

The International Monetary Fund Went through A Reform during the Global Financial Crisis: However Do We Still Need to Question Its Relevance to Today's Global Economic System?

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Abstract: Today's global economic system needs powerful and effective international institutions in order to be more responsible for the world economy and financial stability. Rapid change in the world economy and financial systems make it necessary to bring about reforms in the structure of the international organizations for instance International Monetary Fund (IMF). This study argues that while the IMF went through major reform during the global financial crisis, it still needs further reform to increase its ability to respond economic crisis effectively and to help developing countries in the global economy. The reform could be achieved through reorganization of the IMF's administration, voting powers, quotas share and installing new plans for helping developing countries.

Key words: IMF, Global Economy, Reform, Economic Crisis and Financial Stability

1. Introduction

IMF was essentially formed at Bretton Woods, as an international institution with two primary goals: it would fix the exchange rates among member countries; and it would provide loan at times of crisis to its member with the purpose of balance of payment and international stability of the monetary systems. While its goals have basically remained the same (Peet 2009, p.66), during the past decade, IMF as the prominent organization of international economic and financial cooperation went through reforms, the reforms included voting powers and quotas share of its member countries. It is obvious when the IMF was founded at the Bretton Woods in 1944; the global market and monetary system were very different in comparison to today's economy. After 60 years of IMF's foundation, financial markets and world economy have changed in various ways due to innovations in technology, rise of new actors, globalization of economy and free trade markets. Thus, this research will argue that while the IMF did go through a reform in the last decade, further reforms are required in the IMF's governance structure in order to be more competent and responsible for today's global economic systems. These reforms would include the IMF's administration as well as voting powers and quotas share. In order to address the main question this research is divided into four sections. The First section reviews historical background of the IMF's foundation, its original goals and then collapse of Bretton Woods system and the effects of this collapse on IMF's original goals. The second section analyses voting power and quotas share in the IMF.

The third section discusses IMF quota and governance reform in 2010 and the main consequences of that reform. The concluding section and main part of this research will place an argument as to why further reforms are required when; IMF has already been through a reform in the past decade.

2. What is IMF?

On July 22, 1944 – forty four countries in order to prevent another great depression signed Bretton Woods Agreements which then led to establishment of the IMF and the International Bank for Reconstruction and Development (now commonly known as the World Bank). The agreement was signed at Mount Washington Hotel at Bretton Woods, New Hampshire, therefore the agreement was named after the place Bretton Woods. Since 1944, both IMF and World Bank have been known as the Bretton Wood institutions. The IMF Articles of Agreement were ratified by 29 countries on December 27, 1945, after that the IMF came into force (Vreeland 2007, p. 5). The membership to the IMF is persistently growing; at present 189 countries out of 193 members of the United Nations are its members, the Republic of Nauru is the newest member who joined the IMF on April 12, 2016 (imf.org, 2017). If a country wants to be a member of the IMF, it must apply and then be approved by a majority of the existing members (Boughton 2005, p. 12). However, the vote is not equal among the members of the IMF. When a country becomes a member of the IMF it contributes by its quota subscription and this quota determines the voting power of the country. With ‘joining the Fund, a country pays 25% of its quota in the form of international currencies or SDRs (special drawing rights) and the remaining 75% in its own currency. Each member has 250 basic votes plus one additional vote for each SDR 100,000 of quota’ (Dreher 2006, p. 1247). Therefore, countries with large quota subscription have more power when it comes to the IMF’s decision-making.

It can be said that the Bretton Woods agreements was an international effort to structure an effective and strong global financial and economic systems after the World War II. It was also a step taken to avoid another great depression, like the economic crisis of the 1930s. The article of agreement of the Fund set out objectives for the new institution: to help any member in difficulties and to concern itself actively in preventing a recurrence of the practices of the 1930s. One of the Fund’s basic obligations is ‘to facilitate the expansion and balanced growth of international trade’ (Schweitzer 1969, 7). The second basic role of the IMF was to promote exchange rates among its members (Coffey, & Riley 2006, p. 11).

When the international monetary system moved away from the Bretton Woods system in 1970s, ‘the old exchange system collapsed. The new system did not need the IMF, and the organization faced a crisis of purpose’ (Przeworski & Vreeland 2000, p. 388).

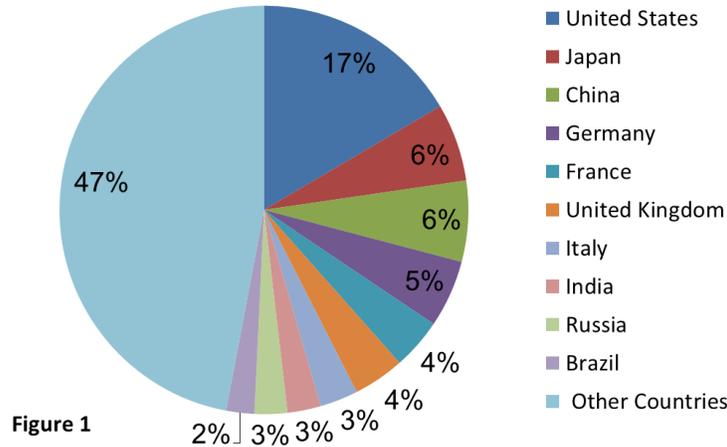
Therefore, the IMF had to change its goals to be more compatible and capable with the new monetary system which was different from the Bretton Woods System. The IMF shifted its main focus from fixed exchange rates and adjusting currency to balance of payments difficulties of its member countries, and also became more engaged in the national policy of the developing countries (Vreeland 2007, p.9). This adjustment came after economic turbulence in the 1970s, when the United States unilaterally decided to end convertibility of the U.S. dollar to the gold. Thus, since 1970s, a new monetary system operates the world economy which is called Floating Exchange Rate. Within this system the currency’s value of countries are determined by the foreign exchange market.

3. Votes and Quotas in the IMF

In recent decades, IMF as international economic institution went through some reforms in order to be more active and responsible to the today's economy and financial crisis. In 2010, the IMF made certain reforms in its voting power and quotas share, therefore, it is important to explain the voting power and quota subscription before explaining IMF's 2010 reform.

As mentioned before, voting power is not equal among IMF's member countries because it is determined by the countries quota subscription. While, each country is equal in the basic vote, the basic votes have declined from 11.3% to 2.1% of the votes in the IMF (Rapkin and Strand 2006, p. 2). This relative decrease of the basic votes "has substantially shifted the balance of power in favour of large-quota countries.... Consequently, the voice of small countries in discussions has been substantially weakened and their participation in decision-making made negligible" (Buirra, 2003, p15). Therefore, the major contributors to the IMF's fund have a strong influence on the decision-making and approving recommendation package to make reforms in the IMF. This makes IMF more vulnerable and unable to make decisions in favour of the poor countries especially the developing countries. The power of decision-making is mostly controlled by Executive Board, which consisted of 24 directors. These directors are appointed by voting, therefore, the largest ten powerful member of the IMF have majority of the voting power. These countries are —the United States (82,994.2 million SDRs or 17.46 % of the total IMF's quota and 16.53% of IMF's votes), Japan (6.48% of quota and 6.16% of votes), China (6.41% of quota and 6.09% of votes), Germany (5.60% of quota and 5.32% of votes), France (4.24% of quota and 4.04% of votes), the United Kingdom (4.24% of quota and 4.04% of votes), Italy (3.17% of quota and 3.02% of votes), India(2.76% of quota and 2.64% of votes), Russia (2.71% of quota and 2.59% of votes) and Brazil (2.32% of quota and 2.22% of votes). (Barro and Lee 2005, p. 1247) (Data updated from International Monetary Fund website (2017)). It can be seen that these ten powerful countries especially the US play a central role in governing IMF. This inequality of power has led to ignore the role of the poor countries in running IMF and its decision-making. For example, even if the votes of more than 50 poor countries are combined together it is still less than the vote of the US alone in the IMF (IMF, 2017), moreover, the votes of ten powerful members of the IMF are more than 181 member countries (see Figure 1). The Executive Board of the IMF can make decisions on various issues such as approving loans and making policy decisions (Weiss 2014). The voting power of the members play a key role in finalizing any issues in the Executive Board, therefore, those countries mentioned before are in a strong position when it comes to making decision in the IMF. This inequality is a clear indication of dominance of few countries in directing the IMF.

Voting power of each of the IMF's 189 members
 after reform



Quotas in the IMF are commonly understood to provide four purposes to its members: first, each member country contributes to the financial meaning of the IMF, second, each member country has opportunity to borrow money from IMF, third, each Member country shares in SDR allocations, fourth, all together provide the voting rights to each member country in the decision making (Bénassy-Quéré & Béreau 2011, p. 225). The problem is that only a few countries have influences on the IMF decision making as mentioned before. Consequently, this inequality of voting in the IMF brings disagreement between rich and poor countries over the way of voting and making decisions both in theory and practice. The large shareholders to the IMF's fund have claimed that the IMF's voting system indicates their positions in the international economy, 'while their less powerful counterparts who use those resources call for votes to be distributed in closer accordance with the juridical equality of states' (Rapkin & Strand 2006, p. 305). It is clear that most of the developing countries only contribute a small amount of fund to the IMF resources so they do not have power to make decision and reform in the IMF. this inequality of voting power in the IMF makes it necessary to bring about further reforms in the IMF's voting and quotas share.

4. IMF's 2010 Reform

Once the IMF was founded in the 1944, only 44 nations were member of the IMF and the basic votes played an important role in the voting power. The total of the basic votes was 11.3 percent in 1944. The fraction of basic votes declined to the half of the original basic votes during 1980s and dropped further in the last decade to only 2.1 percent (Bryant 2008, p. 14). This illustrates that the importance of basic votes has decreased over the time; particularly the voting power of small members because these members are do not have large amount of quota subscription. Thus, they rely more on their basic votes to participate in the IMF's decision. Main argument of this research is that in order to increase the voting power of small shareholders of the IMF, IMF requires further reforms in terms of voting power , quotas share and administration structure.

During 2007-2008, the economy of many countries collapsed because of the global financial crisis and the IMF was unable to prevent the crisis. Therefore, some recommendation packages have been proposed to reform in the IMF. Finally, on 26 March 2008, the Executive Board of the IMF accepted a suggested package to reform in the IMF's voting and quota shares and asked the member countries to approve the recommended quota increases and the adjustment to the Articles of Agreement by the end of April 2008 (IMF, Press Release No. 08/64). Moreover, there were desires among economically powerful countries to reform in the IMF's governance. For instance, at the G20 summit of London in April 2009, the members of G20 decided that it is critically important to make reforms in the governance of the IMF in order to 'reflect changes in the world economy' and that 'emerging and developing countries, including the poorest, must have greater voice and representation' (Bénassy-Quéré, & Béreau 2011, p. 223). In September of the same year the Pittsburgh summit of the G20 reiterated the importance of reform in the governance of the IMF and the World Bank.

In November 2010, the Executive Board of the IMF approved on reform of its quotas and voting. The most significant part of the reform is the called change in quota shares in the IMF in favour of today's economy and developing nations to realize their active 'role in the global economy, while protecting the quota shares and voting power of the poorest countries' (Virmani & Patra 2011). On 15 December 2010, the Board of Governors of the IMF accepted recommended package reforms of the Fund's quotas and governance. The main intention of these reforms is to make changes in quota shares and voting powers so that there is better response to global economic realities, and reinforcement in the Fund's legitimacy and effectiveness, and 'this completes the 14th General Review of Quotas' (IMF, 2013).

The main consequences of these reforms were: Increase in quotas: doubling quotas from SDR 238.4 billion to SDR 476.8 billion, 'with a corresponding roll-back of the New Arrangements to Borrow (NAB)'. Shift in share: 'over 6 percent quota shift from over-represented to under-represented members (and) over 6 percent quota shift to dynamic emerging market and developing countries' (Tweedie, Hagan & Moghadam, R 2010, p. 1). These reforms will protect the power voting and quotas share of the poorest members. A complete review of the present quota formula to be finalized by January 2013, and correspondingly, the accomplishment of 'the 15th General Review of Quotas will be brought forward by about two years to January 2014' (Virmani & Patra 2011). Moreover, the size of the executive board to be maintained at 24 members; every eight years the board composition will be reviewed. The combined board representation of the Advanced European countries to be reduced by two seats in the first election after the quota reform takes effect (Tweedie, Hagan & Moghadam, R 2010, p. 1). It can be said that after 2008-2009 financial crisis, The IMF in order to become more responsible for today's economy and financial crisis has initiated a prolonged seclude to reform in the IMF's voting power and quotas share. These reforms in the IMF did not end the questions about the ability of the IMF to be compatible and responsive to today's world economy and financial market. Therefore, IMF requires further reform in terms of voting power, quotas share and governance structure.

5. Why IMF Needs Further Reform?

In the previous sections, it was explained that IMF went through a reform over the last decade, this reform included IMF's voting power and quotas share. In this section it is important to explain why still IMF needs further reforms in order to be more active and responsible to today's economic and financial systems. The aims of the IMF in the early stages were very ambitious: to build an economic system that

develops prosperity by providing stable exchange rates and free trade. The IMF's original goals as mentioned before were to monitor fixed exchange rates system and to support countries members during financial difficulties and unbalance payments. More than a half century later, the global economy, financial system and even monetary system have changed because the Bretton Woods system of fixed exchange rates collapsed in the early 1970s (Minton-Beddoes, 1995). According to Truman (2006, p. 201) the IMF faces an identity crisis. Moreover, there is no common agreement among IMF's members about the Fund's role in today global economy. There is also lack of consensus on related issues to IMF's governance. Many member countries especially developing countries feel that they are play a passive role in the world economy because they have inadequate voice and vote to bring about to reform or amending in the institution and also there is no active response to their requirements by the IMF. While, the IMF represents 189 countries today, it is still governed by only a few members of economically powerful countries. The administrator and senior management of the IMF are appointed by those countries, and also the IMF represents their interests and dominance, with the fact that major borrowers from IMF are developing countries, but developed countries still maintain Fund's decision making (Woods 2013).

In theoretical background, after the neoliberal theory has become main indicator of the economic system especially in the early 1990s. The removals of capital control on the markets in most countries around the world and most importantly capacity for innovation and openness of countries' economy have transformed the global market and financial system. In addition, globalization and free trade have altered the geographical scope of the world economic system to be more interdependent. As the economics of the developing countries open up to attract foreign capital (Minton-Beddoes, Z 1995). Today, the economic crisis in one country can easily affect the economy of another country due to integration of the global financial system. As it was noticed in 2007-2008 economic crises, that almost all countries faced economic recession and financial difficulties. Therefore, today's economy needs an economic institution which can represent the voices of its members more equally and be more active and responsive to the economic crisis.

6. Conclusion

IMF as an international institution has played an important role to organize international monetary system in terms of fixed exchange rates among its member countries during Bretton Wood system. After the collapse of the Bretton Wood systems, the main goal of the IMF is to focus on balance of payments difficulties of its members. The inequality of voting power is the main weakness of the IMF and this has disabled the institution to make decisions in favour of the less powerful members. While in the last decade IMF went through a reform in order to be more effective and responsible to today's world economy, it still requires further reforms in terms of voting power, quotas share and governance structure.

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