Governance at The International Monetary Fund

James Raymond Vreeland, *Georgetown University*

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1. Introduction

The current financial crisis adds impetus to the demands for the reform of the governance of the International Monetary Fund (IMF). One area in dire need of change is the voting structure. Strange is it that China should only have about three-quarters the vote shares as France or the United Kingdom. And it is, quite frankly, preposterous that a tiny country the size of Belgium should have fifty percent more vote shares than a country the size of Brazil, one of the ten largest economies in the world.

Reform of governance, however, must go beyond just cosmetic changes to vote shares. The largest shareholder will surely remain the United States, as it should, since the United States will remain the largest contributor. Shifts in vote shares, therefore, will not be sufficient to see real changes in the way the IMF has been governed. Other important innovations must also be forthcoming.

Some claim that the IMF has irrevocably lost legitimacy due to past mistakes, and, thus, a new Global Economic Council should be formed, perhaps with governance based on the model of the United Nations Security Council (UNSC). Is the solution to the problems of the IMF an additional international organization? I would rather consider major reform of the old institution (or straightforward replacement) before we add to the international bureaucracy.

Still, a comparison of the governance of the IMF to that of the Security Council is apt. It is widely believed that the United States and its allies virtually control the IMF, especially on issues they really care about; but the United States clearly does not control the UNSC, as evidenced by its frequent public failure to win sufficient votes on resolutions it cares about. To be sure, part of the reason for this is that rivals Russia and China have veto power on the UNSC. Sometimes, however, the veto comes from France. When it comes to the IMF, however, US-French disagreements are rarely disclosed. In fact, for all of the controversy surrounding the decisions of the IMF's Executive Board, we almost never hear about disagreement at the IMF. This is because the IMF operates according to behind-closed-doors "consensus."

In both the UNSC and the IMF, negotiations take place behind closed doors, as is appropriate for politically sensitive matters. In the end, however, only one of these two institutions holds members accountable. At the UNSC, votes on resolutions are by open ballot. Many security issues are sensitive, but we still hold members of the UNSC accountable as they must vote in favor, opposed, or abstain on all resolutions. *At the IMF, official votes are never taken.* Governments do not go on public record as supporting or opposing any of the sensitive and important decisions regarding international economics that the IMF makes. There is no open ballot – indeed, there is not even a secret ballot. Supposedly, all of the world agrees to a "consensus" on the most important economic decisions facing the developing world. Most people believe this is a "consensus" dominated by the United States, and its allies.

Interestingly, setting aside the issue of the open ballot, the governance of the UNSC is inferior to that of the IMF in at least three other dimensions: (1) The IMF has better *regional* accountability for Executive Board members representing a group of countries. (2) The power structure at the IMF is more flexible and can accommodate changes in power relations across countries much easier than can the UNSC. (3) There is a greater diversity of voices and points of view at the IMF than at the UNSC. Both institutions grant greater say to their great power members, and both also require some support from the rest of the world. Yet, the "rest of the world" actually has a stronger voice – at least in formal voting terms – at the IMF than at the UNSC.

All of the advantages of IMF governance, however, are undermined by the lack of an open ballot. Accountability is stronger at the UNSC because voters around the world know how their governments vote on matters of global security. We are left in the dark when it comes to matters of international finance.

In what follows, I compare the governance structure of the IMF and the UNSC. To anticipate, I have four main points:

(1) **Open Ballot Accountability**: The principal advantage of the Security Council model is that votes are by open ballot. At the IMF, all decisions are behind closed doors, and they usually do not even take actual votes, relying instead on "consensus." While sensitive negotiations should remain private, and a delay may be required before some votes are eventually announced, the members of the IMF executive board should be held to account.

(2) **Representation and Regional Accountability**: Regional representatives should be selected by the region. Neither the Security Council nor the IMF has this quite right. The Security Council has designated regional representatives but gives the final say on filling the seats to the United Nations General Assembly not to the region. There are term limits, which further reduce incentives to represent the region. The IMF system is unstructured, so a country like Switzerland can (and does) end up representing Tajikistan, but at least there are no term limits, so representatives work hard to win reelection from their constituents. The IMF should continue to allow reelection, but should have designated regional representatives selected by the regions themselves. This would allow regional powers like Brazil, India, Japan, and South Africa to serve with continuity and regularity. Note that as long as the regional representative is elected by the region itself, the representatives can only be reelected if they act as good neighbors and pursue the interests of the majority in the region.

(3) **Choosing the Great Powers**: The great powers on the Security Council were determined back at the end of World War II – for all time. The great powers on the IMF have evolved over time as changes in economic dominance has changed. The IMF system is superior. The problem is that "economic dominance" is partly defined by US interests because the United States has had a veto over changes to voting rights. Both systems thus suffer from obvious problems that should be addressed. In short, emerging market countries deserve more votes, and votes should be assigned according to an open, transparent process.

(4) **Great Power and "Rest of the World" Support**: Finally, there is the question of voting rules and qualified majorities. The voting rules of the Security Council allow for true

> domination by the great powers, while the IMF allows the rest of the world to have much more say (at least according to the formal voting rules). Whether one voting structure is preferable to the other depends. Great powers may be willing to provide more financial support if they are dominant, but the price is a muted voice from the rest of the world.

Below, I elaborate on these points. There are short sections on *Open Ballot Accountability*, *Representation and Regional Accountability*, *Choosing the Great Powers*, and *Great Power and "Rest of the World" Support*. The concluding section summarizes my suggestions.

2. Open ballots

The major difference between the UNSC and the IMF is transparency in the voting process.

With the Security Council, votes are open ballot, taking place on the international stage. This is not to say that the Security Council holds no private negotiations. To the contrary, there is a private meeting room adjacent to the public meeting room where many sensitive negotiations take place and private information is shared. Often resolutions are entirely drafted by the P3 (United States, United Kingdom, and France), and disagreements are worked out behind closed doors. Candid, private discussions can be most conducive in working out tricky issues that would be impossible in public. In the end, however, resolutions are voted in public, so members can be held accountable.

By contrast, the IMF executive board does *everything* behind closed doors. There is a sophisticated system to allocate votes to each member, according to the size of the contribution each member makes – which in turn is designed to reflect the economic importance of each member. Yet, votes are not actually taken. As explained by the IMF,

> The executive board rarely makes its decisions on the basis of formal voting, but relies on the formation of consensus among its members, a practice that minimizes confrontation on sensitive issues and promotes agreement on the decisions ultimately taken (Driscoll 1997: 9).

Many suspect that a system relying on "the formation of consensus" to "minimize confrontation" really allows a powerful country like the United States to exercise more power than its official vote share. Ironically, the "sense of the meeting" approach apparently came about in the early years of the Fund as a means for the US Executive Director "to exercise his power without convincing the rest of the Directors that discussion was futile because the US view would prevail" (Southard 1979, cited in Thacker 1999). It is reported that lengthier discussions in search of common ground did result. Some claim even today that the consensus approach allows small countries the opportunity to have influence well beyond their voting power because a carefully turned phrase may persuade powerful members.

The problem is that we simply do not know how the IMF makes decisions. The obscure decision-making process allows governments to exploit the IMF to do political "dirty work" (Vaubel 1996) – powerful governments have been known to funnel IMF loans to strategically important countries, while recipients of IMF loans use the obscure IMF lending process to pursue partial reforms that protect elite constituencies.

The IMF should introduce an open ballot. To be clear, I support behind closed doors negotiations. Regarding certain decisions, such as devaluations, votes should remain secret until action has been taken. A delay on releasing votes may be appropriate – along the lines followed by some central banks. But in the end, the IMF Executive Board should be held to account with Directors going on record with their support, opposition, or ambivalence.

3. Representation and accountability

The IMF is often criticized because it does not afford representation to developing and emerging market countries. Yet, in terms of regional representation, the IMF is better than the Security Council.

Representativeness is certainly built into the Security Council. On one hand, the five countries considered most important for international peace and security have permanent seats and have veto power. On the other hand, there are ten temporary seats assigned to specific regions - three for Africa, two for Asia, two for Latin America, one for Eastern Europe, and two for Western Europe and Others (e.g., Australia). Countries are elected from these regions to serve for two years (limited) at a time.

Resolutions must receive no vetoes and nine affirmative votes. The logic of this structure is that resolutions only pass if the great powers agree (or at least not disagree – abstentions are allowed), and they also require some support from the rest of the world (at least four additional votes beyond the permanent five, more if there are abstentions).

This structure gives the resolutions of the Security Council great legitimacy: great power approval along with some support from the rest of the world (see Hurd 2007).

The problem is that there are no mechanisms for accountability. To be blunt, the incentive structure is all wrong due to two institutional features: (1) regional representatives are elected by the General Assembly, and (2) regional representatives face term limits.

Election to the Security Council is by two-thirds majority of the General Assembly. So, even though countries are supposed to "represent" their region, the regions does not select their representatives. To be sure, the spirit of the Council is to allow regions to choose, and when a region nominates just one country for a seat, it is usually respected. But sometimes more than one country runs – countries can self-nominate. In these cases, it is the rest of the world, not the region, who chooses the winner. So, to win election, a government must curry favor with countries outside of its region.

More importantly, however, governments have no incentive to serve as true "representatives" (either for their regions or for the rest of the world) because they cannot be reelected. Most countries serve on the Security Council less than once every ten years. So governments have little incentive to do a good job while serving. As a result, their votes may be bought. Susan

Rose-Ackerman (1999), an expert on corruption, has proposed that politicians are most susceptible to corruption when the probability of reelection is either so high that they can get away with anything, or so low that they cannot be reelected no matter what. With term-limits, reelection is an impossibility, so governments simply have little reason to do what would be necessary to win votes again. In other words, they do not have an incentive to vote the way other countries in their region would like. Perhaps as a result of these short time horizons, Security Council votes have been bought with direct foreign aid (Kuziemko and Werker 2006, Thompson 2006). Sometimes governments actually obfuscate the process by going through other international institutions – governments serving on the UNSC are actually more likely to receive World Bank and IMF programs (Dreher et al. 2008, 2009).

At the IMF, the Executive Board has 24 members, and the five most important members – as determined by contributions – have appointed seats. The nineteen remaining seats are filled through weighted elections with, again, votes pegged to economic importance.

The problem with the IMF's "regional representatives" is that the process is unstructured. In practice, countries group by region. But this is not written, and there are exceptions. I call these holes the "Swiss problem":

Since the late 1990s, Switzerland has catered the favor of a group of newly independent Eastern European and Central Asian states, winning enough votes to secure a seat on the Executive Board. It may be preferable to have designated regional representatives. This would guarantee that the Executive Directors come from the region they represent.

Note, however, that even in the case of the Swiss Executive Director, the incentives are such that the Director is attentive to his constituents. Because Switzerland cares about having a seat on the Executive Board, they cater their IMF representation (and bilateral aid) to the countries it represents.[1] This is because the each Executive Director is directly elected by the countries he[2] is supposed to represent and depends on those votes for reelection.

Regional representatives come from clearly defined regions; they should be elected by the region; and they should be eligible for reelection. This structure not only provides the proper incentives for some kind of meaningful representation, it also builds flexibility into the system to accommodate rising regional powers. Presumably, a regional power should be able to win election more often than a smaller, weaker country. This allows the governance to reflect changing power dynamics over time. Importantly, however, the election and reelection of a regional power relies on winning the votes of other countries in the region. So rather than promoting domination by a regional power, the incentives are structured to promote cooperation and good regional relations in order for a country to serve as the regional representative.

4. Choosing the great powers

The major problems in assigning votes at the IMF are the lack of transparency in the process and the veto power of the United States. The system does, however, have some desirable features. At

[1] Currently, Azerbaijan, Kyrgyz Republic, Poland, Republic of Serbia, Tajikistan, Turkmenistan, and Uzbekistan.
[2] They are nearly always men.

least in principle, flexibility is built in, so that representation can change to reflect global power dynamics.

The great powers on the Security Council are the victors from World War II: the United States, the United Kingdom, France, China, and Russia. These were once the most relevant powers for peace and security. As they are permanent, they have not changed, and attempts to add emerging powers such as Japan, Germany, India, and Brazil have been unsuccessful. The rigidity of the system dooms the Security Council to becoming less and less relevant as new military powers emerge.

The IMF also has five top members who get appointed seats on the Executive Boards. They do not wield veto-power like the great powers on the Security Council, and they are not permanent. On the IMF, for example, there have been changes over time:

- From 1946 to 1958, the appointed Directors were from the United States, the United Kingdom, ***China***, France and ***India***.
- In 1959 and 1960, a sixth Director was appointed by ***Canada***.
- From 1961 to 1968, the appointed Directors were from the United States, the United Kingdom, France, Germany, and ***India***.
- From 1969 to 1970, a sixth Director was appointed by ***Italy***.
- Finally, starting in 1971, the top five members that appoint Directors today emerged, as Japan joined the United States, the United Kingdom, France, and Germany. ***India*** was able to appoint a sixth Director in 1971 and 1972, and ***Saudi Arabia*** was able to appoint a sixth Director from 1979 to 1992. Otherwise the top five have remained the same for over 30 years.

In addition to the appointed directors, some countries have enough votes to elect a Director singlehandedly, such as Russia and China currently.

The flexibility of the IMF system has allowed the institution to adapt to rising and declining economic powers, ensuring that the top members are the most relevant. The problem with the system is its lack of transparency.

As mentioned above, voting power is determined by contributions to the institutions. This is a good thing in that it gives a greater say to countries who contribute more, but some countries would gladly contribute more but are prevented.

Roughly, the contributions to the IMF is determined by economic variables like GDP and measures of trade and exchange. A formula is used to get the process started. But then the numbers can be adjusted by the current Executive Board. Because an 85 percent majority is required for changes in contributions, the United States has de factor veto power with about 17 percent of the votes.

The United States gets close to the results it wants by principally weighting the votes according to Gross Domestic Product measured nominally. If the IMF were to switch to using GDP measured in terms of purchasing power parity, the voting shares of many countries would dramatically change. The major shareholder's votes would not change very much – the US would still have the most voting power by far. But smaller industrialized countries, such as those in Western Europe, would have their vote shares cut dramatically. The windfall would go to emerging market countries. China, for example, would have nearly double the votes of Japan – instead of the other way around, which is the way it is currently. Belgium would have less than one third of the votes that Brazil would have – presently Belgium has fifty percent more votes than Brazil.

So, while the flexibility of the IMF system of governance is preferable to the permanence of the Security Council, neither is ideal. *Vote shares at the IMF should be determined transparently using measures calculated by disinterested parties*.[3]

5. Qualified majorities

Both the Security Council and the IMF have voting systems that favor great powers. There is legitimacy in this: for action to be taken, there must be great power approval along with some support from the rest of the world. What is interesting is that the IMF requires much more support from the rest of the world than the Security Council.

Voting at the Security Council is highly skewed in favor of the great powers. The veto power that the top five members possess make them pivotal in breaking all resolutions. The chances that one of the regional representatives is pivotal in either making or breaking a resolution are slim. Using a method of calculating voting power where all possible combinations of voters are considered and checking the frequency with which a member's votes are pivotal in making, breaking and blocking majority coalitions, Barry O'Neill (1996) shows that the great powers on the Security Council have more than 98 percent of the voting power. The regional representatives are pivotal in less than two percent of possible voting coalitions.

Veto power at the IMF is reserved for changes in voting power and appointment of the Managing Director, which both require 85 percent majorities, giving the United States de factor veto power. Otherwise, decisions are taken by a simple majority rule, according to the weighted votes. Since votes are weighted by economic power, this still gives the stronger economic powers more say than the rest of the world, but some support is still required from the rest of the world – much more so than on the Security Council. Using vote shares from the late 1990s, I calculated the voting power (as opposed to the vote share) of the top five members of the IMF to be about 60 percent if they vote as a block. So, in a worst case scenario, where the top members vote as a block and the rest of the world does not, the cumulative voting power of the rest of the world is still about 40 percent. Since the late 1990s, more vote shares have gone to the rest of the world, so the system has become even more representational. The problem, as laid out above, is that votes are never formally taken.

Should the IMF change its majority rule system? The answer depends on the role the IMF is expected to play in the global economy. If the IMF is to have an advisory role and mainly

[3] The downside of a PPP measure is, of course, that it would not provide the same incentives for contributions to the system for certain countries on the margins. Perhaps an average of the two measures would provide a good compromise.

perform surveillance of the global economy, then a rule that allows for greater representation and more voting power for the developing world may be appropriate. If it is to take on a major role in bailing countries – even developed countries – out of financial crises – and hence be entrusted with immense capital subscriptions – then giving greater say to the major powers might be appropriate. Only if it is to be a truly large institution, along the lines of Lord John Maynard Keynes' *Proposals for an International Currency (or Clearing) Union*, is veto power appropriate. Otherwise, *the current voting rules may be appropriate*. What needs to change is the way in which vote shares are allocated and the fact that votes are never taken.

6. Suggestions

Following the observations and arguments above, I suggest the following governance reforms for the IMF:

(1) Voting should be by open ballot. A delay in releasing these votes is reasonable for sensitive matters, but the Executive Board should be held to account.

(2) Regional representatives should come from clearly defined regions. They should be elected by the region. They should be eligible for reelection.

(3) Voting rights should be assigned according to a transparent process. They should be pegged to economic size, but the measure of economic size should be determined by a disinterested party. (Using Gross Domestic Product as measured according to purchasing power parity is recommended. Such data are collected by the Penn World Tables.)

(4) The voting rules should continue to combine a measure of greater weight for the most powerful members and also require some support from the rest of the world.

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