Li Ruogu: Reform the governance of the IMF

Speech by Mr Li Ruogu, Deputy Governor of the People's Bank of China, on the Seminar on Governance of the Bretton Woods Institutions, Washington DC, 1 October 2004.

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Mr. Chairman, Ladies and Gentlemen,

It is my great pleasure to be invited by the annual meeting organizers to share with you my views on the governance issues of the Bretton Woods institutions, especially on the occasion of their 60th anniversary.

I. The main problem of the governance of the IMF and its negative implication

As we all know, the IMF was established sixty years ago as a global monetary cooperative institution, with the aim to help member countries adjust international balance of payments and stabilize exchange rate movement. The quota has been set as the key factor to determine voting powers and access to Fund's resources of member countries. When the Fund was constituted, the quota distribution was decided by the political and economic situation at that time. Due to this reason, the quota share of the U.S. was as high as 36 percent and that of UK 17 percent. Obviously, few industrial countries dominated the Fund's governance in its very early days. Nevertheless, to reflect the equity of member countries - though in a very limited way - each member country was assigned 250 basic votes in addition to its votes determined by quotas. And the basic votes accounted for 11.3 percent of the total votes at the inception of the IMF.

The following decades have witnessed great changes in global political and economic environment, including emergence of many newly independent sovereign countries, collapse of the Bretton Woods system, the oil crises in the 1970s, the international debt crises in the 1980s, booming international private capital flows throughout most 1990s and subsequent capital account crises in several emerging markets in the late 1990s. The Fund responded with expansion of its memberships from 40 to 184, augmentation of quota size by almost 37 folds and allocations of Special Drawing Rights (SDR) between late 1960s and 1980s. However, these phenomenal developments haven't been accompanied by fundamental improvement of the governance structure within the Fund. **The main problem of its governance is that the decision-making mechanism has not reflected the rapidly evolving political and economic environment and principles used for allocating quotas when the Fund was established has been abandoned resulting in a small group of member countries easily forming majority votes and exercising veto powers.** Thus, the IMF doesn't belong to its majority members but a few from Europe and North America. As Table 1 and Chart 1 show, over the past 60 years, the G-7 countries have kept their quota share, as a group, above 45 percent and that of U.S. above 17 percent. Although the quota share of developing countries increased from 30 percent to 36 percent, this more reflected the increasing memberships of developing countries. What is more, the basic vote has never been touched upon in every round of quota increase, resulting in a sharp drop of share of basic votes to 2.1 percent of total votes today.

What have been the negative implications of the main problem in the Fund's governance?

First, the dominant voting powers of a small group of countries have kept the Fund away from any policy initiative that may benefit the global community as a whole in the long run, but not in the interest of those countries in the short run. The issue of quota increase can serve as a vivid example. Before 1990s, since the industrial countries had had demand for the Fund resources for their balance of payments adjustment, especially in the 1970s, the initiatives of quota increase had been easily adopted. However, when these countries became creditors or concerned about their veto powers, their motives to promote quota increase have significantly lessened, except for those that had strong incentive to increase their quota shares. Many people believe that these were the major reasons underlying the no-increase decisions in the tenth and twelfth reviews, though the share of quota against world trade was at a very low level in the 1990s and the international capital flows were increasingly volatile. The lack of resources to response to emerging markets crises finally forced the major stakeholders in the Fund to agree a quota increase in 1998 through the eleventh quota review.

Second, developing countries have had enormous disadvantages in setting rules of games in the Fund, which have weakened their ability to protect their own interests as well as their ownership to implement the Fund's programs. As mentioned earlier, single majority, which can be easily formed by a small group of countries, is required when many policy decisions are put for votes. In this vein, in not few cases, policy decisions were approved without fully engaging all member countries or even regardless of objection or abstention from developing countries. One unfair rule I would like to draw your attention to is the lack of diversity of representatives in the senior management, which developing countries have fought against for quite a long period of time. But up to now, only one Deputy Managing Director is selected from developing countries. Without fully participating in rule setting and influencing policy decision, the ability of developing countries to protect their own interests has been weakened. They may have difficulties in insisting on their own development ideology and path that may be more feasible. A lesson every one could recall was the Fund's premature suggestion on advancing capital account liberalization in developing countries in the 1980s and 1990s when their financial systems remained vulnerable. As a result, some emerging markets suffered severe capital account crises in the late 1990s. Another negative impact of this undemocratic decision mechanism is that it have weakened the ownership or increased reluctance of developing countries to implement the Fund's programs. The Fund can use conditionality to urge member countries to reform their governance, can we also find binding conditionality for the Fund to make improvement in its representation? Can we also set up conditionality for developed countries to achieve the official development aid goal of 0.7 percent of their GNP?

II. How to reform the Fund's governance

Since the Asian crises, the Fund has taken some efforts to reform its own governance, including increasing transparency of policy decision and taking some administrative measures to enhance the working capacity of Executive Offices of some developing country constituencies. But, these haven't touched upon the fundamental problems in the Fund's governance as I mentioned earlier. Let me put forward several thoughts in relation to the improvement of the Fund's governance.

To democratize its voting structure is key to break the deadlock in reforming the Fund's governance. The work of quota formula revision needs to be finished as soon as possible, to reflect the rapidly changing world economy and comparative strength of member countries. During this process, the variables that can broadly reflect the strength of developing countries should not be discounted. At the same time, an increase of the Fund's quota size is also warranted, taking consideration of the magnitude of world trade and international capital flows. Moreover, to what extent the basic votes can be increased should be further studied.

In addition, we could also explore the possibility of persuading some major industrial countries to give up parts of their quota shares to developing countries. Nevertheless, I take full note of the difficulties in consolidating the quotas of the member countries in the euro area, which may be as equally difficult as persuading the U.S. to forgo its quota portion. To be balanced, simultaneously requesting both U.S. and EU countries to consider giving up parts of their quota shares might be feasible.

Along with changing the voting structure, we may also consider reforming the voting majority requirement on major policy decisions. The special majority requirement on some key policy issues, such as quota increase and revision of Articles of Agreements may be reduced from 85 percent to three fourths (75 percent) or two thirds (66 percent), thus no one single country being able to veto the related decisions.

Last but not least, it is also imperative to reform the management structure of the Fund. In light of large number of developing countries only represented by 10-11 Executive Directors in the Fund, adding another chair of ED elected from developing countries could be considered. As to the senior management, it is wise to consider increasing one to two DMD positions for developing countries over the next few years. Furthermore, the diversification of staff is also very important. It may also be feasible to allocate proximately thirty percent of senior staff positions to qualified staff recruited from developing countries, thus greatly helping bring new perspectives to the Fund and find out well-tailored development path for member countries.

Mr. Chairman, I clearly understand that the road towards a better governance of the IMF may be as bumpy as it was in the past sixty years. But, this is an irreversible journey. The intensified economic globalization and rapid development of developing countries demand a significant improvement in the governance structure of the Bretton Woods institutions, under which nations realize common prosperity through mutual respect, equitable dialogue and interest sharing. It is my firm believe that, with persistent pursuit from the developing world, and deep insight, forward vision, political courage and concerted efforts of the international community, the IMF will much better serve the interests for all of its members.

Thank you all.

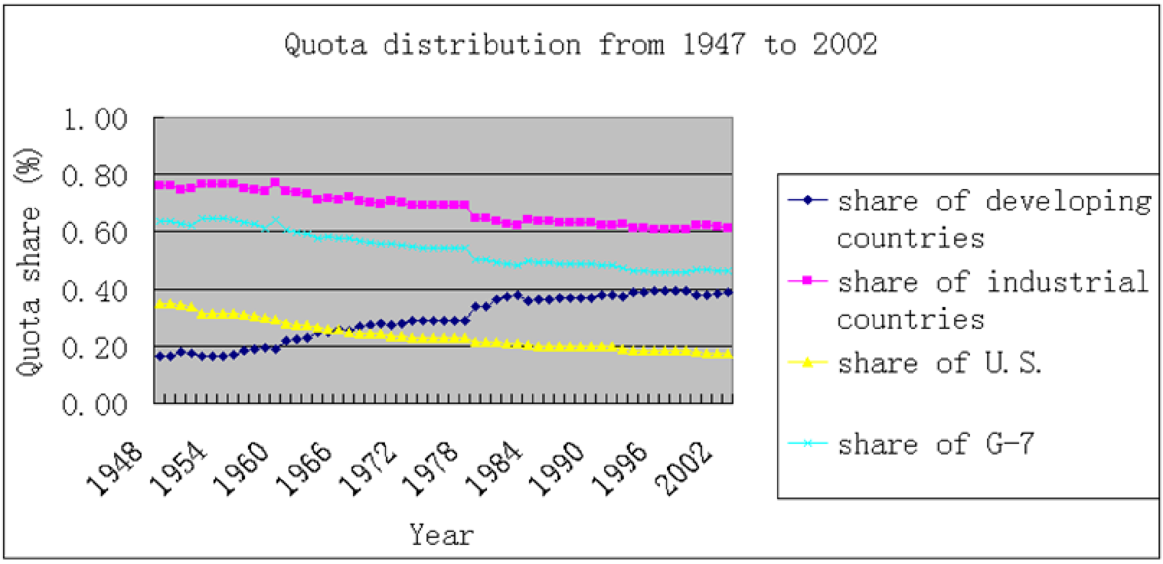
Table 1

Percentage of quota shares of member countries from 1945 to 2004[1]

Year[2]	Total quota (billion SDR)	Number of total member-ship	Quota share of industrial countries (%)	Number of industrial countries	Quota share of G-7 (%)	Quota share of U.S. (%)	Quota share of developing countries[3]	Number of developing countries
1945 (Original membership)	7.5	40	70	–	–	36	30	–
1966 (4th Quin-quennial Review)	20.9	102	64	14	58.0	27	36	88
1970 (5th General Review)	28.8	116	69	22	54.5	23	31	94
1976 (6th General Review)	39.0	133	64.7	22	50.3	21.5	35.3	111
1978 (7th General Review)	61.1	141	63.2	22	49.2	21.0	36.8	119
1983 (8th General Review)	90.0	146	63.1	22	48.9	20.0	36.9	124
1990 (9th General Review)	135.2	175	62.0	24	48.0	20.0	38.0	151
1998 (11th General Review)	212.0	182	61.6	24	46.0	17.4	38.4	158

[1] Data from Silent Revolution (Boughton), IFS. [2] Year in which the quota review was completed, i.e., when the Board of Governors' Resolution on quota increases was approved. The Tenth Review in 1995 and the Twelfth in 2003 did not provide for an increase in quotas. [3] Developing countries include transition economies.

Chart 1



Note: Data from IFS.