Overseas Development Institute

Opinion

September 2006

75

IMF reform: What happens next?

Lauren Phillips

'Given the complexities of the coming negotiations, what ability do under-represented developing countries have to influence the outcome of such reforms? And what should they expect to get out of the reforms?'

Overseas Development Institute ODI is the UK's leading independent think-tank on international development and humanitarian issues.

Barring any major upsets at the annual meetings of the IMF and World Bank in Singapore next week, the road to IMF governance reform is clearer now than ever. After intense negotiations and consultations, the IMF Executive Board sanctioned a first reform to the representation of four fast-growing under-represented countries (China, South Korea, Mexico and Turkey) and put in place a process for reform. If this reform package is agreed by the finance ministers in Singapore (an 85% vote in favour is required), between now and 2008 the IMF shareholders will debate how to change the antiquated formula that determines a country's weighted representation (the 'quota' formula) and address the non-weighted representation of all members through an adjustment of so-called 'basic' votes. The purpose of this exercise is to ensure that both middle and low income countries are better represented on the Board, in the hope that developing countries will not choose simply to walk away from the Fund.

There are still hard choices to be made, and the reform is far from a *fait accompli*. Even approval of the reform *process* did not come easily: a significant subset of middle income countries in Asia, the Middle East and Latin America opposed the 'two-stage' reform process, and European Union (EU) members are still vehemently opposed to any change of the quota formula (which benefits the representation of small, open European economies). There are no possible outcomes which make all members better off, and thus coming to an agreement on the next round of reform will involve intense and complicated political bargaining amongst shareholders, and in some cases between shareholder governments and their legislative branches. Given the complexities of the coming negotiations, what ability do under-represented developing countries have to influence the outcome of such reforms? And what should they expect to get out of the reforms?

Developing countries seeking to gain from the reforms have three distinct advantages in the upcoming negotiations. First, the fact that the IMF's charter (the Articles of Agreement) stipulates that a country's representation cannot be reduced without their explicit consent gives every country an effective veto over the reform process. While this gives power to countries or groups of countries that oppose change, it also implies that developing countries will not be able to lose representation without having the option to veto the deal.

Second, the impetus for this reform is developing countries own economic success – their recent economic growth and stability has made the IMF relatively less important, and therefore the reform process is motivated by a desire to keep them as active participants. A threat to walk away from the IMF has been interpreted by management and major shareholders as valid, and can be capitalised on. A key to making this a valid threat is to continue making progress on the nascent regional financial arrangements which would reduce the Fund's monopoly on being a lender of last resort in the time of crisis. The current probability of a *de jure* break from the Fund remains relatively low as these arrangements are untested and continue to suffer political setbacks in their full implementation. If they do manage to walk away from the Fund, the reform process will become redundant, leaving low income countries who are the Fund's primary clients at present without the means to achieve more adequate representation.

The third advantage is that, rather unusually in the field of global governance reform, the United States is in favour of reform. The US is the Fund's most important shareholder and the only state with individual veto power over all reforms to the Fund, and its support for a substantial reform process will help to moderate the anti-reform position of some countries, and in particular the EU Member States. This support is not completely altruistic – the US stands to lose nothing from a new quota formula more weighted towards GDP because its own representation is under-weighted on this metric. In fact, the distribution of gains and losses from

Table 1: Manipulation of the quota formula has uneven benefits

	Current Representation (% of total votes)	With GDP measured in PPP terms	With GDP measured in PPP and a 10% volatility metric
G7 Countries	45.3%	43.3%	39.0%
Other Developed Countries	15.5%	8.4%	8.3%
Total Developed	60.8%	51.6%	47.3%
Africa	5.7%	3.9%	6.7%
Asia	10.5%	26.3%	24.9%
Middle East	7.7%	3.9%	5.0%
Latin America and Caribbean	7.7%	7.8%	8.4%
Transition Economies	7.7%	6.5%	7.8%
Total Developing	39.2%	48.4%	52.7%

Source: G24, 'An estimation of IMF quotas based on a formula derived from the G-24 Ministers communiqué'

a quota formula reform are far from straightforward: some developing countries (e.g. Brazil and Saudi Arabia) are over-weighted with the current formula, while some fast growing developed countries (e.g. Spain and Ireland) are under-weighted. This makes building 'winning coalitions' more difficult amongst any set of countries.

Given these negotiating strengths, what reform options on the table are attractive to which countries? Broadly speaking, some large developing countries would benefit from a new quota formula which puts more emphasis on GDP, and less on a country's trade 'openness,' as this metric provides greater representation for some of Europe's highly open small economies. Measuring GDP on purchasing power parity (PPP) terms greatly increases the representation of Asia in particular vis-à-vis non G7 developed countries, (see table 1) and therefore increases the total weight of developing countries. However, such a metric actually reduces African representation, and has almost no impact on Latin American representation.

Low income countries do not stand to gain much from changes to the quota formula unless it includes a metric of a nation's vulnerability to external shocks (e.g. volatility of commodity prices). As the Group of 24 (G24) has capably shown, the incorporation of such a metric provides more representation for the poorest nations and Africa in particular (see Table 1). The real possibility for better representation rests on the increase of basic votes, rather than changes to the quota formula. The recent proposal endorsed by the Executive Board plans to at least double, and potentially triple, basic votes. While this sounds impressive, given the fact that basic votes at present only form 2% of total Fund representation, a doubling of basic votes increases African representation from 5.9% to 6.1% of total votes, and tripling only increases this slightly more, to 6.6%. It is therefore a marginal change.

Given that the ultimate shape of the reforms is still largely up for grabs, the coming two years provide an opportunity for under-represented countries to utilise their negotiation advantages to move the reform process more in their favour, despite the anticipated resistance of some countries, and EU Member States in particular. Analysis of the impact of competing offers will need to be calculated, and models of projected economic trends that forecast representation in the future would be useful to determine the longer term impacts of a new quota formula and agreement on the granting of basic votes. A transparent process of debating proposals, and the ability of developing countries to draft their own proposals and quickly assess the impact of others' proposals on their representation would greatly benefit their final representation.

Written by Lauren Phillips, ODI Research Fellow (l.phillips@odi.org)

odi

Overseas Development Institute

111 Westminster Bridge Road, London SE1 7JD

Tel: +44 (0)20 7922 0300

Fax: +44 (0)20 7922 0399

Email: publications@odi.org.uk

ODI Opinion Papers

are signed pieces by ODI researchers on current development and humanitarian topics

This and other ODI Opinions are available from www.odi.org.uk