XX Technical Group Meeting of the G24
March 17-18, 2005
Central Bank, Manila, Philippines

Summary of the Presentations and discussion[1]

The XX Technical Group Meeting of the G24 was chaired by Mr. Jean Eyeghe Ndong, Deputy Minister of Finance, Gabon, and the meeting was opened following the welcoming remarks from the Deputy Governor of the Central Bank, Philippines, Mr. Armando Suratos.

Mr. Praveen Chaudry presented a paper on the need to democratize the governance of the IMF. In the paper, **The International Monetary Fund: Integration and Democratization in the 21st Century,** the authors highlight the ***democratic deficit*** within the governance structure of the Fund which results from (1) the decline in basic votes in the Fund's quota regime that has reduced the voice of smaller member countries; (2) biases in the calculation of the quotas that do not adequately reflect the growing importance of the emerging market economies in the world economy; and (3) the complexity and lack of transparency in the calculation of quotas.

Since the governance structure of the IMF is a product of the political and economic agreements embodied in the calculation of quotas, the authors argue that a revision of the quota formula will provide the means to reduce the democratic deficit. But quota adjustments alone may not be sufficient and the authors propose additional measures including increasing the size of the IMF; defining access to IMF resources in relation to the needs of member countries rather than strictly on the size of quotas; re-examining the voting system and the use of veto power and restructuring the Executive Board so that every director is elected rather than appointed by governments.

The paper draws attention to the reduced size of IMF quotas in relation to the financing needs of member countries, the lack of influence of the IMF on the policies of the larger industrial countries and the fact that the existing voting power of the members do not reflect the increased contribution of the developing countries to world output and trade that has taken place over the past 60 years.

The authors propose that purchasing power parities should replace the use of market exchange rates in the calculation of shares of world output and that the regional trade in common currency areas should be excluded from the calculation of the share of world trade. They recommend a substantial increase in the size of the IMF, a restoration of

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[1] All of the papers presented and the biographies of the presenters are given on the G24 website, www.g24.org

basic votes to 11.3% of total votes and a change in the operational policies to increase the access of members to the use of Fund resources.

There was general agreement among the participants that the paper addressed important issues on the declining ability of the IMF to fulfill its mandate to promote growth and stability in the world economy, on its relevance and legitimacy. Several participants pointed to the growth of reserves in developing countries as protection against the volatility of trade and capital flows, and of the growth of regional monetary arrangements and proposals for regional monetary funds. These developments could provide an impetus to the reform of the IMF and regional funds could complement the role of global institutions in the management of the world economy.

Participants recognized that the proposals for the recalculation of the quota formula would result in winners and losers. If the European Union moved to be represented by one Director, this would mean that both the single EU director and the US would have veto power and this might not help the developing countries that are able under the present system to form coalitions with some members of the EU. On the functioning of the Executive Board, it was pointed out that Directors are appointed by governments that are elected and are therefore accountable to their electorates. It was also pointed out that when the Directors from developing countries agree on an issue, they can be effective even when they do not have the 'official' votes. The lack of ability of non-governmental organizations to influence the views of the Directors was discussed and it was suggested that one avenue would be for Directors to make themselves more accessible to ngos.

The paper presented By Guillermo Le Fort entitled **"Issues on IMF Governance and Representation: An Evaluation of Alternative Options"** reinforced the arguments of the previous paper. The paper examined the characteristics of the under representation of emerging market economies in the IMF using cross-section regression analysis and the results indicate that economic growth, population and credit rating explain most of the under-representation. The author argues that these distortions will increase unless the quota formula is revised. The paper also argues for a substantial increase in the size of quotas and also proposes a change in the role of Executive Directors. The author proposes that all Executive Directors should be elected and that each chair should represent at least three members and not more than 15 members.

The paper presented by Gil Betran "**Governance in the Bretton Woods Institutions"** argued that the demand for good governance must also apply to the Bretton Woods institutions and not only to their member countries. The paper noted that the developed countries accounted for more than 60% of the voting shares of the BWIs and this greatly exceeded their share of world output and trade. The paper also noted that IMF quotas and the capital stock of the World Bank have fallen as a share of world output and trade and this reduced the ability of these institutions to respond to the needs of developing countries.

The IMF quota formulas are biased in favor of the industrial countries and the weights assigned to the variables in the formula are determined arbitrarily and follow no clear

logic. The paper noted that the variables in the quota formula reflect supply determinants and that in order to reduce the bias against developing countries, some demand determinants such as population, and the level of income need to be included.

Participants agreed that the weights assigned in the calculation of IMF quotas have no formal logic and suggested that a revision of the formula could begin with the revision of these weights. There were several views on how to determine the appropriate size of the IMF and whether the benchmark should be the 1990s or go as far back as the 1960s and 1970s. The ability of members to pay their share of the quota increase will be an important factor in determining how much to enlarge the size of quotas. For several countries with large reserves, this will not be a problem since only one quarter of the increase in quotas is payable in hard currencies. In the case of smaller countries, it was suggested that they could use a new SDR allocation to pay for their increased share of the quotas.

The suggestion for a independent and professional Executive Board generated a lively discussion with some participants arguing that the current directors were both independent and professional and that suggestions for improving the functioning of the Board would need to focus more on other obstacles such as the large size of some constituencies and the lack of time and resources to adequately address all the issues that come up before the Board in a timely manner. In this regard, it was suggested that creating one additional chair for Africa would not suffice to increase the voice and participation of the smaller countries, and would need to be complemented by other changes such as an increase in the size of basic votes, greater representation in the staff and greater ownership of programs by developing countries.

The paper by Murilo Portugal **"Improving IMF Governance and Increasing the Influence of Developing Countries in IMF Decision Making**" introduced a number of recommendations for enhancing the voice and participation of developing countries but many of the proposals required an Amendment of the Articles of Agreement and therefore the support of the industrial countries.

The paper argued that the influence of developing countries in the decision making of the IMF was less than desirable given their importance in the world economy and their use of IMF resources. On the other hand, the influence of the G-7 industrial countries was excessive. The aggregate voting power of the emerging market countries, economies in transition and developing countries has been between 37 and 40%.

The proposals to improve the governance of the IMF centered around moderately increasing the size of the quotas of developing countries by increasing their share of world GDP measured in PPP terms, increasing the independence and accountability of the Executive Board; making the selection of the Managing Director more open and transparent; improving the constituency representation at the Board; focusing IMF conditonality on the repayment capacity of borrowers and upgrading the IMF's role in international policy coordination.

The paper proposed to increase the share of developing countries to 45-47% which would leave the industrial countries with the majority share. It was also proposed to adjust the shares of particular emerging market countries (Korea, Turkey, China, South Africa, Iran, Mexico and Brazil) whose quota shares are out of line with their increased importance in the world economy. This would be achieved by adopting a more simplified quota formula, providing special increases for particular emerging market economies and increasing the size of basic votes.

The paper made a number of recommendations for improving the functioning of the Executive Board. The author suggested that the terms of Directors should be limited to six years and one term and that a third of the Directors should be up for renewal every two years. It was suggested that Directors needed to balance their country level responsibilities with their global responsibilities and measures were also need to increase the accountability of Directors.

The author also proposes some changes in the constituency system that might benefit the developing countries. There are at present 24 Directors representing 184 member countries. Several developing countries are represented by a Director from a developed country. Of the 16 constituencies, there are 7 headed by an industrial country and it is believed that developing countries would be better served if they were members of a more homogenous group. A related issue is that some constituencies are simply too large. Two African groups have 21 and 24 members each and this greatly increases the burden on their Directors. The proposal for an extra chair for Africa would reduce this burden and would give developing countries a majority of the Directors at the Board if not in voting power.

The paper by David Rapkin and Jonathan Strand **"Reforming the IMF's Weighted Voting System"** described the historical origins and evolution of the weighted voting system which is the center of the issue of power and influence in the IMF. The size of quotas determine the level of contributions to Fund resources, the access of members to use of these resources, the allocation of SDRs and the member's voting weight in the decision making of the institution.

The quota determination formula is a complex process. Quotas are first calculated on the basis of a system of five weighted formulas based on GDP at market exchange rates, the values and variability of export receipts, imports and reserves. Actual quotas are then determined through a process of negotiations using the calculated quotas as a starting point.

The voting weights have particular importance when considered in the context of the decision making process. There are over fifty categories of decisions that require special majorities. Decisions involving policy and operational matters typically require majorities of 70-85%. Notably, decisions requiring changes in quotas must have an 85% majority and this gives the US with over 17% of the voting power, a veto over major IMF decisions.

In practice, formal votes are rarely taken but a form of self censorship exists whereby issues are not raised that might be over ruled by the votes of the larger industrial countries. The practice has evolved of a consensus based on a “sense of the meeting” as determined by the Managing Director. But is there a consensus or only the appearance of one? Some proposals for reform include the requirement that directors vote so that it would be apparent how they feel on the issues.

The authors propose a number of reforms that would not require an Amendment of the Articles of Agreement such as a more open process for selecting the Managing Director of the IMF, greater representation of developing countries in the management of the IMF, as well as reforms that do require Amendment of the Articles such as an increase in basic votes and revisions in the formulas for calculating quotas, and the use of a double majority system of weighted voting.

During the discussion, participants noted that the issue of voice and participation could not be separated from considering the role of the IMF. Several speakers felt that Fund conditionality should focus on issues of growth and the repayment capacity of the borrowers and the role of the IMF in surveillance should be enhanced. The discussion also focused on the role of executive directors who have a dual function to represent their constituency and who also have a fiduciary responsibility to the institution to take a global view. On the selection of the MD of the IMF, speakers felt that the issue was not who was selected so much as the process which needed to be more open and participatory.

The paper by John Mc Lenaghan “**Measuring GDP: Purchasing Power Parities and IMF Quotas”** reviewed the arguments for replacing the measure of GDP at market exchange rates with purchasing power parities in the calculation of quota shares. In the calculation of quotas, the share of GDP in global GDP is the most important measure and a number of studies have shown that adjusting GDP for purchasing power parity (PPP) yields significantly different results. Estimates by the World Bank and the IMF show that the share of the industrial countries falls from 80% of world output when measured at market exchange rates to 55% of world output when measured in PPP terms. The IMF, the OECD, the UN and the EU have incorporated the use of PPP as a regular feature in their analysis of output growth.

The most comprehensive approach to the compilation of PPPs in terms of country coverage is the International Comparison Program that began in the late 1960s with support from the UN Statistical Office, the World Bank, the Ford Foundation and the University of Pennsylvania. By 1996, ICP surveys had been carried out for 52 countries, 28 developing and 24 developed countries.

Currently, five regions-- Africa, Asia and the Pacific, the Commonwealth of Independent States, Latin America and West Asia—have mobilized staffing and resources to monitor the next round of ICP surveys for 2003-2006. It is expected that 153 countries will participate in the current round of surveys.

The critics of the use of PPP based GDP estimates argue that they do not provide an accurate measure of a country's ability to contribute to IMF resources and that there are significant data and country coverage problems in the ICP surveys. The author argued that the inter country comparisons and the methodology of PPPs are well documented and well tested, and the use of PPPs is a widely used instrument of analysis and forecasting by a growing number of international institutions, and that over the next two years, a significant number of countries will be covered by on going surveys.

In response to the question of whether PPP estimates of GDP were available each year and for all countries, the author said that they are not available each year but the estimation procedures are reliable. Some speakers suggested that the quotas could use a combination of market exchange rates and PPP estimates; others suggested that the PPP estimates could be supplemented with other data such as the size of reserves to determine the ability of member countries to contribute to IMF resources. It was also noted that 158 countries including 30-40 African countries were carrying out ICP surveys for 2005 and this information will be available in a couple of years in time for the next quota review.

The paper by Laura dos Reis **"Measuring Vulnerability: Capital Flows Volatility in the Quota Formula"** discusses a proposal to include a measure of the volatility of capital flows in the quota formula in order to reflect the vulnerability of members to balance of payments crises.

The current formula includes a measure of the volatility of exports and the suggestion to include a measure of capital account volatility was made by the G24 Ministers in October 2004 and was introduced in recent quota review discussions at the IMF. However, the measure of volatility used by the IMF does not adequately capture the adverse impact of capital volatility on developing countries. The IMF measures volatility in absolute dollar terms and by this measure, the industrial countries experience more capital account volatility then developing countries.

The paper proposes an alternative measure, the volatility of exports and net capital flows as a share of GDP and this measure shows a markedly different result. Net capital flows are a larger share of GDP for developing countries and sharp falls in capital flows leads to major cuts in investment and GDP growth because developing countries have a less favorable access to capital markets. Within country groups, volatility measured as proportion of GDP is higher for the smaller industrial countries than for the G7 countries, and among developing countries, Africa is the most vulnerable, followed by Western Hemisphere, the Middle East and Asia.

The paper by Cord Jakobeit entitled **"Enhancing the Voice of Developing Countries in the World Bank"** proposed the use of double majority voting as one element of a reform package to enhance the voice and participation of developing countries in the decision making in the World Bank. The reform proposals include restoring the share of basic votes in the total, the use of PPPs in the quota calculations, the establishment of a Trust Fund to provide technical support to African Executive Directors and the possible addition of a 25th Chair for Africa.

The double majority voting was a concept that was pioneered in the Global Environmental Facility (GEF) to address the interests of donors and recipients but double or qualified majority voting is in the Articles of Agreement of the Inter-American Development Bank and the other regional development banks and has been used without any difficulty or financial disadvantage. Since the introduction of double majority voting in the World Bank would require an Amendment of the Articles of Agreement, the author proposes that the new system be introduced during a two year pilot phase and be limited to certain issues such as project, program and personnel decisions that are the prerogative of management. The issues of general policies, budget and strategic matters should continue to be based on consensus decision making.

In the discussion, participants noted that the GEF had not made much use of the double majority voting system probably because they only meet twice a year and had found ways to avoid bringing issues to a vote. It was also pointed out that qualified voting is used in the Inter-American Development Bank without adversely affecting its bond rating and that policy and financial issues were not excluded. The author said that the restricted use of the double majority voting had the support of the Ministry of Cooperation in Germany; he felt that the suggestion for a pilot phase was designed to test the new system and to win broader support for the idea.

Dennis Leech presented a paper on "**The Voting Power Implications of a Unified European Representation at the IMF.**" This paper was of particular interest because the revision of quotas as suggested by various authors would lead to a reduction in the voting shares of EU members. This paper considered some of the implications of EU members being represented by a single executive director. This would mean that the IMF governance structure would have two powerful voting blocs, the EU and the US.

The paper argues that moving to a single seat will increase the influence of the European Union and will not reduce the influence of member countries. Each EU member would gain power despite losing its seat depending on the internal EU voting system that was adopted, and it was argued that this is essential in order to persuade countries to give up their seat at the Board. The paper also argues that this change would also be beneficial to developing countries since they could also form coalitions that would have veto power. Two powerful voting blocs greatly reduce the power of each major bloc and increase the power of the swing votes. The use of veto power could be used to prevent certain policy changes but all groups would have greater incentive to cooperate to promote desirable policy changes.

Conclusion

There was broad agreement on the need for a simplified formula for allocating IMF quotas and IBRD capital shares, on the use of Purchasing Power Parity (PPP) in the determination of GDP; on the inclusion in the quota formula of measures of the volatility of exports and net capital flows measured as a share of GDP, and of some demand related variables such as population and the incidence of poverty. Participants agreed that the

quotas/shares of developing countries whose shares would decline with the adoption of the new formula should be maintained. There was also agreement on the need to restore the share of basic votes in the total and to increase the overall size of IMF quotas and the IBRD capital to enable these institutions to better assist member countries.

The meeting also agreed to raise in appropriate venues other proposals contained in the papers to enhance the governance of the BWIs including improving the accountability, transparency and professionalism in the Executive Boards; the need for a more transparent and inclusive process for the selection of the heads of the institutions, and the need to enhance the role of the IMF in international macroeconomic policy coordination.

The meeting also agreed to look for ways to strengthen the G24 and cooperation among developing and transition countries by inviting other countries to join the G24; to enhance the role of the G24 Secretariat in supporting the dialogue among Executive Directors and representatives of developing countries at the BWIs, and to seek other ways to enhance the effectiveness of the G24 in fulfilling its mandate.

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