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Introduction

International Monetary Fund(IMF) is one of the two organisations formed after the Bretton woods conference in 1944. the other one is the World Bank. It has to be noted in the earliest that though this article deals with IMF and how the democratic deficit in it affects the poorest of the countries in the world, the IMF works in tandem with the world bank and other international financial institutions.

The founding principle of IMF is rooted deep in the Great Depression of 1930s. During the depression the industrialised countries of the world plummeted themselves by engaging in raising trade barriers, devalued their currencies for competing in the export market and even restricted their citizens from holding any foreign exchange all of these measures resulted in further loss of trade and employment making millions jobless and poor. One of the major reasons for establishing an institution like IMF was to oversee exchange rate stability and international payments ensuring smooth functioning of the complex international monetary system. IMF along with World Bank(WB)was formed in 1945 in the wake of the pressing need for the post war reconstruction and assuring monetary stability in the world economy especially European economy. Though it officially came into existence in December 27, when 29 countries ratified it’s charter or Articles of Agreement in 1945, it started it’s operations only on March 1, 1947. During the cold war years the membership in IMF was limited due to the pressure of Soviet Union on newly independent countries.

End of the fixed standard

As pointed earlier the IMF oversaw the fixed exchange rate system where every currency is pegged at US dollars which can be converted in to Gold. The increasing spending on the war in Vietnam adding to the increasing expenditure on Great Society Programs initiated by US President Lyndon Johnson worsened the already overvalued US dollar. This system was started to be abandoned slowly between 1968 and 1973. The major point came when US President Nixon announced the de-linking of US dollar from gold. But the transition to free floating exchange rate system, where every member of IMF was free to peg it's currency against any currency or group of currencies, was smoothly done. The period also posited another challenge in the form of unprecedented rise of oil prices, culminating in what is called Oil shocks. It responded to the situation by setting up two oil facilities to help oil importers deal with current account deficit and inflation(Nayyar: 2006).

The IMF's engagement with the poor countries starts from the mid 70s when it stated funding these countries through it's Trust Fund. The IMF with the end of the cold war and influenced by The jettisoning of the Keynesian demand management policies after their initial success and success of the liberalisation policies initiated by the Richard Nixon in US and Margaret Thatcher in UK along with the collapse of the Soviet Union and Eastern Bloc bolstered a new era symbolically represented by IMF and World Bank called Neo-Liberalism where both IMF and WB was used to force the erstwhile socialist and mixed economic countries to open their markets to foreign investors and liberalise their financial system, the effects of which were highly destabilizing. While the East Asian economies initially showed high growth rates the same programs resulted in devastations across Sub Saharan Africa. The vehemently critiqued Structural Adjustment Facility which was later changed into Enhanced Structural Adjustment Facility was initiated in March 1986.

The Financial Functions of IMF

Any understanding of the functioning of IMF should also differentiate between IMF and World Bank. The IMF, unlike Bank is not primarily a lending institution like World Bank. The WB also is a complex organisation. It is actually two organisation– International Bank for Reconstruction and Development(IBRD) and International Development Association(IDA). WB is an investment bank. The World Bank functions by issuing bonds the repayment of which is guaranteed by it’s member countries. That is WB lends money to development works through market borrowing. The IDA, on the other hand is a concessional loan associate which is mainly financed by donor nations. The IMF in contrast intermediate between investors and recipients. It demands membership fee from it’s members which is accrued in to a general pool. Each member contributes to this pool according to it’s economic size and strength, providing each member a respective quota which also translate into their voting share in a skewed manner. It’s operations are to a major part are financed through this common pool.

What does IMF exactly do? The IMF’s role is highlighted when any member nation falls into a balance of payment debacle. a country must have both it’s exports and imports at almost equal levels. After the floating exchange rate system was adopted, every nation is left free to peg it’s currency against any or any group of currencies. But it also develops a problem over a period of time. The value of the currency tend to get overvalued. Thus a currency might be pegged at four units to one dollar. After a period of time due to trade fluctuations, the currency's actual value might have reached six units to one dollar. What effects does this over valuation have? At this time the currency's higher value helps in reducing import expenditure whereas at the same time the currency's higher value makes it costlier and reduces export revenue. Thus economy receives less income but spends more. This plummets the economy into a balance of payment crisis. This is where IMF enters into the scene. The IMF being the only international organisation with the support of the dominant economies and with expertise advises and directs nations to escape from such balance of payment crisis. IMF provides short term and medium term loans to tide over the debacle for the time being. But IMF also has influence over the decision making in World Bank and other financial institutions. The loans are not without fetters however. The loans are accompanied by a series of conditions generally termed as conditionalities .

Thus the major functions of the IMF can be broadly classified as follows:

1) to promote exchange rate stability to maintain international trade stability

2) by providing short term and medium term financial assistance to members facing shortage of foreign currency.

3) It also plays an advisory role on macro-economic policy issues so that the economic policies of member countries do not adversely affect the balance of payment situation.

4) it also assist member nations in expanding their markets where they can exchange currencies without restriction. (Sharma, 2002: 90).

Democratic deficit

What is meant by democracy in the case of international organizations like IMF? It is well known that the IMF was originally not conceived to be an organisation to help the third world countries or less developed erstwhile colonies. It's chief aim, along with World Bank was to ensure reconstruction of the capitalist economies in the war ravaged European nations. The agenda of lending and interfering in developing countries was initiated in the course of the cold war attempting to lure newly independent countries away from the socialist bloc dominated by Soviet Union. No surprise that still the organisation of the chief decision making bodies inside the Bretton woods institution reflect the political equations existing at the time of the second world war completely tuned to the interest of the Developed countries. When IMF and Bank was formed, except for United States, members were expected to be both contributors and borrowers.

The decisions in the Executive board is reached through voting, if not reached by consensus. Each country holds a share of vote with regard to their contribution to the world economy. The united states the with the largest voting power holds 17. 09 % of shares. Almost 63% of shares is held by just 12 member countries including US out of 186 members of the IMF. The same condition prevails in the world bank also. The 24-country African group in contrast carries only 1. 42% of total voting share power making their influence practically nil in the agenda setting and decision making processes and policies. This problem arises because, there are only 8 member countries enjoying their own seat on the board. The remaining 16 are divided between the remaining 179 countries. This skewed system renders other member countries to group together to augment their collective bargaining or voting share represented by an Executive Director. This reflects in the policies of the IMF and it's results. However, the democratic deficit is not the cause of the problems associated with the IMF. Rather, the very democratic structure of both the IMF and Bank are themselves symptoms of a much structural problem, the present world order based on the capitalist model of production and it's prevailing ideology ' neo-liberalism'.

Unequal representation

Constituencies

The groupings of the member countries have created what has come to be called ' Constituency system'.. all the members other than eight of them who have their own seats group together to form constituencies to elect a Director for their constituency to represent them. These constituencies are not static groupings. The size of the constituencies i. e. the memberships both qualitatively and quantitatively change depending on various factors, especially economic factors. This happens because every country except for some are on the lookout to increase their leverage vis-a vis other constituencies and within their constituency to apportion a bigger share out of the collective bargaining. But, in some cases, member countries also shift constituencies due to ideological considerations. For example, Indonesia joined the constituency headed by Italy in 1950s and later moved to a constituency of Islamic countries of North Africa and Malaysia. Later, Indonesia formed a constituency on geographical basis, consisting of Korea, Philippines and Vietnam. One of the major reasons why members change constituencies has been to hold a more influential or senior position within the constituency. For example, earlier, Spain was within the constituency headed by Italy along with Poland and Greece. Later in 1978, Spain joined a central American constituency including Mexico and Venezuela assuming the post of Executive Director (Wood, 2006: 483).

The representation as shown above is based on the economic might of the members. The 24 member African constituency headed by Equatorial Guinea and the 19 member African constituency headed by Nigeria ahold only 1. 42% and 3. 01% respectively. But paradoxically these are the countries which are directly and severely affected by the policies of the IMF and World Bank. It has to be reminded that it is the masses , peasants, working classes of these countries who toil hard to repay their country’s debits. But they have almost no say on whatever the decisions that impinge and affect on their lives. It is a process of taxation without representation.

But the IMF and Bank were not planned to be as undemocratic as they are now in their origin. The Bretton Woods Institutions also provide 250 basic votes to every member of the organisation. This was actually introduced to ensure a minimum sense of equal representation and fair play among members. The basic vote system atleast ensured a minimum of equal stake along with the share on the basis of contribution. The quota votes are added to basic votes to form the total vote. But the basic votes which formed 14% of the total votes in 1955 has now come down to around 3 percent in both IMF and World Bank.

Selection of the head

The selection of the head of the IMf is the most glaring evidence of unequal representation and hegemony of the dominant western industrialized nations. The IMF's executive board is responsible for selecting the Managing Director. Any Executive Director may submit a nomination for the position. If more than one gets nominated, the executive board reaches a decision by consensus. But by precedence, usually only a European becomes the Managing director of IMF. And in the case of World Bank only an American becomes the head.

Accountability

The executive board do not adequately hold staff and management to account. There are no official mechanisms for holding elected Directors, members after being elected. The Dutch executive Director however, has introduced a template to ground evaluation of his staff which is slowly gathering favour and being implemented by other Directors. But still there are no rules and regulations except for a vague and broad mention in sec 14 d of the By-Laws. It states " It shall be the duty of an executive Director and his alternate to devote all the time and attention to the business of the Fund that it's interests require and between them, to be continually available at the principle offices of the Fund."

According to IMF' Articles of Agreement the Managing Director " The Managing Director shall be chief of the operating staff of the Fund and shall conduct, under the direction of the Executive Board, the ordinary business of the Fund. Subject to the general control of the Executive Board, he shall be responsible for the organization, appointment, and dismissal of the staff of the Fund" (article xii, 4, b). Regarding the accountability of the Directors, a code of conduct was established only in 2000 applicable to Executive Directors, their alternates and senior Advisors. It has established some standards of ethical conduct regarding conflict of interests arising from the functioning as Executive Director and also supposed to treat confidential information. It also mandates disclosure of regular financial reports. For the purpose of confirming to confidentiality and other ethical issues, an Ethics committee of five Executive Directors was formed. But far most, the committee can only warn the relevant Executive Director communicate it to the respective Governor. It has to be kept in mind that ultimately the internal accountability comes down to moral persuasions.

Accountability of Executive Directors, in relation to the countries they represent, however, work in different terms. The countries with their own representatives can hold their directors directly accountable. He can be dismissed and replaced at will. But a representative Director who was elected cannot be dismissed or replaced by any of the members until his term ends. A member can be induced to resign but no Articles provide the members the right to require resignation from him. The problem with this set up is obvious. There is no mandated obligation for him to follow the orders or directions of the member countries. The director can even vote against the interests of the very member, he/she represent. Reading this with the sec 14 d of the article provides a much more clear picture. Where the Director is not mandatorily obligated to follow the directions of the countries represented by him, he is obligated to work in tandem with other members. This creates enormous opportunities for developed nations to simply buy-out the representatives of developing and under-developed countries. This problem emanates from the fact also that constituencies are not mandatorily legitimate units of representation.

Regarding the accountability of the staffs and management towards executive board, three reasons are cited. First, it is difficult for members of the Executive Board to prepare papers and positions on all countries. Many Executive Directors remain in the job only for a short time. In the cases of constituencies, as there are rotations of the seat of Director, the time for the Director is too short to acquire real idea of the organizational set up. Second, the tendency to present a picture of unified view in Board discussions, the staff and management fail to play a proactive role by seriously debating over their disagreement. Third, the most important problem is that many discussion are taken by Executive Boards before the board meetings. This is especially the sign of influence of the dominant countries in the decision making processes of the IMF. Issues like loans to countries that are against the US approval or interest will not at all be presented before the board.

IMF also lacks accountability to it’s member nations. IMF by its, functioning is accountable only to the Finance ministers and central bank Governors. But the role of IMf has expanded to such areas that the accountability needs to be widened. The IMF’s prescriptions are now not only restricted to only matters concerning finance ministries and central bank governors.

Expanding activities:

IMF was not instituted by it’s founders to carry out the range of activities it is currently carrying out. The IMF was instituted on the basis of the Keynesian demand management. It was understood that there should be an international organisation to overlook the monetary activities of the countries to keep the exchange rates relatively stable and insulated from shocks. But the area of interest expanded with decreasing clout of the Soviet bloc. More nations switched over to capitalist model and IMF and world Bank were rested with the duty to open the various . These functions got impetus with the neo-liberal policies initiated by Reagan and Thatcher in the United States and Britain. A major transformation came with the demise of the Soviet bloc after which the marketisation of these economies become the main objective of the Bretton Woods institutions. With these they have almost became the primary instruments of globalisation of world economy. The BWIs have come to be the only large lenders and monetary policy institutions. More and more countries are forced to approach these organizations in the absence of an alternative. In a sample of 25 countries, there were only between six and ten measures of performance criteria for loans on conditionality whereas it increased to 25 measures at the end of 1990s. But the accountability and transparency of the IMF has not increased with these new functions.

The role of US and other developing countries

The role of US especially the Treasury in the functioning of the Bretton Woods institution has been a matter of concern and critique for the democratization of the global financial institutions. Also the US along with other developed countries called G7 form a formidable group controlling almost 47. 13% of the total voting power. These countries act as a de facto management of IMF. Also unlike the developing countries they have well equipped staffs . They co-ordinate between each other. This is ensured by their shared interests, being the major creditors. The ministers, central bank governors convene a meeting on issues and agendas before the annual and spring meetings and issue press communiqué together. The Executive Directors also co-ordinate with each other on common positions. The IMF has acted more as an arm of the western especially US financial interests. The liberalization policy was forced on Kenya by the US Treasury through the IMF. The experience of Kenya when it implemented financial liberalization was devastating. The result was fourteen bank failures in 1993 and 1994. Also the US holds the only veto power in the IMF with it’s 17% voting share. Also in 2000 the US congress was unilaterally able to propose and pass a resolution and later implement a measure of change and reform in IMF without consulting any other member. The US through it’s executive Board members, staffs and location of the organization and as the BWIs court US’ favour for their operation exercise a hegemonic influence over both IMF and Bank (Stiglitz, 2002).

Needed Reforms

Most of the problems regarding IMF arise because of the dissonance created between IMF’s supposed functions and the current functions it is carrying out. The IMF, to use Nobel laureate and earlier chief economist in World Bank, Joseph Stiglitz ‘ the IMF never likes to discuss the uncertainties associated with the policies that it recommends, but rather, likes to project an image of being infallible”(Stiglitz, 2002: 230). The IMF, time and again has been only admitting mistakes as in the handling East Asia crisis. The IMF have also been slow in learning from it’s mistakes. But the mistakes are not simply mistakes by indifferent individuals. They are also evidence to the level of influence of free market ideology professed by the international financial community and the US Treasury.

The reforms must also focus on the operational costs being forced on to the developing countries, the principle borrowers. The operational costs of IMF is financed by the subscriptions every member country makes and also from the interests to the loans debtor countries pay back. By this logic, it is the developing countries which are financing most of the IMF expenses. From the breakdown of the expenses of the IMF, it has been founded that the contribution of the developed countries who are the creditors have come down to 29% in 2000 from 71% in 1980. this means that three fourths of the administrative expenses of the IMF is financed by the same countries are dependent on the loans provided by the IMF. Also the fund allocated for the Report on the Observance of Standards and Codes(ROSCs) and the Financial Sector Assessment Program (FSAP). Nearly 89 countries and 95 countries have participated in these schemes, respectively. But the majority of the countries who have had the assessments are developed countries. Developing countries and Sub Saharan African countries were hardly assessed about their financial and monetary status. Thus a good amount of money is spent on countries that are in good health rather than on those who need help and re-structuring (Woods, 2006: 498).

The IMF should restrict itself to the mandated functions it was allocated to it when it was formed i. e to only monitoring and advising on the exchange rate stability. The lending business should be handed over entirely to the world bank.

Also the basic votes to the member countries should be brought back to the level at earlier years of IMF and should be slowly increased to enable a far more democratic practice than what is practiced now.

Developing countries like India, China, Brazil, South Africa should be provided more voting share as their global contribution has also increased in recent years. Especially the case for increase of voting share of China is a long standing issue came to spotlight during the recent financial crisis when China has bargained for an increase in it’s voting share. More seats of Executive Directors should be formed to accommodate varied under-represented countries(Ambrose, 2007).

Also agencies f horizontal accountability have to be built like independent evaluation unit. Like the supreme court acts as horizontal agency working as a component of constitutionalism one of the benchmarks of democracy in modern era, offices endowed with overseeing accountability and transparency have to be established.

Conclusion

The IMF and World bank, especially IMF have veered away from their mandated area of functioning. The need for an international monetary agency always remains as long as capitalist economy prevails. The veto power hld by US also need to be balanced at least by providing other larger economies including developing economies with more role in decision making process. A more rational approach towards representation of poor nations has to be made. The liberalization of the asian economic powers has created rifts even within borrowers regarding the kind of schemes of lending.

While developing countries like China, India, Indonesia etc. are provided with schemes with less scrutiny, Sub-Saharan countries receive credit after a long process of office work. The democratization of IMF based on the economic strength of present era will obviously provide great boost in bargaining power of developing countries vis-à-vis developed countries. But it is not sure whether the process will surely benefit even the poorest in these developing countries, let alone other poor countries of Latin America and Africa. The constituency system should be replaced by atleast minimum one per one country added with the vote in relation to their contribution to the world economy. Accountability within the organization can be developed only when the term of the Directors are ensured unlike in the case of constituency where rotation system operates.

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