A way out for IMF reform[1]

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I. Introduction

IMF reform has been one long-standing objective of developing nations, going back at least to the 1990s. They recognize the relevance of the Fund as a near-universal multilateral institution, especially in times of crisis. And precisely for this reason emerging market and developing countries (EMDCs)[3], middle-income as well as low-income, seek greater voice and representation in the Fund. However, progress has been patchy and slow, leading to a sentiment of frustration and hopelessness.

The purpose of this paper is to address the topic once again, seeking to enquire whether there is still a way forward for IMF reform and to discuss what paths it could possibly take. It is the second and final stage of a study undertaken with support of Bretton Woods Project. The first paper, completed in August 2023, discussed IMF reform in the run-up to the 16th General Review of Quotas.[4] The present paper, an expanded, revised and updated version of the first one, takes up the matter in light of the meager results of this review. It includes new proposals that seem both realistic and relevant to those seeking to improve the IMF. Although written in a way that can be accessible to a wider readership, its main target audience are those interested in international governance issues and the reform of the Bretton Woods institutions. The author is more a practitioner than an academic researcher of the topic, having been for more than eight years, from 2007 to 2015, a member of the IMF Board, as Executive Director for Brazil and other countries.[5] A large part of what will be presented here draws on my experience of the IMF, especially of the workings of the institution, its governance, the steps taken to reform it and the many hurdles to fundamental changes.

The immediate reason for taking up this topic one more time was the planned quota review, scheduled to be completed December 2023. It was indeed completed as scheduled, but so-called completion was achieved without producing meaningful results. This was not unexpected at all and had been foreseen by many observers and participants in the process. The reasons for skepticism about the prospects of reform were set out in some detail in the August paper and are taken up again in this one.

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[1] This working paper is the final part of a project supported by Bretton Woods Project. The views expressed are solely those of its author.
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[3] A list of acronyms used in the paper can be found on p. 37.
[4] Nogueira Batista Jr. (2023a).
[5] An Executive Director of a multi-country chair (or "constituency" in IMF parlance) has the advantage of acquiring a wider and richer experience of the relations between the institution and different types of nations. The Brazilian chair or constituency was formed by nine countries in 2007, when I started to work in the Fund: Brazil, Colombia, Ecuador, Guyana, Suriname, Panama, Dominican Republic, Trinidad & Tobago, and Haiti. At the end my tenure, in 2015, the number of countries had risen to 11, after the departure of Colombia and the entry of Nicaragua, Cabo Verde, and Timor Leste.

As is well-known, quotas play crucial roles in the IMF, including as the main basis for the determination of voting power of member countries. However, IMF quotas, equivalent to shares in the institution's capital base, are only one of many aspects of governance. Executive Board composition and Management selection procedures, among other issues, also play crucial roles in defining the way decisions are taken in the IMF and need to be addressed if the intention is to truly reform the institution's governance.

The paper will proceed as follows. It begins by an examination of the objectives and results (or lack thereof) of the 16th Review of Quotas. Other IMF governance reforms, not contemplated by the 16th Review but often as important as redistribution of quotas and voting power, will also be discussed.

For reasons, mainly geopolitical, the predominant view, shared by me, was fully borne out by the meager results of the 16th Review. The natural follow-up issue is what consequences will arise from this further failure of the IMF to achieve meaningful quota and governance reform. What will result for the institution and, more broadly, for international financial governance? How will or should EMDCs react to yet another failure to reform? Should they give up on the IMF entirely? Should they continue to foster alternative institutions and financing mechanisms? Or could they perhaps, without giving up on a truly ambitious reform or alternative mechanisms, seek to promote a partial and gradualist approach to changes in the Fund? This might be a way forward after the 16th Review, as expected, failed to produce relevant changes. The paper addresses all these questions and moves on, in its final sections, to an attempt to specify what a viable reform agenda might look like.

The main take aways from the paper can be anticipated in a few paragraphs. The rivalry between the West, led by the United States, and emerging powers, notably China, is at the root of the current widespread pessimism concerning IMF reform. Always a difficult endeavor, this reform now stumbles on the fact that the main shareholders, the United States, European countries, as well as Japan and other high-income nations, are dead set against contemplating any reform that would provide more decision-making power for China. China, however, is precisely the country that is most heavily underrepresented by any conceivable metric and, therefore, the one that most stands to gain from a redistribution of quotas and voting power in the Fund. In other words, China is at the same time the main reason and the main obstacle to reform. The other side of the coin is that the developed countries, especially European members, are heavily overrepresented. Countries that control the institution would therefore definitely stand to lose from the redistribution of quotas and votes. The developed world, notably Europe, is at the same time the main reason and the main obstacle to reform.

The further failure in 2023 of another attempt at reform is undeniably a considerable, even if not lethal blow to the Fund's credibility. Given the institution's many functions and the practical difficulties of quickly and fully replacing it by alternative multilateral or national financing mechanisms, the IMF will in all probability continue to play an important role in the foreseeable future. However, its centrality and relevance tend to diminish, undermined as they are by the geopolitical fractures that have emerged starkly in the recent decades.

EMDCs would nevertheless hardly be advised to neglect or abandon the Fund, for reasons that will be explored in this paper. Without giving up on the traditional ambitious goals of making the IMF more reflective of 21st century realities, they might contemplate working together to promote consensus on a gradualist attempt at reform, by advocating measures and specific reforms that could increase the relevance of the Fund to the EMDCs, especially the low-

income, small and climate vulnerable. The key to the definition of a viable agenda is to identify objectives, well defined, that would benefit the developing world and the institution without running up against the entrenched vetoes of the developed world.

The modest agenda proposed in the August paper has been revised and expanded in light of further reflection, the results of the 16th Review and the new stance taken by the US Treasury in late 2023. The overall approach remains the same. All proposals presented here would improve the workings of the IMF for the benefit of EMDCs, especially low-income, but would presumably not run up against the long-standing veto of high-income nations to any changes that threaten their hold on the institution.

Admittedly, the reform agenda that will be proposed here is much too coherent to be realistic, so to speak. Reality is always messier and fundamentally disorganized, but some concessions to order and logic must be made if a somewhat understandable argument is to be set out on paper for discussion.

In this paper, I will avoid what is known as "fundese", the jargon created in the institution. "Fundese" serves a purpose: like all jargon, it can facilitate and speed up communication within the IMF and with a small community of outside experts. But it is also a barrier, intentional or not, to non-experts that may wish to understand how the institution works and evolves. Specific IMF concepts will be used sparingly and always defined beforehand. The IMF is relevant to a broader audience and reform of the institution can and should be discussed in a transparent way.

However, the matter is difficult to explain to a wider audience because of the intricacies of the IMF, the often bewildering details of how it works in practice, a chronic and partly deliberate lack of transparency common to many public and private organizations, and in particular the prevalence in many areas of the institution of traditions and unwritten rules. Nevertheless, I will do my best to clarify and make accessible the many issues pertaining to IMF reform.

As a simplification and presentational device, the near universal membership of the Fund will be subdivided in three broad groupings: 1) The high-income developed members, the United States and Canada, most Western and Central European nations, Japan, South Korea, Australia, as well as a few other small non-European countries, such as New Zealand and Singapore. 2) The emerging market countries, middle-income nations in Asia, Latin America, the Middle East, as well some African nations. 3) The low-income countries from Africa, Latin America and Asia, poorer nations that rely on concessional financing, including from the IMF and the World Bank. One way to summarize the imbalance in the current international governance is to recall that the first group controls the Bretton Woods institutions, but accounts for only about 15% of the planet's population. The second and third groupings, although hosting 85% of humanity, have no decisive influence on the Washington-based multilateral institutions.

II. The 16th General Review of Quotas and other IMF governance reforms

The official objectives of the 16th Review concluded in December were valid and ambitious, covering very familiar ground. The stated goals and basic commitments were to revisit "the adequacy of quotas" and to continue "the process of IMF governance reform, including a new quota formula as a guide". The intention of ensuring "the primary role of quotas in IMF resources" was once again proclaimed. The expectation was also reaffirmed that "any

adjustment in quota shares would be expected to result in increases in the quota shares of dynamic economies in line with their relative positions in the world economy and hence likely in the share of emerging market and developing countries as a whole, while protecting the voice and representation of the poorest members."[6] All these goals, without exception, are carried over *ipsis litteris* from previous unsuccessful, or only partly successful, rounds of negotiations.

In the end, only one of these goals was achieved, and modestly at that: an increase in overall quotas by 50% with a corresponding reduction in borrowing arrangements. The increase in quotas was "equiproportional", meaning that all individual country quotas were increased in the same proportion. Thus, no redistribution of quotas and voting power was achieved. Moreover, given that borrowing arrangements are going to be reduced by the same amount, the Fund´s lending power will remain unchanged. In a futile attempt to preserve appearances, the IMF promised again to review quota shares and the quota formula by June 2025.[7] This amounts of course to kicking the can down the road. Needless to say, the new target date has even less credibility than the previous one.

The meager results of the 16th Review will be described in a more detailed manner in a subsequent section of this paper. In so far as quotas and quota redistribution are concerned, there was nothing much to object to the way the goals of this review were formulated. In somewhat clumsy and involved language, it pointed to some major requirements of what would be an appropriate reform, including a new quota formula, increases in quotas shares of rapidly growing countries, coupled with protection of the voice and representation of LICs. If all these goals were yet to be achieved at some point, the IMF would become a new institution. But the 16th Review, as expected, failed in nearly all respects.

It should not be forgotten, moreover, that in contrast to some earlier IMF reform rounds the 2023 reform was confined to quota matters, leaving out of consideration other aspects of IMF governance reform that have never been adequately addressed, notably i) the selection of the Managing Director (MD) and the other members of Management; and ii) the composition of the Executive Board, mirrored in the composition of the International Monetary and Financial Committee (IMFC), the ministerial body that has an advisory role in the Fund.

Later in this paper, I will come back to these and other non-quota governance matters. For now, it suffices to point out that, first, Management, notably the MD, as in all multilateral institutions, has a leading role in the conduct of the institution. It commands the technical staff, chairs Board meetings, and has a decisive say in all matters, including governance arrangements. Second, the MD and his or her Deputies report to the resident Executive Board, composed of 24 chairs, which takes the final decisions on lending, surveillance, and other strategic issues. The IMFC, the ministerial level advisory body that meets twice a year, replicates almost exactly the composition of the Executive Board. The point here is that not only voting power but also the composition of the Board and of the IMFC, meaning the number of chairs held by different countries and regions of the world, considerably influences governance, financial operations, surveillance, and other activities. Effective, well prepared, and experienced Executive Directors, together with ministerial engagement, make quite a difference in practice, and this is one of the main reasons why reference is often made to "voice and representation" as goals of IMF reforms.

[6] International Monetary Fund (2020), p. 2 and 3.
[7] International Monetary Fund (2023d).

In any case, quotas are a sufficiently relevant matter to make a difference even if tackled in isolation. And the goals of the 16th Review, as mentioned, were broad enough. If achieved they would have definitely brought the Fund closer to the desired *aggiornamento*, to the long-sought goal of at long last taking the institution into the 21st century. These objectives were not new at all and can now even be called "classic". They are basically those that have been on the table with the same or very similar language for at least 15 years. They had been only very partially achieved, or not at all, in previous rounds of reform.

As a result of the delay in moving forward on governance, the structure and rules of decision-making in the IMF are still too much a reflection of the international political reality and balance of power that existed at the time of its creation at the end of World War II, almost 80 years ago. And the central imbalance to be corrected remains the discrepancy between relative size of members in the world economy and their voting power in the Fund. Correcting this discrepancy would indeed amount to ensuring an increase in the overall share of EMDCs in quotas and votes, particularly that of dynamic economies.

Even without revolutionary changes, i.e., even staying within or not departing very much from the current IMF framework in terms of quota formula and stated principles for quota redistribution, one could have a long way in achieving the goals of the 16th Review. For instance, by making some changes to the variables and weights used in the current quota formula that go back to the 2008 reform.[8] This formula is relatively simple:

CQS = (0.50*GDP + 0.30*Openness + 0.15*Variability + 0.05*Reserves)^K.

Where: CQS is the calculated quota share of a member country; GDP a blend using 60 percent market and 40 percent PPP exchange rates; and K is a compression factor of 0.95.

A quick look at how these variables are defined by the IMF. GDP at market exchange rates is obtained by converting GDPs by currently observed market exchange rates. GDP PPP is calculated by using PPP exchange rates, i.e., the rate at which the currency of one country would have to be converted into that of another to purchase the same amount of goods and services in each country.[9] Openness is measured by the relative size of current payments and current receipts for goods, services, income, and transfers. Variability is the standard deviation for current receipts and net capital flows. Reserves are the official international reserves, including foreign exchange assets in reserve currencies, Special Drawing Rights (SDR) holdings, reserve position in the Fund, and monetary gold. The compression factor is introduced to reduce the dispersion of quota shares, diminishing the calculated quota shares of larger members and increasing those of smaller ones. Combined with basic votes, about which more will be said later, the compression factor produces a somewhat more balanced distribution of voting power among large and small countries.

The application of this formula determines the "calculated quotas". Actual quotas and quota shares result from these calculated quotas plus *ad hoc* adjustments agreed to in governance reforms. If a country's calculated quota share is higher (lower) than its actual quota share it is said to be underrepresented (overrepresented) under the formula.

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[8] International Monetary Fund (2022d).

[9] On the use of PPP versus market exchange rates, see Callen (2017).

Openness and variability, amounting to 45% of total weight, distort in a major way the distribution of quotas to the advantage of most developed countries and disadvantage of EMDCs, without reflecting the relative importance of members in the world economy.

A few examples to illustrate the inadequacy, not to say eccentricity, of the current formula. Strange as it may seem, the calculated quota of a small country such as Luxemburg is considerably higher than those of Colombia, the Philippines, and Egypt. Ireland has a calculated quota that exceeds, also by a large margin, those of Argentina, South Africa, and Nigeria. The Netherlands' quota is larger than those of Brazil and Indonesia.[10] Many other such comparisons could be given to show that the case for a revision of the quota formula is crystalline clear.

An update of the quota formula in line with goals of the 16th Review would essentially have involved taking out variability and openness or diminishing their weights, opening up space for an increase in the weight of the blended GDP variable. The preponderance of market GDP in the GDP blend also favors developed countries. Increasing the weight of GDP PPP in the blend would favor EMDCs as whole since they are estimated to account for about 60% of world GDP PPP.

As an example, a revised quota formula, under an ambitious quota reform, could look like this:

CQS = (0.95*GDP-PPP + 0.05*Reserves)^K.

Alternatively, with somewhat less ambition, the revision of the formula might lead to something like this:

CQS = (0.95*GDP' + 0.05*Reserves)^K.

Where GDP' is a revised blend using 60 percent of GDP-PPP and 40 percent of market exchange rates GDP.

With a few and simple to spell out modifications such as these, a very significant change in calculated quotas could be produced, allowing them to better reflect relative weights in the world economy. Combined with a large increase in overall quota size, a game changing redistribution of actual quotas and quota shares could be put into effect. The desirable shift of quotas and voting power from developed nations to EMDCs would be achieved by this combination of a new quota formula and a substantial increase in overall quota size.

In short, no radical departure from the current conceptual tools would be required to effect a fundamental change. What is mostly lacking are not new ideas or new formulas, but the political will on the part of the dominant shareholders to cede space to dynamic developing economies. Naturally, developed country authorities do not recognize their unwillingness to move and resort to all sorts of rhetorical tricks and devices to disguise their resistance to fundamental change. A veil of hypocrisy seeks to protect them from public scrutiny. But what we have is a truly enormous and growing gap between the rhetoric of developed countries and what they are willing to accept in practice. This leads to an equally enormous gap between stated objectives of reforms and the actual outcomes of nearly all rounds of reform. Ambitious reform requires consensus, it is stated, and the consensus is simply not there.

[10] Based on data published in International Monetary Fund (2022e).

III. European overrepresentation and resistance to change

It is actually somewhat unfair to put all developed countries in one single basket. The main distortion in the Fund's governance is the overrepresentation of Europe[11], meaning among other things the discrepancy between the diminishing weight of the continent in the world economy and its oversized presence in the IMF's quotas. With a few exceptions, Spain being the main one, European countries are sizably overweight in terms of quotas and votes. In the case of the United States relative size is not far below voting power in the IMF, 15.2% of world GDP-PPP compared to 17.4% of votes. In the case of Japan, the second largest quota holder, overrepresentation measured by GDP-PPP is more pronounced, only 3.7% of world GDP compared to 6.5% of voting power in the IMF.[12] Over time these discrepancies will continue to increase, as US and Japanese economic growth rates lag behind those of EMDCs, mainly those in Asia.

European overrepresentation goes way beyond quotas and voting power. Europe's presence is in fact so large that it rivals the United States as a dominant force in the Fund. The continent's overrepresentation has three dimensions to it. First, as mentioned, quotas and voting power are much larger than the present share of Europe in the world economy. The 27 countries of the European Union hold 29.4% of voting power, nearly twice their 15% share of world GDP at PPP. If one adds to that the voting power of the United Kingdom to the EU27, a country that always acts as part of the European bloc in the IMF, the share of voting power held by European nations rises to slightly more than one third of total votes.

Second dimension: the large number of Executive Board and IMFC positions held by European countries, between 7 and 9 out of the 24 chairs, or about one third of the Board and the IMFC. In a few cases, European countries lead for part of the time, rotating with EMDCs, in multicountry chairs. Thus, the European share of positions in the Board and the IMFC fluctuates at around one third.

Third, the unwritten rule that reserves to a national of a European country the position of MD, the highest position in Management, mirrored in the commitment to reserve to a US national the position of President in the World Bank.

On this point, one subtlety might be noted in passing. Legally speaking, the MD, as well as the other members of Management, the First Deputy Managing Director (FDMD) and the three other Deputy Managing Directors (DMDs), are not country or regional representatives and owe their loyalty exclusively to the institution. Politically speaking, however, nationality counts. In practice, the unwritten rule imparts a bias that favors Europe, given the crucial role of the MD. It is difficult to dispute this point once one gains any knowledge of how decisions are taken in the Fund, as well as in other multilateral institutions where the same discrepancy between legal frameworks and political realities exists. The political dimension tends to override the legal one, especially in crisis situations. So much so that Europeans are loath to give up this privilege and can be expected to resist to the bitter end any attempt to eliminate it. The same holds of course for the United States in the World Bank.

European resistance to reform is a long-standing intractable problem, at the root of a large part of the IMF's increasing legitimacy problems. Europe makes at most partial or even only

[11] For purposes of this paper, "Europe" is understood to include the 27 countries of the European Union plus the United Kingdom, Norway, Iceland, and Switzerland.
[12] International Monetary Fund (2023b) and (2024).

verbal concessions on these matters. So, for instance, Europe joins the other IMF members in supporting misleading proclamations that the selection of the MD is “merit-based”.[13] For some curious reason, however, merit-based selection always ends up in the selection of a national from a European country… In the election that was won by Christine Lagarde in 2011, officially merit based as usual, a rather comic situation arose. Her candidacy was put forth early on and Europeans rushed *en bloc* to support her – even before the closure of the period for applications. They seem to have sensed somehow that, based on merit, any other conceivable candidates would be inferior to the European one.

The same sort of issue will arise, I note in passing, when the current MD’s term ends in September 2024. If Kristalina Georgieva does not run for a second five-year term, Europe will certainly put forward another candidate. Alternative non-European candidates may come forward but are unlikely to stand any chance of being seriously considered. Barring a rift between Europe and the US, the “election” result will be a foregone conclusion. Any other candidates would be “protest candidates”, as sometimes happen in fake elections held in dictatorial regimes. EMDCs could at most use the opportunity to highlight once again the unfairness of IMF governance.

IV. Geopolitics of IMF reform

For these and many other reasons, IMF governance displays in some crucial respects a remarkable stability. Changes to the decision-making structure come infrequently and far apart. This makes the institution predictable, for good and for bad.

The reasons for this stability – perhaps stagnation is a better word – are not difficult to understand. The rules that protect the existing governance structure are precisely those that would need to be rebalanced. The unequal distribution of voting power protects the unequal distribution of voting power; veto power protects veto power, and so forth. As Giordano Bruno said in his struggle with the Catholic Church, it is naïf to think that power will reform power. Changes occur, if at all, only when power suffers overwhelming pressure from outside or when power is divided within itself. From 2008 to 2010, a window of opportunity for reform arose precisely because of a division of views among the main shareholders. I will come back to this later.

Since the second decade of the 21st century, a geopolitical context has emerged that makes the always difficult reform of international governance seem a near impossibility – meaning by “reform” fundamental change and not mere tinkering at the margins. In the IMF and the World Bank, as well as in many other spheres, the West is playing a long-winded defensive game, a systematic and fierce resistance to any fundamental revision of the international governance rules. Even piecemeal and partial changes are often resisted. To be sure, disagreements do arise within the Western camp, but they are infrequent and almost never sufficiently strong to open the way for fundamental reform.

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[13] The non-existence of the proclaimed merit-based selection of the MD is a not really a purely non-quota governance matter. Indeed, it is the skewed distribution of voting power in the Executive Board that ensures the regular enforcement of the informal rule that reserves the no. 1 position in IMF Management to Europe and the no. 1 position in World Bank Management to the United States. Working in tandem, Americans and Europeans can easily mobilize the required simple majorities of weighted votes to ensure that elections in both institutions abide by the informal understanding.

This state of affairs is regrettable but ultimately understandable. Transfer of power never, or rarely, occurs voluntarily. The usual pattern is for dominant countries or sectors of society to hang on to privileges and positions of power as long as possible. Enlightened recognition of new realities seldom happens in practice.

Thus, the gap between IMF governance and economic reality keeps increasing year by year. There is nothing that the West can do about this uncomfortable trend – except of course to give in to the rebalancing the governance rules they are so attached to. *Status quo* is increasingly difficult to defend with rational arguments or to disguise with clever rhetoric. And not allowing economic, political, and demographic changes to be appropriately reflected in the IMF's governance structure does considerable damage to the institution's standing in the world. Nonetheless, the desirable transfer or sharing of power, even only partial, is delayed indefinitely.

As indicated, the issue is fundamentally political or geopolitical. It always has been, since the institution's early times. However, in the last 10 or 15 years the geopolitical dimension became critical. It will remain so in the foreseeable future. So much so, that it can be said without exaggeration that the issue is not really technical in any sense of the word. The apparently complexity of quota criteria, definitions and calculations play only a very secondary role in obstructing change, if only because quota reform is far from being rocket science. It is mostly a lot of arithmetic and identities reinforced by IMF jargon. No major conceptual effort is required to grasp the essentials of the matter.

The essentials of the matter lie in the West´s attachment to the institution as an instrument of international power and control, as well as in the way China's rapid rise is perceived as a strategic long-term threat. The West's attachment to the institution they created is easily understood. The United States, European and other high-income countries, sometimes referred to as "the international community", attach great value to the IMF. For many reasons, including the fact that they use (or misuse) the institution as a political tool, providing support to client countries or allies, and denying support to countries that do not fall into line. This leverage arises from the fact that the United States, European, Japan, together with a few other developed countries, easily form the simple majority required to approve or reject loans to member countries. A friendly country or client state can obtain financial backing, in large amounts, even without a convincing adjustment program, whereas a country that is frowned upon by the West will not obtain support even if willing and able to follow a strong adjustment program. Discrimination, not evenhandedness is often the rule. While not the only reason, this is key to understanding the attachment of the developed countries to the IMF and their reluctance to contemplate any substantial redistribution of power within the institution.

This governance arrangement worked well for many decades, in the second half of the 20th century and into the early years of the 21st. However, tectonic shifts in relative economic power disturb the comfortable hold of the developed world on the Bretton Woods institutions. The developed countries of West can still cling, as they do, to their predominance, but at the cost of making the Washington multilateral institutions increasingly outdated. This is understood by all the parties involved.

In short, the increasingly multipolar world slowly but surely undermines the arrangements established at the end of World War II under US leadership. The IMF's unbalanced

decision-making is increasingly inconsistent with the desire of the developed countries to proclaim its global standing as a universal or near-universal financial institution.

V. Implications of China's rise for the IMF

The apparent multipolarization of the world is a complex phenomenon that has many aspects to it. For the matter at hand, as for many others, it is convenient to single out one of these aspects – China's extraordinary rise to power in economic and political terms, with implications that go well beyond East Asia. Since the 1980s, China's economic dynamism has led to a rapid and uninterrupted increase in its share of world GDP, cross border trade, and international lending and investment. In PPP terms, the most relevant tool to assess relative economic size of countries, it has become the world's largest economy, overtaking that of the United States. The joint GDP of the BRICS – Brazil, Russia, India, China, and South Africa – is now larger than that of the G-7, reflecting China and India's rapid economic expansion.[14]

For IMF reform plans, China is the flashing point, given the United States' firmly held perception that it threatens the stability of the "international rules-based order". What this international order actually amounts to is never totally clear and has become ever opaquer due to the West's propensity to act strictly and narrowly in defense of its goals, in a manner that violates "rules" and creates new "rules" with no defensible logic or, more precisely, according to a pattern that directly reflects Western perception of where their interests and priorities lie in any given moment.

As previously observed, China is the most blatant case of underrepresentation in the IMF, even under the current flawed quota formula. The country´s actual quota is less than half its calculated quota based on this formula.[15] If one considers a revised formula that would take GDP as a benchmark, even in a blend dominated by market-exchange rate GDP, the underrepresentation of China would become even clearer. China would become the Fund's largest shareholder by a considerable margin, easily overtaking Japan and the United States. And of course, measures of China´s underrepresentation would reach a peak if GDP PPP were taken as the sole benchmark.[16]

This creates a fundamental stumbling block, a conundrum that is probably fatal to reform plans in the short and even medium-term. The United States and other developed nations will want to keep China down. Any quota redistribution to China, even modest, even if approved in the IMF, would not be approved by US Congress, given the overwhelming bipartisan hostility to China. Similar resistance is present in Japan and European countries. In short, the geopolitical context is fundamentally hostile to IMF reform. China is the major reason for change and China is at the same time the major obstacle to change.

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[14] On a PPP basis, the five BRICS (Brazil, Russia, India, China, and South Africa) account for 30.5 % of world GDP. The G7 (US, Canada, France, Germany, Italy, the UK, and Japan) for 29.4%. Based on data published in International Monetary Fund (2023b).

[15] China's actual quota after the 14th Review rose to 6.4% of total quotas; its calculated quota under the formula is 14.1% of the total. International Monetary Fund (2022e) and (2024).

[16] China's share world GDP PPP is estimated at 19.1%, about three times its calculated IMF quota. International Monetary Fund (2023b).

US opposition is strongly reinforced by Europe's resistance to change in the IMF in general, and to a greater role for China in particular. This European resistance antedates concerns over China's uninterrupted rise. Overrepresentation in the IMF is in fact largely due Europe, as explained above. Europe would thus have to foot the bill. For reform to occur, high-income Europe must agree to give away greater quota shares, mostly to China and other middle-income Asian countries. In the zero-sum game of quota reform, China, India, and others would gain, Europe would lose in terms of relative quotas and voting power.

Europeans can be expected to do their utmost to retain their current positions in the IMF. And Japan, as indicated, will help block the way, resisting as much as it can to losing its current number 2 status to China, now number 3. Again, given China's extraordinary dynamism in the last four decades, any relatively fair quota redistribution based on the usual metrics would in all certainty make China overtake Japan. In short, therefore, major shareholders, Americans, Europeans and Japanese, join hands in blocking any relevant changes in IMF governance. Foot dragging and stone walling will continue to be the norm.

Nothing more needs to be said in support of a skeptical assessment of prospects for IMF reform and the same holds, I note in passing, of World Bank reform. The need for reform is abundantly clear. But support for reform in the developed countries is at best rather limited. To repeat, the essential difficulty lies in the following uncomfortable reality: the correction of the unequal and unfair distribution of voting power must be done through this unequal voting power itself.

Quota redistribution is by definition a zero-sum game. The high-income countries, in particular the Europeans, have never shown any inclination to accept the argument that they would gain from redistribution of quotas and votes in a qualitative manner, i.e., that they would have, so to speak, a smaller share of a better pie. Preserving relative power in an increasingly weakened institution is not really a victory. This line of argumentation, however, is totally unpersuasive to them.

Regrettably, as discussions evolve, we even see the return of old ideas that run counter to the desired *aggiornamento* of the IMF. For instance, the attempt to introduce financial contributions in the quota formula. Japan and other influential members favor this idea according to which countries would have a higher quota share depending on their financial contributions to the institution. This would amount to selling shares. The IMF would become, even more than it already is, a rich man's club, deepening the institution's legitimacy problems and democratic deficit. That this sort of idea resurfaces with some support is yet another indication of the poor prospects for reform.

VI. The 2008 and 2010 reforms

Many of the obstacles to reform are as old as the institution itself. One only needs to point out that from the time of its creation in 1944 to the North Atlantic financial crisis in 2008, apart from the entry to the Fund of former Soviet bloc countries, nothing crucial happened in terms of IMF governance and decision-making – the remarkable stability or stagnation already referred to. The picture changed to some extent after the collapse of Lehman Brothers and the ensuing financial chaos on both sides of the North Atlantic. Developed nations reached out for political support to major emerging powers, especially the BRICS, and promises of IMF and World

Bank reform were included in the package of measures agreed to in the G20 as part of the response to the acute financial crisis.

While these promises were not really kept, some changes did actually occur in the IMF in the 2008 and the 2010 quota and governance reform rounds. I am proud to have been a participant of these rounds of negotiation, as a member of the Executive Board. Together with other Board members, mainly from the BRICS, we contributed to what can be seen as the most significant IMF governance reforms ever. Nothing like this happened before or since. But pride of co-authorship must be tempered, strongly it must be said, by the realistic recognition that nothing much had happened before. And nothing since.

Taking the 2008 and 2010 rounds together, the main achievements were a substantial increase in overall quota size, a new quota formula – still problematic but considerably better than the previous incomprehensible combination of arcane criteria –, and a shift of voting power from developed countries to EMDCs amounting to 5.3 percentage points. This shift was, however, insufficient to produce a truly meaningful modification of the overall distribution of voting power, given that developed countries retained 55% of total voting power in the Fund, way above their 41% share of world GDP at PPP.[17] The United States' share of votes fell slightly to 16.5% but remained above the critical 15% threshold that corresponds to veto power under the IMF's Articles of Agreement (AoA).[18]

The substantial gains obtained by China and Brazil led the BRICS combined voting power to rise to 14.8%, very close to the 15% threshold that provides veto power. With little effort in terms of attracting other countries and their voting power, the five BRICS countries can mobilize enough votes to veto, or threaten to veto, any proposals that involve amendments to the AoA, as well as any other changes that, under the Articles, require an 85% minimum of voting power for approval.[19] Provided that the BRICS manage to coordinate their positions, as the Europeans do, the IMF would henceforth include in practice three major veto power holders: the United States, the European bloc, and the BRICS.[20]

The BRICS also gained veto power in the New Arrangements to Borrow (NAB) that was being expanded and restructured at the time. The NAB is a multilateral borrowing arrangement through which participating countries provide resources to the Fund under common rules. As part of the response to the financial crisis that erupted in 2008, the NAB was substantially revised and augmented to bolster the funds available to the IMF in a time of crisis. China, India, Russia,

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[17] International Monetary Fund (2023b) and (2024). The share of developed countries in voting power is somewhat underestimated since for purposes of quota and governance discussions, the IMF considers as "emerging market economies" some high-income countries, such as South Korea, Singapore, and the Czech Republic, that are usually classified as "advanced".

[18] International Monetary Fund (2024).

[19] Decisions that require a supermajority of 85% include, among others, increases in overall quotas, changes in quota shares, allocations of SDRs, and increases or decreases in the number of Executive Directors. International Monetary Fund (2016), 121-122.

[20] I observe, in passing, that this configuration of voting power makes the apparently useful suggestion of increasing the threshold of veto power from 15% to, say, 20% to 30% of total votes, rather less attractive than may seem at first glance. If the threshold were to be increased to more than 15%, the United States would indeed lose its privilege of being the only individual member holding veto power over a number of important matters. However, the BRICS would also lose this power. The only grouping maintaining it would be the European one. Not by coincidence, the proposal to raise the threshold has often been made by Europeans with little or no support from non-Europeans. Since to implement it the AoA would have to be amended, the proposal is in effect dead in the water.

and Brazil were asked to join as new creditors. Mirroring what happens in the IMF itself, a threshold of 15% also defines veto power over major decisions in the NAB. After difficult negotiations, in which I represented Brazil, we overcame resistance from some developed countries and achieved a joint participation slightly exceeding the 15% threshold. Assuming that they do manage to coordinate their positions, a far from foregone conclusion,[21] the BRICS could henceforth exert decisive influence and power over the "activation" (IMF jargon for authorization to use) of one of the major sources of financing for the Fund. While this veto power has not been used, in so far as I know, it is there and could function as leverage for this group of countries within the institution.[22]

The smaller members of the IMF, many of which are LICs, benefited from a tripling of basic votes in the 2008 reform, the first such increase since the Fund's creation in 1944. Since basic votes are distributed in equal absolute amounts to all members, the smaller countries benefit more in terms of percentage growth of voting power with each allocation. For Sub-Saharan Africa, an additional gain in the 2008 round was the creation of a second Alternate Executive Director position for chairs that include seven countries or more. This mitigates the burden placed on the two African chairs that have a much larger number of members than the other multicountry chairs in the Board and in the IMFC.

On top of this, some crucial forward-looking elements were included in the reform package approved in 2010: 1) the rollback of IMF borrowing into quotas so as to bring the institution closer to being quota-based; 2) a review by January 2013 of the quota formula approved in 2008 in order to better reflect the weights of countries in the world economy; and 3) a completion of the 15th General Review of Quotas by January 2014 with a view to further increasing the voice and representation of EMDCs, including the poorest.

Only the first of these three objectives was realized: overall quotas were doubled in size, partly replacing borrowing arrangements and rising significantly as a proportion of the IMF's total resources. The other two were blatantly disregarded. The quota formula continues to this day to be the one approved in 2008 with all its shortcomings that tend to work against middle- and low-income countries. The 15th General Review of Quotas was postponed and despite postponement failed to produce any changes. Even the entry in force of the quotas agreed to in 2010, only happened five years later, due to the reluctance of US Congress to ratify them. As a result of this reluctance, the IMF only managed to reach end 2015 the threshold of 85% of voting power required for the realization of what had been negotiated in the 14th Review.

Having said that, the 2008 and 2010 packages, taken together, were undoubtedly significant as far as IMF reforms go. This was possible not only because of the weakness of the

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[21] Coordination requires a minimum of cohesion that the BRICS have not always managed to demonstrate in practice. Cohesion would imply, for instance, that that all members of the group, particularly China, the largest one, refrain from rupturing a common front by occasionally striking out on its own path and thereby obtaining concessions for itself in the IMF. Far from being only theoretical, this seems to have happened in practice. Nogueira Batista Jr. (2022), p. 7. China's moderation on certain disputed points has been rewarded by the inclusion of its currency in the SDR basket and the creation of a fourth DMD position for a Chinese national in IMF Management. About the latter point more will be said in a subsequent section of this paper.

[22] Note, in any case, that veto power over critical decisions, as in the case of the activation of the NAB every six months, is used very rarely. It is a sort of "atomic bomb" that only a small number of countries possess. What is more common is the threat to resort to veto power before any actual decisions are formally proposed in the NAB or in the Fund itself. That is the approach that the United States and Europe normally follow when they intend to block certain decisions.

North Atlantic powers in the wake of the deep crisis in their financial systems, but also because a rift emerged within the ruling bloc, with the United States in the early years of the Obama administration willing to depart from the traditional alliance with Europe and to challenge European conservatism in the Fund, thereby offering some support to the reformist ambitions of the BRICS and other emerging market countries. This was referred to in the United States as the "pivot to Asia" and had a real impact on IMF negotiations.

However, this so-called pivot did not last long; it was soon to be abandoned, already in the Obama period and even more in the Trump and Biden administrations, being replaced by a strong and aggressive policy aimed at containing China's rise. However, the window of opportunity associated to Obama's "pivot to Asia" lasted long enough for the BRICS and others to push through the above-mentioned partial reforms of IMF governance.

As one of those developing country officials involved in those negotiations, I can testify to the fact that the reforms of 2008 and 2020, albeit limited, would not have happened without the convergence of these two decisive factors: the deepest financial crisis in the West since the 1930s and the fissure between the US and its traditional European allies.[23]

VII. The meager results of the 16th Review – a *postmortem.*

These two decisive factors have been absent in subsequent years. No deep crisis has emerged in the major financial centers of the international economy, and the United States and Europe have come closer together in order to face up to the challenges coming from China, Russia, and other countries. As mentioned already, most forward-looking elements of the 14th Review went unfulfilled, the 15th Review came out empty, and the results of the 16th Review were meager, to no one's surprise.

In discussing the outcomes of the 16th Review three aspects stand out. First, the problematic quota formula remains unchanged. Second, the approved 50% quota increase will be equiproportional. Third, no increase is foreseen in the IMF's available resources since the quota increase will be matched by an equivalent reduction in borrowing. Let us look briefly at each of these points.

The failure to revise the quota formula, despite repeated promises, was not unexpected but is doubtlessly harmful to the institution's standing. The present quota formula goes back, as observed above, to the 2008 reform. It is clear that it distorts calculated quotas in a major way, for the reasons set out earlier in this paper. Precisely because of this, repeated commitments to review and adjust the formula were made. That once again IMF members were unable to agree on a new formula damages the battered credibility of the institution. The renewed promise now made to review the formula by June 2025 as a guide for quota realignment under the 17th Review cannot be taken seriously. No one does so.

There was some movement in so far as the overall size of quotas is concerned. The 50% increase was defined as equiproportional, however. As indicated, an equiproportional increase means that each and every member obtains the right to acquire the same 50% percentage increase in their individual quotas. No change in relative quotas means no change in voting power (since basic votes were not altered). *Status quo*, therefore. Actual relative quotas will only

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[23] For a fuller account of the 2008 and 2010 reforms, see Nogueira Batista Jr. (2021), p. 125-143 and p. 174-190.

change if one or more countries decline to buy their share of newly allocated quotas, something unlikely to occur by any significant amount.[24] Thus, the distribution of power will remain the same, despite the glaring and ever-increasing discrepancy between weights of countries inside the Fund and their weights in the world economy.

Moreover, a 50% increase is insufficient to reverse the downward trend in the IMF's relative size, i.e., in the size of IMF quotas compared to international flows and stocks (trade in goods and services, capital flows, and external debt levels, for instance). Now, what matters is not the absolute size of total IMF quotas in dollars, but its relative size in the world economy. Relative indicators are measures of the size the Fund's role can take in practice when assisting countries facing balance-of-payments problems. As the relative indicators diminish, so does the IMF's practical relevance.

Why a larger equiproportional increase was not approved is an interesting question, and one that was not addressed in IMF documents and statements so far. At least two possible explanations can be put forward. One could be that countries standing to gain from a future quota realignment, China most of all, were opposed to a larger quota increase, the reason being that this would contribute to delay any increases in the future. Since individual quotas cannot be reduced under the IMF's Articles of Agreement, changes in relative quotas depend on an overall quota increase. The larger the increase now the lesser the need for a quota increase down the road, something that would make a future realignment even less likely than it already is. Another possible explanation is aversion on the part of some high income countries to any expansion in an international bureaucracy and, in particular, to a supposedly inflationary expansion in international liquidity. This is often the position of Germany, for example. It also helps explain, by the way, why opposition to new SDR allocations is usually strong.

To make things worse, the modest increase in quotas was matched by a roll-back in borrowing arrangements on a one-to-one basis. Therefore, the IMF's actual firepower remained unchanged. Barring any changes in operational parameters, its capacity to mobilize funds will be exactly the same as before.

Nevertheless, there could some minor advantages in what was decided. The IMF will be a more quota-based institution, i.e., more of its financing capacity will derive from quotas and less from borrowing (multilateral or bilateral). As a result of the 16th Review, the share of quotas in total resources will increase from 49% to around 70%.[25] This means a greater stability on the funding side, since quotas are more automatic and predictable than borrowing. This is because the bilateral arrangements need to be renewed as they mature. And the multilateral arrangement, known as the New Arrangements to Borrow (NAB), has to be renewed every five

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[24] The readiness to acquire quotas comes from the fact that they can be bought mostly by using the country's national currency. For countries that do not issue reserve currencies, this is a channel through which international reserves can be created by simply issuing domestic money. The county is allowed to buy up to 75% of the quotas allocated to it by depositing national currency and the rest by providing SDRs or reserve currencies out of its reserves. The latter portion implies a change in the composition of the country's foreign reserves. In the case of reserve currency issuers, the matter is even simpler: the whole amount of quotas can be bought by issuing national currency. For the 16th Review, in line with previous practice, it was proposed that 25 percent of the increase be paid in SDRs, currencies of other members specified by the Fund, or any combination thereof, and the remaining 75 percent be paid in the member's own currency. International Monetary Fund (2023e), p. 7.

[25] *Ibid*., p. 4

years and activated every six months.[26] Quotas, in contrast, are a permanent and fully automatic resource for the IMF.

Even this improvement, however, is less important than it seems. The bilateral arrangements tend to be readily extended by the lending countries upon the IMF's request. And the NAB activations and renewals occur without major difficulties, on a nearly automatic basis.

Why is this so? To understand this one should not lose sight of the very special nature of lending to the Fund. First, lending to the IMF is risk-free, given the institution's special standing. Second, the remuneration is roughly comparable to what central banks obtain in international markets when investing their hard currency reserves. In other words, the opportunity cost of lending to the IMF is thus negligible or non-existent. Third, the resources provided to the Fund are totally liquid, can be drawn at any time and are, therefore, counted as part of the international reserves of the lending member. This liquidity is assured by the fact that the pooling arrangement system applied to quotas and SDRs is also applied to lending arrangements. A member is free to request an early repayment of its loan, and if it does so the IMF calls on other participants to provide the resources needed to cover the withdrawal request.

In other words, lending to the IMF actually amounts to a change in the composition of reserves, the same being partly true of quota acquisitions. Countries are therefore inclined to agree to any extension of borrowing that the IMF may request in the same way that they are usually ready to buy any quotas assigned to them. The rise in quotas relative to borrowing is therefore a partly fictitious improvement. It is more a simplification than an actual significant increase in the automaticity of available resources.

On the other hand, one could inquire whether another possible positive result from the quota increase would be an increase in countries' capacity to borrow from the IMF? Would access to resources rise by 50% for each member? This may seem to be the case since access to IMF loans is proportional to country quotas, as noted above. The amount that can be secured from the Fund by any country is regulated by access limits defined as a proportion of its quota. *Ceteris paribus*, the amount that can be borrowed would rise by 50%. However, *ceteris non paribus*. Since the IMF´s total available resources did not increase in the 16th Review, one can expect the Executive Board to lower access limits accordingly. If conservatism prevails, this lowering of limits would be defined so as to leave countries' capacity to borrow unchanged.

When all this is considered, one cannot help concluding that the 16th Review was largely a waste of time. Frustration is the one word that comes to mind when one carefully examines the actual practical results. This makes it all the more necessary to consider possible alternative paths to reform and specific measures that could contain the damage to the IMF's relevance and credibility.

But before we go into that, a quick word on some non-quota matters that were addressed in parallel to the 16th Review. Only one of them looks truly promising: the creation of a third chair for Sub-Saharan Africa. This proposal was discussed in the August version of this paper and will be taken up again in the final sections of this paper. The decisive step here was the announcement by the US Treasury last September that it was dropping its longstanding opposition to the expansion of the Board. In the Marrakesh IMFC chair's statement, in October,

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[26] As mentioned previously, every six months, NAB participants have to decide whether to "activate" the arrangement, i.e., whether to allow the Fund to draw on NAB resources to fund its disbursements to borrowing members.

the decision to allow for a 3rd Sub-Saharan chair was confirmed. This would significantly increase the voice of this region in the Executive Board and the IMFC. An attempt by Egypt to argue that the new chair should be for Africa and not specifically for Sub-Saharan Africa did not garner support.

The other welcome change, also proposed by many outside experts as well as in the August version of this paper, would be a lowering of surcharges in IMF lending, i.e., the excessive additional interest rate cost applied to borrowers of large amounts or for longer periods. On this point, progress made was small. The US Treasury stated that it was open to discuss the matter but stressed more the possibility of using IMF internal resources for another purpose: the augmentation of the facilities that provide lending to low-income countries. This is also an important proposal but it competes with the reduction in surcharges for the possible use of the institution's internal resources. In turn, the IMFC adopted cautious language, indicating vaguely a willingness to consider a review of surcharge policies – a disappointment for countries that are borrowing at high cost from the IMF. This goes to show that even modest proposals encounter more resistance than one could perhaps imagine.

In short, the 16th Review and parallel discussions in and around the Marrakesh Annual Meetings resulted basically in: a) a modest equiproportional quota increase; b) the commitments to grant greater voice to Sub-Saharan Africa through an additional chair in the Executive Boad and the IMFC; and c) and a timid endorsement of a discussion on the alleviation of surcharges. The rest of the Board decisions and IMFC recommendations amount to next to nothing, taking the form of "we promise to", "we welcome this or that", "we urge attention to this or that". Actually, the timid endorsement of surcharge review also falls into the next to nothing category.

VIII. Consequences of the failure of the 16th Review for the IMF

Will the IMF be able to handle or even survive this further frustrated attempt at reform? Views vary considerably on this crucial question, ranging from complacency to forecasts of doom and demise. Will the IMF become a failed institution, following in the footsteps of the World Trade Organization (WTO)? Or can it rely on its strongpoints to overcome the loss of credibility arising from one more unsuccessful governance reform?

Predictions, as usual, are colored by interests and preconceptions. Developed country representatives and spokespersons tend to minimize the damage to the institution. Officials and representatives from emerging market countries are more inclined to make pessimistic assessments of the Fund's future.

It is not at all easy to anticipate what effects the failure of the 16th General Review of Quotas will have on the IMF's standing. As mentioned above, the 16th Review ended with no redistribution of quotas and no change in the current formula. Since practically no other reforms in governance were contemplated in this round of negotiation, the package came out almost void and nearly all countries aspiring for a greater role and representation left the negotiating table empty-handed.[27] The Executive Board simply reported to the Board of Governors that no

[27] The sole exceptions were the countries of Sub-Saharan Africa, contemplated with a third chair in the Executive Board and the IMFC.

support could be garnered to make the planned changes. A modest equiproportional increase in quotas with a corresponding reduction in borrowing was the only practical outcome. The IMF avoided of course using the word "failure", but what came out can be seen as nothing else.

IMF Management and the major shareholders need to take a long and hard look at the consequences of this lack of results. They would need to ask themselves, to repeat, could this further failure, following many others, amount to a major crisis for the institution and a catastrophic loss of credibility? Or could it still be seen as something that the institution would just take in its stride, continuing with business as usual?

In favor of the more complacent view, a few arguments can be arraigned. The IMF is to some extent irreplaceable, at least in the medium-term, in some of the roles it fulfills. For instance, countries find it difficult to obtain alternative balance-of-payments financing in times of crisis. Also, the IMF´s surveillance – multilateral, regional, and national –, is considered a useful source of information and analysis. Furthermore, the institution's technical assistance in matters of its expertise – monetary, financial, and fiscal – is definitely valued by the membership, particularly by less developed countries. Finally, applied economic research, linked to surveillance activities, often throws light on issues relevant to developed nations and EMDCs. More on this in the following section.

So maybe the institution can again avoid catastrophe and retain relevance. However, it is unrealistic to believe that the IMF and the controlling developed countries will be able to take failure in their stride and go on with business as usual, as though nothing much had happened. There is more than one reason not to remain complacent. First, this failure is the second in a row, given that the 15th Review also failed to produce results. These two failures come on top of the non-implementation of forward-looking elements of the 14th Review, a part of the reform package agreed back in 2010, in particular the review of the quota formula by January 2013 and the conclusion of a quota review, based on the new formula by January 2014. It should be stressed that the failure to abide by these forward-looking commitments, assumed by the all the major developed countries at the highest possible level, namely at the leaders' level in the G20, was a major blow to trust. Unavoidably, the further frustration of reforms plans in 2023 is harmful to the standing of the Fund and the credibility of the countries that control the institution.

Moreover, to make things worse, some other, non-quota aspects of the 2010 reform were only implemented *pro forma* or even not at all. First, selection of the MD remains non-merit-based, despite commitments to the contrary. The MD continues to be a European and DMD positions continue to follow long-standing rules based on nationality.[28] Second, under considerable pressure, from the United States and emerging market countries, Europeans had reluctantly accepted a modest commitment to reduce by two the number of chairs of the Executive Board and the IMFC held or led by high-income European countries. However, the way the commitment was cleverly formulated by European officials provided an escape clause. As drafted, the commitment was to give up two chairs to non-specified EMDCs by 2024. This formulation was a trap: it resulted essentially in a greater presence of emerging market *European* countries, i.e., no relevant change to the composition of the Board since emerging Europe tends

[28] The FDMD is traditionally an American national. One of the other DMDs is always a Japanese national and another a national of an emerging-market or low-income country. In 2011, a fourth DMD position was created with the understanding that it would be occupied by a Chinese national.

to follow the lead of developed Europe.[29] The changes in Board and IMFC composition were, in some respects, for the worse. For instance, Switzerland is traditionally more independent than Eastern European nations, say, Poland or the Czech Republic, and sometimes acts in a constructive manner in the IMF. But Switzerland was forced to rotate with Poland in commanding a chair of the Board and the IMFC as part of the results of the 2010 package of reform. What difference did this make? Only a reduction of the role of an independent voice in the Board and the IMFC, partly replaced by a European satellite.

For all these reasons, complacency with respect to the implications of reform failure is hard to justify, even if a collapse of the IMF can be seen as unlikely. The most probable scenario, judging from experience, is not a full-blown crisis of the institution but the continuation of a slow decline, a gradual but persistent loss of influence.

IX. How should EMDCs respond to the stagnation of IMF reform?

Even if complacency is not advisable, the above-mentioned points should be kept in mind. First of all, the Fund, whatever governance insufficiencies it may have, always gains practical relevance in times of international crises, when a larger number of member countries need balance-of-payments support and are unable to obtain it elsewhere. As an international lender of last resort, the IMF fulfills a valuable function for countries facing scarcity of foreign exchange and a balance-of-payments crisis, even if its value to borrowers in distress is considerably reduced by interest rates that can reach 8% or more, a point that will be discussed in greater detail later in this paper. Nevertheless, the fact is that the Fund does provide lending when market access does not exist or has disappeared, opening space to soften macroeconomic adjustment and spread it over time. LICs often find in the IMF a source of concessional loans that will remain attractive in comparison with other rather limited sources of financing. Experienced officials from these countries do not ignore this.

Second, the IMF is not only about balance-of-payments support in times of national or international crises. Quite apart from emergency financing needs, small states and lower income countries will retain an interest in the IMF and continue to engage as usual, given lack or scarcity of alternatives for other purposes. These countries care less about voting power and more about other Fund activities such as technical assistance and bilateral surveillance. As mentioned, they value the technical assistance that the IMF provides in public finance, financial and central bank matters. Moreover, bilateral IMF surveillance is often the main or even sole source of more or less reliable macroeconomic information for smaller and less developed countries, serving as a potential basis for accessing international capital markets. Also, individual quotas are normally the main determinant of the amount of financing that a country can obtain from the IMF. Whatever interest low-income or low-middle income countries may attach to quotas, this is mostly less because of voting power and more because they resort with greater frequency to IMF lending. Given access limits, the higher their quotas, the higher the amount of resources they can potentially obtain from the institution.

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[29] Even this modest concession looks unlikely to be fulfilled. After much higgling and haggling among Europeans, the changes in rotation arrangements in multicountry chairs are still not sufficient to ensure the agreed reduction of the weight of high-income European countries in the Board and the IMFC – yet another example of their reluctance to cede space in the IMF and readiness to breach commitments.

In contrast, most middle-income countries are past the stage of often resorting to the Fund for emergency financing. They attach greater value to their voting power and voice in the IMF. They do not depend as much as LICs on the IMF's technical assistance and bilateral surveillance. Thus, one might well ask: can indefinite postponement of reform lead middle-income countries to disengage from the institution? Probably, yes. They would certainly lose interest. No country is likely to leave the IMF anytime soon, except perhaps Russia for completely different reasons, but participation would become weaker. Countries may continue to go through the motions but would increasingly refrain from active and interested participation in the IMF and listen less and less to its economic advice.

More importantly, these nations, especially the larger ones, would have more incentive to continue exploring alternative routes, i.e., national or new multilateral mechanisms to provide balance-of-payments financing in lieu of the Fund. Central bank bilateral swap lines between emerging market and developing countries are increasingly used to provide hard-currency support, with China assuming the role of main provider of resources. Regional monetary arrangements, such as the Arab Monetary Fund (AMF), the Chiang Mai Initiative (CMI) in East Asia and the Latin American Reserve Fund (Fondo Latino-Americano de Reservas – FLAR), or a transregional mechanisms, the BRICS Contingent Reserve Arrangement (CRA) have emerged and some of them are being gradually expanded.[30] Multilateral development banks established by BRICS countries, the BRICS New Development Bank (NDB) and the China-led Asian Infrastructure Investment Bank (AIIB), may also be called on to offer emergency support, provided their legal frameworks are flexible enough or can be adapted to allow this. As these alternative routes develop, increasingly attractive financing options will become available, leading to less dependence of EMDCs, especially the smaller or poorer countries on the IMF. If this trend should continue, the Fund's relevance would indeed suffer a major blow.

One warning note, however, perhaps excessively "idealistic". To make a difference, to offer alternatives that are truly attractive to developing nations in general, the larger emerging market countries, the BRICS and others, would need to achieve something that they have only partly achieved so far: the capacity at the national and multilateral level of operating in efficient, innovative and non-intrusive ways, i.e., in ways that are suited to the requirements of EMDCs and, at the same time, respectful of their sovereignty and national plans. In other words, what is needed is nothing short of a new vision of social and economic development, essentially different from the neocolonial approach still taken, consciously or not, admittedly or not, by the IMF, the World Bank and other institutions controlled by developed nations.

This broad goal is perhaps more difficult to achieve than one can imagine. It must be seen not only as a matter for grand proclamations in strategy documents and in speeches and public statements but an actual, practical commitment, on a day-to-day basis, of acting differently, in an open-minded and non-egoistic manner, proving by concrete actions that middle-income countries understand and share the concerns of smaller and poorer nations. One thing that may help us in this regard is the fact that BRICS and other middle-income countries have only in the recent past emerged from poverty and external financial dependence. We have ourselves been, not so long ago, victims of the injustices and distortions of the existing international financial arrangements. We know from practical and recent experience the downsides of depending too much on the IMF and other institutions run by the West. A Brazilian or Indonesian official may thus be better placed than, say, a Canadian or French official to

[30] Kring & Haihong (2022), p. 11 and 14.

understand the predicament of low- or low-middle- income countries in their search for external financial support.

Some additional warning notes of a practical nature. First, the existing alternative financing arrangements cover only part of the countries of the world. The IMF is still the only near universal institution of its nature. Second, in some cases these alternative financing mechanisms are partly dependent on the institution they are supposed to rival or replace. A curious sign of their immaturity is the fact that they outsource surveillance and conditionality to the IMF. In the CMI and the CRA, surveillance is partly borrowed or copied from the Fund and, more importantly, lending beyond certain small amounts requires the existence for the borrowing country of a traditional, upper-tranche conditionality program, the so-called IMF-link.

Third, and related to the second point, the experience of middle-income countries in the last decades in setting up new multilateral institutions shows, one must recognize, that the task is tougher than we perhaps imagined at the outset. The performance of these alternative mechanism has been patchy. The AMF and the FLAR have been quite active. However, the CMI, launched in 2000, and seen at least initially as a potential Asian Monetary Fund, although considerably expanded in size, has not carried out any operations so far, perhaps because of the IMF-link. In 2015, the BRICS established two already mentioned financing mechanisms: a multilateral development bank, the NDB, and a monetary fund, the CRA. Up to now, results have been disappointing, especially if compared to our initial expectations. The CRA has remained largely frozen. The NDB has struggled to become a successful financial alternative. These problems are too complex and too varied to be addressed in this paper and I will leave them to one side. I discussed the first five years of the CRA and NDB, as well as the negotiations that led to their creation, in a book that came out in 2022, *The BRICS and the financing mechanisms they created*.[31] More recently, I published an updated overview that confirmed the frustrating results of the BRICS financing mechanisms.[32]

Be as it may, whatever relevance one may attribute to these warning notes and whatever emphasis one may place on setting up or expanding alternative financing mechanisms, the question remains: how should the larger emerging market countries, BRICS and others, respond to the continuing stagnation of IMF quota and governance reform?

The inclination to basically give up on the Fund, is understandable, but would perhaps not be advisable, given all the above considerations about the institution's varied and valuable roles. By simply turning away from the IMF, emerging market countries would be dissociating themselves from poorer and smaller developing countries that still attach value to the institution. In other words, governance and the distribution of power, is only a part, however important, of the issues related to the IMF's present and future.

A purely negative attitude and disengagement might not be strategically useful. Would it not be preferable for the emerging market countries to take in turn a long and hard outlook at the IMF's possible ways forward and, without giving up on the traditional and more ambitious goals, decide to work together on supporting a realistic, even if incomplete, reform agenda? The following sections of this paper will offer some suggestions on how this agenda could look like.

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[31] Nogueira Batista Jr. (2022).
[32] Nogueira Batista Jr. (2023b).

X. A new approach by the US Treasury in 2023

In September, an official pronouncement of the US Treasury, a speech given by Jay Shambaugh, the Under Secretary for International Affairs,[33] marked an important shift in the stance of the main shareholder of the IMF in the immediate run up to the conclusion of the 16th Review. While the United States does not hold sufficient voting power to decide on its own, it does have considerable weight in all matters pertaining to the Fund, especially when it works in tandem with Europe, Japan, and other high-income countries. Thus, the pronouncement of the Treasury's Under Secretary immediately garnered the attention of all those that take an interest in IMF matters.

By coincidence, the US Treasury, took in effect the overall approach suggested in the August version of this paper, i.e., since no change in quota redistribution was acceptable to the United States and other developed countries, American authorities decided to indicate their support for partial reforms that could make the institution they created and largely control somewhat more relevant to middle- and low-income nations. Decision-making would remain in the hands of the United States and Europe, but a number of changes were now advocated by the US Treasury with the unstated but nonetheless evident purpose of mitigating the fall-out to the IMF's credibility derived from the expected failure of the 16th Review in the wake of the failure previous attempts to reform governance in fundamental ways.

The close coincidence between the approach suggested by me and the stance taken the US Treasury made me reflect, I must say, whether the approach advocated in the August paper was not excessively conservative in addressing IMF reform options. That may well be, but the fact remains that it is fruitless to insist on far-reaching reforms when the objective conditions and correlation of forces that would make them feasible are not there, not even remotely.

The US Treasury proposed a number of changes to IMF operations and non-quota governance, all of them useful, especially if taken as a package. Most of them had long been advocated by developing country officials without obtaining support from the United States up to now. Four proposals were presented as "next steps": a) the creation of a sixth position in IMF Management, specifically a fifth DMD to help look after matters concerning emerging market and developing countries; b) a strengthening of some of the existing lending facilities, specifically the one designed for low-income countries (the Poverty Reduction and Growth Trust – PRGT) and the one intended to build resilience to climate change and pandemics (the Resilience and Sustainability Trust – RST); c) a third chair for Sub-Saharan countries in the Executive Board and the IMFC; and d) an indication that the United States would be willing to consider a revision of surcharges in IMF loans. These are all positive improvements, without exception. In the subsequent section of this paper, they will be included and explained as elements of a broader short- or medium-term agenda for IMF reform.

XI. A seven-point reform agenda for the IMF

Given the poor results of the 16th Review and bleak prospects for IMF reform in the foreseeable future, as well as the many reasons for still attaching importance to the institution, one possible way forward would be to separate reform in two stages: 1) a more ambitious reform agenda that could be expected to become feasible only in the medium or long term, if at all,

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[33] Shambaugh (2023).

from what could be called 2) a partial and gradualist agenda that might happen in the next few years. Proposals would need to be down to earth and fit what is conceived to be feasible.

Let us focus on the shorter-term agenda. The overall features of a more ambitious agenda have been discussed above and correspond basically to what were the stated goals of the 16th Review coupled with some non-quota governance reforms.

The horizon for the short- or medium-term agenda could be, say, the next two or three years – time enough to build the required consensus for the proposed measures. It would include changes that might be considered a partial success for the Fund and its membership, improving the institution's capacity to respond to the needs of EMDCs, in particular the poorest, smaller and climate vulnerable countries. A revamped IMF would be better placed to make a contribution, even if limited, to the alleviation of poverty and the redistribution of income among countries.

The items of this agenda would need to be tailored to the political and practical constraints under which IMF reform is occurring. The more ambitious agenda, as indicated above, would seek to make fundamental changes in governance without departing entirely from the approaches that have been attempted or partially applied in the IMF, including those that were planned for the 16th Review. In one sentence, given the many barriers to an ambitious agenda of fundamental reforms, the institution and its membership could seek ways to make some progress within the immediately following years – without giving up plans for more far-reaching results down the road.

A viable agenda might include some of the points to be briefly set out below, all of which would bring about welcome modifications in the governance or in the functioning of the IMF without requiring a major overhaul of the institution. Some inroads into this agenda might be important and perceived to be so by IMF Management and major quota holders. It would allow the institution to avoid some of the fall-out from the failure of the 16th Review, in the wake of the lack of outcomes of the 15th and the non-implementation of forward-looking elements of the 14th Review.

Would this be a realistic goal? Possibly. It should be noted again that those interested in the continuing relevance of the Fund can hardly ignore that the absence of any meaningful changes risks entailing a major strain in its already weakened credibility, perhaps even a crisis for the institution, as discussed above. Could the IMF take the route of the WTO, one might ask again, even if the reasons for institutional failure would be very different from those that discredited the international trade body? While the Fund still performs the valuable functions previously referred to, one cannot really rule out a scenario in which t gradually becomes a failed institution.

XII. Some reform proposals

Let us look at some possible points of a reform agenda. They will be set out in no particular order of importance or practical feasibility. However different they are or may look like, it should be kept in mind that they share the two already mentioned characteristics: a) they benefit EMDCs, particularly smaller and poorer countries; and b) they do not run up against the resistance of major shareholders to changes in the balance of power in the Fund. It would of course remain to be seen whether this sort of approach, limited as it is, has any real chance of

success. In its favor one could point out that IMF Management, always influential in these matters, might well realize that movement, even if only partial or gradual, will to some extent compensate for the failure to achieve the broader quota-related goals of the 16th Review. The major shareholders – the United States, European countries, and Japan – may support changes that improve the institution they control, while not challenging their positions of power. These proposals, none or almost none of which are new and that have not been successful so far, could stand a chance of being approved in the special context of an agenda designed to salvage the IMF's damaged credibility. Needless to say, to have this effect and not be seen as mere face-saving expedients, changes would have to truly alter the way the institution works in practice.

One thing to keep in mind is the partly illustrative nature of the specific proposals briefly explained below. They plausibly share the two features mentioned above but may well face other barriers and forms of resistance not contemplated in this paper. On the other hand, other proposals of the same nature can certainly be formulated by persons with inside knowledge of the IMF.

Possibilities of approval would depend on a meeting of minds between the developed world and the major emerging market countries. The latter would have to still attach relevance and value to the IMF despite the bleak prospects of an ambitious governance reform. The developed countries would have to recognize that repeated failures of attempts at fundamental reforms, without compensating movements, will do considerable harm to the institution they command.

The practical feasibility of the items that will be explained below can be better assessed by the IMF's Management and Executive Board, i.e., by those persons that are currently responsible for the institution on a day-to-day basis. Having said this, let us set out a few possible components of what a viable agenda for the Fund could be.

XII.1 Reforming conditionality

The IMF is often criticized, and rightly so, for imposing excessive conditionality on borrowers. There are at least two not mutually exclusive ways of addressing this problem: a) to revise and flexibilize the application of conditionality in the Fund's traditional lending instruments; and b) to revise and strengthen the low-conditionality instruments created in recent years.

Le us begin by addressing traditional instruments where full conditionality can be applied. It is of course understandable that countries resorting to emergency lending be required to implement adjustment programs tailored to their circumstances. National authorities need to face up to the harsh realities that made them resort to the IMF and the institution needs to protect its resources. However, conditionality is often too stringent, leading to excessive economic and social costs and/or repeated failures to implement agreed macroeconomic targets. This harms, sometimes in a major way, the credibility of countries and of the IMF itself.

There is actually another major problem in conditionality, briefly alluded to above: the lack of even-handedness. The treatment received from the Fund varies considerably depending on the state of relations between the nation requesting support and the major developed countries. Repeated complaints of lack of balanced treatment across countries have fallen on deaf ears. Countries seen as friendly and cooperative tend to obtain programs quickly, in large amounts, not many questions asked. Those seen as hostile or excessively independent have great difficulties with the IMF. Their requests often do not even come to the Executive Board for

consideration. When they do, amounts are smaller and conditionality harsher. Compare, for instance, programs for Ukraine and Serbia.

Can these two problems be addressed or at least mitigated? One should certainly try even if prospects are not very encouraging. With respect to the second one, the fact of the matter is that the major developed nations are keen to retain the possibility of using the IMF as a political tool to reward or punish counties facing severe balance-of-payments or macroeconomic issues. Evenhandedness is more proclaimed than practiced by them.

The first problem in turn runs up against the traditional orthodox macroeconomic thinking that normally prevails in the institution. Punishing conditionality is seen as inevitable for economic but also, it should be noted, for moral reasons. Countries that are guilty of overspending or following irrational policies need to pay a price, it is believed. This approach often resonates in major high income countries, Germany being a case in point.

Austerity in the form of sharply restrictive fiscal and monetary policies is imposed even in circumstances that would recommend a more gradualist approach. In excessive doses, fiscal and monetary tightening may well be self-defeating, particularly when the result is a collapse of economic activity and employment that inevitably leads to social hardship, political resistance, as well as fiscal imbalances. Attempts to correct these fiscal imbalances by means of further expenditure cuts and/or tax increases tend to generate renewed adverse effects, including on fiscal balances. And if further fiscal austerity is imposed, the country falls deeper into a well-known vicious circle.

Can the IMF correct, at least in part, these two chronic problems? The lack of even-handedness is more challenging, since this would ultimately require a more balanced distribution of voting power in the Executive Board where country programs are approved and supervised. The least one could do, however, would be to revise conditionality policies so as to inhibit somewhat the political use of the Fund by the major developed countries. The Board would have to recognize the problem and clearly commit to address it in practice. This might impede the more blatant cases of lack of even-handedness.

A little more could be expected in the way of revising the application of conditionality in approved programs under traditional lending instruments. One requirement here would be to carry out a revision of the economic doctrines that underly IMF adjustment policies, something that could be carried out by the Board and staff, perhaps with the outside help of innovative economists well versed in the traps of traditional macroeconomics.

A revision could lead, for example, to the more frequent use of six-month targets *in lieu* of quarterly ones. Also, and more importantly, to the application of less stringent requirements in terms of policy interest rates, fiscal primary surplus targets and other economic performance criteria. As they become easier to achieve, missed targets would be less common and programs would less frequently go off-track, preserving the credibility of the national authorities and of the IMF.

Admittedly, these less stringent requirements should be designed so as to preserve the market-credibility of IMF programs and could therefore not be excessively lenient. And, by the way, the sometimes very soft treatment of client states does considerable harm to the institution's standing. What is being contemplated here is only a reduction in the ambition and intensity of adjustment targets.

Softer programs spread over longer periods may require a bolstering of the overall resources of the Fund, especially if lending is to larger member countries. This could be hampered by the reluctance of major shareholders to accept large increases in the Fund's overall resources, as seems to have happened again in the 16th Review. That would be another reason to revise the roll-back of borrowing arrangements foreseen in this review, a point that will be addressed below.

A second approach to an overall reform of IMF conditionality, perhaps more promising in practice than reviewing the way traditional lending instruments work, could be to strengthen the existing low-conditionality and non-concessional lending facilities, perhaps especially the Flexible Credit Line – FCL and the Resilience and Sustainability Trust – RST.

The FCL, created in 2009, is an example of a facility that could be made more accessible. The Brazilian chair, took an active and leading role in its establishment. The new facility was designed and approved by the Executive Board in order to provide a very low-conditionality and fast disbursing source of funds to countries with a strong overall macroeconomic performance that nevertheless require IMF support. Support under this lending instrument can be on a disbursing or a precautionary basis. Conditionality would be only *ex ante*, i.e., the IMF would limit itself to assessing whether the requesting country indeed meets from the start the economic criteria for strong performance (fiscal, monetary, balance-of-payments, among others), and not *ex post*, i.e., based on targets and economic performance criteria to be observed over time as the program unfolds. In effect, the FCL meant a return to Keynes' original view of how IMF conditionality was supposed to work, namely with flexibility and speed.

In practice, unfortunately, the FCL was hampered in its application by rigid interpretation, bureaucracy, and (again) non-economic criteria. Few countries used the line and all or almost all of them were politically close to the United States and major European countries (Mexico, Poland and Colombia were the first takers).[34] A greater practical relevance of the FCL would probably depend more on better implementation than on revision of the facility's innovative design.

The RST, established more recently, in 2022, is intended to help countries face balance-of-payments risks arising from the new challenges of climate change and pandemics. Conditionality is somewhat lower and disbursements faster than in traditional facilities. Despite this, only 10 takers have come forward and obtained access to the RST.[35] Possible explanations would be that the amounts available and the conditions attached still do not compensate for the stigma often attached to resorting to the IMF. Thus, greater access and some loosening of conditionality could increase the attractiveness and use of the RST.

On the whole, the underlying problem remains the same across all IMF lending instruments, traditional as well as newer ones: the formulation and application of lending conditions tend to suffer from the excessive conservatism and rigidity of the institution – Executive Board, Management, and staff, as well as the authorities of the major developed

[34] For a discussion of the FCL, see Nogueira Batista Jr. (2021), p. 151-158.
[35] Shambaugh (2023) and International Monetary Fund (2022a) and (2022b).

countries. Borrowers are treated more often than not – with the striking exceptions of client states – as requiring not only resources but also harsh treatment.

Again, as in the case of the traditional lending instruments, a strengthening of the low-conditionality fast-disbursing facilities may require the always difficult to come by increase of the Fund's overall financing capacity. The US Treasury is seeking Congressional approval for lending US$ 21 billion to the RST and PRGT.[36] However, obtaining Congressional support for increasing resources to the IMF has proven again and again a challenging task for the US authorities, as well as for some of their counterparts in other developed nations.

At the end of the day, the question remains: will the major shareholders and the IMF be ready at some point to take into greater consideration the excessive harshness of the way in which it applies conditionality? If so, something along the lines of what was explained here could be seriously considered and at least partly implemented.[37]

XII.2 Reduction in surcharges

Surcharges are the increases in IMF interest rates that are applied to lending in larger amounts or longer maturities. Countries that borrow longer-term and beyond certain limits, defined in terms of their individual quotas, are penalized by higher interest rates. From the point of view of the Fund, this compensates for the higher risk associated to larger and longer-term loans.

Reduction in surcharges would benefit all countries resorting to exceptionally high and long-term borrowing from the IMF. These would be mostly middle-income countries. Low-income members would normally have access to the Fund's concessional lending facilities. High-income countries very rarely resort to IMF loans.[38]

The rationale for this reduction is well-known. Why charge exceptionally high rates to countries most in need? This runs counter to the alleviation that resort to the Fund is supposed to bring to countries going through severe macroeconomic difficulties. Note that the total cost of borrowing from the IMF can reach high levels. The interest rate charged is actually formed by the three components. The SDR interest rate (a weighted average of short-term market interest rate of major currencies), a fixed margin above that (currently at 100 basis points), and the surcharges applied to large and longer-term programs. Surcharges can reach as much as 300 basis points. In total, some borrowers have paid or are paying an annual interest rate of 8% or more. Countries that have lost access to market lending often have no other choices and are thus burdened by these high interest rates.[39]

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[36] Shambaugh (2023).

[37] A closer look would have to be taken at the FCL and the RST than was done for this paper. The other facilities of a similar nature could also be examined: the Precautionary Liquidity Line (PLL) and the Short-Term Credit Line (SCL). For a recent review of the FCL, the PLL and the SCL, see International Monetary Fund (2023a). Reform proposals made in this review may help achieve the overall goal of making the Fund more flexible and responsive.

[38] IMF programs for high-income nations are few and far between. In the recent past, a handful of European countries, those that were hard-hit by international financial shocks and the euro area crisis, requested and obtained Fund loans. Before that, IMF lending to developed countries went back to the 1970s.

[39] On surcharges and other components of the interest rate charged by the IMF see, for instance, Stiglitz & Gallagher (2022) and Gallagher, Guzman & Stiglitz (2023).

A reduction in IMF interest rates could also come through a lower fixed margin but bringing down surcharges would make more of a difference for countries that have to borrow more and for longer periods. Granted that there is indeed a higher risk associated to lending to a member in large amounts and for longer periods, the nature of the IMF, in particular its privileged creditor status, makes for a moderate increase in credit risk in practice. Why is this so? First, the IMF is the largest existing reserve pooling arrangement. This spreads the burden of indirect credit risk among a large number of creditor countries that lend to other countries through the IMF. The institution holds in any case large liquid reserves that can quickly be mobilized to cover any losses. Moreover, these losses are few and far between, given that the Fund holds a privileged creditor status, recognized by all. Thus, borrowers very rarely default on the IMF, and when a risk of default appears this is mostly handled by providing new loans to cover the debt service of previous lending. Creditors in turn generally recognize that the Fund has a first claim in cases of payment crises, defaults and reschedulings in countries indebted to the institution.

This practical reality could be appropriately reflected in a scaling down of surcharges. Rates would still increase with the level and duration of borrowing but much more moderately than under current rules. The Fund would cease to profit excessively from lending to countries in dire straits, almost all which are EMDCs and many of them less developed nations. Resort to the IMF would become less onerous and more attractive.

XII.3 Bolstering concessional financing

The IMF provides concessional loans to low-income countries, through a special facility: the Poverty Reduction and Growth Trust – the PRGT. LICs are therefore not exposed to the high cost of borrowing from normal facilities. For the poorest countries, the PRGT interest rate is now zero.[40]

One welcome reform would be to increase the availability and perhaps further reduce the cost of loans from the PRGT, strengthening the capacity of low-income countries to face up to balance-payments problems and other macroeconomic challenges. Many PRGT-eligible nations have been hard hit by climate change, pandemics and other exogenous shocks in recent years and the IMF could respond by reinforcing the PRGT and making it more attractive to eligible members. The US Treasury, as briefly indicated above, threw its weight behind the proposal to bolster the PRGT last September. This increases the possibility of implementing improvements in this area to the benefit of low-income IMF members.

The main constraint here is of course financial. Where would the needed resources come from? Additional external funds from developed countries may be hard to obtain. In 2022, the United States contributed a modest US$ 70 million to the PRGT's subsidy account.[41] Additional resources for this purpose seem to face an up-hill struggle in US Congress. Similar limitations may exist in other potential country donors. Given possible constraints in high-income members, could middle-income countries be persuaded to provide additional financing to the PRGT? This might part of a concerted effort led by larger middle-income members, such as China, Indonesia, Brazil, or Mexico, to implement an IMF reform package benefiting mostly poorer nations.

Barring additional external financing, a bolstering of the PRGT would depend on the Fund's internal resources but only to the extent that this would not threaten the institution's

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[40] Shambaugh (2023).
[41] *Ibid*.

precautionary buffer. However, as indicated earlier, this approach competes with the aim of reducing surcharges, another potential demand on the Fund's internal resources.

XII.4 Increase in the IMF's overall resources

Could the Executive Board and the Board of Governors be persuaded to revise the arrangements for the roll-back of IMF borrowing arrangements? The idea would be to make the reduction in the stock of borrowing smaller, allowing the equiproportional quota increase to generate some increase in the Fund's total resources. Under normal IMF practices this seems unlikely. However, if an effort to sustain or restore the Fund's relevance is understood to be necessary and feasible, as argued in this paper, such a revision could yet be contemplated.

It is doubtful whether what was agreed in the 16th Review in any way suits the interests of EMDCs. As indicated above, one needs again to distinguish between the poorer developing countries and the middle-income emerging market countries. The lower-income countries would probably view the approach more favorably, being as they are more interested in borrowing in times of crises than in increasing their votes. Since borrowing is based partly on individual quotas, the increase in quotas would, in theory, lead to a rise in potential access. The second group, and within in it the underrepresented, mostly Asian countries, would probably be opposed or indifferent, being as they are more interested in voting power than in borrowing from the Fund. Several of them, as well as emerging market countries from other regions, have indeed become lenders to the Fund in the last 15 years or so, bilaterally or as participants of the NAB, the already mentioned multilateral scheme in which members with strong external positions lend to the institution under common agreed rules.

The benefits to potential borrowers from an equiproportional increase in quotas are larger if it entails an augmentation of the IMF's overall resources. For that to happen, the roll-back of borrowing arrangements would need to be smaller than the quota increase. In this case, the Fund's fire power increases and the quota-based nature of the institution is reinforced in any case, with quota resources rising relatively to borrowed resources. For EMDCs, this would be seen as positive, given that many of them, as noted, still rely on the IMF's liquidity support in times of strain. For emerging market middle-income countries, most of which are no longer takers of IMF resources, acceptance of this proposal would only make sense, if at all, as a gesture of solidarity with the poorer countries and of support for the institution. Sacrifice of national interests would be of course greater for heavily underrepresented countries, such as China, India, and other Asian nations.

As things turned out EMDCs on the whole, even China, went along with the small equiproportional increase approved in the 16th Review. Their reluctance or lack of enthusiasm might help understand the increase was only 50%. Indeed, as previously explained, the higher the equiproportional the less likely would a quota realignment be in the future.

However, since the rollback will occur on a one-to-one basis, the decision is less attractive, the sole gains being a reinforcement of the quota-based character of the IMF and higher quotas for the potential borrowers. The composition will change, with borrowing replaced by quotas, but the overall amount of resources available to the institution will remain constant.

The inclusion of an equiproportional increase should preferably have been accompanied by the indication that the roll-back of borrowing arrangements would be consistent in size with some increase in the Fund's total envelope, i.e., quotas would rise by more than borrowing would diminish, leading to a net increase in the IMF's lending capacity. The numerical

specification could have initially been left open, with an indication, however, that calculations would endeavor to restore the IMF's size compared to international economic and financial flows, reversing at least partly the long-term down-ward trend of the relevant relative indicators.

Note in passing that if the rollback is focused primarily on the bilateral borrowing arrangements, this would probably make the proposal more acceptable to those high- and middle-income countries that are large bilateral creditors to the IMF. More importantly, to suit in particular the interests of the BRICS countries, any reduction in the size of the NAB, whether it leads or not to an increase in total Fund resources, should also be equiproportional, i.e., country shares would have to be reduced by the same percentage amount, keeping relative shares constant. Foreseen in the 16th Review,[42] this preserves the BRICS's veto power in the NAB, hard-won as reported above. The same holds of course for the other holders of veto power, the United States and the European bloc.

Although an equiproportional increase does not challenge, by definition, the distribution of decision-making power, the moderate result approved in the 16th Review may also have been due to resistance on the part of the United States and other major shareholders to any more substantial increase in quotas and in overall Fund resources. The historical behavior of US authorities indicates that their support for a much larger IMF may not be easy to obtain. They value the Fund but, except in times of crisis as in 2008-2009, are not enthusiastic about big increases in its role and lending capacity. This reflects, on the one hand, traditional US hostility to public international bureaucracies and, on the other, the desire to maintain a central role for its national central bank, the Federal Reserve, in providing international liquidity to selected trusted and credit-worthy central banks when liquidity problems arise.

Nothing would impede, in legal terms, the IMF from coming back on its December 2023 decision to maintain the Fund's overall envelope. A new decision sometime soon could simply establish that the rollback of borrowing will not be on a one-to-one basis, allowing for some increase in the IMF's capacity to lend.

However, and this further point should not be neglected, it would be important that the increase in countries' access to IMF resources derived from larger individual quotas not be annulled by a reduction in access limits. Depending on the size of this reduction, one of the few positive results of the 16th Review will be wiped away. The increase in the Fund's overall lending potential, as suggested here, would contribute to avoid an excessive reduction in access limits, allowing perhaps the Board to do without any changes at all to these limits, thus maximizing the increase in access to resources.

XII.5 Higher proportion of basic votes

Basic votes were introduced in the IMF to compensate for size, amounting to a recognition that quotas by themselves would bias voting power in favor of larger countries. Voting power of each member is determined by two factors: individual country quotas, by far the most important one, supplemented by so-called basic votes. The weight of quotas in the determination of votes is corrected in part by allocating the same absolute number of basic votes to all member countries, thus leading to a larger percentage increase in voting power for the smaller quota-holders.[43] The smaller the member the more it benefits percentage-wise from basic votes. In other words, voting power is larger than quota shares for smaller members, with

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[42] International Monetary Fund (2023e), p. 5.
[43] AoA, Article XII, section 6. International Monetary Fund (2016).

the reverse being true for larger members. After being tripled in the 2008 reform, basic votes currently represent 5.5% of total votes. No legal obstacle exists to changing basic votes independently of an increase in quotas. An amendment to the AoA would be required, however.

A further large increase in the proportion of basic votes, say, to 8% or even doubling them to 11% of total votes, could be considered, subject to numerical consideration of the impact of these increases in the voting power of large members.[44] The constraint would be, in particular, the effect of increasing basic votes on the voting power of the largest member, the United States. Would it bring its share of votes below or even close to the 15% threshold that provides veto power? Any increase of basic votes that would represent or could be seen as a challenge to the hold of the United States and other high-income countries on the institution would be a non-starter for the reasons explained earlier. Even if the higher weight of basic votes were to leave US voting power above the 15% threshold, there could still be objections from the side of the American authorities. This would be the case if the increase in basic votes were to bring US voting power too close to what they view as a comfortable margin above the threshold. This sort of constraint arises in the discussion of quota redistribution as well. Any shift in calculated and actual quotas faces this specific limitation: the US quota needs to remain not only above but comfortably above 15%. If it does not, the United States immediately signals that it would veto the proposed quota change or increase in basic votes. Veto power, as always, is used to protect veto power.

The proposal to increase basic votes would favor all small countries. Admittedly, the gaining group includes small high-income countries, such as Singapore, Switzerland, and Luxemburg. Most small countries, however, are developing nations and many are among the poorest. Moreover, this part of the membership includes countries that are particularly vulnerable to climate change, such as island states in the Caribbean and the Pacific. The proposal seems therefore defensible. All small countries are members of multicountry chairs in the Executive Board and the IMFC. An increase of their voting power would increase the voting power of the Board chairs of which they are members, as well their influence within these chairs. And voting power would be higher for each small country in the Board of Governors where votes are cast on an individual country basis.[45]

XII.6 Third chair for Sub-Saharan Africa

As we have seen, one of the distortions of IMF governance is the unfair distribution of the 24 chairs in the Executive Board and in the IMFC. Europe is excessively represented. EMDCs, especially Sub-Saharan countries, are underrepresented. Europe leads 7 to 9 chairs;[46] non-European EMDCs command 12 chairs. This issue pertains not to voting power *per se* but to voice and representation, another important and sometimes neglected aspect of governance. The two

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[44] The original 1946 level of basic votes was 11 percent of total votes. Dennis Leech & Robert Leech (2009), p. 18.

[45] In the Executive Board, voting is done on a constituency basis, i.e., votes are cast by the Executive Directors of the 24 chairs. In the Board of Governors, voting is on a national basis, i.e., votes are cast by the Governors appointed by members, who are normally Finance Ministers or Central Bank Governors.

[46] The exact number of chairs led by Europeans fluctuates in this range due to rotation arrangements in a few constituencies, as mentioned before. For example, in one of the three Latin American chairs in the Executive Board and the IMFC, Spain leads for part of the time, rotating with Mexico every two years in the Board, and with Mexico and Colombia in the IMFC. As a matter of fact, the IMF is the only place where Spain has not yet been expelled from Latin America…

Sub-Saharan African chairs include mostly low- or lower-income countries, precisely those that this reform package would be designed to benefit.

The problem of underrepresentation in the Board and the IMF is acute for Sub-Saharan African countries because the two existing chairs include an exceptionally high number of members, as many as 22 and 23 countries. The voice of each individual member of these chairs is severely diluted. The capacity of the Directors to effectively represent such large constituencies is open to doubt, to say the least. The already mentioned creation of a second Alternate position for chairs with seven or more countries, as part of the 2008 reform, went some way in addressing this short-coming but did not really solve it. African officials have often complained about this unfairness and repeatedly called for a third Sub-Saharan chair.

They were successful in the World Bank, where a 25th chair was created for Sub-Saharan African countries. However, implementation fell short of expectations. The new chair included, as it happened, a small number of larger countries, leaving the other two Sub-Saharan chairs still overburdened by an excessive number of members. The exercise largely defeated its purpose. Note that what was gained occurred at the expense of increasing the size of an arguably too large Executive Board, something that hinders its effectiveness, as has been pointed out in the past by US representatives and others. And this is an undeniable down-side to introducing a third chair for Sub-Saharan Africa.

To avoid a recurrence in the IMF of the frustrating experience in the World Bank, Sub-Saharan African countries could be asked to commit, as part of the deal, to a roughly balanced distribution of countries among the three chairs. The matter is ultimately one for African nations to decide. Nevertheless, an overall commitment not to repeat anything similar to the disappointing experience in the World Bank might well be in order and may indeed be welcomed by the smaller African countries as a way to increase their leverage vis-à-vis the larger ones.

This 25th chair was one of the very few areas in which progress was made in 2023. In September, as previously observed, the US Treasury announced that it was dropping its long-standing opposition to the expansion of the Board.[47] Subsequently, the IMFC called for the creation of a 25th chair on the IMF Executive Board for Sub-Saharan Africa, recognizing the need to improve its voice and representation and the overall balance of regional representation in the Board and the IMFC itself.[48] Barring unlikely difficulties, it can be expected that this additional chair will be created on occasion of the next election of Executive Directors, scheduled for October 2024.

[47] Shambaugh (2023). Traditionally, the US favored increasing the number of seats allotted to EMDCs by cutting European seats. The entrenched resistance of Europe to any such reduction made this impossible. In passing, note that the same limitation is felt in the G20, where Sub-Saharan Africa is underrepresented and Europe overrepresented. Given the practical impossibility of removing European countries from the group, the solution will be to increase the number of countries around the table. In 2023, the African Union was added as a permanent member of the G20. Group of 20 (2023), paragraph 76. Sub-Saharan Africa remains underrepresented, however (only South Africa has been part of the group since the very beginning), and perhaps at least one other country of the region should be invited to join during the Brazilian presidency of the G20 in 2024.

[48] Paragraph 10 of the IMFC Chair's Statement in Marrakech, Morocco, October 2023. International Monetary Fund (2023c).

XII.7 Fifth Deputy Managing Director position

For some time now, there have been four Deputy Managing Directors (DMDs) in the IMF´s Administration – a First Deputy Managing Director (FDMD), always a US national, and three other DMDs: one Japanese national, one Chinese national and one from a middle- or low-income country. The latter is supposed to stand in for or "represent" all middle- or low-income nations except China. The imbalance is thus obvious. On top of the well-known rule that reserves the number one position, that of MD, to a European national, there are a four other informal rules: the one that reserves the FDMD position to the US plus the above mentioned rules for Japan, China and all other EMDCs.

Note that the word "representation" was deliberately surrounded with quotation marks in the previous paragraph, given the legal status of the members of Management, a point alluded to in an earlier part of this paper. Although nationality does play a role in practice and is indeed crucial, Management and staff of the Fund are legally committed to devoting themselves entirely to the interests and advancement of the institution, and hence the quotation marks are required, strictly speaking.[49] From a legal point of view, representation of countries in the IMF is done by the Executive Directors, not by Management.[50] Therefore, the legal structure of the Fund constrains the MD and his or her Deputies to some extent, outlawing blatant advocacy and defense of national or regional interests.

However – and this point is essential to understand the proposal for the creation of a fifth DMD slot –, the inaccuracy of the notion of representation is only partial. In practical and political terms, the person's origin and nationality actually play a critical role, witness the insistence of Europeans on the survival of the rule that applies to the MD. This political reality is recognized by all. To recall one example, when Dominique Strauss-Kahn was chosen for the position of MD in 2007, he publicly stated: "*Je reste français, je reste socialiste*" (I remain French, I remain a socialist).[51] The US, Japan and China are similarly attached to the informal rules that benefit them.

Given the above, the relevance for EMDCs of creating a fifth DMD position is pretty straightforward. In the present circumstances, it is especially relevant for middle-income countries. The DMD coming from the developing world is currently an African national. A fifth DMD would thus presumably be a national of a middle-income nation, perhaps from Latin America and the Caribbean, since Asia and Africa are already contemplated in Management.

What is the role of a DMD? Needless to say, the other DMDs are less powerful than the MD and the FDMD. While personalities matter and a well-prepared and active DMD can in practice exert considerable influence and even rival that of the FDMD, the legal determinations are unambiguous. In any case, a DMD always has his or her own portfolio and coordinates activities therein specified. For instance, a DMD normally chairs Board meetings and supervises staff activities for country and policy issues concerning his or her portfolio. A fifth DMD might,

[49] Under the AoA, Article XII, section 4, "the Managing Director and the staff of the Fund, in the discharge of their functions, shall owe their duty entirely to the Fund and to no other authority. Each member of the Fund shall respect the international character of this duty and shall refrain from all attempts to influence any of the staff in the discharge of these functions." International Monetary Fund (2016).

[50] An additional nuance, in the same vein, may be of some interest here. Whereas from a legal standpoint country representation is a prerogative of the Executive Director, in multicountry chairs country representation is undertaken in practice, at least partly, by other officials that are members of the Board, i.e., by nationals of countries other than the one that leads the chair. This applies particularly, but not only, to Alternate Executive Directors of multicountry constituencies. Once again, legal provisions are overridden by political realities.

[51] Nogueira Batista Jr. (2021), p. 104.

for instance, chair Executive Board meetings on middle-income countries and oversee discussion on policy matters that pertain mostly to these countries.

To give just one example, a fifth DMD could well be charged with leading discussions of lending and conditionality policies, matters that are of special concern to those middle-income countries that rely on the Fund´s resources. As previously discussed, can the IMF's macroeconomic criteria for lending be revised and made more flexible? Can new facilities be created or existing ones be revamped to make access less rigid and bureaucratic for countries with strong policies hit by exogenous shocks? Can surcharges be diminished so as to make borrowing from the IMF less burdensome? A fifth DMD can play a role in addressing these issues.

In short, creating an additional DMD position could make a difference even if the outmoded rules governing the choice of the MD and the FDMD remain in place. There seems to be no reason to believe that high-income countries would necessarily block this proposal. At least the United States, has made public its support for the idea in the already mentioned September speech by the Treasury's Under Secretary for International Affairs.

XIII. The future of the IMF: final considerations

In conclusion, what can be said of these proposals for partial reform of the IMF? The approach taken here should be regarded as a package, meaning that to have the desired effect of recovering, at least partly, the Fund's credibility the proposals would have to be implemented over the next few years as part of an agenda to be made public as a target at the beginning of the process. The package would be an open one, i.e., the specific proposals could be modified, some could be abandoned as less practical, others of the same nature could be added, all of them could be adjusted and improved as negotiations proceed.

At the risk of belaboring the point and tiring the reader with skeptical considerations, the sad truth is, however, that even limited proposals such as the ones sketched out here are likely to encounter resistance from major shareholders, as they have in the past.

Will they realize, however, that this resistance is going too far, that some breaking point for the Fund will be reached, perhaps sooner than they expect? Or will they stick to their habitual inertia and attachment to *status quo*, counting on the perception that even an unreformed IMF would remain a relevant and valuable financial institution?

Whatever might seem more likely going forward, I believe the attempt should be made to persuade the major shareholders, basically the United States and the larger European countries, and IMF Management, the MD and his/her deputies, that piecemeal change is preferable to *status quo*. Simply condoning the failure of the 16th Review, and full stop, will in the end be more costly than accepting some forward movement in matters dear to at least part of the developing world and that do not threaten the balance of power in Fund. The proposals discussed above fit this bill and are, as noted, not exhaustive. Other ideas in the same vein could be identified and put forward.

It can be argued that this whole exercise is somewhat pointless. Even if all these proposals were to be implemented anytime soon, the Fund would remain a fundamentally imbalanced institution, a carry-over from the last century, distant from the realities of the present era. Granted. A true reform would require changes that the major shareholders have shown again and again that they are not willing to support. The fact remains that the IMF is still a valuable institution from many points of view. Even unreformed, it fulfills purposes which other financial mechanisms and institutions do not seem yet capable of fulfilling. So much so that middle- and low-income countries continue to press for fundamental reform. If they did not

attach value to the IMF, they would hardly waste time in arguing and struggling for its reform. The day these countries stop doing this will be the day that the IMF has effectively become irrelevant. Developed countries will then be the sole owners of an empty institution.

If inertia prevails and no compensating changes occur in operational principles or non-quota governance, the question may soon no longer be "will the Fund remain relevant?" but "can the Fund become relevant again?". It seems to be in the interest of the Fund and its main shareholders to move forward, even if on the basis of piecemeal measures.

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As usual, however, any errors or omissions are to be attributed only to the author. Moreover, issues addressed here are complex and controversial in nature and thus disagreements among experts and officials are only natural and, needless to say, people mentioned in this note are not expected to share the views put forward by me.

Acronyms

AoA – Articles of Agreement of the IMF.

BRICS – Brazil, Russian, India, China, and South Africa.

CQS – Calculated quota shares.

CMI – Chiang Mai Initiative.

CRA – BRICS Contingent Arrangement.

DMDs – Deputy Managing Directors.

EMDCs – Emerging-market and developing countries.

EU27 – Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, and Sweden.

FDMD – First Deputy Managing Director.

FLAR – Fondo Latino-Americano de Reservas.

G7 – Group of 7 (United States, Canada, Germany, France, United Kingdom, Italy, and Japan).

G20 – Group of 20 (United States, Canada, Germany, France, United Kingdom, Italy, European Union, Japan, South Korea, Australia, Brazil, Russia, India, China, South Africa, African Union, Indonesia, Saudi Arabia, Turkey, Argentina, and Mexico).

LICs – Low-income countries.

IMFC – International Monetary and Financial Committee.

NAB – New Arrangements to Borrow.

NDB – New Development Bank.

MD – Managing Director.

SDR – Special Drawing Rights.

WTO – World Trade Organization.

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