



# **Workshop on Debt, Finance and Emerging Issues in Financial Integration**

Financing for Development Office (FFD) DESA  
8 and 9 April 2008

## **The IDA Deputies: A Governance Issue**

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I. Introduction and Summary

1. The role played by the Deputies of the International Development Association (IDA) in the decision-making processes of the World Ba

## II. Evolution of IDA Deputies Role

2. IDA began operations in November 1960 as a concessionary window of the World Bank Group, with its own Articles of Agreement and with a nominal capital of \$ 1 billion. Because of the different sources on which IDA would largely depend (budgetary grants as opposed to market borrowing in the case of IBRD), some IDA members were characterized as “donors” and classified as Part I countries while potential “recipients” were classified as Part II countries. IDA started with Part I members subscribing three-quarters of the initial capital but it was recognized that IDA would require periodic additions to its resources (designated as “replenishments”) that would have to be approved by a two-thirds majority of IDA’s total voting power. While the power to authorize additional subscriptions and to determine the related terms and conditions were non-delegable and could be exercised only by the Board of Governors, policy-making and IDA’s general operations fall within the responsibility of IDA’s Executive Directors under a broad delegation of authority given to them by the IDA Board of Governors.

3. From the inception of IDA and through the first replenishment (1965-68) , negotiations were primarily conducted between Bank Management and the principal donor countries, with the largest contributors to IDA’s initial resources (France, Germany, Italy, U.K. and the USA) holding informal meetings to discuss the total amount of an increase in the resources of IDA and the proportion of the total amount that each country might be prepared to contribute. A formal cast to these meetings was given in 1967, in the wake of prolonged and contentious discussions by Bank Management with the US Administration for the second replenishment (1969-71) when the Governor for the Netherlands proposed breaking the impasse by convening a special conference of high level representatives of Part I countries – at the level of Ministers – “preceded if necessary by one or two meetings of their Deputies”<sup>1</sup> for reaching a final agreement. The reference in the quoted sentence is probably the

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<sup>1</sup> The IDA Deputies: An Historical Perspective (IDA 13, November 2001). The following three paragraphs of

beginning of the IDA Deputies as a formal grouping of officials working in national capitals, separate and distinct from their representatives resident at IDA headquarters in Washington, who, in their capacity as Executive Directors, operated under a split mandate of being both representatives of their countries and officers of a multilateral institution. Moreover, the Deputies tended to be national officials higher up in the hierarchy and closer to the ultimate decision-makers in their respective countries and their insistence on having a dominant role in the replenishment exercises stemmed from the fact that contributions to IDA funding are grants that come directly from national budgets and are therefore of keen interest to their parliamentary taskmasters. <sup>2</sup>

4. The replenishment reports in the earlier years setting forth the agreed funding arrangements included the size of each replenishment and relative burden sharing among donors, effectiveness and advance commitment mechanisms and payments procedures etc., These were drafted in the format of Executive Director reports. By the time of IDA 8 (1988-90), however, the documents began to be drafted

replenishments included principles governing voting rights arrangements (in IDA-3), burden-sharing issues (IDA-4 and IDA-7), denominating donor contributions in SDR (IDA-5), switching the denomination of IDA credits from US dollars to SDR (IDA-6), restricting the use of part of their contributions (IDA-7) and harmonizing donor voting rights between IDA and IBRD (IDA-8).

6. From IDA-9 onwards, however, policy issues that would generally be considered as falling within the jurisdiction of the Executive Board began to feature in the Deputies' Reports. In their report on the Ninth Replenishment (1991-93), one of the key issues advocated was the adoption by borrowing countries of environmentally sustainable policies and demands that the Bank increase its collaboration with the IMF. IDA-10 (1994-96) intensified the focus on environmentally-related issues (including progress made in carrying out environmental assessments) and prescribed that IDA was to maintain separate rising trends for both sectoral and anti-poverty programs. This report also began to emphasize governance matters (typically, a euphemism for control of corruption in public services) and the efficiency of public sector management and extended its span of attention to such issues as the role of women in development planning and the allocation of non-development spending, including military expenditures. IDA-12 (2000-02) included specific recommendations for greater emphasis on governance factors in the rationing criteria for allocation of scarce IDA resources, the need for a private sector development strategy and public disclosure of

centering on IDA's role were identified for treatment: (i) IDA's role in the global aid architecture; (ii) country-level effectiveness and (iii) addressing the special challenges of states coming out of conflict or seeking to avoid breakdown of the state (i.e. fragile states).<sup>4</sup> It is therefore not surprising that a perception has grown that "in discharging their responsibilities during the replenishment process, the IDA Deputies have become involved in IDA policy-making, which is the responsibility of IDA Executive Directors..(and)..calls have been made to review the role of IDA Deputies vis-à-vis the role of the Board"<sup>5</sup>

8. While this paper focuses on the role of the Deputies of IDA, it is important to recognize that the influence attributable to the Deputies emerges out of a broader movement of thought and action on the part of donor governments, as these are articulated through numerous channels, including the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI) mechanisms, the rules of the Paris Club and other creditor groupings as well as through instruments devised in cooperation with other multilateral institutions, of which the IMF is perhaps the most important. Low income countries (LICs) have become subject to two layers of overlapping jurisdiction, one applied to recipients of the IMF's Poverty Reduction and Growth Facility (PRGF) and signaling mechanisms( such as PSI) and the other applying to IDA recipients. It is not easy to disentangle which institution is the source of any particular initiative but together they constitute a compendium of conditionalities that applies to low-income countries. While it would not therefore be correct to attribute their imposition to the IDA Deputies exclusively, there is a sense in which it is the IDA Deputies who hold much the stronger hand in the exercise, if only because the IMF's mandate restricts its concessionary financial involvement in any member-country to a limited duration whereas IDA remains the largest source of concessionary funding for poor countries and maintains a broad-range, longer-term relationship with all eligible countries.<sup>6</sup>

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<sup>4</sup> A detailed discussion of these themes is covered in IDA 15 Final Report titled Additions to IDA Resources: Fifteenth Replenishment and subtitled IDA: The Platform for Achieving Results at the Country Level (Approved by the Executive Directors of IDA on 02/28/08)

<sup>5</sup> para 31, op.cit. fn 3.

<sup>6</sup> Moreover, as stated in the IDA 15 Final Report, "Not only does IDA provide direct financing, policy advice and knowledge services to client countries, but it also serves as a platform for the effective delivery of overall



matrix consists of a set of indicator thresholds of two “stock” and one “flow” external debt indicators, viz (i) the ratio of the Net Present Value (NPV) of public and publicly guaranteed (PPG) external debt to GDP; (ii) the ratio of NPV of PPG external debt to exports; and (iii) the ratio of the service on PPG external debt to exports.

11. These quantitative measures are combined with judgments on countries’ policies and institutions as well as their vulnerability to external shocks. The appropriate credit and grant mix for each country is then determined according to its debt distress category, with a process established to translate DSF risk ratings into IDA “traffic lights”. The traffic lights come in three colors: green corresponds to a low risk of debt distress; yellow to a moderate risk and red to a high risk of debt distress or actually being judged to be in debt distress. A configuration of credits and grants by traffic lights is then given as follows: a green light results in an allocation of 100 percent IDA credits; yellow light results in an allocation of 50 percent of IDA credits and 50 percent as grants and red light results in an allocation of 100 percent grants.<sup>7</sup> However, some allowance is made for changed country circumstances that are not reflected in available DSAs or in borderline cases. The annex Table lists configurations of debt distress categories and traffic lights for 2008 and illustrates the reliance of IDA grant allocation criteria on the DSF/DSA frameworks and their dominant role in ranking the creditworthiness of its clients.

12. However, the Deputies’ recommendations on eligibility for grants has generated another layer of conditionality following the launching in 2006 of IDA’s Non-Concessional Borrowing Policy (NCBP) . Under this policy, IDA can deny grant eligibility if a country’s government or other public sector entities contract or guarantee new loans from alternative sources of financing which threaten to defeat the debt sustainability objective that IDA grants are intended to achieve. The policy designed to act as a disincentive for non-concessional borrowing by IDA clients and is implemented through ceilings on allowable borrowing on commercial terms (the ceilings being typically set at zero). The NCBP has been criticized for

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<sup>7</sup> However, to prevent any perverse incentives to neglect debt-sustainability considerations in order to qualify for 100 percent grant treatment, a discount factor is applied to the allocation for countries in that category. (For details on this and other aspects of DSF and DSA frameworks, see IDA 15 paper titled The Role of IDA in Ensuring Debt Sustainability: A Progress Report (September 2007).



its restrictive effects on client country freedom to enter into debt contracts and is being refined to allow for exceptions to such ceilings, although the ostensible rationale is not for reducing constraints on debtor governments but “to provide borrowers with some leverage

well. The same influence has gradually seeped into process conditionalities relating to transparency, disclosure and accountability, and the last-mentioned has resulted in an exposure for IBRD operations to the same intensity of public scrutiny that was inevitable for its sister agency that was funded by taxpayer grants.<sup>11</sup>

14. Similar effects on other lending and guarantee agencies under the WBG rubric – the International Finance Corporation (IFC) and the Multinational Investment Guarantee Agency (MIGA) -- are less readily discerned. Although the IFC has a separate mandate for funding private sector enterprises and does not require the member-government guarantees that are necessary for lending/guarantee transactions under the Articles of Agreements of IBRD and IDA, the growing engagement of these two agencies in private sector-led growth strategies has led to a call for greater collaboration with IFC.<sup>12</sup> A more significant development is the decisions taken in 2007 to transfer a portion of the profits of IFC (as was done already in earlier years from IBRD profits) for funding IDA operations.<sup>13</sup>

15. Another set of institutions to which IDA directs its outreach efforts in the debt sustainability area is the complex of the five regional development banks with a view to harmonizing their lending practices broadly on lines suggested by the risk assessments contained in joint Bank-Fund DSAs. A similar effort has been mounted with bilateral creditors under NCBP. In addition to controlling non-concessionary borrowing by IDA clients, this policy has the dual objective of constraining “free riders” i.e., *new* official or commercial lenders who seek to exploit the addition to borrowing capacity emerging from the debt relief provided by *previous* creditors (e.g., through the HIPC and MDRI

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capitals) selected and supported by ED offices, and provided with Bank funding for their travels, thereby replicating the network of recipient representation already present on IDA's Board of Directors.

17. Meanwhile, on the donor side, the number of Deputies has been growing as a number of middle-income countries have joined the previous group of "Part I" members bringing the current list of IDA donors to 45. With major "Part II" countries like Brazil, China, Egypt and South Africa recently joining the list of donors, there is reason to wonder how much the Borrower Representatives could be contributing as value-added to the IDA replenishment process.<sup>15</sup> Some of the uneasiness on this score has been papered over by gradually moving away from speaking of Deputies and Borrower Representatives and referring to them collectively as Participants but behind the semantics is the cold wording of the first footnote in the IDA 15 Final Report which states that "Beginning with the IDA 13 period, Borrower Representatives have participated in the replenishment discussions, providing borrower country perspectives on the issues under discussion. *However, in a formal sense, the recommendations are those of the Deputies*"(Italics supplied).<sup>16</sup>

18. The persistence of the unease is reflected in the argument made at the start of the IDA 15 period against "opening issues on the relationship between the IDA Board and the IDA Deputies at this particular time" and that given the "complex negotiation process", there might be "unintended consequences".<sup>17</sup> Now that the negotiations for IDA 15 have been successfully concluded, the issue of the Board-Deputies relationship should go back to the drawing board.

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<sup>15</sup> Some of the uneasiness on this score has been reflected in such mundane matters as the difficulty of seating over fifty –four delegates (45+9) around the table, with access to a microphone, and with opportunity to be heard during a typical two-to-three-day meeting.

<sup>16</sup>Op.cit., fn 3

## VI. Improving Deputies-Board Relationship

19. As recounted in previous sections, the power of the IDA Deputies to exert influence over IDA policies and programs has grown over the years and not necessarily in step with the growth of their contributions to IDA resources, since there has been a rising volume of IDA reflows and transfers from Bank profits (and latterly from IFC retained earnings) in recent years. Decisions under the HIPC and MDRI mechanisms have meant that a portion of contributions that would otherwise have been better used for financing new programs and projects have been diverted instead to providing debt relief and the policy inaugurated in FY 2006 of allocating 26 percent of annual financing in the form of grants means that a non-trivial portion of future IDA reflows are being surrendered. True, IDA Deputies have recommended that in addition to SDR 16.5 billion (equivalent to US \$ 25.1 billion) for the IDA 15 Replenishment, that they would pledge substantial resources to achieve a total replenishment of SDR 27.3 billion ( equivalent to US \$ 41.6 billion) or an increase of xy percent over the IDA 14 total commitment figure. There can be no gainsaying that when it comes to issues of the size of donor contributions to IDA replenishments and the issues of burden-sharing among donors, the Deputies inevitably must exercise a dominant role in the exercise. However, their continuing intervention in how IDA policie

recipient representation on the IDA Board<sup>18</sup> while leaving with the Board the formal obligation – but not the substantive responsibility – of conveying this document to the Board of Governors for their approval of the accompanying Resolution.<sup>19</sup>

20. This distancing, in practice, of the IDA Executive Directors representing IDA recipient members has the effect of weakening the participation of developing and transition countries (DTC) in decision making that the creators of IDA had embedded in the voting schema of the Association and which is radically different from that to be found in the charters of the IBRD and the IMF. Voting power in IDA has two components: membership votes which are allocated to all members equally and subscription votes, which vary with the amount each member has subscribed. While the subscription votes of each Part I country correspond to its share of total cumulative Part I resources contributed to IDA (in successive replenishment exercises), the relative voting power of the Part II countries is maintained by allocating subscription votes to them at a nominal cost *of one vote for each \$25<sup>20</sup> subscribed while membership votes are conferred without additional charge when subscriptions are made*. If Part II members were to subscribe to the full amount of subscription votes allocated to them, the Part II block would be holding about 48 percent of total IDA votes and their share would have been fully protected through the successive replenishments. The intent of the founders was clearly to ensure that recipients would have, and would maintain, a very substantive participation in all IDA decision making. This intent, however, has been subverted by the exceptional influence gained over the years by the IDA Deputies and by the failure of all Part II members to take up their allotted shares. The total unsubscribed subscriptions of DTC at the end of FY 2007 were 15.28 million and at \$ 25 per vote would require an outlay of

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<sup>18</sup> As the Development Committee document points out: “Although the Board reviews and approves the conclusions of the IDA Deputies and Borrower Representatives as set out in the Deputies’ Report, it would be difficult in practice for the Board not to approve the Deputies report” Para 35, *Ibid*.

<sup>19</sup> The Board Resolution states that “Now therefore the Board of Governors hereby ACCEPTS the Report as approved by the Executive Directors, ADOPTS its conclusions and recommendations AND RESOLVES THAT a general increase in subscriptions of the Association is authorized.....” (The capitalized letters are in the text of the Resolution).

<sup>20</sup> Based on exchange rates at the time of replenishment agreements.

US\$382 million, not a trivial sum, but more than half of which is owing from emerging market economies and commodity producers holding or building large foreign exchange reserves. It should not be beyond the capacity of the latter group of countries to not only come up with their own subscriptions but also help out some of the poorer countries pay for their allocations in the framework of South-South solidarity.<sup>21</sup> This could be a first step in bringing the participation of DTC to a voting level commensurate with their interest in restoring the substantive role of the IDA Board of Directors in the replenishment exercises. Absent such demonstration of serious intent, it would be difficult to expect IDA Deputies to forego the influence they have gained in IDA policy and operational matters over the years. The increased voting power

Annex 1. Traffic Indicators for 2008-2010. IDA-eligible countries

2008

Best stock indicators

Country	2008	2009	2010	Indicator
Green				Ghana
Green	93	48		Maldives
				Samoa
				Tanzania
				Uganda
				Vietnam
				Bangladesh
				Ethiopia
				Kyrgyz Republic
Yellow				
Yellow				
Green				
Red				
Yellow				