

## Three treaties for the reform of the IMF and the World Bank

### Background

- 5.1 This chapter considers three treaty actions for the reform of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (the World Bank):
- *Proposed Amendment of the Articles of Agreement of the International Monetary Fund to Enhance Voice and Participation in the International Monetary Fund (IMF Voice and Participation Amendment);*
  - *Proposed Amendment of the Articles of Agreement of the International Monetary Fund to Expand the Investment Authority of the International Monetary Fund (IMF Investment Authority Amendment); and*
  - *Proposed Amendment of the Articles of Agreement of the International Bank for Reconstruction and Development to Enhance Voice and Participation in the International Bank for Reconstruction and Development (World Bank Voice and Participation Amendment).*
- 5.2 The three treaty actions were presented together with a single National Interest Analysis (NIA). According to the Treasury, the three treaties were presented together because they have the common aim of improving the effectiveness and legitimacy of the IMF and the World Bank.<sup>1</sup>

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1 National Interest Analysis (NIA), Para 8.

## Government request to expedite consideration and Report 104

- 5.3 The three treaties were tabled in Parliament on 20 August 2009<sup>2</sup>, with the Committee's time for consideration expiring on 18 November 2009.
- 5.4 On 27 August 2009, the Treasurer, the Hon Wayne Swan MP, wrote to the Committee to request that a recommendation on treaty action in relation to these three treaties be made by 10 September 2009.
- 5.5 In support of this request, the Treasurer advised that 10 September 2009 was the last date on which member nations could advise the IMF that they had accepted the reforms contained in the IMF Voice and Participation Amendment and the IMF Investment Authority Amendment if the member nation wished to be included in the list of countries accepting the amendment presented to the G20 meeting on 24 and 25 September 2009.<sup>3</sup>
- 5.6 The Treasurer argued that, as Australia had been co-chair of the G20 Working Group on IMF Reform, it would be politic for Australia to be amongst those seen to be supporting the reform of the IMF. The Treasurer also stated that having the reforms agreed prior to a forthcoming G20 summit would substantially assist Australia's negotiating position on future reforms.<sup>4</sup>
- 5.7 After conducting a hearing with Treasury officials and satisfying itself that ratification of the treaties was in Australia's interests, the Committee agreed to the Treasurer's request. On 9 September 2009, the Committee tabled Report 104, which indicated the Committee's support for binding treaty action in relation to the three treaties.<sup>5</sup>
- 5.8 In making this recommendation, the Committee noted that it would provide a more detailed report on the treaties at a later date.<sup>6</sup>

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2 Parliament of the Commonwealth of Australia, House of Representatives, *Votes and Proceedings* No 113, p. 1268.

3 The Hon Wayne Swan MP, *Correspondence*, 27 August 2009.

4 The Hon Wayne Swan MP, *Correspondence*, 27 August 2009.

5 Joint Standing Committee on Treaties, *Report 104*, p. 2.

6 Joint Standing Committee on Treaties, *Report 104*, p. 2.

## The IMF and the World Bank

- 5.9 The IMF and the World Bank are institutions formed as a result of a meeting in July 1944, attended by 45 countries, which established a framework for international financial cooperation after the Second World War. The framework was intended to prevent a repeat of the circumstances that had produced the Great Depression. The IMF and World Bank are collectively known as the Bretton Woods Institutions, after the location of the meeting.<sup>7</sup>
- 5.10 The IMF is an international membership based organisation with the goals of supporting stability in the global economy through:
- ...promoting international monetary cooperation, exchange stability, and orderly exchange arrangements; fostering economic growth and employment; and providing temporary financial assistance to members, helping to ease balance of payments adjustment.<sup>8</sup>
- 5.11 The World Bank supports international economic development and poverty reduction in developing and emerging economies through the provision of loans, grants, guarantees, equity, risk management products and non-lending analytical services. It is also an international membership based organisation.<sup>9</sup>

## IMF Voice Participation Amendment

- 5.12 Participation in the IMF is based on a voting system that provides 250 votes for each member nation, and additional votes based on relative economic weight of each member country in the global economy. These additional votes are referred to as 'quotas'. Quotas are allocated using a formula that incorporates the GDP, openness, economic variability and the international reserves of each member nation.<sup>10</sup>
- 5.13 Because of the way the quotas are allocated, the number of votes in each quota has increased significantly since the establishment of the IMF, while

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7 International Monetary Fund, *About the IMF*, 2009, <<http://www.imf.org/external/about/history.htm>>, viewed on 11 October 2009.

8 NIA, Para 8.

9 NIA, Para 9.

10 International Monetary Fund, *Fact Sheet – IMF quotas*, 2009, <<http://www.imf.org/external/np/exr/facts/quotas.htm>>, viewed on 11 October 2009.

the basic voting allocation for each member nation has remained the same. Consequently, there has been a shift in the balance of power within the IMF towards the countries with greater economic weight. There are currently 2,217,033 votes, of which only 46,500 constitute the basic voting allocation.<sup>11</sup>

- 5.14 According to the NIA, the IMF Voice and Participation Amendment aims to redress this steadily increasing imbalance by tripling the number of basic votes allocated to each country to 750, and then fixing the proportion of basic votes to quota votes in perpetuity. The change will result in a decline in the voting power of the countries with larger economies.<sup>12</sup> In total, the reform package will result in a shift in voting share of 2.7 per cent from large economies to smaller economies.<sup>13</sup>
- 5.15 Australia's voting share will decline marginally from 1.47 per cent of votes to 1.31 per cent of votes.<sup>14</sup>
- 5.16 The IMF Voice and Participation Amendment will also change the staffing allocation system within the IMF. The full time board of the IMF is made up of 24 Executive Directors. Each Executive Director is permitted to appoint an alternate who can assist with their workload. A number of these represent individual countries, but 19 are elected to represent a number of countries in constituencies. Constituency based Executive Directors can have significant workloads.<sup>15</sup>
- 5.17 The Treaty will allow some of the constituency based Executive Directors to appoint two alternates in order to better balance their workload.<sup>16</sup>
- 5.18 The voice participation amendments were recommended by the IMF Executive Board in March 2008.<sup>17</sup> At the time, the reforms were described by a former United States Assistant Treasury Secretary and others in the senior ranks of the international financial community as:

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11 NIA, Para 12.

12 NIA, Para 13.

13 NIA, Para 14.

14 NIA, Para 15.

15 NIA, Para 16.

16 NIA, Para 16.

17 International Monetary Fund, *IMF Executive Board Recommends Reforms to Overhaul Quota and Voice*, Press Release No. 08/64, March 28, 2008, <<http://www.imf.org/external/np/sec/pr/2008/pr0864.htm>>, viewed on 11 October 2009.

...falling far short in addressing the challenges facing the IMF and its evolution towards a truly global institution with more balanced and incisive representation and voting power.<sup>18</sup>

- 5.19 Representatives of countries that will benefit from this reform have also indicated their dissatisfaction with the extent of the changes. In an article commenting on the proposals at the time, the *Washington Post* quoted India's executive director at the IMF as stating that the proposal '...falls short of our expectations...and is certainly not a huge shift.'<sup>19</sup>
- 5.20 In light of this criticism, the IMF has continued to examine reform options, and in March 2009 released the Final Report of the Committee on IMF Governance.<sup>20</sup>
- 5.21 The Report identifies a number of flaws in the IMF governance regime. In particular, the Report found:
- the changes in voting power to date have been marginal, and ongoing reform of voting power is slow, with a further review of voting power not scheduled until 2013;<sup>21</sup>
  - the second dimension of governance, the decision making process itself, has not been subject to reform, and is a significant contributor to the lack of trust, confidence and legitimacy in the organisation;<sup>22</sup>
  - the Governance bodies in the organisation have impeded timely responses to problems, and have resulted in less formal, and consequently less transparent, decision making mechanisms being adopted;<sup>23</sup> and

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18 C Swan, *Washington Post*, 'Critics Assail IMF Plan on Developing Nations' Voting Share,' March 29 2008, <[http://www.washingtonpost.com/wp-dyn/content/article/2008/03/28/AR2008032803459\\_pf.html](http://www.washingtonpost.com/wp-dyn/content/article/2008/03/28/AR2008032803459_pf.html)>, viewed on 11 October 2009.

19 C Swan, *Washington Post*, 'Critics Assail IMF Plan on Developing Nations' Voting Share,' March 29 2008, <[http://www.washingtonpost.com/wp-dyn/content/article/2008/03/28/AR2008032803459\\_pf.html](http://www.washingtonpost.com/wp-dyn/content/article/2008/03/28/AR2008032803459_pf.html)>, viewed on 11 October 2009.

20 Committee on IMF Governance Reform, *Final Report*, International Monetary Fund, Washington, 2009.

21 Committee on IMF Governance Reform, *Final Report*, International Monetary Fund, Washington, 2009, p. 7.

22 Committee on IMF Governance Reform, *Final Report*, International Monetary Fund, Washington, 2009, p. 9.

23 Committee on IMF Governance Reform, *Final Report*, International Monetary Fund, Washington, 2009, p. 7.

- the governance regime lacked oversight and direction from high level political representation such as the leaders of the member countries.<sup>24</sup>

5.22 The Committee recommended that:

- the next review of voting power be conducted in Spring 2010;<sup>25</sup>
- the creation of a ministerial level council to foster political engagement in the funds' decisions and make the key strategic decisions for the organisation;<sup>26</sup> and
- the creation of a Board to perform the executive function, implementing the decisions of the ministerial level council.<sup>27</sup>

5.23 The Committee on IMF Governance Reform's recommendations appear to have had some impact. The Department of the Treasury advised the Treaties Committee that the G20 group of nations agreed to bring forward the next review of voting power to January 2011, and that '...there is an expectation that that quota increase will be substantial.'<sup>28</sup>

5.24 The Report of the Committee on IMF Governance Reform argues that the IMF's problems with legitimacy, trust and confidence extend a good deal further than the balance of quotas. This view is backed up by the response to the acceptance of the IMF Voice and Participation Amendment at the G20 meeting attended by the Treasurer on 24 and 25 September 2009. Quoted in Bloomberg.com, the President of the Centre for Global Development, Ms Nancy Birdsall stated:

These are steps in the right direction, but we should not fool ourselves that this is going to bring any fundamental, structural shift in power and influence by itself.<sup>29</sup>

5.25 The Committee expresses concern about the ongoing IMF voting imbalance. The Committee believes that if Australia is to continue playing

24 Committee on IMF Governance Reform, *Final Report*, International Monetary Fund, Washington, 2009, p. 9.

25 Committee on IMF Governance Reform, *Final Report*, International Monetary Fund, Washington, 2009, p. 7.

26 Committee on IMF Governance Reform, *Final Report*, International Monetary Fund, Washington, 2009, p. 11.

27 Committee on IMF Governance Reform, *Final Report*, International Monetary Fund, Washington, 2009, p. 11.

28 Department of the Treasury, *Transcript of Evidence*, 7 September 2009, p. 4.

29 S Rastello, *Bloomberg.com*, 'G20 Agrees to Boost Emerging Nations' Clout at IMF, World Bank', September 26 2009, <<http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a1eMHRbceJNU>>, viewed on 11 October 2009.

a significant role in improving the legitimacy of the IMF, the Government will need to consider developing approaches to improve the legitimacy of the decision making processes within the IMF.

- 5.26 It is clear there are a number of well-considered proposals to guide further reforms. If the international community is serious about addressing trust and confidence in the IMF, then the IMF Voice and Participation Amendment is really only a small first step in the process. The Committee believes that the Australian Government should use the good will it has gained by having the IMF Voice and Participation Amendment agreed prior to the G20 meeting to support reforms that improve confidence in the IMF's decision making process.

### **Recommendation 5**

**The Committee recommends that the Australian Government use the good will it has gained by agreeing to the IMF Voice and Participation Amendment prior to the G20 meeting to progress improvements in the balance of voting power and the confidence and legitimacy of the IMF's decision making process.**

## **IMF Investment Authority Amendment**

- 5.27 The IMF's income derived from its lending activities to finance its general administrative expenses is given effect by the IMF Articles, which provide that the IMF can only invest in the marketable obligations of members or international organisations.<sup>30</sup> In other words, the IMF relies on interest payments from loans made to member countries.
- 5.28 In recent years, this income has declined sharply, causing a deterioration in the budgetary position of the IMF. In the 2007-08 financial year, the IMF ran a deficit of US\$165m.<sup>31</sup>
- 5.29 Lending in the last financial year has increased, so income is also expected to increase. However, the NIA states that some reform of the income model is required to diversify the income base of the IMF and reduce reliance on loan repayments.<sup>32</sup>

30 NIA, Para 22.

31 NIA, Para 20.

32 NIA, Para 21.

- 5.30 The new funding model combines income from lending activities with the following new sources of income:
- an endowment funded by profits from the sale of some of the IMF's gold reserves (the IMF is one of the largest holders of gold reserves in the world);
  - a mandate to invest funds; and
  - cost recovery from concessional lending.<sup>33</sup>
- 5.31 Any profits made using this funding model will be returned to member states in the form of dividend payments.<sup>34</sup>
- 5.32 The IMF's discretion to invest funds will be limited. The IMF Investment Authority Amendment would require:
- ...that all investments be made in accordance with rules and regulations... adopted by the Fund by a 70 per cent majority of total voting power.<sup>35</sup>
- 5.33 In discussing the investment aspect of the new funding model, the IMF Board of Governors indicated that:
- The Board of Governors' approval of a broader investment mandate will enable the Fund to increase the average expected return and adapt its investment strategy over time. The investment policies will reflect the public nature of the funds to be invested and include safeguards to ensure that the broadened investment authority does not lead to actual or perceived conflicts of interest.<sup>36</sup>
- 5.34 The Committee is of the view that additional safeguards are necessary to ensure that the IMF's investment strategy does not conflict with its goals of international economic stability and fostering growth and economic development. In particular:
- IMF funds should not be invested in such a way as to endanger those funds through high risk investments;

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33 International Monetary Fund, *About the IMF*, 2009, <<http://www.imf.org/external/about/income.htm>>, viewed on 11 October 2009.

34 International Monetary Fund, *About the IMF*, 2009, <<http://www.imf.org/external/about/income.htm>>, viewed on 11 October 2009.

35 NIA, Para 22.

36 International Monetary Fund, *IMF Board of Governors Approves Key Element of IMF's New Income Model*, Press Release No. 08/101, 6 May 2008, <<http://www.imf.org/external/np/sec/pr/2008/pr08101.htm>>, viewed on 11 October 2009.



- IMF funds should not be used to invest in the manufacture of arms or military equipment; and
  - IMF funds should not be used to invest in environmentally damaging industries.
- 5.35 The Committee believes that, when participating in IMF discussions about its investment strategy, the Australian Government should advocate a position consistent with these goals.

### **Recommendation 6**

**The Committee recommends that, consistent with the IMF's goals of international economic stability and fostering growth and economic development, the Australian Government advocate that the IMF not invest in:**

- **high risk investments;**
- **the manufacture of arms or military equipment; and**
- **environmentally damaging industries.**

## **World Bank Voice and Participation Amendment**

- 5.36 The World Bank has a similar participation system to the IMF, with voting power distributed on a basic allocation for each country and a quota allocation based on the size of a member country's economy. Like the IMF, the voting structure has resulted in a concentration of voting power in the hands of larger economies over time.<sup>37</sup>
- 5.37 The World Bank Voice and Participation Amendment will double the number of basic votes allocated to each country and then fix the proportion of basic votes to total votes in perpetuity. The change will result in an increase in the voting power of small economies from 42.6 per cent to 44 per cent. Australia's share of the votes will decline from 1.53 per cent to 1.49 per cent of the vote.<sup>38</sup>
- 5.38 The World Bank considers this change, agreed to in 2008, as only the starting point for a larger shift in voting power. Indeed, on

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37 NIA, Para 17.

38 NIA, Para 19.

6 October 2009, the Development Committee of the World Bank released a proposal to increase the quota of votes allocated to developing countries to at least 47 per cent.<sup>39</sup> This proposal will be considered by the Board of Governors in the Northern Spring of 2010. In addition, when the President of the World Bank recently addressed the Board of Governors, he foreshadowed an attempt to bring the share of votes for developing countries up to 50 per cent over time.<sup>40</sup>

- 5.39 As with the IMF, it is clear that the World Bank Voice and Participation Amendment addresses only one aspect of the legitimacy problem being experienced by the World Bank. According to the Centre for Global Development, other identified aspects of the legitimacy problem include:
- a lack of a transparent, formalised method for selecting the World Bank president;<sup>41</sup>
  - the relative lack of representation from African member nations on the Board;<sup>42</sup>
  - confusion within the Bank about the role it should play in each particular setting;<sup>43</sup> and
  - a lack of sensitivity to the political constraints existing within member nations using the Bank's services.<sup>44</sup>
- 5.40 It is also clear that the Bank is now seen only as a lender of last resort in middle income countries such as China and India. Middle income countries in need of loan services are increasingly accessing private capital markets as an alternative to the World Bank, undermining the World Bank's reputation as an international institution.<sup>45</sup>

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39 The World Bank, *The World Bank Group Beyond the Crisis – Remarks by the President of the World Bank to the Board of Governors*, 6 October 2009, <<http://go.worldbank.org/5JYWTSK5U0>>, viewed on 11 October 2009.

40 The World Bank, *The World Bank Group Beyond the Crisis – Remarks by the President of the World Bank to the Board of Governors*, 6 October 2009, <<http://go.worldbank.org/5JYWTSK5U0>>, viewed on 11 October 2009.

41 N Birdsall and D Kapur, *The Hardest Job in the World: Five Crucial Tasks for the New President of the World Bank*, Centre for Global Development, Washington, 2005, p. 26.

42 M Ahmed, 'Votes and Voice: Reforming Governance at the World Bank' in *Rescuing the World Bank*, Centre for Global Development, Washington, 2006, p. 92.

43 N Birdsall and D Kapur, *The Hardest Job in the World: Five Crucial Tasks for the New President of the World Bank*, Centre for Global Development, Washington, 2005, p. 2.

44 M Ahmed, 'Votes and Voice: Reforming Governance at the World Bank' in *Rescuing the World Bank*, Centre for Global Development, Washington, 2006, p. 103.

45 N Birdsall and D Kapur, *The Hardest Job in the World: Five Crucial Tasks for the New President of the World Bank*, Centre for Global Development, Washington, 2005, p. 8.

- 5.41 The wider reform context is likely to become the focus of attention at the World Bank as the High Level Commission examining World Bank Governance, set up by the President of the World Bank in 2008, reports later this year.<sup>46</sup>
- 5.42 While recognising that Voice and Participation reforms are only a small part of an overall process of reform, the Committee believes the Australia Government can make a contribution to the reform process by supporting the recent proposal of the Development Committee of the World Bank to increase the quota of votes allocated to developing countries at the World Bank's meeting in 2010.

### **Recommendation 7**

**The Committee recommends that the Australian Government support the proposal of the Development Committee of the World Bank to increase the quota of votes allocated to developing countries to at least 47 per cent.**

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46 The World Bank, *World Bank Reforming to Meet New Challenges, Zoellick Says, Press Release No:2010/092/EXC, October 6, 2009*, <<http://go.worldbank.org/5JYWTSK5U0>>, viewed on 11 October 2009.

