Democratizing the IMF

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The Need

The international economic system is a major determinant of the economic performance and social progress of developing countries. The international financial system has played a particularly important role over the last 25-30 years, through the effects of debt and financial crises, the mechanisms used to deal with them, and direct and indirect constraints on policy space.

The decisions made in the IMF play a central role in shaping this system; and the Fund's governance structure, in turn, shapes these decisions. Voting reform is not the only issue in this context – others include the Fund's accountability to its members, the non-transparency of its policy-making processes, and the appointment process for its Managing Director; but voting reform must necessarily play a central part in any meaningful process of governance reform.

The current system of economically-weighted voting places effective control of decision-making power in the hands of the developed country governments. This is largely because it gives the developed countries, which account for one-sixth of the world's population, more than 60% of the votes. However, this is further compounded by four other factors:

- a constituency system in which many developing countries are in constituencies dominated by developed countries, and Executive Directors are unable to split their votes;
- an asymmetry in the accountability of Directors representing constituencies and those appointed directly by the major developed country governments;
- the excessive workloads and inadequate resources of Directors representing large developing country constituencies; and
- the more limited potential for coordination by Directors representing developing country constituencies than for developed country groupings such as the G7 and the European Union.

The resulting concentration of power in the hands of the developed country governments, in an institution whose policies almost exclusively impact on developing countries, has seriously limited the Fund's effectiveness, legitimacy and credibility. It is now also arguably endangering its viability, both politically and financially.

The developed countries' dominance of the IMF has resulted in its failure to tackle the serious debt problems of Sub-Saharan African countries in the 30 years since the crisis began in Zaire; it has seriously undermined the effectiveness of the Fund's response to the financial crises in Asia and other emerging market economies in the 1990s; and it has resulted in the continued promotion of neo-liberal economic policies across much of the developing world in the face of increasing doubts about their appropriateness or effectiveness. These factors together have contributed substantially to a dramatic slowdown in the rate of poverty reduction and health improvement in developing countries since the 1980s. Further serious risks arise from the constraint the economically-weighted voting system imposes on the Fund's ability to act independently and effectively to avert the current threat of a disorderly adjustment of global imbalances, when the US holds one-sixth of the total votes.

The Opportunity

Voting reform in the IMF, though by no means a panacea, could thus contribute substantially to the establishment of a more conducive global environment for sustainable economic and social development. This gives the developing countries a strong interest in securing major reform; and the current five-yearly Quota Review provides an opportunity for them to initiate such reform.

In the past, the Fund's weighted voting system, together with the threefold role of quotas (as determinants of financial contributions and access to Fund resources as well as voting weights) has given rise to considerable inertia, as the developed country governments have been able to use their dominance of voting to protect the system which confers power on them. However, this is beginning to change, for two reasons.

First, emerging market economies have responded to the failings of the IMF in dealing with the financial crises of the 1990s by building up large international reserves, to avoid future crises and avert the need for IMF involvement should they arise. They thus have the means to establish their own mechanisms for crisis prevention and response, under their own control – and have taken some first steps towards doing so. Thus, they have a *credible "walk-away" threat*. Since the IMF is dependent on interest from its loans to finance its operating costs, and is already under increasing financial pressure as many middle-income countries are opting to repay their loans early, this represents a potentially serious threat to its continued viability. This is a major bargaining chip in negotiations.

Second, there is increasing public awareness in developed countries of the acute problems facing many low-income countries, particularly in Sub-Saharan Africa. Together with the central role of the IMF's failure to tackle the debt crisis effectively in creating these conditions, and the clear disparity between the governance system of the Fund and the democratic principles generally accepted as appropriate at the national level, this gives a *strong moral case for reform*, which could be used to generate considerable public pressure for reform in developed countries. This could be reinforced by stressing the parallels between the IMF (as an institution controlled by developed country governments, while exerting a considerable level of control over policies in developing countries) and the colonial era.

If developing countries can combine these two instruments in support of their case effectively, this could allow them to make considerably more progress on IMF voting reform than has previously been possible. However, this requires a united front between those middle-income countries able to credibly make the "walk-away" threat and the low-income countries which can most effectively exploit the moral case. Their political strength could be further increased by extending the concept of an alternative to the IMF as a broad South-South institution encompassing low-income as well as emerging market economies.

The Options

The potential benefits (or costs) of different options for the IMF voting system can be judged against eight criteria.

- congruence with generally accepted democratic principles;
- congruence with cooperative or credit union governance principles;
- adequate representation for all individual countries;
- avoidance of domination by one country or country grouping;
- proportionality of differences in voting weights between countries;
- appropriate balance of voting weights between "creditor" and "borrowing" countries;
- adequate representation for all country groups; and
- potential for a reasonably symmetrical constituency system.

Politically, if a proposal is to secure the breadth of support among developing countries required to allow the political possibility of reform, it is also important to ensure that it increases the votes of as many developing countries as possible, and in particular, to minimize the number of politically important countries whose votes are reduced.

A number of options for voting reform are currently under consideration. The Cooper Commission proposed a revised quota formula based on GDP and variability, supported by the US, and the European Union has proposed a formula based on GDP and economic openness. However, both these proposals substantially *worsen* the system in terms of the above criteria, and have serious negative effects on developing countries. It is therefore particularly important to ensure that discussions of quota reform do not degenerate into a debate between these two options.

More positively, there is now a commitment to "at least doubling" the *basic vote* from the current level of 2.1% of total votes. However, while the effects of doing so would be more favourable, they would remain negligible even if the basic vote were returned to its original relative size (11.3% of voting power), and would become substantial only if it reached 50%.

An alternative quota formula proposed by Ariel Buira (based on GDP at purchasing power parity) would provide a more significant improvement in terms of the criteria proposed above, and would offer some benefits to developing countries as a whole. However, besides remaining subject to data problems over the medium term, its effects would be relatively limited, leaving the dominance of the developed countries largely intact. Moreover, while relatively few developing countries would see their votes reduced, these include a disproportionate number of politically important countries, including Argentina, Chile, Malaysia, Nigeria, Russia, South Africa and Venezuela.

A more promising option in principle would be to abandon the principle of economically weighted voting altogether, by de-linking voting shares from quotas and basing them exclusively on population. Besides shifting voting power more decisively towards developing countries, this would have the political attraction of orienting the debate towards one of principle (economically weighted voting versus democratic principles) rather than technical arguments about how best to measure relative economic weights.

Making *votes directly proportional to population* would arguably result in too great a concentration of power in India and China, while almost all other countries would lose, many smaller countries having a negligible voting share. This could be limited by *coupling a population-weighted vote with a greatly increased basic vote*, equal for all countries; but this would result in a considerable degree of compression between the votes of all but the few largest countries. Again, a number of politically key players would be among the losers, including Argentina, Korea, Malaysia, Mexico, Russia, South Africa and Venezuela, and potentially (depending on the level of the basic vote), Brazil, Chile and/or Iran.

A more favourable alternative, in terms of the proposed criteria and of the implications for developing countries, would be to make votes proportional to the *square root of population*. This performs well against the criteria outlined above; and, while there would be some politically important losers (Argentina, Russia and Venezuela), these are fewer than for the above options.

Clearly, the elimination of economically weighted voting is not on the agenda for the current quota review. However, it is both a legitimate demand and a desirable long-term objective for developing countries, as well as reorienting the debate to the advantage of democratization. This suggests a need for a common fall-back position, which at the same time offers substantial benefits to developing countries in the short-term, and is consistent with continued pressure to the long-term objective of democratization.

Such an option is provided by the recent proposal by Zaidi and Mirakhor, which combines a much larger basic vote based on the one-country-one vote principle, with a second basic vote directly proportional to population, and a revised quota formula which gives more equal weights to capacity to finance the Fund and need for access to Fund resources. While some further work is needed to develop and refine the quota formula, this provides a useful basis for further progress. Once the dual basic vote principle is established, pressure could be applied in subsequent quota reviews for progressive increases in the weights attached to the basic votes as a means of diluting economic weighting, with a view to achieving parity between the three components.

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This Policy Brief is based on the author's paper, IMF Voting Reform: Need, Opportunity and Options written for the G24 Technical Group Meeting held in New York on 12 March 2007 (supplemented by his forthcoming paper for the Global Knowledge Network on Globalisation and Health, entitled IMF and World Bank Governance: Implications for the Social Determinants of Health). Readers are referred to these papers for more detailed discussions of the issues.