

Options for democratising the World Bank and the IMF

Paul Ladd
Christian Aid
London

contact details
paul@laddy.co.uk

Correction:

Readers should note one correction, on page two, of this document. Namely that an expert group to advise Minister Trevor Manuel was not approved.

Note:

The extent of poverty in Southern Africa makes the region highly dependent on the operations of the World Bank and the International Monetary Fund. One indicator, amongst many, is the extent to which states in Southern Africa are engaged in PRSP processes in an attempt to qualify for HIPC debt relief. This analysis was commissioned by the Southern African Regional Poverty Network (SARPN) to increase public awareness, primarily within Southern Africa, of the key policy issues involved in restructuring the Bretton Woods institutions. It should be read and compared with the outcomes of the impending meeting of the Development Committee.

CONTENTS

	Page
Introduction	2
Summary	3
Problems with the current system	4
Allocation of votes	4
Allocation of seats on governing bodies	5
Constraints on capacity	6
Board transparency	6
Selecting IFI leaders	7
Options for reform	7
Allocation of votes	7
Increasing and/or reallocating seats	9
Increasing resources to address capacity	11
Transparency of board decisions	11
Selecting IFI leaders	11
References	13

Introduction

At their Spring meetings held in April 2003, the major shareholders of the World Bank and IMF considered how they could 'enhance the voice and participation' of developing countries in the decisions and policy-making of the institutions.

They agreed on a set of limited capacity building measures to help fellow developing country Executive Directors on their Boards, but failed to address substantive imbalances in the number of seats allocated to developing countries, and a skewed voting structure.

The Fund Executive Board to the IMFC is preparing a status report on the adequacy of IMF resources, the distribution of quotas, and the strengthening of Fund governance for its next meeting. In light of this, the shareholders requested the Boards of the Bank and Fund to:

“consider and elaborate upon options with a potential for broad support, taking account of shareholder and institutional implications.”

As part of this they asked Trevor Manuel – South African Minister of Finance – to form an expert group to consider the issue further and report back to the Boards before their Annual meetings being held in Dubai in September 2003.

The paper - prepared at the invitation of the Southern African Regional Poverty Network (SARPN) - discusses some of the issues around, and options for reforming, the governance structures of the World Bank and IMF. It is based on a submission that the UK development agency Christian Aid prepared as an input into the debate on improving developing country voice and participation in the World Bank and IMF. The submission was written and researched on behalf of Christian Aid by Angela Wood, formerly of the Bretton Woods Project, a UK based network for monitoring the policy and practices of the IFIs.

More information on this longstanding area of debate can be found at the website of the Bretton Woods Project:

<http://www.brettonwoodsproject.org/topic/governance/index.shtml>

The communiqués from the meetings of the World Bank and IMF shareholders can be found at the following addresses:

[http://lnweb18.worldbank.org/DCS/devcom.nsf/\(communiquesm\)/15F072E02473F18F85256D0700653045?OpenDocument](http://lnweb18.worldbank.org/DCS/devcom.nsf/(communiquesm)/15F072E02473F18F85256D0700653045?OpenDocument)

<http://www.imf.org/external/np/cm/2003/041303.htm>

<http://www.imf.org/external/am/2003/about.htm>

Paul Ladd, Christian Aid, May 2003

Summary

The World Bank and IMF have promoted participation in national decision-making, yet their own workings remain largely hidden. The Monterrey Consensus, agreed at the Financing for Development Conference in March 2002, stated that the IMF and World Bank should 'continue to enhance the participation of all developing countries and countries with economies in transition in their decision-making.'

This paper looks at how developing countries are represented in the governance structures of the World Bank and IMF. The analysis contained in the paper takes as its starting point the fundamental right to representation. Poor countries and poor people have a right to be adequately represented at the institutions of which they are 'clients'.

Beyond this right to representation lie issues of the effectiveness of the institutions. It is likely that better representation of the poorest countries at the IMF and World Bank would lead to more appropriate, and better-informed, decision-making and ownership. In turn, better representation would improve the effectiveness of both institutions in contributing towards poverty eradication.

The paper argues that changes to the current systems of IFI governance systems are needed in the following areas:

- **Voting** IFI voting structures should, ideally, be based on the principle of one-country-one-vote, or one-person-one-vote. Since this is unlikely to be achieved in the near future, reforms are needed that move in this direction. These include increasing the basic vote allocated to all countries and a more fair and transparent formula for allocating votes based on economic size and population. Double-majority voting should be introduced for special votes and the consensus system of decision-making should be replaced with up-down voting with all votes published.
- **Seats** Allocation of seats on the boards and the oversight committees should be reformulated to give a wider range of members access to decision-making. The allocation of board seats and seats on the International Monetary and Finance Committee (IMFC) and Development Committee needs to be revised to give balance between industrialised, middle-income and low-income countries. The size of constituencies should be equalised with no single-seat constituencies.
- **Capacity** The capacity of executive directors (EDs) who represent developing countries would be significantly enhanced by reducing the size of the largest constituencies. There are currently some limited efforts to increase staff in these constituencies and widen their access to technical expertise.
- **Board transparency** In order to improve the transparency of IFI board meetings, detailed minutes should be published within two weeks. Formal votes should replace the current system of consensus decision-making. At a minimum, EDs should be required to publish the statements they make to the board.

- **Selecting leaders** A fair and transparent process for selecting IFI leadership is essential. All countries should be able to nominate candidates; there should be no restrictions placed on a candidate's nationality; and the voting process should be fair and transparent. When selecting leaders each member country should have a single vote.

Problems with the current system

Allocation of votes

It is widely perceived by many civil society groups, developing-country governments and academics that the IMF and World Bank are controlled and dominated by North America and Western Europe, while developing countries are marginalized. This is not simply a historical relic left over from a period when only a few countries were members of the IFIs. The root source of this power imbalance is the worsening inequality in the distribution of votes.

This inequality leads to two inter-related problems. Firstly, developing countries – which are directly affected by IFI decisions and are reliant upon them to address resource constraints – are unable to significantly shape IFI policies. Secondly, just one country, the United States, has a controlling share of over 16 per cent of the total votes in both institutions, giving it veto power for major decisions (which require an 85 per cent majority) and unrivalled influence. By contrast, the combined vote of 80 of the poorest countries eligible for the IMF's Poverty Reduction Growth Facility amounts to only 10 per cent.

More generally, this inequality means that G7 countries are relatively unrestrained in their pursuit of economic and foreign policy priorities through the IFIs. This small group of countries can agree policies outside the IFIs and implement these policies through them. Developing countries are continually adjusting to the latest economic fashions of the IFIs, which in turn are influenced by the needs of industrialised countries.

Inequality in the distribution of votes in the IFIs has worsened as the significance of the basic vote (250 votes) allocated to all members has declined in proportion to the number of votes allocated according to a country's economic strength.¹ The failure to maintain the value of the basic vote has shifted the balance of power further to industrialised countries. As this 'equity factor' has diminished in significance, the allocation of votes has moved much closer to one-dollar-one-vote.

The IMF's quota formula (based on GDP, foreign exchange reserves and trade flows),² is open to manipulation to the advantage of industrialised countries. For example, biases in GDP calculations lead to underestimation of the size of developing-country economies.³ Moreover, the quota formula is not applied as a fair and transparent means of determining a country's vote; instead, it is more generally used as a negotiating guideline. Thus, despite the increase in developing countries' share of world GDP and the decline of that of European countries, the allocation of votes has altered little. The failure to increase the votes of several Asian countries in

¹ Originally, the basic vote accounted for 11.3 per cent of total votes; today it accounts for only 3 per cent (Kelkar et al 2003).

² The quota formula is used to calculate the amount of capital paid in, access to IMF resources and the allocation of votes for each country.

³ See IMF 2001; Woods 1998; Kelkar 2003.

line with their growing economic power, for instance, diminishes the credibility of the industrial countries' argument that the allocation of votes is equitable on the basis of economic size.

The lack of any substantive recommendations to improve the fairness of the quota formula in the recent Cooper report produced by the IMF's Quota Formula Review Group reflects the parameters of their terms of reference and the unwillingness of powerful shareholders to address the equality issue. Its conclusions offer nothing more than options to 'retro-fit' the quota formula better to the existing distribution of votes.

In the case of the World Bank, particularly the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), the major shareholders have traditionally argued that their greater contribution of resources justifies their greater share of the votes. Historically, industrial country guarantees were indeed important for the IBRD's credit rating. But today they contribute only a small, declining fraction of the IBRD's capital through paid-in capital subscriptions. The IBRD raises most of its capital from the markets and earns additional income to cover running costs from loan repayments from middle-income countries (as does the IMF). While these countries are generating a significant proportion of net income (which helps fund the IDA), it is typically the larger, non-borrowing shareholders who decide how to spend it. IDA is thus increasingly dependent on its borrowers rather than rich countries.

Major shareholders of the institutions have also argued that the IFI system of consensus decision-making increases the influence of developing countries beyond their meagre votes. In fact, informal decision-making which relies on behind-the-scenes negotiation is likely to magnify the inequality in resources at the disposal of the executive directors, with those members with more resources better able to win a crucial argument.

Moreover, decisions at the boards continue to be taken when a majority of votes (informally counted) is achieved, not a majority of executive directors. Perhaps even more importantly, the weight of a country's voice, judged by its voting power, is critical in determining which specific issues and potential loans are actually brought to the table for discussion. The underlying voting power profoundly influences decisions. Voting allocation is therefore crucial to a country's influence (Woods 1998).

Allocation of seats on governing bodies

The unequal allocation of votes is magnified by the system of allocating seats on the IMF and World Bank boards and on the Development Committee and IMFC. Seats on these bodies are allocated on the basis of one per constituency with the five largest vote holders allocated one seat each (the US, UK, France, Germany and Japan). A further three countries are in single-country constituencies and therefore have guaranteed seats on the boards (China, Russia and Saudi Arabia). The remaining 176 member countries share just 16 seats between them.

In several constituencies, the executive director is appointed by the country with the largest number of votes, for example, Canada, Australia, the Netherlands, Switzerland, Italy and Belgium (in the IMF) head up their constituencies. In the remainder, which group together mostly developing countries who typically hold similar numbers of votes, the ED appointment is rotated amongst the members. Effectively, those countries with the greatest voting power also have a louder 'voice' since they can assume permanent membership of the board. Those countries most affected by IMF decisions are also most distanced from decision-making. These

inequalities are replicated in the oversight committees of the executive boards, the Development Committee and the IMFC.

Although the seats on both boards and the oversight committees are allocated more or less equally between high-income countries (creditor countries) and developing countries (debtor countries), in practice high-income countries represent only 19 per cent of all member countries. If seats were allocated proportionately between high-, middle- and low-income countries, then high-income countries would head up only five constituencies. The under-representation of non-industrialised countries is seen even more starkly if one examines the ratio in terms of population. Low- and middle-income countries as a group comprise 84 per cent of the world's population, yet they have only 30 per cent of IFI votes and less than half the seats on the executive boards.

Constraints on capacity

The size of a constituency is significant in determining to what extent each country can be represented by its ED. The most striking example is that over 40 sub-Saharan African countries are represented by just two EDs, while five G7 countries, which no longer borrow from the Fund or the Bank, are each represented by a single ED. Not only, therefore, do developing country EDs have fewer votes and are themselves under-represented on the boards, they have the additional burden of representing more people.

This leads to a much greater workload for developing country EDs. Each ED must deal with the business of representing his/her constituents, negotiating and implementing adjustment and debt relief programmes in addition to daily board business. Typically, they have less support from civil servants and technical expertise from their members' countries. Since the ED position rotates frequently in developing-country constituencies, it also means that these EDs are handicapped by less institutional knowledge of the IFIs. The result is that developing country EDs tend to have less capacity to invest time and energy into formulating and advocating policy positions.

Board transparency

That developing countries are under-represented in the institutions both in terms of vote and voice is clearly a problem made worse by the fact that the decisions taken by the board are not transparent. Decisions are reached by consensus, requiring no formal vote; this process may open up discussions to all EDs, but it also serves to make decision-making opaque, obscuring responsibility.

Most citizens in developing countries are not able, through domestic political structures, to hold their politicians to account for policies agreed at the IMF board. Nor are IMF staff or management accountable through national judiciary systems. It is imperative, therefore, that there should be transparency in decision-making at the institutional level.

Significant steps have been taken to improve board transparency by, for instance, releasing board papers and summaries of board discussions. Although these efforts are welcome, they do not result in the degree of transparency necessary for members of the public to know who is responsible for the decisions that affect them – a lack which is even more important when the decisions under discussion may have an adverse effect on people in the developing world.

Selecting IFI leaders

Given the far-reaching influence of the IFIs in developing countries, the heads of the IFIs are often as important to the lives and livelihoods of people in these countries as their own leaders, sometimes more so. Millions of people depend on the quality of IFI leadership. Yet startlingly few countries have any involvement in senior IFI appointments. The lack of democracy in the selection process became abundantly clear following the US government's rejection of Germany's first candidate for the IMF leadership in 2000.

Apart from the practice of the executive boards appointing IFI leaders, neither the World Bank nor the IMF has formal selection procedures. This has allowed the US and Western Europe to maintain the outdated arrangement by which the European governments select the IMF managing director and the US government selects the World Bank president (and other senior IMF staff). This arrangement can no longer be justified given the growing importance of other countries in the global economy and the diverse needs of the IFI membership. Clare Short, who until recently was the UK Secretary of State for International Development, remarked to the Parliamentary oversight committee on development issues last November that:

the US gets the World Bank and Europe gets the IMF...it cannot go on, surely. What about the rest of the world? The geographical carve-up is intolerable and the system for selecting is a kind of political fix system. [The present system] is an outrage ...and it needs continuing pressure to make it transparent.

The current process is not only unfair and 'intolerable'; it is potentially inefficient. By limiting the pool from which leaders and senior staff are selected, the IFIs run the risk that inferior candidates may be appointed. In any event, by selecting the most senior staff from the US and Europe, it is virtually guaranteed that office-bearers will have insufficient insight into the problems and aspirations of the majority of the membership. Not only are non-European and non-US members unable to nominate candidates, there is no opportunity for them to make a selection between nominated candidates since a list of nominations is not presented.

Options for reform

Allocation of votes

- **Increasing the basic vote**

The IFI voting system was established as a compromise between one-country-one-vote and one-dollar-one-vote. With the decline in the basic vote the system has moved much closer to the latter. With the aim of moving to a system based on one-country-one-vote, an interim arrangement in which the basic vote allocated to all members was increased would serve to strengthen the voice of poorer countries (Woods 1997, Bradlow 2000, Buirra 2002, Kelkar 2003).

Within that context, one proposal is to increase the basic vote to 18.3 per cent, giving each member country a minimum 0.1 per cent of the vote. This would result in a combined vote for developing countries (including votes linked to quotas) of 53 per cent, which would give them a slight overall majority. It would also reduce the US share to 14.74 per cent of total voting power and therefore remove its veto (Buirra 2002).

A developing-country majority would seem particularly appropriate for the World Bank given that, unlike the IMF, developing countries are the Bank's sole clients. This would not be a precedent. The constitution of the Inter-American Development Bank (IADB) ensures that borrowers hold a majority of shares. At the Asian Development Bank (ADB) the basic vote amounts to 20 per cent of all votes. This proportion of the basic vote to the total vote is maintained in the ADB's constitution. Similarly, for the IFIs, once an increase in the basic vote has been agreed, the Bank and Fund's articles of agreement should be amended to ensure that future capital/quota increases do not erode again the proportion of the basic vote relative to the total number of votes, although the option should remain to increase the proportion of the basic vote (Buirra 2002).

It should be noted that a substantial increase in the basic vote would increase the power of the smaller developing countries at the cost of the larger developing countries (such as India, China, Mexico and Brazil). To avoid the latter group blocking such a proposal, it would be necessary also to selectively increase the quotas of these countries and reformulate the quota formula to better reflect the relative weight of these countries in the global economy (Buirra 2002).

- **Double majorities**

A complementary option would be to require a double majority for decisions requiring a special majority (ie more than 70 or 85 per cent in agreement). The majorities of both developed and developing countries should be in favour for a decision to be accepted. Alternatively, a vote could require a majority of EDs to support a measure as well as a majority of votes/shares; the equitability of this option would be enhanced if more board seats were allocated to developing countries (see below).⁴

- **Reforming the quota formula**

The use of the quota formula to determine amounts to be paid to the IMF,⁵ voting allocations and borrowing limits is no longer useful. This practice reflects a period when all members were expected both to contribute and borrow from the IFIs. To improve transparency, there should be separate mechanisms to determine:

- **IFI contributions** A country's contribution to IFI resources should be based on its ability to pay.
- **Borrowing limits** Access to resources should be determined on the basis of need, with an upper limit established to ensure sufficient resources remain for the use of other members.
- **Voting allocations** Until a system of one-country-one-vote is introduced, allocations of votes additional to the basic vote should be determined according to a transparent formula based on economic size and population size. GDP should be calculated in relation to purchasing power parity (PPP) rather than market exchange rates, in order to more accurately represent the real size of developing countries' economies (Woods,

⁴ In the Global Environment Facility (GEF), a double majority is required for decisions that cannot be reached by consensus. A vote requires that a majority (60 per cent) of the total number of participants in the GEF must be in favour as well as a majority (60 per cent) of contributions to the fund (Woods 1998).

⁵ The World Bank does not adhere to a formula but allocates shares according to market size, roughly paralleling the allocation in the IMF.

1998, Kelkar 2003). Whether a country is a borrower or a creditor to the IFIs could also be taken into account with the former receiving a higher weighting.

To ensure transparency and good governance, the formulas should be strictly applied so that each country's voting allocation is impartially derived from the formula rather than serving as a guideline for political negotiation. No country should have a voting share that would give it veto power, as this fundamentally contradicts the principles of multilateralism.

Increasing and/or reallocating seats

• Seats on the board

There has been some discussion about increasing the number of seats on the board (Griffith-Jones 2002, Evans and Finnemore 2001). Logically, this is appropriate since membership of the institutions has grown considerably more than the board, forcing constituency sizes to grow. Since 1944, the number of members has increased from 39 to 184 countries, while the number of EDs has only risen from 12 to 24. Griffith-Jones proposes that one new seat should be created for sub-Saharan Africa, while Evans and Finnemore advocate two more seats. However, not even this proposal fundamentally addresses the imbalance of power between developed and developing countries and fails to acknowledge the growing influence of Asian countries.

The conservatism of these proposals reflects the argument of industrialised countries that expanding the board will impede the decision-making process. Clearly this would not be desirable. But it should not be assumed that the marginalisation of developing-country interests in the current process achieves equitable or appropriate decisions.

Limited board size need not be an impediment to democratic representation if seats were reallocated in favour of developing countries and constituencies reconfigured to achieve an equal number of constituents.

It is tacitly accepted that the countries with most votes, that is the industrialised countries, should be represented on the boards of the IFIs. This tends to reinforce the existing voting inequalities. IFIs have negligible policy influence over these countries; as a group, they tend to hold similar positions and are at similar stages of development. Given the importance of the IFIs in developing countries, and their diversity, it is arguable that the majority of seats should be allocated to them. This would go some way to achieving a better balance of power and introduce a wider range of views into discussions.

The obvious candidates for a reduction in seats are the European countries which have the largest number of representatives on the boards (holding 8/9 seats out of 24), particularly since five of these countries (Belgium, Netherlands, France, Germany and Italy) are part of the Euro currency system.

Ultimately, it would be desirable to move to a structure where there:

- are no single-member constituencies
- are no more than eight countries per constituency (originally EDs represented no more than five countries)

- is no permanent representation by any one country of a constituency, with terms fixed for a maximum of three years.

Constituencies could be reallocated in a number of different ways, any of which would mark an improvement. For example, constituencies could be grouped:

- into an equal number of low-income, middle-income and industrialised country constituencies
- so that each constituency includes an even spread of countries at different stages of economic development
- according to population size, so that each constituency represents a roughly similar number of people
- by region.

It would be preferable if constituencies could include a number of these features (Wood 2001).

In addition, since the executive boards are supposed to oversee the management and staff of the IFIs, it is inappropriate that the chairs of the boards are the managing director and president. This leads to the perverse position that the board tends to be dominated by the staff. It would be more appropriate if the chairs were rotated amongst the EDs with each serving a six month or one year term. This would ensure that the executive board rather than the managing director or president set the board's agenda.

• **The IMFC and Development Committees**

There is no convincing reason why the IFI oversight committees should have more developed-country than developing-country members. The current allocation of seats simply replicates existing inequalities. A better arrangement would be to allocate seats equitably between industrialised, emerging-market, middle-income and least-developed countries, with an equitable regional spread. To expand representation, those countries with representatives on the executive boards should not be allowed to appoint representatives to the oversight committees. Terms of office should be fixed and rotated every three years.

Changes also need to be made to the election of the chair. The chair of these committees is an important position offering significant opportunities to set priorities for discussions and influence debates. Unlike the chair of the Development Committee, which rotates every two years, the chair of the IMFC can be held for as long as s/he maintains the support of the committee. Also unlike the Development Committee, the chair has never been held by a developing country. This practice should be revised so that the chair rotates among all members of the committee.

There has been some discussion of transforming the IMFC into a council that would have greater formal involvement in key IMF decisions. The same should be considered for the Development Committee. At present, both committees have an advisory role, and help direct the IFIs, but they have no formal role in decision-making.

Increasing resources to address capacity

IFI resources allocated to ED offices are distributed equally, regardless of how many countries the office represents. This gives a greater benefit to the single-country constituencies and to those who do not represent programme (borrowing) countries, both of which have a much smaller workload compared to those ED offices which represent large groups of programme countries. This system should be replaced by one in which resources are allocated according to the number of countries in each constituency and whether these are programme countries. Developing-country constituencies would thereby receive more resources. One way to achieve this objective would be to transfer staff from single ED offices and smaller constituencies to the larger ones.

Transparency of board decisions

The IMF must be more open about its proceedings and give a greater voice to developing countries when discussing issues of direct relevance to their economic well-being. Hence we believe there is a case for publishing both the agenda and minutes of the executive board meetings.

UK Treasury Committee Third Report, 1999-2000 session

Transparency of board decisions must be improved. The board should hold formal votes and publish the results of how each country or constituency voted. A second-best option, should consensus decision-making be retained, would be to require EDs to publish the statements they make to the board. In both cases, detailed minutes of board meetings should be published within two weeks.

Making public the minutes of IMF board meetings would help to clarify the positions of both board members and management. Objections to making minutes public may be raised on the grounds that discussions would be less frank. However, the UK government's experience of publishing the minutes of Monetary Committee meetings is that the benefits of transparency outweigh the costs. The minutes should specify which executive directors have expressed support for a decision, and which have withheld support or proposed amendments.

Selecting IFI leaders

In all of these [international] institutions, the UK government favours open and competitive processes for the selection of top management. This could include a definition of the competencies for the post, selection and search committees and a clear process for taking the final decision, in which competence would be put above considerations of nationality.

UK government, 2000

The report by two ED committees investigating the IFI leadership selection process following the appointment of Horst Kohler as IMF managing director in 2000 made useful recommendations on the search and selection process. But the report failed to tackle the fundamental issue of the nationality of candidates.

The following proposals would go some way in moving towards a more fair and equitable appointment procedure:

- the establishment of a search committee to assist and oversee the whole process, formed from a grouping of knowledgeable outside experts
- that all IFI members should be able to nominate candidates, with no limitation on nationality
- that candidates are interviewed by the ED committee, with proceedings open to all EDs (who attend in an observer capacity)
- that selection is made in a two-stage voting process whereby the first two candidates from the first round are shortlisted for a final round of voting. The winners of the first round are made public prior to the final vote
- that each member has one vote.

In addition, it is inappropriate that the US should appoint the deputy managing director at the IMF. All senior management posts should be appointed in accordance with transparent, competitive procedures.

References

Buira, A, 2002, 'A New Voting Structure for the IMF', preliminary draft (mimeo).

Evans, P and A Finnemore, 2001, 'Organizational reform and the expansion of the South's voice at the Fund', Washington DC.

Griffith-Jones, S, 2002, 'Governance of the World Bank', IDS, Sussex.

IMF, 2001, *Financial organization and operations of the IMF* Washington DC.

Kelkar et al, 2003, *Reforming the governance of the International Monetary Fund* (forthcoming).

Wood, A, 2001, 'Structural adjustment for the IMF: Options for reforming the governance structures', Bretton Woods Project, London.

Woods, N, 1998, 'Governance in international organisations: The case for reform in the Bretton Woods institutions', International Financial and Monetary Issues, UNDP.