Special Issue: Is there a need for Reforms in IMF?

Developing Economies and Global Governance: Will IMF Rethink Its Orthodox View?

Jain and Gupta
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Received: Oct 19, 2017; Accepted: Dec 15, 2017

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Abstract

It has been constantly viewed that the developed economies unevenly ruled the governance structures in the international organizations such as International Monetary Fund (IMF). The continuous development in Emerging and Developing Economies (EDEs) over the last 20 years witnessed their growing importance in the world economy, but at the same time little increase in their voice in the IMF. There are reasons for the discontent of the EDEs in the present structure such as the increase of regional monetary arrangements, uneven distribution of quota shares, IMF quota reforms, and IMF voting structure. The world economy is witnessing a tremendous growth of these EDEs and is now at the verge where Asian economies are capable of leading, rather than the North Atlantic economies. This issue should be acknowledged properly and must be responded adequately. This paper makes an attempt to understand the prime issues that should be fixed in the current quotas system and voting structure in the IMF.

Keywords: Developing economies; Governance; International Monetary Fund; Reforms; Quotas.

1. INTRODUCTION

The last few years have seen a number of heated arguments over the long-awaited changes in economic governance across the globe. These arguments draw their roots from the fact that despite the approval of the board of governors in 2010, implemented in 2016, least has been done in the direction of economic reforms by the International Monetary Fund (IMF). The United States (US), being the largest member of the IMF, enjoys an effective veto with a current quota (as of March 2017) of Special Drawing Right (SDR) 82.99 billion (about US$113 billion), which accounts for 17.7% of the quota share (and 16.7% of the vote share), therefore making any reform in the current quota system impossible without the consent of developed countries, as more than 85% of total votes are required to make it happen (IMF, 2016c). The biggest irony is that the reforms are delayed due to the failure of the U.S. administration to obtain approval from the U.S. congress despite the fact that the US was the main architect of the 2010 agreement (Truman, 2015), which emphasized the need to increase the share of EDEs by marginally reducing the share of European countries.

The quota reviews in the IMF, which should be implemented in a period not exceeding five years, have been delayed unprecedentedly. This is mainly due to the resistance of the so-called advanced economies (AEs) and the obscurity of the U.S. administrations in getting the essential approval of the Congress. Keeping in mind the fragile nature of the global economy and the repercussions of the North Atlantic financial crisis (NAFC), such as sovereign debt, the indisposition of IMF management and its members is difficult to comprehend.

Despite the fact that the world economy is facing ongoing substantial modifications in the dissemination of economic power, this reluctance of the AEs group has great importance, as they don’t want any changes in the present structure of global governance. The current framework has been in place since World War II end, when the conception of the IMF and the World Bank took place in the Bretton Woods Conference (BWC). Subsequently, many international organizations, such as the World Trade Organization (WTO) in 1942, Regional Development Bank in 1960, and Asian Development Bank in 1966, were formed. However, the only noteworthy change to the present structure was the formation of Financial Stability Board (FSB) in year 2009 as a result of the NAFC.
The problem at present is the unceasing dominance of these global bodies by the AEs regardless of the significant modifications that are now happening in the present global economic framework. The formation of BRICS Bank (a $100 billion New Development Bank) by the BRICS countries (Brazil, Russia, India, China, and South Africa) and the Asian Infrastructure Investment Bank (hereafter AIIB) majorly led by China is a sign of the dissatisfaction of EDEs with the present structure of global governance.

Here, the question is, why these issues are now brought out with more focus rather than two decades back? We are continuously debating that we are now at the verge where Asian economies are capable of leading the world economy that has not been viewed over the past two centuries. Moreover, the stability in the world economic framework can be viewed from World War II end till the twentieth century. Although in the same period the AEs were having 60-70% share of the world gross domestic product (GDP), owing to postwar economic changes in Japan and Germany, the AEs’ relative weights themselves vary. However, during the period, the continuous dominance of the US was seen in the global economy. Since the twentieth century, the rapid shift in the world economy weight from the North Atlantic economies to Asian economies has been observed. The evidence of this historical development over the past 15 years is the root cause of today’s vigorous debate. With the hope of such change hastening the current scenario over the next two or three decades or so, the present incremental change in global governance will not suffice; rather it will have to be more indispensable.

This paper is an attempt to draw attention to the major problems that are being faced by developing economies, specifically related to global economic governance by the IMF. The rest of the paper is outlined as follows. Section 2 details the historical perspective of the modifications that took place in the world economy over several periods and the need for the same at present. Section 3 highlights the changes in the IMFs global governance framework in the last seven decades. In addition, this section describes why there is a need for IMF to rethink its orthodox view particularly in reviewing the quota formula as to cater the present changes going on in the world economy. Section 4 assesses the importance and role of EDEs in governance of various international platforms while the final Section 5 concludes by conferring the necessities of changes on the regular interval so as to make the IMF more effective and trustworthy institution.

2. ECONOMIC SHIFTS AND NEED FOR GOVERNANCE

The world witnessed a dramatic change in the global economy in the eighteenth and nineteenth centuries with the industrial revolution that took place in Europe, which later gathered pace in the US and Japan as well. This marked the advent of colonialism and imperialism classifying the developing countries as groups of European powers. However, the constitutional repercussions of First World War and the subsequent Second World War undermined the European control and led to the emergence of the US as the central economic, political, and military power.

Another shift in the global growth rate took place in the 1950s with the rapid emergence of Asian and Latin American economies causing a shift in the economic power in favor of developing countries. Despite a rapid growth recorded in Japan in the 1950s, which ignited a growth trend in other Asian countries as well, the Asian tigers continued to have lower economic weight in the world economy because of small share in world GDP. According to the IMF report, the EDEs long-term GDP growth will be higher than that of AEs (Figure 1). Due to these noteworthy and substantial developments in the economies of developing countries and their repercussions for world economic governance that arouse the need for a paper that highlights on the importance and the role of these economies, a change in the quota reforms so as to have increase in the quota share and voice in the IMF.

The world had started witnessing the growth of two Asian largest economies namely India and China during the late 1970s. But this growth surprisingly became more noticeable, with the commencement of fundamental reforms by these two economies—China started in the 1980s and then India in the early 1990s. Thereafter, almost for the next three decades, both economies recorded high growth, specifically China. According to Organization for Economic Cooperation and Development (OECD) report, during 1980-2014, India recorded over 6% average change in the annual real GDP growth than that of China, which recorded nearly close to 10% (Figure 2). Further in the same phase (1990s and 2000s), the Latin American region,
particularly Brazil, witnessed the high growth due to comparative macroeconomic stability in that region (Figure 2).

The rapid, continuous, and sustained growth in the economies of the BRICS countries has led to increase their combined share in the global world economy (more than 31% of the share of world GDP) and hence become major players today. Furthermore, the IMF estimates (source: IMF, 2017b) the BRICS members share in the global GDP (PPP basis), which is expected to increase to 34% and 35.4% by 2020 and 2022, respectively. The year 2016 witnessed the increase in share in the world GDP of BRICs than that of the G-7 economies. Moreover, the same can be inferred from Figure 3, where the share of G-7 economies in the global GDP (PPP basis) decreased from about 46% in 1992 to about 31% in 2016 and further expected to decrease to about 27.6% by 2022, with a comparable rise in the BRICS’ share from 17% in 1992 to 31.4% in 2016 and further expected to increase to 35.4% by 2022.

What is noteworthy is that in spite of sustained and high growth in Asia in almost past five decades, the overall economic weight of EDEs did not change in that ratio, and merely 10% increase concerning global GDP (PPP basis) has been observed in between 1970s and 1999. It can be noticed that in the same time span
their share concerning global GDP (MER basis) recorded a 5% downfall (Table 1) whereas the share of AEs remained constant during that period. Hence, it can be argued that these advanced economies had their dominance, and they themselves (with in G7 or G10) could easily decide the world economic framework and the contours of governance.

Nevertheless since 2000 the very rapid increase in the economies of the AEs at one side and the BRICS at the other is histrionic. Furthermore, the increasing role of EDEs in the world economy and involvement in deciding governance necessitates more accountability. With finer economic institutions and research centers, the US and Europe continue to rule the global economic power as compared to developing countries that are way lacking the essential sophistication. However, one thing is for sure that this gap can soon be bridged.

As we talk about EDEs and their relative weight in the world economy, we should first question the existence of the IMF as a coordinating institution and have an analysis of global economic policy. Until the 1970s, the IMF financial flows were basically meant for trade financing until the collapse of the Bretton Woods system that instigated the mechanism to the use of IMFs resources to be augmented significantly.
A number of financial crises occurred between 1970 and 2011 (Boorman, 2015), mostly in EDEs, which led to the classification of two different groups among the IMF member countries: first, creditor countries (mainly AEs); second, debtor countries (mainly EDEs). While most of the creditor countries were AEs, the dawn of the NAFC viewed 20 systematic banking crises in the AEs as well since 2008. This led to the need of an institution that could lend a helping hand to the stressed economies and play a leading role in the economic governance worldwide, thus the critical role of the IMF.

There has always been a need for an institution such as the IMF, which could bring stability in times of significant global economic changes such as the introduction of fixed but modifiable exchange rates of gold/dollar standard, since Bretton Woods arrangements collapsed. This need was further accentuated with the introduction of floating exchange rates and free flow of capital, which led to more frequent banking, exchange rate, and sovereign debt crises. Adding to this is the NAFC, which forced European economies to increase their access limits as high as 1000% of quota in the 1990s (IMF, 2016a).

Technological changes in the 1990s and till date have brought a mammoth change in the role of IMF. Free flow of capital and the simultaneous introduction of financial liberalization policies in AEs and EDEs both brought ever bigger sizes of rescue programs. The credit need of even developing countries increased significantly so that the IMF funds have to be supported by European organizations. With the increasing size of EDEs, the probability of the financial crisis in future and growing financial dependence of economies on each other, whether of developing or developed countries, the importance of the IMF cannot be ruled out.

The IMF played a vital role in the resolution of many crises: primarily, the 1980s debt crises in Latin America and then the 1990s Asian crisis brought stillness in the global economy. The level of contentment increased, and there was an oversight in the observation of the world economy that led to the NAFC. As a result, the IMF alternatively arranged huge borrowings through the New Arrangements to Borrow (NAB) and subsequently from Bilateral Arrangements (Mohan and Kapur, 2015).

It is therefore clear that the role of the IMF increasingly will become more dominant in the near future with the rapid changes in the world economy. Equally important is the fact that the EDEs should be provided more powers in the IMF; it can be in terms of quota or in voice in the executive board. However, despite the fact that developing countries should be provided their due share, the U.S. dominance will continue with respect to economic weight owing to its superior institutions leaving the Europe way behind.

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Table 1. GDP and Quota Shares of Emerging and Developing Economies vis-à-vis Advance Economies.

| Item                              | 1980 | 1990 | 1999 | 2005 | 2011 | 2016 | 2020 | 2022 |
|-----------------------------------|------|------|------|------|------|------|------|------|
| **Share in global GDP (PPP basis)** |      |      |      |      |      |      |      |      |
| Emerging and Developing Economies | 36.4 | 36.3 | 42.6 | 47.3 | 54.7 | 58.2 | 60.8 | 62.4 |
| Emerging and Developing Asia     | 9.0  | 12.5 | 16.5 | 20.0 | 26.7 | 31.6 | 35.2 | 36.9 |
| Advance Economies                 | 63.6 | 63.7 | 57.4 | 52.7 | 45.3 | 41.9 | 39.2 | 37.6 |
| **Share in global GDP (MER basis)** |      |      |      |      |      |      |      |      |
| Emerging and Developing Economies | 24.2 | 21.8 | 19.6 | 23.7 | 36.6 | 38.8 | 42.4 | 44.3 |
| Emerging and Developing Asia     | 6.8  | 4.8  | 6.6  | 8.7  | 15.9 | 21.4 | 24.3 | 26.0 |
| Advance Economies                 | 75.8 | 78.2 | 80.4 | 76.3 | 63.4 | 61.2 | 57.6 | 55.7 |
| **Share in IMF Quota**            |      |      |      |      |      |      |      |      |
| Emerging and Developing Economies | 35.1 | 34.5 | 36.0 | 35.5 | 36.6 | 42.4 | n.a. | n.a. |
| Advance Economies                 | 35.7 | 35.2 | 37.0 | 37.5 | 63.8 | 57.6 | n.a. | n.a. |

Note: Data for 2020 and 2022 are IMF predictions.
Source: Author’s elaboration based on data extracted from IMF (2017b).
3. IMF QUOTA HISTORY AND GOVERNANCE REFORM

The history of Quota system started when the founding fathers of IMFs intended to include involvement so that the world economic structure might be monitored more effectively in the unbiased method. Nevertheless, it took almost six decades to achieve this purpose of inclusive membership. In 1944, 40 members were the members of the IMF; which increased to more than triple fold in the late 1970s, with the continuing dominance of the established nations and the joining of autonomous African nations. Hence, the significant growth in membership had been witnessed till early 1990s making IMF a globally known institution with worldwide membership, but there was no proportionate change in the institutional overall governance.

The quota system in the IMF works in a fashion that a specific quota is allocated to each member of the fund that later defines the borrowing capacity and voting power of that member. In addition, the fund is managed in a manner that the allocated quotas are likely to offer enduring and adequate resources for granting. Since its commencement, formulae have been used while assigning quotas to members and have been constantly revised periodically. Moreover, the formulae are generally worked as initial ideas, and the value of real quota differs from the allocated one. Meanwhile, for subsets of members, the system also implemented selective and ad hoc increases. The quota formulae used in allocating funds become cumbersome over the period of time because of the increased number of formulae in the next three to four decades. In 1983, the formulae count reduced to five, thus, reducing the complexity of the quota system up to some extent. This complication continued till the IMF board agreed to apply new comparatively modest formula in 2008 (source: author’s elaboration based on data is extracted from Box 2, IMF, 2000, pp. 15-16 and Box 2, IMF, 2016a, p. 22). Although, the current formula is easy and simple to understand, it still suffers from major flaws that have been highlighted later in this paper.

The quotas initially in 1944 were assigned through ex ante mechanism rather than based on original formula (Mirakhor and Zaidi, 2006) and the ex post mechanism where the quota formula was established to justify the assigned quotas (Virmani and Patra, 2011). The current U.S. President Roosevelt instructed his treasury staff to modify the formula in such a way that the formula favors the US in grabbing the largest quotas from its three major allies (United Kingdom (UK), Union of Soviet Socialist Republics (USSR), and China).¹ One of the primary purposes of the quota formula was basically to weaken the influence of the US in the global economy and thus ensuring that the quota limit must be allocated broadly so as to make IMF more appealing in the global platform (Mohan and Kapur, 2015). Despite this, many equally positioned countries have different quota shares which in turn created dissatisfaction among the delegations regarding the allocation done and hence, a need for revision in the present structure of quota formula is warranted.

As the borrowing limits and the withdrawal needs were connected to the members’ quota shares, their relative importance was increased over time. In the late 1960s, the noteworthy change assumed in the quota shares was when SDRs were introduced and connected to the quotas (de Vries, 1976). More essentially, the continuing determined change in the economy, in particular GDP) among the members of the fund, led to claim for a further strong modification in the relative members quota shares. It can be observed that earlier in 1960s the rapidly developing countries such as Japan and Germany had contributed more in the global GDP and had more quota shares earlier rather than the slowly developing countries such as India and China. Nevertheless, the scenario has now been witnessing the reverse with EDEs, in particular Emerging and Developing Asia (EDAs), growing rapidly and outperforming the AEs (Table 1).

¹ “In mid-April 1943, shortly after the White plan was made public, White called me to his office and asked that I prepare a formula for the ISF [International Stabilization Fund] quotas that would be based on the members’ gold and dollar holdings, national incomes, and foreign trade. He gave no instructions on the weights to be used, but I was to give the United States a quota of approximately $2.9 billion; the United Kingdom (including its colonies), about half the U .S. quota; the Soviet Union, an amount just under that of the United Kingdom; and China, somewhat less. He also wanted the total of the quotas to be about $10 billion. White’s major concern was that our military allies (President Roosevelt’s Big Four) should have the largest quotas, with a ranking on which the president and the secretary of state had agreed. I was surprised that White did not mention France, which was usually regarded as being third in economic importance among the Allied powers. He said he did not care where France ranked, and its ranking did not need to be an objective in the exercise.” (Mikesell, 1994, p. 22)
Furthermore, besides the allocation of members’ quota shares, all the fourteen general reviews held had a healthy discussion on the amount of the quota resources. Necessity for the increased quotas resources has been warranted as the world economy perceiving enormous growth since the last two decades. In addition, it has been suggested in every successive reviews that the AEs preferred a very less increase (say 20-40%) in the overall amount of the quota resources allocated for multiple causes: worldwide presence of private markets; restrictions on ability to be responsible for resources by their own, and they may be the cause for any inflationary part in the world economy. In contrary, the EDEs favored a comparatively more increase in the overall amount of the quota resources (say 80-95%) as the developing economies require more external financial assistance if they suffer from any possible crisis from increasing trade and economic interdependence (de Vries, 1976, 1985). It can be well said with respect to quota resources in the IMF that the potential borrower economies normally sought large amount whereas the creditor economies tried to resist them.

During almost two decades of its existence, there was generally no increase in the quotas of the Fund. Some modest changes that occurred in the 1960s were also distributed in proportion to the existing quotas. With countries such as Japan and Germany gaining relative weight in the global economy, it was demanded to reflect this in the form of increase in quotas during the 1959. The mammoth task ahead of the IMF in the fifth general review was to strike a balance between the demands of EDEs and that of fast growing economies.

The sixth general review witnessed the 33.6% increase in the quota share, much demanded from the developing economies to protect their shares. This led to a more improvised methodology in quota allocation and moved the attention toward quota formula and its variables (de Vries, 1976). The US has always been a dominant power in the quota share. However, during the 1970s, its share had dropped from 33.5% in 1946 to 23% but that did not affect in any way its veto power over key fund decisions. “U.S. officials argued that the United States needed some margin to retain at least 20 percent of voting power. U.S. officials argued, too, that lowering the voting power of the United States to below 20 percent of the total might well lower the commitment to the Fund by the U.S. government and even by the U.S. public at large, which would be contrary to the interests of the Fund itself” (de Vries, 1985, p. 521). This led to augment the majority required for special voting from 80 to 85% in the Second Amendment to the Articles in 1978, thus empowering veto at 15%.

The seventh review witnessed 51% increase in the quotas mostly in proportion to their present status with selective increase of 1% for only 11 EDEs who had a fewer shares as compared to their calculated quota shares (CQSs). The eighth review with 48% increase in the overall quota was tilted more regarding selective growth (29%) rather than an equiproportionate growth (19%). After that the ninth review in June 1990 also noticed a 50% increase in the overall quotas slanted more toward equiproportionate increase (30%) than the selective one (20%). After that, there had been no change in the overall quota share in the tenth general review conducted in 1995. The eleventh review (1998) also led to an equiproportionate distribution of an increase of 45% in the quotas. Despite the rapid growth in the EDEs after 2000, there had been no change in the overall quota as well as relative quota positions in the two successive reviews—twelfth in 2003 and thirteenth in 2008.

The rapid growth in the EDEs brought into light the mismatch between their quota shares and economic weight (Table 1), and thus 54 countries had an ad hoc increment in their quota shares in 2006 and 2008. This trend also continued in the fourteenth review, where, as a result of NAFC, the IMF’s total quota resources for the first time increased by 100% after a lag of 13 years. However, unfortunately even with prominent increase in gross capital inflows and outflows and a notable increase in trade, the increase in Fund’s quota resources did not fare well in relation to global economy. Adding onto this, the delays in the implementation further nullified its effect.

After the enforcement of the fourteenth review in January 2016, the marginal increase of 3% (39.6-42.4%) has been observed in the EDEs’ member quota share. The fourteenth review marks a change in representation in the governance board and the initiation of quota reviews in a comprehensive manner (January 2013). Hopefully, the fifteenth Review expected to emerge in 2019 will witness a new quota formula with the executive board working expeditiously on it in accordance with its understandings and the guidance provided by the IMFC (IMF, 2016b).

There is an ever increasing gap between the relative weight of EDEs in the world economy and their state in the global governance, almost 15% points to be specific (IMF, 2017b). Hence, the conservative
approach till now followed in adjustment of quotas and delays in bringing them into effect and with some solemn faults in the prevailing quota formula, and this gap is likely to broaden in future.

Long-term forecasts from the OECD specify further prominence of these trends in favor of the EDEs\(^2\) (Figure 4). As the economies of both G7 and BRICS have sustained rapid growth, even then the BRICS share in global GDP (34\%) have 8\% less than that of G7 (42\%). In addition, OECD (2017) forecasts that by the end of 2022, the cumulative share in the global GDP of BRICS would surpass the same of G7. Further by 2060, the OECD estimates 49\% increment in the share of BRICS, whereas the same of G7 would decrease to 30\%. The OECD also estimates that, by the end of 2020, the individual share of China in world GDP would surpass the same of the US and it continues further and by the end of 2060, China’s GDP (17\%) would be 8\% more than that of the US (25\%). Most importantly, the OECD (2017) report also estimates that, by the end of 2060, India’s individual share in global GDP (18\%) would surpass the same of the US (17\%) by 1\% (Figure 4). Consequently, if these OECD (2017) forecasts come out to be precise, the world economic framework would definitely be palpably different from todays’ position. Moreover, this change in the framework would be accepted by the world economic governance. Nonetheless, as all these estimates are imprecise, the question always haunts whether the high past growth sustained in future or not?\(^3\)

3.1. Necessity of Revision in Present Quota Formula
Quota shares were considered instead of EDEs with an equally supportive equation and effective factors that are marked as remarkable alternative, where GDP was taken as the prime element. Prior to the quota

\(^2\)There may be difference between data from OECD (2017) and the same from (IMF, 2017b).

\(^3\)"As Pritchett and Lawrence (2014) argue, abnormally rapid growth is rarely persistent; regression to the mean is empirically the most salient feature of economic growth. In developing countries, episodes of rapid growth are frequently punctuated by discontinuous drop-offs in growth and accordingly, these authors expect that growth in China and India will be much less rapid than is currently anticipated. We are, for example, witnessing a marked slowdown in EDE growth at the present time, including the BRICS countries"
share consideration, the PPP GDP statistics was questioned regarding the quality aspects, which were verified by the Fund staff and also were declared optimum to be implemented in the quota formula as per IMF statistics (IMF, 2014a, 2014b, 2015). Conceptually, 40% at PPP and 60% for GDP at MER were taken as weights for PPP GDP in the formula. The inclusion of PPP in GDP rather assisted the low-income nations to have their say heard in the governance aspect (IMF, 2016a).

The GDP (PPP basis) formula was inclusive of a major drawback, in particular openness variable. In the present scenario, GDP and country size in the trade openness variable is inversely related. Though being openness variable has no link or reflection to the world’s economic and financial framework, this drawback had positive impact on the nation small in size as compared to a large economy. In addition, the drawback persists despite the policies relating to trade and external affairs are equivalent both to small and large economy. According to the World Bank report in 2014, the U.S. economy in the world (as measured by trade-to-GDP ratio) was well behind than that of Sweden, Finland, Norway, and even India! This biasness of openness variable has been experienced by euro countries as well. Hence, the change in the quota formula with respect to openness variable requires significant attention and responded adequately either by minimizing (the variable impact should favor the GDP blend) or by eliminating it fully, but the change according to the IMF report on quota data updates revealed that the openness variable continued to play significant role in the formula (IMF, 2016a).

The variability in current receipts and net capital flows is the third variable in the quota formula. The IMF fund staff itself acknowledged two major issues related to this context: first, there is a weak relationship among the variability and BOP needs; second, the increase in share for PPP GDP as compared to market GDP will benefit almost all countries placed in the bottommost part (measures in terms of income distribution), and their relative gains will also increase up to the maximum (Mohan and Kapur, 2015). Furthermore, the size does not play any significant role if the share of PPP GDP becomes high whereas gains from openness variable gets benefited as income is positively related to openness (IMF, 2014a, 2014b, 2015). Hence, the above findings conclude that the “variability” variable should be dropped in the next review and the increment weight in the PPP GDP share would largely be supportive to the low-income countries. This suggestion for dropping “variability” variable from the formula received considerable support but not yet removed with the major concern on how the portion of this variable is reallocated? (IMF, 2016a)

It can be noteworthy that a higher shift in the portion GDP variable will definitely help the US directly; else their CQS (under the current formula) might decline up to the level below the veto controlling threshold (currently 15%). Furthermore, the EDEs relative growth and the decrease in the U.S. quota shares from 19% in 2005 to 14.3% in 2014 (source: author’s elaboration based on data extracted from Table 1a, p. 9, IMF, 2016a), led EDEs to raise their voice in the governance of the IMF. Moreover, these issues become prominent at present, and this remains questionable that in coming years how this issue is addressed: Will there be any adjustment made in the articles to increase the voting shares of the super powers such as the US and the EU or will there be change in the existing quota formula such as shifting of weight toward GDP variable, or Will US let go its veto power?

Finally, the present quota formula is lagging since its inception, and the delays in implementation worsened the effect of these lags. For illustration, the fifteenth review meeting that is proposed to be completed by the 2017 Annual Meetings (IMF, 2016b) have to use the data available up to 2015. The noticeable point here is that the current formula applied three-year averages for the GDP variable. Therefore, in the fifteenth review, following the same averaging practice, the GDP variable thus should be calculated by averaging the values of 2013, 2014, and 2015. It can be noteworthy that the persistent growth of EDEs (almost 11% increase from 47.2 to 58.3%) with respect to AEs in the last decade portrays the backward look of the present quota formula. Further to address this issue, the following possibilities can be considered: first, instead of using three-year averages, the data for the latest year can be used for GDP variable; second, the proportionate weighted average for the last three years can also be used to compute the GDP with higher weight to the latest year data and less weights to the two foregoing years accordingly; and lastly, the two-years moving average can also be used, with more weight to the latest year. Meanwhile, the existing quota formula effectually relates to the dissemination of added quota resources, there is substantial change in the effect causing in the development of increasing voice in the IMF. As in the current scenario, for any IMF member, no arrangement has been set for decrease in the entire quotas. Thus, it can be said that such substantial change necessitates great value in delivering permanence in the governance of the IMF.
It can be noteworthy that since 1998 and prior to fourteenth general review (100% increase in quota resources) the IMF quota resources remain unaltered, although only nominal ad hoc increment was conducted in year 2006 and 2008. The period between 1998 and 2008 witnessed both the enormous growth in the world economy as well as the subsequent great recession. Furthermore, keeping in mind the fragile nature of the global economy and the repercussions of the NAFC, the size of IMF programs has also been on the governing part with respect to GDPs or quotas. Therefore, one could easily implicit that any increase in the IMF quota resources exposed the high importance of super powers in the world economic governance.

The aforementioned improvements have greater consequences for the legitimacy and integrity of the Fund. Hence, for the Fund to implement its activities, resourced should be sufficient, and it should have efficacy and reliability, and its governance framework should be afar criticism.

4. ROLE OF EDES IN GOVERNANCE IN DIVERSE GROUPS

The members of the executive board in the IMF have been changed due to rearrangements made in the quotas. During the first few years since the IMF inception, India and China were among the top five largest quotas countries. Consequently, both of them were authorized to “appoint” their individual Directors. It can be noteworthy that the number of representation of nonindustrial countries, as Executive Directors in the Board, has been nearly half although they have only 31% voting power (Boughton, 2001). India, due to its lethargic growth, lost its “appointed” prominence in the fifth general review (1970) before the quota amendment came into force in 1972. Moreover, due to its enormous growth performance, Japan took the appointed chair of India. Later on, India regained its position as “elected” seat in the Board (Table 2).

Despite the enormous growth of EDEs observed in the early 1990s in the world economy, it has been continuously argued that the two major global institutions namely the World Bank and the IMF governance have been ruled by the AEs, more specially by the European Union (hereafter EU). The dominance can be understood by the fact that every third chair in the Board is governed by the member of the “Advanced Europe” group (EU, Switzerland, and Norway), and hence their voting power rights were more than a third

| “Country”          | 1944 | 1959 | 1966 | 1970 | 1978 | 1980 | 1983 | 1992 | 1999 | 2011 | 2016 |
|--------------------|------|------|------|------|------|------|------|------|------|------|------|
| Quota share (percent to total) |     |      |      |      |      |      |      |      |      |      |      |
| United States      | 32.5 | 28.4 | 24.3 | 23.1 | 21.2 | 21.2 | 20.2 | 18.8 | 17.7 | 17.7 | 17.4 |
| Japan              | 3.4  | 3.4  | 4.1  | 4.2  | 4.2  | 4.8  | 5.8  | 6.3  | 6.6  | 6.5  |      |
| China, P.R.:       |      |      |      |      |      |      |      |      |      |      |      |
| Mainland           | 3.0  | 2.7  | 2.4  | 2.2  | 4.0  | 6.4  |      |      |      |      |      |
| Germany            | 5.4  | 5.7  | 5.5  | 5.4  | 5.4  | 6.1  | 5.8  | 6.2  | 6.1  | 5.6  |      |
| United Kingdom     | 15.4 | 13.4 | 11.5 | 9.7  | 7.4  | 7.4  | 7.0  | 5.2  | 5.1  | 4.5  | 4.2  |
| France             | 6.2  | 5.4  | 4.6  | 5.2  | 4.9  | 4.8  | 5.1  | 5.2  | 5.1  | 4.5  | 4.2  |
| Italy              | 2.1  | 1.9  | 2.9  | 3.5  | 3.1  | 3.1  | 3.3  | 3.2  | 3.4  | 3.3  | 3.2  |
| India              | 4.7  | 4.1  | 3.5  | 3.2  | 2.9  | 2.9  | 2.5  | 2.2  | 2.0  | 2.4  | 2.7  |
| Russia             |      |      |      |      | 3.1  | 2.8  | 2.5  | 2.5  | 2.5  | 2.5  |      |
| Brazil             | 1.8  | 1.0  | 1.7  | 1.5  | 1.7  | 1.7  | 1.7  | 1.5  | 1.4  | 1.8  | 2.3  |
| Canada             | 3.5  | 3.8  | 3.5  | 3.8  | 3.4  | 3.4  | 3.3  | 3.1  | 3.0  | 2.7  | 2.3  |
| Saudi Arabia       | 0.1  | 0.4  | 0.3  | 1.5  | 1.7  | 3.6  | 2.3  | 3.3  | 2.9  | 2.1  |      |

Continued
Note: The table encompasses top 20 countries with leading quota shares (as per 2010 reforms).

Source: Author's elaboration based on the data extracted from IMF (2016a).
representation from Africa. Although the Bretton Woods institutions failed to adequately represent EDEs in their governance structure in the last six decades, things are slowly getting better. These changes are mandatory if it has to retain its credibility and to cope up with the legality of the issues it is dealing with.

There has been a general trend for almost seven decades now that the U.S. nationals ruled the World Bank, whereas the IMF is headed by the European nationals since their origin. In some aspect, it provides judgment that there should be an informal agreement for the same (Boughton, 2001). Despite the fact that GATT was headed by European nationals since their inception, its successor WTO is an exception to this nationality-based rule. This does not in many manners defy the proficiency of past heads of IMF but draws attention toward this reality that other members, including EDEs, could also provide to equally valuable leaders. It is high time now that the selection of the head of these global institutions should be made transparent so as to increase its legality and to counter the thought that only major developed economies can run the Fund (Kenen, 2007).

5. CONCLUSION

Currently, the IMF and the world economic power worldwide must go hand. With the growth in global GDP, the world economy has developed considerably, combined and mutually, in such a way that a little change in the economy of one country can be a cause of multiple changes in the global economy. The loans provided to Greece to save its economy in 2010, 2012, and 2015 vouch the statement effectively. Therefore, the most challenging task in the years to come is to maintain financial stability across the world by focusing on effective financial regulation. This becomes mandatory if the global economy should be saved from the fallout of financial crisis that might occur in the future.

NAFC, which led to the Great Recession, has put a huge pressure on the IMF resources and accentuated the need to bring about reforms in the IMF. The reforms can take place in two ways: first, increase in quota resources in tandem with its share in global economy; second, equal distribution of voting powers in its governance structure. According to Truman (2015, p. 2), “The world needs the IMF to function for the benefit of strong and troubled counties alike. Its participation in the stabilization programs for countries in financial crisis in Europe from Ireland to Ukraine was only the most recent example of its indispensable role. But China and other countries have grown vary of the Fund’s governance because they see it as failing to recognise their increasing importance in the world economy.”

The formation of BRICS Bank (a $100 billion New Development Bank), BRICS’ Contingent Reserve Arrangement (CRA) by the BRICS countries, and the AIIB majorly led by China are the sign of the dissatisfaction of EDEs with the present structure of global governance. So much is the deadlock in the quota increase that the IMF has to resort to borrowed resources to such unparalleled level that its own resources of SDR 475 billion (about US$ 675 billion) constitutes nearly 60% of the total possible fund accessible to the IMF. If at any point of time the situation arises to use a major chunk of borrowed resources, the IMF would come under much financial distress. With the increasingly growing size of IMF programs post NAFC and European sovereign debt crisis, its own financial trustworthiness is at greater risk. With ever-growing interdependency of economies, by the seventeenth review (2025), IMF should have increased its permanent resources (mostly quotas) to an amount of about US$ 1.25 trillion (Truman, 2015).

An important factor in determining the shares of economies in the global scenario, along with their per capita income, is the level of sophistication in their soft power, which unfortunately in case of EDEs is not rising in proportion to developed countries such as the US. However, this does not warrant delaying the process of realignment of quotas in any manner, knowing the fact that the US would not suffer in any case by the same. The US, being far superior to EDEs in terms of the efficient financial markets, will continue to provide headship even if the current quota system is modified in favor of EDEs. Knowing the fact that the leading reserve denomination across the globe is still the U.S. dollar at present and will continue as such in the subsequent years, the level of trust the US repose in the IMF determines to a large extent its efficacy and credit standing.

The upcoming fifteenth and the future reviews of IMF quotas should be vital with respect to the representation of EDEs in their governance. Although there is a disparity between EDEs, in particular BRICS, economic weight, and their relative shares, the major victim of this mismatch is the US itself. The share of
the US in the global GDP is analogous to that of the EU. But its CQS as per latest 2014 data is 13.1% less than that of the EU (IMF, 2017b). The same has been argued by Truman (2008, p. 6), “….until the Europeans agree to a substantial reduction of their combined voting share in the IMF from the current EU share of more than 30 per cent to something close to the US share, reducing the US voting share below 15 per cent is a non-starter.”

It can be noteworthy that, in a broad sense, the combined BRICS shares as per market GDP are comparable to that of the US and the EU, while their quota portions are fairly changed. However, regarding GDP (PPP basis), the BRICS share is significantly high than that of the EU and the US. Hence, in future, a need for revision in the present structure of quota formula is warranted, which offers a significant weight to GDP shares accompanied by any change in other variables that may be considered essential.

As acknowledged in the paper, each quota review that took place earlier had very disruptive argument and to reduce the same in subsequent reviews the IMF must give greater thought to inoculating more automaticity with respect to quota resources. A revised formula could be designed in determining the complete IMF quota resources that pay more attention on the appropriate weight of global GDP, on gross trade produced by the concerned economy and on complete financial flows in the world economy. If the IMF could design this formula, it would offer more permanence in terms of size of resources, comparative to the requirements of the world economy, accessible to them. This settlement on the comprehensive principles finally helps in reducing the time consumption in the Board’s discussions.

There are serious drawbacks in the current quota formula such as poor PPP-GDP data and a mistaken openness indicator, which should be addressed appropriately to improve the representation issue. This would not be possible without the considerable guidance from the IMF management and the dominant countries in the IMF such as the US and G20.

The change of the century in terms of equitable and fair economic governance is the need of the hour in order to guarantee economic stability across the globe. The period of European and North American supremacy has now come to an end, and adequate measures should be taken to give the rising economies their due place in the global economy.

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4 “Global output, trade and gross financial flows can be expected to continue with their upward trend and hence the IMF’s quota resources need to increase commensurately. Although growth in both AEs and EDEs has slowed down since the NAFC, its [it] remains substantially positive, with growth in EDEs still outpacing that in the AEs. Therefore, the view that the level of global output might not increase in the coming decades (there might only be a shift of global output in favour of the EDEs) and hence there may not be case for an increase in the level of IMF quota resources does not appear to be realistic.”
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Citation: Jain M, Gupta H. 2018. Developing economies and global governance: will IMF rethink its orthodox view? Management and Economics Research Journal 4: 67-80.