well as the distribution of Special Drawing Rights (SDRs).[2] However from the outset of the Fund's operations in 1946 the formula used to calculate quotas was spurious, since agreement had already been reached about the total amount of quotas and the relative sizes of the quotas for the most powerful countries. A trial-and-error process was then used to devise a formula – the Bretton Woods formula- that generated the desired results.[3] In the early 1960s the Bretton Woods formula was re-specified, and four supplementary formulas were added in an attempt to reflect, among other things, the financing needs of small primary commodity exporting nations. In addition, the equations were calculated using two different sets of data to take into account more subtle and improved current account balance of payments measures. Thus, from 1963 until 1983 the 'calculated quotas' were based on a fairly complex relationship between ten different equations.[4] In 1983 the system currently used for calculating quotas came into effect, modifying the equations once more and eliminating the five not based on improved current account data.

Following the Eleventh General Review completed in 1998, and reflecting the concerns of some of the Fund's principal shareholders, an independent review of quota formulas was undertaken by a panel of eight external experts. This Quota Formula Review Group (QFRG) submitted its report in 2000.[5] However, its

[2] SDRs are the IMF's unit of account linked to four major currencies and also constitutes a financial resource created by the IMF and distributed, on occasion, to its members. Members of the IMF pay subscriptions equivalent to their quotas. Up to 25 per cent of the subscription is paid in the form of international reserve assets specified by the IMF (SDRs or widely accepted foreign reserves currencies such as US dollars, Euros, Japanese yen or pounds sterling) with the rest being paid in the member's own currency. Each member of the IMF has 250 basic votes plus one additional vote for each SDR 100,000 of quota. Access limits to IMF resources via the range of facilities that it offers are based in part on quotas. Similarly, allocations of SDRs are set in proportion to member countries' quotas.

[3] See Mikesell (1994) for a fascinating first-hand account. Lister (1984: 53) points out that even after these computational gymnastics the deviation of actual from the computed quotas were enormous, with the highest difference being seventy-five percent.

[4] The final calculated quota was the higher of the revised original Bretton Woods formula and the average of the two lowest of the additional formulae. See IMF (2001: 7-8, and Annex II).

[5] For a more detailed and technical review of quota issues, see IMF 2000 and IMF 2000a. Jha and Saggar (2000) provide a valuable and more independent overview and suggest their own alternative formula.

recommendations, which involved adopting a much-simplified formula, based on GDP averaged over three years and external variability comprising both current receipts and capital flows, were not warmly received (i.e. effectively rejected) by the Fund's Executive Board which agreed to "carry forward the work of the panel" (IMF 2000). Consideration of alternative formulas has constituted a part of the Fund's work programme since then.[6] But there is no suggestion that consensus is any closer.

In addition to occasional refinements to the quota formulas, which affect calculated quotas, the 'actual' quotas themselves also undergo frequent review and adjustment. These can occur because of special events that need to be accommodated, such as the accession to membership of the IMF, or because of economic developments that dramatically alter the financial significance of a country, as in the case of Saudi Arabia in the 1970s. In these cases it is often just the quota for a single country or small group of countries that is adjusted.

More generally, however, there are periodic reviews of the full range of quotas that take place at least once every five years, of which the Twelfth General Review is the most recent. These reviews are the mechanism by which major changes in actual quotas are made, occasionally leading to substantial changes in total quotas as well as to a realignment of relative shares. Of the General Quota Reviews that there have been the first, second, third, tenth and twelfth (concluded in 2003) did not recommend any enlargement in overall quotas. The remaining eight (including one extraordinary review in 1958/9) recommended quota increases averaging just over 44 percent, with a range from 30.7 percent (1965) to 60.7 percent (1959). When quotas have been generally increased, this has usually been based in part on existing actual quotas and in part on the calculated quotas derived from the quota formulas.

[6] See IMF 2001 and 2001a.

In terms of institutional governance, individual country quotas are the major determinant of relative voting power at the IMF. Furthermore, individual quotas affect countries' contributions and access to IMF resources, while collectively they determine the aggregate resource base of the IMF. As a consequence, quotas have important political economy dimensions, and frequently generate vigorous debate.

The struggle over quota assignments is well illustrated by the recent Twelfth Review. During the course of this review the Fund failed to come up with a definitive solution to the quota formula problem, and simultaneously failed to reach a consensus regarding a change in total subscriptions. Despite seminars, staff papers and the work of its own QFRG, the IMF's Executive Board failed to reach a conclusion at its October 2001 and June 2002 meetings. Indeed, an important feature of the Board's discussions of quotas has been the wide divergence of opinion.

Disagreements can exist because the formal equations are not the objective and authoritative or, for that matter, legally binding (Lister, 1984: 54) determinant of quotas. The Fund's major financial contributors have not been prepared to commit to a completely objective and binding formula for quota calculations. In the context of the Twelth General Review, the US was reluctant to expand the resource base of the IMF or to see its share of votes decline. The US view, albeit somewhat caricatured, is that private capital markets should be the principal source of financing for emerging economies and that the IMF should not be lending long term to developing countries. Indeed, while conceding to a quota increase at the end of the 1990s, the US Congress made their acceptance conditional on the establishment of a commission to examine the role of the IMF and other IFIs. Congress selected as the Chairman of the Commission someone who had publicly expressed doubts about the continuing need for the IMF. European economies have generally been associated with a more accommodating view but were reluctant to cede their influence. Developing countries would have welcomed an increase in their share of total votes and an enhanced role in IMF governance as well as greater access to IMF resources, but might have been unenthusiastic about increasing their obligations to the Fund. Moreover, many of the poorest countries draw from the Fund under the concessionary Poverty Reduction and Growth Facility and the resources for this do not come from quota-based subscriptions. An increase in quota assignments may thus have required these countries to contribute more in the form of subscriptions without really affecting the resource base from which they usually draw. A critical problem is that the quota system is simply charged with too many, potentially inconsistent, functions. We examine these in the following two sections.

3. RESOURCE ADEQUACY AND ACCESS

Quotas affect (but no longer wholly determine) each country's access to Fund resources on an individual basis. Collectively the subscriptions based on them provide a significant proportion of the resources available to the IMF through its General Resources Account (GRA), though these funds are not used for its concessionary lending window. Thus quotas arguably operate on both the supply and demand sides of IMF resource use, with critical implications for resource adequacy.

In identifying the tensions that have emerged in the IMF's quota system, it is instructive to examine how access to IMF resources has evolved. The IMF was initially established in the form of a credit union where most members were seen as being equally likely to require the kind of temporary financial assistance that the IMF was designed to provide. The theory and early practice of operating the Bretton

Woods fixed exchange rate system suggested that wealthier industrial members were as likely to draw on IMF resources as the poorer members. Clearly the amounts drawn by the former would be larger due to their relative economic size, but then their contributions would also be larger. In fact, from 1947 to 1978, the single largest purchaser of IMF resources was the UK, accounting for over a quarter of all purchases. Industrial countries accounted for over 60 percent of all purchases. As there were mechanisms to encourage economic adjustment built into both IMF conditionality (as it eventually emerged) and the fixed exchange rate system, no country was envisaged as being perpetually a net contributor or client. Balance of payments problems were viewed as cyclical rather than endemic. The exception to this rule was the United States, whose dominant role as a supplier of finance was incorporated into the IMF's financial and governance structure. There were various reasons for the collapse of the Bretton Woods system in 1971-73 (these are summarised in Bird, 1985) but amongst them was the failure was to accommodate a balance of payments adjustment process for the US.

It took only a few years for the post-Bretton Woods IMF to become bifurcated. After 1976, industrial countries became absent from the list of credit-tranche agreement clients.[7] Effectively there emerged two types of members: rich country 'lenders' and poor country 'borrowers'. This division made the quota structure increasingly untenable and unsuitable as a means of determining simultaneously contributions and access. It also inevitably complicated questions of

[7] The first 25 percent of a country's quota, called the 'reserve tranche', can be accessed by a country without negotiating an IMF program. The remaining seventy five percent of the quota is paid in the country's domestic currency, and for most developing and emerging market countries is thus not very useful for dealing with balance of payments problems. Loans of hard currencies above the reserve tranche amount are considered to be from the 'upper tranche purchases' that are not accessible without a negotiated program.

governance as well. Lenders may be expected to adopt different positions than debtors and will be unwilling to cede control to them.

In practice the IMF accommodated this division by breaking, or at least bending, the connection between quotas and borrowing limits. This innovation reflected the increased financial volatility that emerged after the early 1970s. While quotas had initially been based on national income, reserves, imports, export variance, and trade dependence, actual balance of payments structures and imbalances were often more dependent on financial flows that were not part of the quota calculation. Countries with substantial current account deficits, the presumed trigger for an IMF agreement under the Bretton Woods system, could avoid crises by relying on private or non-IMF official financing. However, when these alternative sources dried up, countries were forced to ask the IMF to fill a far larger financing gap than the quota structure had foreseen. The IMF responded to this new situation by increasingly lending above the original 100 percent of quota limit.

The crises in emerging markets in the 1990s illustrated just how disconnected the relationship had become. It became difficult to maintain the pretence of carefully planned and regulated credit limits, or to claim that quotas were appropriate to the task.[8] Beginning with the Tequila Crisis in 1994/95, financial crises triggered large IMF programs that bore little connection to the original lending limits. Funding requirements were only loosely linked to the volatility measures on the current account that were represented in the quota calculations. The clearest signal of the break between quotas and resource access came in the form of the Supplemental Reserve Facility, established at the end of 1997 in the midst of the Asian Crisis, which had no resource use limits linked to quotas.

[8] IMF (1998) lays out very clearly just how complex the IMF's lending facility structure became, and how lending under these facilities were linked (or not) to quotas.

In an extensive review of access to GRA resources the IMF (2003: 3,6) still claimed that in the period after 1994 over 90 percent of arrangements fell within the normal access limits. But 85 percent of the Fund's commitments at the end of 2002 were concentrated in five arrangements with exceptional access. Of these cases, Argentina's use was over 5 times its total quota. Turkey borrowed resources over 15 times its quota (IMF 2002b: 166-169). Thus, while claiming that quotas remained relevant, the Fund in fact adopted a pragmatic response to the borrowing needs of its members, unconstrained by quotas.

The fact that standard quota calculations have become completely inadequate as a measure of the real borrowing needs of members is reflected in the reforms suggested by the QFRG. The QFRG argued that financial openness and volatility should be part of the quota formula. However, it proved easier to acknowledge the need for reform in principle than to come to an agreement on the specifics of reform. Moreover, the formula revision favoured by the QFRG highlighted the fact that reforming quotas to reflect the needs of its borrowing members necessarily implied unnecessary changes in access for advanced countries for whom IMF support is irrelevant. More importantly, however, quota changes to reflect borrowing needs imply more contentious changes to individual country subscriptions to the Fund, overall resource levels in the GRA, and, perhaps most significantly, voting power.

The absence of formal access limits that has emerged as a pragmatic response, however, must also be regarded with some concern. For as long as they operated, limits provided greater predictability in terms of financing packages, eased resource management problems for the Fund, and may have played a useful role in sending appropriate signals to financial markets. They may also have constrained the Fund's vulnerability to political manipulation both by key shareholders and large borrowers.

Without a credible mechanism for denying exceptionally large loans, the IMF can be subjected to greater pressure to lend liberally to favoured nations, as perhaps the loans to Argentina and Turkey illustrate. The debacle between the IMF and Argentina in the early 2000s illustrates, however, that when these loans become too large the IMF is compromised in its ability to disengage from a program for fear of jeopardising its portfolio. [9]

Moreover, the quota system should have helped ensure that the Fund had sufficient resources to meet the demand from countries in balance of payments difficulties. If access limits are relaxed, what happens when the demand for IMF resources exceeds the supply of resources provided by quota-based subscriptions? The chances of this happening may be minimised in as much as the demanders of IMF resources are developing and emerging economies whereas the suppliers are advanced economies. But large loans to emerging economies can strain the IMF's liquidity and compromise the Fund's ability to handle financial crises without supplementary bilateral financing, thereby politicising a process that was supposed to have been institutionalised.

In response to real or potential shortages, the IMF has made alternative arrangements to increase its resources beyond those generated by quotas. These arrangements include the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB), which provide a means of supplementing IMF resources by borrowing from wealthier nations deemed sufficiently sound financially. The IMF also has the right to borrow from private markets, though it has never exercised this (see Bird and Rowlands, 2001).

[9] Excessive lending also damages the IMF's reputation and has wider implications for international finance. In the case of the Argentina program, private lenders have challenged the preferred creditor status of the IMF, presumably because they see reckless IMF lending as jeopardising their own repayment prospects.

In theory the IMF could also seek to enhance its resources through the allocation of Special Drawing Rights (SDRs). However, the initial idea that SDRs would become the principal reserve asset in the international financial system, and would be created on a regular basis to meet systemic reserve needs, has not materialised. National currencies, and in particular the US dollar, have continued to perform the role of the principal international reserve asset, and flexible exchange rates, combined with increased private capital flows, have undermined the need for SDRs in a systemic role. Regular allocations of SDRs have not occurred.

Moreover, SDRs were originally allocated on the basis of quotas since these were assumed to stand as a proxy for the demand to hold reserves. The implication was that countries would hold on to the SDRs they were allocated. In practice, poor countries have generally spent them and richer countries have generally acquired them. Thus the theoretical justification for using quotas as the basis for SDR allocation turned out to be misplaced. Some observers have suggested that SDRs should be allocated more exclusively to low income countries to provide them with additional financial assistance, breaking away from the use of quotas (Bird, 1994). Others have simply viewed the role of quotas in determining allocations as irrelevant given the severely diminished role of SDRs. Having been overtaken by innovations in the international financial system, and crippled by conflict over their distribution, SDRs cannot be seen as a realistic means of supplementing the Fund's resource base.

So are IMF resources adequate or inadequate? G-24 publications regularly emphasise the decline in IMF quotas relative to world trade, falling from 17 per cent of total imports in 1950 to 4 per cent in 2000 (Buira, 2002, 2004). The IMF's management sometimes alludes to a trend towards inadequacy; though some argue that this represents the bureaucratic pursuit of self-interest (Vaubel, 1991, 1994. 1996). In February 2002 the Fund's Executive Board requested its Treasurer's Department to quantify resource adequacy (IMF, 2002a). In general its report identifies a declining trend in resource adequacy since 1972, as measured by the ratio of total quotas to the GDP of members, calculated quotas, current payments, reserves, and the variability of current receipts. The report also notes that a similar conclusion is reached when other measures (such as Gross Financing Need) are used. Furthermore, the report claims that the unpredictability of claims on IMF resources (IMF 2002a, point 31, and Rowlands, 1998) and the increase in private capital flows makes the current resource base too low to handle potential risks. Consequently, and with specific reference to the decline in the ratio of quotas to members' GDPs, the report recommends an increase in quotas to ensure that the IMF's own resources are adequate to meet the challenges of managing the international financial system.

However, there are counter arguments. The IMF recognizes that its immediate resource adequacy ('liquidity') is linked to 'usable resources'; the holdings of currencies of members deemed to be financially strong, minus current resource commitments. Its own calculated liquidity ratio (the ratio of usable resources to its liquid liabilities) shows high volatility but no declining trend over the period 1984-2002 (IMF, 2002b). [10]

Figure 1 shows the ratio of industrial country quotas (a proxy for usable resources) to various current account balance of payments measures, including world trade (total world exports), the total of all developing country current account deficits, and the total of all developing country current account deficits above five percent of GDP. Aside from the large drop in the ratio in the mid-1970s, there has been no

[10] The calculation has only been made since 1984, however, so a longer time series is not available.

discernible trend thereafter. Furthermore, the underlying question about the IMF's resource adequacy is 'adequate for what?' However, it is perhaps unsurprising that G24, envisaging an enhanced lending role for the Fund, also views IMF resources as inadequate, whereas the US and others who envisage a truncated lending role view its resources as adequate or even excessive. Much will depend on one's perception of the relative importance of market failure in the context of private capital markets, and institutional failure in terms of the way in which the Fund conducts its affairs. The issues are not straightforward and we do not examine them here. For a recent review of them see Bird and Joyce (2001).

Where does this leave us? The *de facto* separation of its members into 'lenders' and 'borrowers' has eroded the original credit union nature of the IMF; actual access is no longer related to actual contributions. The modifications that have taken place to deal with resource constraints and access limits have occurred in a pragmatic, but largely piecemeal way. The dangers of this response are twofold. First, dealing with resource constraints through *ad hoc* borrowing agreements and bilateral contributions introduces delays and additional political constraints on IMF operations. These restrictions may be particularly costly during crises. Second, it complicates resource management and accountability.

The overall conclusion with regards the adequacy of the IMF's resources and access to them cannot be separated from the broader debate about the role of the Fund. However, little objective support for the quota system emerges. Apart from the fact that actual quotas have deviated sharply for those calculated on the basis of the quota formulas, they have failed to generate the access to IMF resources deemed necessary in large crisis country cases. They have failed to ensure that the Fund has adequate resources in the sense that there have been efforts to supplement them, and they have failed to generate the distribution of SDRs that was either originally intended or that some critics would favour. Reforming the quota system to meet the imperatives of access and resource management, however, would have implications for the governance of the IMF as well. In order to understand why the quota structure has not been modified in the light of its obvious financial shortcomings, it is necessary to understand the political dimensions of quotas.

4. IMF AND GOVERNANCE

The IMF's organisational structure is currently based on quotas. The ultimate decision-making body at the IMF is the Board of Governors, comprising a governor (and an alternate) for each member country. Each member has 250 'basic' votes plus one vote for every 100,000 SDRs of their quota.[11] The distribution of votes is shown in Table 1. While the 250 basic votes technically generate a bias in favour of small countries, this does nothing in practice to reduce the dominance of the advanced economies in overall voting rights. Basic votes as a percentage of total votes have fallen from about 10 per cent up until the mid-1970s to barely 2 per cent in 2002, thus reducing the voting power of small, developing countries.

The day-to-day running of the IMF is managed by its Executive Board, consisting of 24 members elected in 'constituencies'. Eight of these consist of single countries that have their own permanent seat (United States, Japan, Germany, France, United Kingdom, Saudi Arabia, China, and Russia). The remaining countries are organized into sixteen multiple-country constituencies. Of these, five are dominated by a single member with more than half of the combined votes of the constituency

[11] Thus, for example, Angola, with a quota of SDR 286,300,000 has 3113 votes (2863+250).

(Brazil, Canada, India, Italy and Switzerland). Four have either clearly dominant members (Belgium, Netherlands, Argentina) or a reasonably dominant member (Australia). The remaining seven constituencies have a greater dispersion of votes amongst members. It is through their dominance of the multiple constituencies that the influence of European countries within the Fund is further enhanced (Kenen et al, 2004).

This governance structure is more complex in reality. Informally the IMF's decisions are made by consensus with few actual votes taken. On the one hand, the apparently smooth operation of the Fund in most decision-making areas may be attributable to the common beliefs and attitudes of its Governors and Board members given their origins in central banks and finance departments. On the other hand, the consensus principle does not mean strict unanimity. As Van Houtven (2002: 23) argues, consensus is determined by the Chair of the Board, and is meant to ensure that all key players and groups are broadly accepting of a decision. This consensus is also in part engineered inasmuch as technical aspects of debates are shaped by IMF staff who are clearly aware of the distribution of influence and power in the Executive Board. Moreover, the constituencies that contain both developed and developing countries may help to forge a consensus between initially opposed groups (Van Houtven, 2002: 68) although they could also, in principle, be a conduit for coercion. However, while the nature of the consensus process and extent to which it constrains actual decision-making is largely unknown (De Gregorio et al., 1999: 80), it may be safe to conclude that it cannot be entirely divorced from underlying voting power. Consensus is facilitated by the fact that the formal rules could be invoked. For most decisions a simple majority is sufficient.

For strategically more important decisions, however, special majorities are required.[12] It is in these areas that the element of power embedded in voting shares is most apparent. Two majority levels for key decisions are used: one at 70 per cent and the other at 85 percent. Quota changes are among the decisions governed by the 85 percent requirement.[13] In fact this was the first key decision singled out for a special majority in the initial conception of the IMF (Lister, 1984: 82). The only country to wield an individual veto over these most critical changes is currently, and traditionally, the United States with just over 17 percent of the votes, although, as a group, the European Union also has an effective veto. Despite the general use of consensual decision-making, the contentious nature of quotas is therefore easily understood in terms of the formal voting rights that underpin the IMF as an organisation.

The politics of IMF governance creates various dilemmas. Given they represent 85 per cent of the total membership of the Fund, developing countries believe that they have an inappropriately small voice within the institution. As noted above, the emphasis on consensual decision-taking is not a substitute for voting rights. This line of argument has been clearly articulated by G-24, where it is suggested that the bias in favour of advanced countries undermines the legitimacy and representativeness, as well as ultimately the effectiveness of the IMF, since the majority of members feel that they exert insufficient influence over the Fund's operations (Buira, 2004). But the arguments have also been endorsed outside the G-24 (see Kenen et al, 2004). Advanced countries point out that actual quotas disproportionately favour developing countries by comparison with the calculated quotas, and even developing countries may be wary of increasing their voting rights if this simultaneously encourages

[12] See Lister (1984) for a discussion of how these special majorities have evolved.

advanced economies to become any further disengaged from the IMF, bypassing the Fund in favour of other decision-making bodies that they dominate, such as G7. The external review of quotas, for which developing countries pushed, recommended a new formula that would have increased the voting share of advanced economies. With increasing membership, advanced countries have sought to retain their veto and their powerful position within the governance of the IMF by manipulating the majorities required for key decisions. It is not therefore the objectivity of the quota system that determines the governance of the IMF but rather power politics. The quota system has simply been the instrument through which the power politics has been played out.

The IMF governance structure and reform process allows past political influence to become perpetuated within and through the Fund. Consequently the Fund's political structure puts at risk the institution's role in international financial governance. This danger is most clearly seen in the frequent abandonment of the IMF as the venue of choice in discussions relating to international financial reform. This process is especially true when the financial system faces unprecedented events, such as the breakdown of the fixed exchange rate system, the debt crisis, or other financial crises. The Financial Stability Forum, G-20, and the plethora of discussion groups and arrangements associated with the Bank for International Settlements, all attest to the perceived deficiencies of the IMF as a forum for discussing, and sometimes overseeing, fundamental reform.[14]

So governance at the IMF also appears to be far from ideal, certainly in terms of criteria such as legitimacy, representativeness and accountability, and is in as much

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[13] For a list of decisions governed by special majority, see De Gregorio et al. 1999: 80-81.

[14] In the case of the G-20, for example, it was seen as a necessary development given the perceived lack of legitimacy for the G-7 in dealing with fundamental questions of international economic and financial management (see the G-20 website). The perceived need was to construct a forum that balanced the voices of advanced and developing countries. In the end, however, the composition of the

need of reform as the Fund's financial operations. The concern is that in remedying these governance-related deficiencies, the future effectiveness of the Fund may be endangered. Although effectiveness may also be impaired if developing countries feel under-represented. As Van Houtven (2002: 8) points out, "there is no quota formula that is sensible from a financial perspective and that would also solve the governance issue". What has emerged is an *ad hoc* compromise in which the politics of IMF governance drives the quota system and the economic consequences of this are then handled by expediency. Is it possible to do better than this?

5. REFORMING IMF QUOTAS: BROAD PRINCIPLES

There is no simple solution to the reform of quotas. There will be underlying conflicts of interest, and progress will depend on compromise. Given the multiplicity of roles performed by quotas, it is not surprising that consensus for reforming the quota system has been impossible to achieve. The system initially balanced the responsibilities and privileges of IMF members. With the division of this membership into those that borrow and those that provide resources, this balance disappeared. In some cases individual countries must weigh up the potentially contradictory effects of a quota increase on their contributions of hard currency on the one hand, and their nominal access to resources on the other. An increase in the share of developing country quotas would increase their relative voting rights but also their obligations. The lender-borrower fault lines that generate tension over resource provision and access largely coincide with divisions over governance and international financial management. Despite the sometimes significant differences within these two broad groups of members, problems with the quota structure have increasingly become

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G-20 was remarkably similar to that of the IMF's Executive Board, which was clearly dismissed as an defined as a zero-sum game based on differentiated roles and relative power. Such fundamental conflict within the decision-making structure of the IMF has prevented meaningful restructuring and is likely to lead to a continuing reform impasse. Can the impasse be overcome? Without proposing specific and detailed reforms, it may be useful to identify some broad principles upon which reform may be based. These principles are hardly new. They were, for example, enunciated and examined in some detail by one of us in the 1980s (Bird, 1987). More recently the same basic ideas have been reaffirmed by others (see, for example, Kelkar et al, 2004).

If we take as a starting point the IMF's mandate to promote international monetary and financial stability, it is possible to identify some of the factors that need to underpin its structure. Fund resources need to be adequate to handle its financing responsibilities, with each member's obligations being grounded in their capacity to provide these resources. Access to IMF resources, and by extension SDR distribution, however, should reflect financial needs. Finally, governance must be such as to allow all members to feel that their views are taken into account and represented, but at the same time must be sensitive to both financial and political power and the need for effective operation.

Subscriptions and Resource Adequacy

A member's subscription should reflect its ability to provide resources and should be firmly based on wealth. Beneath some level of GDP per capita, poor countries could either be exempt from making subscriptions to the Fund altogether or could be asked to make only nominal contributions in terms of their own domestic currencies. Paying such a subscription might make them more committed to the institution but could

inappropriate venue for such important discussions. See also Kenen et al (2004).

create additional domestic fiscal problems. Poor countries are by definition short of foreign exchange and it may seem illogical that they have to contribute it to the Fund in exchange for access to credit. Therefore, in terms of providing useful resources, while minimizing resource burdens on the poor, GDP could serve as the sole or at least the primary determinant of contributions.[15]

In terms of designing a subscription system, it may be useful to think of three groups of member countries. One group consisting of relatively poor countries should not be required to make any subscription in the form of hard currency. At the other end is the group of wealthy industrial countries that have not made any significant drawing on the Fund for over twenty-five years[16]; their contributions should constitute the vast majority of the IMF's resources. A third group lies between these two; it consists of countries within the income range in which occasional (and occasionally very large) drawings from the IMF occur. These countries could provide an intermediate level of financing, including hard currencies.

A related issue in re-structuring subscriptions to the IMF is to determine the overall amount of resources that the Fund needs. With a link to GDP, contributions would automatically rise in step with global economic growth. However, this might not always guarantee that the Fund would have 'adequate' resources. But, as noted earlier, determining 'adequacy' requires a clear definition of the role of the IMF. Is it an adjustment or a financing institution? What is its role in the context of crises?

Should the IMF have enough resources on a permanent basis to handle crises that only occur periodically, or should the Fund's resource base be temporarily expanded as needed through the GAB, NAB or private borrowing? If resources are

[15] There is still a technical question of which GDP measure to use, noting that purchasing power parity adjustments tend to increase the measured GDP of poor countries (Buira, 2002, Kelkar et al, 2004).

permanently in place, some may fear that the IMF will push loans, especially if institutional welfare depends on the quantity of lending. On the other hand, a delayed response to crisis may mean that it is managed less efficiently.

It is reasonably easy to deal with the resource provisioning of the IMF while minimizing the burden of membership on poorer members. By manipulating the level and allocation of quotas, and the proportion of quotas paid in domestic currency, it is possible to generate any combination of IMF resource levels, relative voting shares, and access for countries that need to borrow. But identifying an adequate resource base first requires a consensus about the role of the Fund, which in turn affects political considerations and questions of resource access.

Access

Should the IMF be a fully-fledged international lender of last resort? Should it completely fill the financial vacuum created when there are outflows of private capital? These questions strike at the very heart of the debate over the Fund's role and it is impossible to supply a definitive statement about access to IMF resources until they are answered.

To fulfil its current Articles, the IMF must ensure that access depends on balance of payments need. To all intents and purposes, however, the IMF has already broken the connection between quotas and access. The question is therefore whether retaining the notion of quota-based access limits has any value, or should each case be decided on its own merits?

Even a modified quota formula may be too restrictive. On the one hand, it is difficult to anticipate all future circumstances in the context of a transparent and

[16] Though given the enormity of the current U.S. fiscal and current account deficit, and the potential for substitution away from the U.S. dollar, we should be cautious in assuming that large industrial

simple formula. On the other hand, leaving everything to the circumstances of the time may be excessively flexible and may leave IMF lending open to whimsy and serendipity. The difficulty is in balancing the need to provide sufficient resources to avoid damaging the international financial system or compromising the welfare of the people it is supposed to serve, with the need to provide administrative accountability, predictability, and protection from undue interference.

Any system would have to lie between the two extremes of lending programs that are credible but restrictive and flexible but arbitrary. This would most likely require introducing an access formula that would endeavour to reflect the sources of balance of payments vulnerability both in terms of current account and capital account shocks. It would also contain a scale factor in terms of GDP or total trade. Perhaps, however, any resulting formula should only be a management tool. It should provide a benchmark against which the size of IMF lending to individual countries could be judged. Lending above these limits could occur, but, to avoid excessive political influences on lending, this would need to be overseen by some form of independent review panel. This oversight could be conducted *ex ante*, but this would generate undue delay. A better alternative might be to encourage the Independent Evaluation Office to audit cases where lending was significantly in excess of quota limits. Systemically the Fund should also focus on how best to catalyse others to lend, either private capital markets or aid donors, since this would reduce claims on its own resources.

countries will never need IMF assistance.

Governance

The IMF plays a critical role in the international financial system. It disburses some money on a concessional basis, and can, in principle, affect the operation of private capital markets and the delivery of official capital flows. It also helps to create rules for behaviour in international financial and monetary matters. Its programs blend policy conditionality with adjustment financing. Control over these functions is certainly a non-trivial matter for members.

To the extent that they provide the bulk of usable resources in the GRA and the concessional facilities, advanced creditor economies will demand ultimate control. If they are pressured to give it up, they may simply withdraw their support for the IMF which relies on them for its resources. As former British Prime Minister Thatcher stated "there was no way in which I was going to put British deposits into a bank which was totally run by those on overdraft" (cited in Bakker1996: 52).

But the IMF does more than simply provide resources. It establishes the rules under which these resources will be provided, as well as the general rules for the conduct of the international financial system. The developing and emerging market countries have a clear stake in how the IMF functions, and considerable experience to bring to the discussions. They should not be side-lined. The failure of the IMF to balance its financial role with its consultative and systemic management role has led to its diminished stature in both. These roles must be reconciled or separated.

While the tradition of the IMF has been to seek consensus and thereby dilute the degree to which its governance is fractured into an adversarial system, problems still arise in building political and governance structures on a voting system nominally anchored in economic-based formulas. From amongst the advanced economies, the

US, that has traditionally maintained a dominant role within the IMF, will be reluctant to relinquish it. The same may be said of Europe. One can envisage a stand-off that will stimy the Fund's operations. Changing nothing may consign the Fund to irrelevance because of its inability to adapt to new global financial realities, while significant changes risk the disengagement of key players upon whose presence the system relies.

Clearly this dilemma is difficult to resolve. There is no straightforward technically superior solution. And even if there were, it would need to be politically acceptable, reflecting both the reality of the current distribution of power in the international system as well as the distribution of voting power in the Fund's own current governance structure. Options include, first, restoring the significance of basic votes to a level that was initially intended, accounting for 10 or 11 per cent of total votes. A second option, favoured by G-24 and other outside 'experts' (Kenen et al, 2004) is to reduce the relative votes of European countries and raise those of developing and emerging economies. The logic for this is that European countries exercise disproportionate influence relative to GDP. Much of their trade is intra European, and 12 European countries now share the same currency, the euro. European countries could, for example, be divided into two constituencies within the Executive Board representing the euro and non-euro areas. European countries may resist such proposals and may have to be offered political incentives to entice them to agree (Kenen et al, 2004, discuss what these might be). Another related possibility would be to revisit the composition of constituencies in order to enhance the influence of developing and emerging economies within them.

There is little alternative to political compromise. A management and governance structure has to be found which allows developing countries to have an effective voice and exert an influence on discussions that affect them but also allows advanced economies to retain the degree of control associated with their creditor status. The current quota system is unsatisfactory in this regard, and finding an alternative has been made more difficult by the other functions that quotas seek to achieve. A challenging task has thereby in effect been made impossible. By reforming subscriptions, access, and resource adequacy it may become easier to resolve the governance issue. If not, the IMF will likely lose its role in international financial management to institutional arrangements that better reflect the current global views on power and legitimacy.

But, of course, current governance structures will constrain reform. The hope must be that growing recognition of the deficiencies of the current quota system and the implications of these for the future relevance of the IMF will eventually galvanise a momentum for reform.

6. CONCLUDING REMARKS

Following a period of relative neglect, a number of external and internal reports on IMF quotas has been written since the end of the 1990s. However, there has been no progress in reforming the quota system. The report of the Quota Formula Review Group found little favour within the Executive Board – or indeed elsewhere - and the Fund's staff were sent away to think again following their initial attempts to come up with more acceptable formulas. The whole question of the specific design of quota formulas can appear arcane and irrelevant. This is unfortunate since quotas are, to quote the *IMF Survey*, September 2002, the "basic building blocks of the IMF." Subscriptions, drawing rights and votes within the Fund are influenced by quotas.

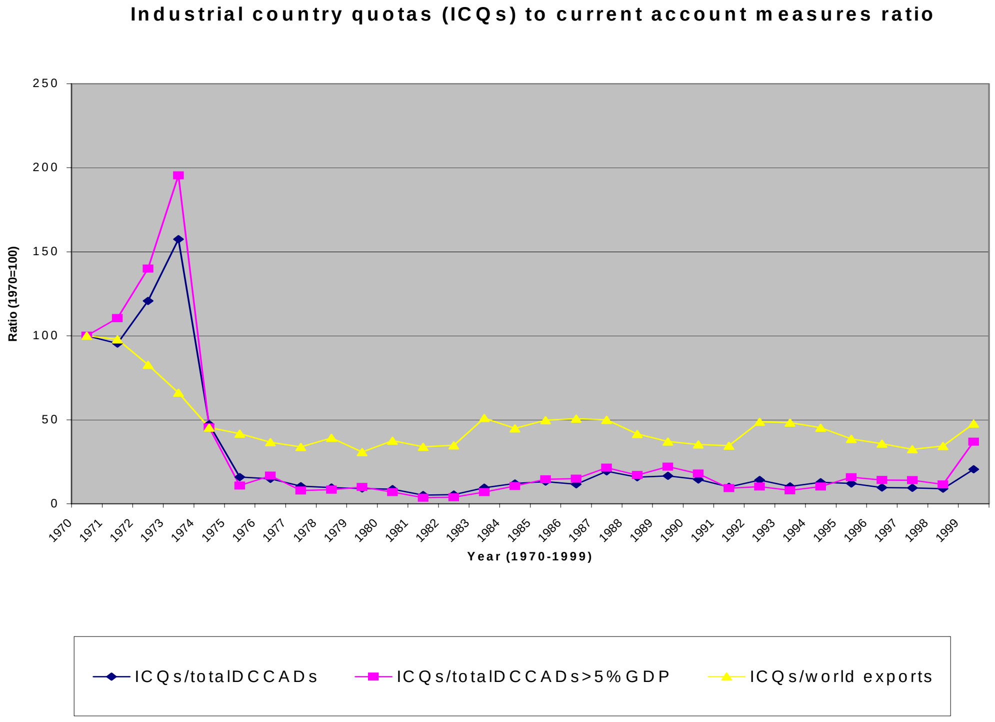
The existing quota system is deficient in a number of ways. Actual quotas differ from calculated ones, so that objectivity and transparency are lost. On important occasions quotas miscalculate the demand for IMF resources and they may not ensure resource adequacy. Moreover, they provide a distribution of voting rights that many countries regard as inappropriate for a global institution.

The analysis in this paper emphasises that the debate about quotas in fact cuts to the very essence of the Fund's operations. It should be given a much higher profile that it has been. At the same time, given the design flaws of the existing quota system, it is difficult to see how current problems can be overcome by simply modifying existing quota formulas. As currently constituted, quotas are being asked to do too much. One instrument will not achieve all the targets that it has been set.

More fundamental reform that goes beyond tinkering with formulas is needed if the Fund's role as the premier international financial institution is to be maintained and enhanced. The solution suggested here is to split up the various functions that, at present, one quota is being asked to perform. Existing quotas were designed when the IMF was envisaged as a credit union. It no longer is and quotas should be reformed to reflect this. Countries should contribute to the Fund according to their ability to pay based on GDP, and should have access to Fund resources according to their balance of payments need. In terms of governance, all countries that are affected by the decisions made should be able to contribute a reasonable input into influencing those decisions. However, equity needs to be constrained by expediency. Poor countries may gain little if a more powerful voice is purchased at the cost of losing the support of the advanced economies for the Fund's operations. It is difficult to envisage the Fund's major shareholders giving up their control. Political pragmatism will dictate the outcome.

If quotas are indeed the ‘building blocks’ of the Fund, they are inferior building blocks and an IMF which uses them will be relatively unstable and insecure. They provide a weak foundation for the Fund’s operations. It is important that the quota system is reformed. Putting off decisions and rolling over current arrangements is not the answer and will tend to gradually erode the Fund’s role in the world economy. Undeniably reform is difficult since it relates to fundamental issues, including the lending capacity of the Fund, its governance, and the governance of the international financial system. But side-stepping the underlying issues has led to a series of *ad hoc* and possibly ill thought out palliatives. If reforming the IMF is part of a new international financial architecture, the Fund needs to address its own financial architecture, and the reform of quotas is a key component of this.

Figure 1:



Industrial country quotas (ICQs) to current account measures ratio
Ratio (1970=100)
250
200
150
100
50
0
1970
1971
1972
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
Year (1970-1999)
ICQs/totalDCCADs
ICQs/totalDCCADs>5%GDP
ICQs/world exports

Table 1: The Distribution of Votes at the IMF

Constituency	Votes
Total votes in OECD-dominated constituencies	1537691
United States	371743
Japan	133378
EU single country constituencies	345602
OECD-dominated constituencies	686968
Total votes in Non-OECD-dominated constituencies	621985
Non-OECD single country constituencies	193751
Non-OECD constituencies with a dominant country	148929
Non-OECD constituencies without a dominant country	279305
Total of all votes (April, 2002)	2159676

Source: Calculated from IMF Annual Reports.

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