



THE IMF AND THE WORLD BANK

IT'S TIME TO SEPARATE THE CONJOINED TWINS

Lex Rieffel



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Lex Rieffel is a Nonresident Senior Fellow in the Global Economy and Development program at the Brookings Institution.

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ABSTRACT

The IMF and the World Bank were created in 1944 to be at the center of the international financial system, but they have not adapted well to the far-reaching changes in the global economy over the past twenty years. Their legitimacy has been called into question due to their antiquated governance structures, and as a consequence they are losing relevance and effectiveness.

If the IMF and World Bank did not exist today, we would create them to address global threats such as

financial instability and weak states. But we would create them in different forms and not locate both in Washington.

The United States is the principal obstacle to re-positioning these two vital institutions to achieve their potential and be valued by all members. An initiative by the next President to rescue the IMF and World Bank could be one of the least costly and most convincing elements of a foreign policy designed to move the United States from being the sole military superpower to being a trusted global partner.

INTRODUCTION

The United States fathered the International Monetary Fund and the World Bank in 1944 and they were born as conjoined twins. They grew up and performed well for 50 years, but they have been ill for the past ten years. Numerous reform proposals have been advanced and some small improvements have been implemented, but the prospects for restoring health to these potentially vital global institutions are not encouraging.

The United States is the main obstacle to fixing the IMF and World Bank. In effect it is choking both institutions because American opinion is polarized between marginalizing these institutions and revitalizing them.

The next U.S. president will have an opportunity to save the IMF and World Bank from sinking into irrelevance, and to ensure that they will continue to contribute to the security and prosperity of the United States. The potential benefits of action in this area are large and the budget costs are negligible.

One purpose of this essay is to make the case that restoring the vitality of the IMF and World Bank is a critical foreign policy objective for the United States. A second purpose is to highlight the advantages of separating them rather than merging them or letting them drift. Key policy choices in the process of separating the two institutions are also examined.

THE PROBLEM AND POSSIBLE SOLUTIONS

Many factors contribute to the poor health of the IMF and World Bank. An anachronistic governance structure, in which the emerging market countries are woefully underrepresented, is the target of most current reform proposals. Mission creep by both institutions is another well-studied factor. Here we argue that confusion about the distinct role of each one is at the heart of the problem. They look indistinguishable to the man or woman in the street. Even graduate students in leading schools of international relations have a hard time explaining how they differ.

Some of the confusion relates to overlapping missions. Much of it, however, comes simply from the fact that for decades their headquarters buildings have been located across the street from each other in downtown Washington, DC. Another factor that has received insufficient attention is how U.S. policy toward these institutions is framed by a single piece of legislation, the Bretton Woods Agreements Act of 1945. A third rarely mentioned factor is the “divided loyalty” between the finance ministers and central bank governors who provide policy guidance to the two institutions.

Extremists on both ends of the political spectrum have called for shutting down both the IMF and the World Bank, either because they create moral hazard or because they are hurting poor and politically weak countries. The strongest argument for shutting them down or sharply limiting their role is that today’s international capital markets obviate the need to have multilateral intermediaries to channel capital to the middle- and low-income countries.

The idea of merging the Fund and the Bank seems to be gaining support, based primarily on efficiency

arguments. By combining the two institutions, overhead costs could be greatly reduced, the number of multilateral meetings that divert ministers from other matters could be cut back, and financial operations in borrowing countries could be simplified.

Here we argue that the benefits to the world as a whole from shutting down or merging the IMF and World Bank are small compared to the benefits of greater separation.

Confusion in a changed world

Two separate institutions were created in 1944 because the job of managing the international monetary system was considered to be fundamentally different from the job of post-war reconstruction and development. This reason remains valid, but the world has changed greatly over the past sixty-four years and the IMF and World Bank have not kept pace with the changes.

One critical change was the move in the 1970s from an international monetary system based on fixed exchange rates to a system based on floating exchange rates. A fixed-rate system inherently requires more management and more financing, so the move to a floating rate system implied less “intervention” by the IMF. This consequence was not so apparent in the 1980s because many developing countries maintained transitional exchange rate regimes that were more fixed than flexible. Over the past twenty years, however, the leading emerging market countries have become more tolerant of market-driven exchange rate fluctuations and have developed their financial systems to a point where they have been able to remove most capital controls.

Another critical change was the broad economic transformation in most developing countries that oc-

curred between the 1940s and the 1990s, a phenomenon epitomized by the emergence of China as a global economic power. This transformation has involved an unprecedented leap in educational standards and institutional development. Today every “developing country” has at least a handful of citizens with technical and managerial skills on a par with those in the “developed countries.” It is now possible to find counterparts in the developing world to the most respected public sector and private sector institutions in the developed world. Moreover, national economies have been woven together into a single global economy where the distinction between developed and developing countries is rapidly losing meaning.

The overlapping activities of the IMF and World Bank are a major source of the confusion. The IMF crossed a line in the late 1980s when it began to get heavily involved in the low-income countries that are the World Bank’s major clients.

The headquarters of the IMF and the headquarters of the World Bank were located in Washington, DC, because the United States, as the sole economic superpower emerging from World War II, was the biggest shareholder in each institution and decided to locate them in its capital city instead of other possibilities such as New York or San Francisco. Until the 1990s, the advantages of this choice outweighed the disadvantages: ministers could transact business with both institutions on a single visit to Washington; Fund and Bank staff members could more easily share information in the days before photocopiers, fax machines, and the internet became ubiquitous; and it was easier to get quota increases and capital infusions from the United States because the institutions were under the watchful eye of the U.S. Congress.

The disadvantages of co-location now outweigh the advantages. In particular, the United States is no lon-

ger the strongest supporter of these two institutions. Both Europe and Japan are more committed to them, especially financially. The skeptical or even negative attitude of the U.S. Congress is especially worrisome. For example, the U.S. Congress has been sitting on legislation for ten years that is required to enable the IMF to allocate Special Drawing Rights (a kind of IMF money) to the former Soviet bloc countries that joined the IMF in the 1990s and therefore had not shared in the allocations carried out in the 1970s.¹

An even greater disadvantage is the confusion about their roles simply because their staffs work in such physical proximity, and because the Fund and Bank experts appear so much alike when they fly into borrowing countries from far-away Washington.

The overlapping activities of the IMF and World Bank are a major source of the confusion. The IMF crossed a line in the late 1980s when it began to get heavily involved in the low-income countries that are the World Bank’s major clients. Budget constraints in the United States were one reason this happened. Faced with insurmountable obstacles to increasing bilateral development financing to the extent that other high-income countries were willing and able to support, the U.S. government saw increased IMF financing as an alternative means of advancing its foreign policy goals. Another reason was “aid fatigue.” The U.S. Congress became increasingly concerned that bilateral development assistance was not generating sufficient progress in low-income countries. The Treasury Department was successful in arguing that U.S. funds given to multilateral institutions would have a bigger development impact. Confusion about the roles of the IMF and World Bank peaked after 1996 as they began joint implementation of the Highly-Indebted Poor Country (HIPC) Initiative and the Multilateral Debt Reduction Initiative through which the debts of low-income countries to these two institutions are be-

ing written off by means of an extremely complex and burdensome process.

A subtler source of confusion is the historical legacy of framing U.S. policy toward the two institutions in a single act of Congress, the Bretton Woods Agreements Act of 1945. As a consequence, U.S. policy toward the IMF and the World Bank exhibits a high degree of parallelism.² Restrictions on U.S. support for the operations of the one institution usually apply with the same force to its twin. For example, the U.S. Executive Directors in each institution are required by the Act to vote against loans to countries whose governments engage in gross violations of human rights.³ The same authorizing and appropriations committees handle oversight and funding for both institutions even though their basic functions are fundamentally different. The Treasury Department, which clearly has competence on matters related to the global monetary and financial systems dealt with by the IMF, is the lead agency on World Bank matters where its competence is highly questionable.

A fourth and still more subtle source of confusion has been the changing roles of finance ministers and central bankers in the work of the IMF. The IMF is often described as the world's "central bank" and central bank governors have played prominent roles in the life of the IMF from the beginning. Fundamentally, however, it is a tool for finance ministers, and its future effectiveness depends on progressively reducing the role of central bank governors.⁴

Five factors explain why the IMF is increasingly becoming a "club" for finance ministers:

- *Monetary policy vs fiscal policy.* Fiscal policy has become the critical element of macroeconomic management, with monetary policy serving in a subordinate role to reinforce strong fiscal policies

or counterbalance weak fiscal policies. Finance ministers alone are responsible for fiscal policy, and in most governments the finance minister's position is the most important cabinet post, or second after the foreign minister's position.

- *The move toward central bank independence.* Forty years ago, macroeconomic management in emerging market countries was a shared responsibility between finance ministers and central bank governors, with both implementing government policies. For countries that have made their central bank independent, it makes little sense for the central bank to be the lead agency on IMF matters.
- *The growing institutional capacity of central banks in emerging market countries.* Forty years ago they were far less sophisticated and credible than their developed country counterparts. Now the central banks in countries like Brazil and South Korea are functionally in same league as the central banks in the G-10 countries, or very close to it.
- *The greater importance of financial system issues domestically (banking sector reform and capital market development) and globally (systemic stability).* In most countries these issues are more the responsibility of finance ministers than central bank governors.
- *The growing number of emerging market central banks that have been accepted as members of the Bank for International Settlements (BIS).* Central bankers are better able to exchange views on the major issues of the day in their own "club."

The theme of finance ministers vs. central bank governors in the life of the IMF is further developed below on pages 13-14 under "Restructuring the IMFC and the Executive Board."

The benefits for the United States of a strong IMF and a strong World Bank

Today the United States is in a deep hole economically and a deeper hole politically. The economic hole

is reflected in the bearish outlook for growth in the US economy, its unprecedented indebtedness to the rest of the world, and the weak dollar. Fiscal and monetary policies have been loose for a decade, pushing consumption to unsustainable levels and leaving little room for stimulus in a downturn. Other signs not missed by our global partners are deeply rooted structural weaknesses in the health and education sectors, and insufficient infrastructure investment to meet the requirements of a growing economy. The mammoth losses in the financial sector that have been exposed since mid-2007 are having an adverse impact on the rest of the world and raise serious questions about the American "growth model."

Politically, the respect garnered by the United States after the collapse of the Soviet Union and its emergence as the world's only superpower has dissipated as others saw the United States opt for insensitive approaches to critical issues such as global warming. The enormous sympathy extended to the United States from around the world after 9/11 has been squandered in a mismanaged military adventure in the Middle East and a questionable "war" on terrorism, compounded by heavy-handedness in areas such as visas for foreign students. While other countries go through the motions of normalcy in their relations with the United States, few are interested in doing the Bush administration any favors in its last lame-duck year. Most are saving any room to make deals for the next administration.

Digging out of the political hole will require a long-term effort across the foreign policy spectrum and a realignment of both hard power and soft power instruments. Clearly one part of a successful strategy will involve a new U.S. policy on global governance in the United Nations and in the G-8 Summit process. Another part will involve a new U.S. policy toward the international financial institutions.

U.S. policy toward the United Nations goes well beyond the scope of this essay. It is worth noting, however, that the IMF and World Bank are both "specialized agencies" of the United Nations. Governance reforms in these two institutions could be models for reform elsewhere in the U.N. system.

The G-8 Summit process is loosely linked to the IMF and World Bank because historically the G-8 agenda has been dominated by economic and financial issues. It has also been used as forum for consensus building on specific IMF and World Bank issues such as the Heavily-Indebted Poor Country (HIPC) initiative. Reforming the G-8 Summit process is also beyond the scope of this essay but a successor process that gives a meaningful role to rising powers such as Brazil, China, and India could certainly play an important role in providing political support for fundamental improvements in the operations of the IMF and World Bank.⁵

The task at hand is to show how a bold set of reforms in the IMF and the World Bank can advance the long-term security and prosperity of the United States.

Fixing the IMF

A critical difference between the IMF and World Bank, which escapes most educated people with an interest in international affairs, lies in the scope of their activities. The IMF is focused on the international financial (including monetary) system as a whole. It must therefore give priority to the policies and performance of the world's biggest economies and financial centers, which means focusing on the United States and other high-income countries in Europe and Asia. By contrast, the World Bank is focused on improving conditions in the poorest countries in the world. It does continue to play an important role in "middle-income" countries,

but it stops lending to countries when they achieve “upper-income” status. As the “Knowledge Bank,” the World Bank follows closely sectoral developments in the upper-income “developed” countries (largely consisting of the “original” 24 members of the OECD), but it has no mandate to innovate in these countries as it does in the developing countries. The Bank is also increasingly working on “global public goods” such as the trade regime, the environment (global warming), labor migration, and remittances, but its core mission is alleviate poverty.

The IMF is the only global body with a mandate to “examine” the United States, and here is where we find both the core of the problem and the heart of the opportunity. As Americans know from more than 200 years of experience, checks and balances are critical to good governance. The problem is that the IMF has yet to demonstrate an ability to serve as an effective check and balance on the United States or other “old powers” like the U.K, France, and Germany. The United States and its European partners have effectively tamed (some would say neutered) the IMF so that its concerns and criticisms are muted. Even when visible, they are more often than not disputed or ignored. The world’s “new powers” (Brazil, China, India, etc.) are unlikely to take the IMF seriously, or feel much of an ownership interest in it, until it is restructured to serve as a more effective check and balance vis-à-vis the old powers.

The specific reforms in the IMF required to enable it to live up to its potential are substantial and certainly will have the effect of diminishing U.S. *control*. They can, however, increase U.S. *influence* because now the rest of the world tends to tune out on messages from the IMF. Even with U.S. control declining significantly, U.S. influence will increase if the rest of the world pays more attention to what the IMF is doing. And the

United States will still have plenty of control for many years to come. Under any reasonable formula for determining voting shares, the United States will remain the largest shareholder by a factor of two over any other country. Within fifty years, however, China’s (and maybe India’s) GDP weight could approach that of the United States. Reflecting this possibility now in the Fund’s governance structure and operations will be a critical step in convincing China and other rising economic powers to take a greater interest in the IMF.

Fixing the World Bank

The World Bank is punching below its weight because it is too American, too big, and too expensive. The most obvious sense in which the Bank is too American is the tradition of having an American president. U.S. credibility in the area of global governance was badly damaged when President Bush nominated Paul Wolfowitz to be the President of the World Bank, and then followed up with the appointment of Robert Zoellick after Wolfowitz departed under a cloud in mid-2007.⁶ If the next president of the United States fails to open the door to a non-American World Bank president at the end of Zoellick’s first term, the rest of the world will groan and shift its attention toward other vehicles for addressing poverty and other global issues. The Bank is also too American because its headquarters is located in the United States. As a result, despite holding non-American passports, its staff has fully imbibed U.S. culture and is perceived as “American” by the poorer countries the Bank is trying to help. It is also difficult for people in the rest of the world to de-link the Bank from unpopular U.S. policy choices.

The World Bank is too big partly because of mission creep but also because of its peculiar organizational structure. For historical reasons that are no longer valid, the World Bank consists of three sepa-

rate corporate entities with four different balance sheets: the International Bank for Reconstruction and Development (IBRD), which makes loans on quasi-market terms to middle-income countries, with an additional balance sheet for the International Development Association (IDA) that makes “soft” loans and grants to poor countries, the International Finance Corporation (IFC), which invests in private companies outside of the high-income countries, and the Multilateral Investment Guarantee Agency (MIGA), which guarantees foreign investment in the same group of middle- and low-income countries. The Asian Development Bank and the European Bank for Reconstruction and Development are able to perform the same functions within a single corporate structure.

As of mid-2007, the World Bank Group as a whole had more than 12,000 employees, with almost 40 percent employed in its field missions. In addition, it had more than 1,000 consultants and temporary employees on its payroll. For more than a decade the Bank has exhibited signs of negative synergy: the whole has become less than the sum of its parts for several reasons including bureaucratic layering.

The World Bank is too expensive because so much of its staff is living in high-cost Washington, DC. Granted that Washington, DC, is looking cheaper and cheaper as the dollar depreciates, its costs are also elevated by two practices that are outmoded and questionable. One is relying on Washington-based country experts who fly back and forth from the countries they are helping at frequent intervals, normally on business class fares and living in the best hotels during their trips to the field. The other is relying heavily on contractors based in high-income countries, whose costs are correspondingly high.

High costs, however, are probably not the biggest problem with the Bank’s Washington-centered modus operandi. A bigger one is the psychological gap between the Bank and the poor people it is trying to help, a gap that seems to be growing by the day. People living on less than a dollar a day are naturally suspicious of people earning \$400 a day (conservatively), who don’t speak their language, and who fly in from the other side of the world to “help” them. People whose children go to the best schools and are cared for by the best doctors in Washington, DC, cannot be expected to empathize well with people who go to schools with no books and don’t have enough money to buy antibiotics even when they are available locally. Empathy is not one of the skills taught in the graduate schools that the Bank’s degree-laden staff members have attended.

Other fundamental problems with the Bank have been amply documented by others and could be easier to correct in the context of a move out of Washington.⁷ One is the Bank’s “approval culture” that rewards staff members who get projects started and monies disbursed and rarely penalizes them when the promised benefits of the projects fail to materialize. Another is its vulnerability to the “fads” that have plagued the development assistance business for fifty years as donors switch priorities in the hope of finding an approach that will yield better results, and in the process withdraw support prematurely for projects yielding long-term payoffs. A third problem is the Bank’s tendency to avoid taking risks and to replicate approaches that have been successful in one country in other countries without sufficient adjustments for the cultural differences. A fourth is the difficulty the Bank has in cooperating with the regional development banks (Asian Development Bank, etc.) because its staff is perceived as being arrogant and aloof. None of these problems would be “solved” by moving the Bank

out of Washington, but the impact of a move would be in the right direction.

At first blush, moving the World Bank out of Washington would appear to be a diplomatic loss for the United States, and even the loss of an important instrument of foreign policy. If sensibly approached, however, it would be a diplomatic coup and could be critical to transforming the World Bank into a more effective instrument of foreign policy.

Summing up

The paramount benefit to the United States of the improvements proposed here for both the IMF and World Bank increased credibility and respect as a global partner. They would demonstrate America's readiness to graduate from the paternalism that has characterized its relations with the developing world for the past sixty years, and to become more of a "senior partner" in managing the global economy. A shift in this direction could also create diplomatic space for greater use of U.S. military power in operations that have broad international support. The second great benefit is the increased effectiveness that would come from the IMF and World Bank being perceived as truly global organizations rather than instruments of U.S. or Western policy.

On the cost side, in contrast to many policy initiatives being proposed to repair U.S. relations with the rest of the world, the steps proposed here to improve the effectiveness of the IMF and World Bank have virtually zero budget cost.

Alternative approaches

Three alternatives to separating and strengthening the IMF and World Bank are to merge the two institutions, phase them out, or leave them alone.

Merging the two institutions has been mentioned by people as distinguished as former U.K. Prime Minister Tony Blair.⁸ He did not elaborate on the rationale but the obvious one is administrative efficiency. Efficiency is an important objective for all public sector institutions, but one of the strong principles of public policy is that separate policy objectives are best pursued with separate instruments. If the policy objectives of the IMF and the World Bank were the same, then there would be a compelling argument for merging the two. We argue here, however, that the two institutions have quite distinct objectives: global financial stability for the IMF and the reduction of global poverty for the World Bank. From this perspective, merging them is about the worst change imaginable.⁹

A strong argument for phasing out the World Bank can be made with four points:

- The capacity of developing countries to manage their own development, to chart a path toward national prosperity, has improved greatly since the end of colonialism gave birth to many new and underdeveloped nations. The need for policy guidance from the World Bank's elite staff of PhD economists is much reduced because most developing countries have their own PhD economists who have graduated from the same universities and even have the same elitist outlooks.
- Many developing countries are no longer dependent on official aid because they have gained access to private capital flows.
- The regional development banks created over the past forty years can do everything the World Bank does.
- Part of the problem with development assistance is an excessive number of aid agencies. Eliminating the biggest aid agency could make life easier for policy makers in the countries that are still dependent of foreign aid.

These arguments are not compelling, however, in a world that is now highly integrated and becoming more so. A stable and prospering world order will depend on having strong global institutions to address global issues. If the world did not already have a World Bank, it would have to create one. If the World Bank is not doing what the world needs it to do, then the real options are to fix the Bank or replace it with a new multilateral institution. If the United States supports the fixes outlined later in this essay, then the laborious and surely contentious process of replacing the Bank can be avoided.

The only respectable argument for phasing out the IMF is an ideological one, linked to an aversion to all public sector institutions and a distrust or fear of multilateral ones in particular. The recent turmoil in the international financial system originating in the subprime mortgage market in the United States shows the weakness of this argument. The most common argument for doing away with the IMF is that it harms poor countries by giving them bad advice and forcing them to adopt policies that make people suffer. This

argument is simply not credible for anyone with first-hand experience with the IMF. Which is not to say that the IMF is doing everything right. Here too the real options are either to fix the IMF or to replace it. Fixing it along the lines spelled out below is surely the smarter route for the United States.

Sadly, the option of letting the IMF and World Bank remain on their present course is the option most likely to prevail in the absence of a global crisis on a par with the Depression of the 1930s or World War II. Historical experience suggests that the odds are stacked against the United States providing the political leadership required at this moment. The odds are also stacked against the rest of the world providing the necessary degree of political will to engage in a serious effort to fix the Fund and the Bank if the United States does open the door to the possibility. Spasms of marginal improvements are likely to materialize but the general trend is most likely to be a vicious cycle of diminishing effectiveness and diminishing support for both institutions.

FIXING THE INTERNATIONAL MONETARY FUND

Nine improvements that are bold but not radical would restore the IMF's position at the center of the international system and more effectively advance the vital U.S. objective of promoting global economic progress while reducing the frequency and severity of financial crises. The first four relate directly to the governance of the Fund. The next four relate to the mission and operations of the Fund. The last relates to the legislation that governs U.S. participation in the Fund.

Separating the IMF and the World Bank from each other is skipped over in this section, but is addressed at length in Section C below dealing with the Bank. The discussion in this section is premised, however, on greater separation.

Giving up the U.S. veto

The most impressive step the United States could take to promote a sense of global ownership in the IMF is to give up its veto power. The IMF's charter (Articles of Agreement) requires a super-majority of 85 percent of total votes for major issues such as an increase in quotas or amending the Articles. The US voting share has declined a bit over the years and now stands at 16.77 percent. The next largest quota share, held by Japan, is 6.02 percent. The ability of the United States to block actions that other members wish to take has been exercised with some regularity, most notably in the timing and magnitude of quota increases. It is a constant irritant in an organization created to serve the world as a whole, not a subset of countries.

Giving up the U.S. veto will have little impact on the day-to-day operations of the IMF because major issues only arise at intervals of several years. Moreover,

the United States will still have the largest quota. When it has strong reasons for opposing an action requiring a super majority of votes, it will not be difficult to find other members to join a blocking coalition.

The two simplest ways for the United States to forego its veto power are to lower the super-majority to 80 percent or to let the U.S. quota share fall below 15 percent in the context of a general quota increase. Each has advantages and disadvantages and the ultimate choice will properly be made in the context of negotiating a broad set of improvements.¹⁰

Selecting the next managing director

The current head of the IMF, Dominique Strauss-Kahn from France, was appointed at the beginning of November 2007. Despite intense pressure from civil society, academia, and the press for an open selection process, the tradition of filling this position with a European was continued. The decision by the European members not to let go of their hold on this position has undermined respect for the IMF in much of the world, where it was already low to begin with. Regardless of how effective a leader Strauss-Kahn may turn out to be, appointing a non-European as his successor will surely be an essential step in gaining the respect the IMF requires to be taken seriously by the world's rising economic powers.

The main obstacle to this improvement is the parallel tradition of letting the United States select the president of the World Bank. These two traditions might have endured for another decade or so if the appointing powers (the United States and Europe) had been wiser in their choice of candidates. In the case of the Bank, when its presidency became vacant in 2005, instead of choosing a person who would command broad bipartisan support, or who was "above

politics," President Bush nominated his highly controversial Deputy Secretary of the Defense Department, Paul Wolfowitz. In the case of the Fund, neither of the Europeans who served as Managing Directors immediately before Strauss-Kahn served out their full 5-year terms.

The Europeans took so much flak in the 2007 transition at the IMF that they seem inclined to open up the process, or nominate a non-European, when the time comes to find a successor to Strauss-Kahn. If so, the United States will be further embarrassed if it sticks with the tradition of appointing an American to head the World Bank. The diplomatic advantages for the United States of seizing the initiative in this matter are obvious. They will be clearly and quickly visible if the next U.S. President in his first public statements about the World Bank commits to selecting a new president through an open process when Robert Zoellick's term ends in 2012. This will certainly force the Europeans to open the process for selecting a successor to Strauss-Kahn, and the United States will earn political capital for this improvement as well.

Re-ordering quota shares and votes

Each country's "quota" determines the amount of its currency deposited in the IMF, in effect its capital contribution. The size of each country's quota is arrived at by a formula that takes into account variables such as GDP, trade, and foreign exchange reserves, with considerable political jockeying at the margins to avoid a sharp drop in the quota share of any major country.

Voting shares are not precisely aligned with quota shares because every member begins with a fixed number of "basic votes" to which are added "quota-based" votes. Part of the governance problem is that

the level of basic votes has been constant since the establishment of the Fund in 1946. As a consequence, as quotas have increased, the share of basic votes in total votes has slipped from a high of 15.6 percent in 1958 to the current level of 2.1 percent.¹¹ This erosion works to the disadvantage of economically small countries that constitute a majority of the Fund's 185 members. A major complication is that changing the level of basic votes requires an amendment of the Fund's Articles, which means it must be ratified by the U.S. Congress.

Intensive negotiations have been underway since mid-2005 for an adjustment in quotas to reflect the growing economic weight of the leading emerging market countries, and an increase in basic votes. A two-phase process was adopted and small increases in quotas for four countries were approved in April 2007.¹² The second phase was concluded in principle when the IMF Governors approved, by a very high majority of votes, a package of changes that included a tripling of basic votes, a new formula for calculating quotas, and a comprehensive (but a "jury-rigged" and not large) re-alignment of quotas and voting shares. The package, however, requires ratification by the members before it takes effect, and ratification by the U.S. Congress cannot be taken for granted. The negotiations to arrive at the agreed package were contentious. While the G-8 and the management of the IMF have trumpeted the package as a major improvement in governance, the package has been widely criticized as too little too late and concerns about the IMF's legitimacy remain.

For the purposes of this paper, as an alternative to arguing in favor of one quota formula over another, it may be more constructive to simply mention one approach that has not been considered so far: placing a cap on the number of votes a single member

can have. Such a cap, for example, could allow the United States to end up with a larger quota (say 20 percent), but a smaller voting share (say 12 percent, if that were the agreed cap). The challenge is to find a share that is large enough to reflect the position of the United States as the world's largest economy and small enough to make the United States look more like a senior partner than the boss.

In short, the April 2008 package is a small step in the right direction. Early ratification by the U.S. Congress would helpfully remove some of the existing concerns in the rest of the world about U.S. support for improvements in IMF governance. But the United States (along with the other G-10 countries) will have to go substantially further to put the IMF at the center of the international monetary and financial system, and the goal is unlikely to be reached in the near term (5-10 years) without U.S. leadership.

Restructuring the International Monetary and Financial Committee (IMFC) and the IMF Executive Board

Before focusing on how to restructure the IMFC and the Executive Board, it helps to consider the question of whether member countries will be represented by their finance ministers or their central bank governors. The primary responsibility of central bank governors is monetary stability, and they have their own forum, the Bank for International Settlements. Financial stability, the preoccupation of the IMF, is a primary responsibility of finance ministers. The important policy choices related to the IMF are made by governments. As noted above, it is contradictory for government policy choices to be made by, or conveyed by, central bank governors in a world where more and more central banks are becoming independent.

At the beginning of 2008, the votes of 92 member countries were cast by their finance ministers who had been selected by these countries to be their "IMF Governor." The votes of 82 countries were cast by their central bank governors, serving as "IMF Governor" for their country.¹³ These include notably Belgium, China, Germany, Netherlands, South Africa, Sweden, and Switzerland. We proceed in the belief that:

- this surprising division is a source of dysfunctionality;
- making the IMF more clearly an institution primarily serving finance ministers would help to make the IMF more effective;
- member countries will be represented in the IMFC increasingly by finance ministers rather than central bank governors; and,
- Executive Directors will increasingly come out of finance ministries rather than central banks.

Reaching agreement on major policy issues and on specific operations is not easy in an organization with 185 sovereign countries as members. The process that has evolved to accomplish the objective involves a ministerial-level policy guidance forum (the IMFC) that meets twice a year, a full-time body (the Executive Board) that makes operational decisions, and a constituency structure. Currently both the Committee and the Board have 24 members.¹⁴

The well-established practice in organizing these two bodies, consistent with the Fund's Articles, begins by giving the countries with the five largest quotas (United States, Japan, Germany, France, U.K.) a single-member seat in each body. Then China, Russia, and Saudi Arabia are each allowed to have a single-member seat. The remaining member countries are then grouped into sixteen constituencies of anywhere from four to twenty-four members. Most constituencies are

headed by the country in the group that has the largest quota. In many constituencies there is a rotation system so each of the members has a chance to head the constituency for a fixed term.

The IMFC meets for one day in the spring and one day in the fall. It reviews recent developments and near-term prospects for the global economy, and provides guidance to the Executive Board and the staff of the IMF in addressing the critical issues of the day.

Members of the Executive Board are full-time employees of the Fund. They meet several days every week to review the reports produced by the staff, approve specific financial operations, and work toward a consensus on the major policy issues that will be considered at the next IMFC meeting.

The general sense is that both the IMFC and the Executive Board would be more effective if they were smaller. Beside the obvious problem of forcing some members off, a major obstacle to shrinking their size is the over-representation of European countries. Eight of the 24 seats are occupied by members of the European Union, reflecting their legacies as founding members of the Fund and the adoption of quota formulas that give them relatively large quotas.¹⁵ Strong arguments have been advanced both for reducing Europe's representation to a single seat for all fifteen countries that have adopted the Euro as their national currency, or for reducing Europe's representation in stages from eight to two or three. Arguably, there is no "right" number. It is one of the variables to be hammered out in negotiations for a package of improvements. Inevitably, the ultimate solution will leave some countries dissatisfied and resentful.¹⁶

The problem of over-representation of European countries is compounded by the involvement of cen-

tral bank governors. It appears that the strongest resistance to reducing Europe's representation is coming from the central banks in Belgium, Germany, and Netherlands. This is rather ironic given the fact that European monetary policy is no longer in the hands of these banks but has been transferred to the European Central Bank.

The chairmanship of the IMFC has recently become a problem. The IMFC tends to be more effective as its chairman gains experience in this position. Gordon Brown served ably in this position from 1999 to 2007, but government changes since then have cut short the chairmanships of his successors. A possible solution would be to begin a practice of having the U.S. Treasury Secretary chair meetings of the IMFC (at least those held in Washington), in return for ending the practice of holding G-7 meetings the day before every IMFC meeting.

The IMF's Independent Evaluation Office put out a report on the governance of the IMF in May 2008.¹⁷ The evaluation examines four dimensions of governance: effectiveness, efficiency, accountability, and voice. Among the most important recommendations are clarifying the roles of the three main governance bodies (the IMFC, the Executive Board, and Management), and getting more systematic ministerial involvement by activating the "Council" that was provided for in the original Articles of Agreement but has never materialized. Most of the recommendations in this report could usefully be included in a package of reforms.

Refocusing the IMF's mission

By and large the IMF's Articles of Agreement provide a sufficiently clear mandate to meet the critical challenges it will face over the next 50 years. The IMF's two biggest mission-related problems are weak sur-

veillance of the “old powers” and spending too much energy on countries that have no systemic significance.¹⁸ The IMF is sometimes criticized for not being a real-time participant in the international financial markets, but this looks more like a missed opportunity than a problem.

Surveillance of old powers

The simplest explanation for the weakness of the IMF’s surveillance of the old powers, including its surveillance of the international financial system, is that the finance ministers in the G-10 countries do not like to be criticized.¹⁹ They view the IMF primarily as an instrument for fixing the rest of the world, not for self-discipline. This attitude is entirely natural given how the Fund was created and the role it played in its first 50 years. If the attitude is not changed, however, the world’s “new powers” will have a strong reason to pay less attention to the IMF and let it continue drifting toward irrelevance.²⁰

Part of the problem is that the finance ministers from the G-10 countries are not accustomed to engaging with the Managing Director of the IMF as a peer. The United States and the United Kingdom have been especially dismissive of IMF Managing Directors over the years, expecting them to get in synch with the G-10 position on important issues and not “interfere” with how the G-10 finance ministers are managing their economies. The persons the United States and the United Kingdom appoint to the IMF Executive Board are rarely persons of stature. It is not uncommon for Executive Directors from emerging market countries to return home and become a finance minister or central bank governor. For the most part, the G-10 Executive Directors are well-behaved bureaucrats.

The world needs an IMF that will be listened to by powerful countries, both old and new. For that to happen,

the United States and the other old powers will need to stop “sitting on” the IMF and make sure it has leaders whose views will not be brushed off or ignored. Improvement in this area will require a degree of political will (courage) that has not been seen for many years.²¹

Many observers have noted that the IMF from its inception has focused on the exchange policies of its members, but in recent years when exchange-rate misalignments have become exceptionally large the Fund has not taken strong positions on these misalignments. Clearly, to gain credibility, the IMF will have to have a tangible impact on exchange-rate management in countries that appear to be contributing to an unsustainable pattern of international payments.²²

Many observers have also criticized the IMF for being asleep at the wheel when the international financial system began imploding with the subprime mortgage crisis in the United States in mid-2007. These criticisms are partly justified, but again much of the blame rests with the old powers. Two examples may be sufficient to nail down the point:

- After the Asian financial crisis in 1997, the members of the G-20 agreed to participate in the joint IMF-World Bank “financial sector assessment program.” Logically, one of the first assessments should have been done in the United States. In fact, the United States stalled until 2007 when the subprime crisis occurred, and then it agreed that the evaluation could be started in 2009.²³
- The IMF Department responsible for surveillance of the U.S. economy is the Western Hemisphere Department, where the only other industrial economy it is responsible for is Canada. Until a department is created that focuses exclusively on the United States (and Canada), it is unlikely that the Fund’s surveillance of the U.S. economy will be sufficiently robust to have an impact on U.S. policies.

Gordon Brown has proposed going much further in this direction. Specifically, he has called for an IMF that can "... act with the same independence as a central bank—responsible for the surveillance of the world economy, for informing and educating markets, and for enforcing transparency through the system."²⁴ The idea is appealing but it is hard to imagine that the United States is ready to yield this much sovereignty to the IMF, and it does not appear necessary to do so to strengthen the Fund's surveillance of the old powers.

The IMF's role in low-income (low significance) countries

A large dose of political courage will also be required to reduce the IMF's involvement in low-income countries. The rationale for doing less is simple: these countries do not play a significant role in the international financial system. As they begin to assume significant roles, individually, the IMF can add them to its surveillance agenda.²⁵

The emphasis here is on reducing the IMF's involvement in low-income countries, not eliminating it. Three obvious steps to make the IMF less focused on low-income countries are: making IMF Article IV consultations with these countries the exception rather than the rule; ending "special" financing operations involving contributed funds extended on concessional terms; and moving to fee-based technical assistance.²⁶

In the case of technical assistance, the old and new powers have the capacity to pay, and requiring payment will help to ensure both that the Fund's expertise is solid, and that its advice will be taken seriously. For the low-income countries, the IMF's technical assistance, at its standard rates, can be paid for by grants from multilateral and bilateral donor institutions, and

even from the private sector. Naturally, as the IMF gives less attention to low-income countries, it will make sense for the World Bank to compensate by scaling up its attention.

Devoting less attention to low-income countries has important implications for quota shares and the composition of the IMFC and the Executive Board ("shares and chairs"). Specifically, it implies not raising the current quota share of the low-income countries, and abandoning the current effort to "reserve" seats for representatives from low-income countries. Naturally this is a sensitive issue, but the sensible political solution is to offset a lower profile for low-income countries in the IMF with more shares, more chairs, and more financing from the World Bank.

Given the IMF's responsibility for global financial stability, a surprising fact is that the World Bank runs circles around the IMF when it comes to real-time participating in international financial markets. The simple reason for the disparity is that the World Bank has been a major borrower in international capital markets for fifty years while the IMF has been funded exclusively by the central banks of its member countries. Moreover, the World Bank has been a leading innovator including the development of currency swap markets. The World Bank also manages assets placed by the sovereign wealth funds of several of its members. The Fund has considered from time to time being an active market participant, but has shied away from this step. Opening the door to IMF participation in these markets could be an important component of a package of improvements.

Retooling the staff

At the end of the 1980s, on the eve of the collapse of the Soviet bloc, the IMF staff numbered around 2,000.

Morale was good and the Fund operated at a level of efficiency that no other multilateral institution approached. During the 1990s, the staff ballooned to 3,000 both to shepherd the countries in transition from centrally-planned to market economies that were joining the Fund for the first time, and to assist the numerous small low-income countries in every region of the world that were falling behind economically as the larger developing countries began growing rapidly and integrating into the global economy.

Now the transition countries have much less need of a shepherd. We also believe that the World Bank can do a better job of helping low-income countries if it does not share overall responsibility with the IMF. The implication is that the “right” size for the IMF for the next 5-10 years is probably closer to 2,000 than 3,000. The IMF is moving in the right direction but for the wrong reason. It is in the process of shedding as many as 400 positions, but the driver is the funding problem discussed below.

More important than numbers is the kind of skills the IMF seeks when it recruits staff, and the kinds of competencies it values when it promotes staff. Two improvements in this area would help the IMF gain respect and effectiveness. The more important improvement is to put much more emphasis on country expertise. Having people on IMF surveillance teams who can speak the language of the country with near native ability could increase dramatically both the staff’s understanding of the country and its ability to communicate its views to the citizens of that country. Combined with greater knowledge of the country’s history, culture, and politics, the credibility of the IMF could be boosted impressively.²⁷

The other improvement is to cut back on the large volume of research that gives the IMF much of its academic character. The Fund hires freshly minted PhD

economists and then rewards them for work that resembles post-doctoral research, not just in their early years at the Fund but throughout their careers. The world would benefit more from an IMF that does relatively little research in-house but supports policy-oriented research from the best outside experts globally (some of whom may be outside universities in policy think tanks, for-profit consulting firms, law firms, etc.). The Fund’s support could be direct by commissioning studies or indirect by finding and calling attention to outstanding work supported by others.

Jurisdiction over capital movements

When the IMF was established, it was only given jurisdiction over current account transactions (trade in goods and services) because capital controls were deemed to be critical to maintaining systemic stability in a system of fixed exchange rates. When the IMF Articles were amended in the 1970s in the process of moving to a system of floating exchange rates, even though the rationale for capital controls had largely evaporated, the IMF’s mandate with regard to capital movements was left unchanged. One reason, presumably, was uncertainty about how well the floating rate system would function.

The other improvement is to cut back on the large volume of research that gives the IMF much of its academic character. The world would benefit more from an IMF that does relatively little research in-house but supports policy-oriented research from the best outside experts globally.

By 1990, the high-income countries (members of the OECD) had removed all significant controls on capital movements. By 2000, virtually all of the leading emerging market economies had either removed most capital controls or were in the process of doing so.

In the mid-1990s, IMF Managing Director Michel Camdessus waged an ill-fated campaign to amend the Fund's Articles to give it jurisdiction over capital movements.

The IMF's lack of jurisdiction over capital movements leaves an uncomfortable gap in the international system between the World Trade Organization (WTO) and the IMF. The case for assigning this responsibility to the IMF rather than the WTO or some other institution is strong. What stopped the campaign in the 1990s was the source of the initiative (the IMF Managing Director rather than the major shareholders) and unlucky timing (the Asian financial crisis in 1997 was the nail in the coffin).

Since giving the IMF jurisdiction over capital movements can only be done by amending its Articles, it makes sense to include this improvement as part of a package of improvements proposed by the United States. Support from the European members can be assumed. Some resistance from developing countries is inevitable, but in the course of an open and inclusive vetting of the pros and cons, their concerns can be allayed.²⁸

Financial issues

The IMF is in the midst of a budget crisis. Until quite recently, the spread between the interest charged on the credit extended to members and the interest paid to the members making their currencies available generated enough income to cover the IMF's administrative costs (staff salaries, travel, utilities, etc.). In the exceptionally favorable global economic environment between 2003 and 2007, however, most of the largest users of IMF credit pre-paid their outstanding balances. As a result, the IMF is currently operating in the red and will continue to do so unless costs are sharply

reduced, borrowing increases sharply, or a new financial model is adopted.

The IMF is in the process of cutting costs, including a large reduction of staff positions. The prospects of an increase in borrowing may have improved as a result of the current turmoil in global financial markets, but this outcome is not one to be wished for. A "Committee of Eminent Persons to Study Sustainable Long-term Financing of the IMF" was formed to consider a new financial model and its recommendations were contained in a report that came out at the beginning of 2007.

One of the recommended steps to put the IMF's finances on a sustainable basis was to sell a portion of its stock of gold and invest the proceeds in interest-bearing securities or other financial assets offering an acceptable balance of yield and risk. Any sale of gold, however, requires the approval of the U.S. Congress, which has opposed all recent proposals to sell IMF gold.

This awkward situation is one of the most vivid illustrations of how the United States is choking the IMF. Thus, an important component of any credible reform proposal from the United States will be obtaining Congressional support for selling a modest portion of the IMF's ample stock of gold.²⁹

A related but less critical ingredient of a package of improvements would be Congressional approval (ratification) of the fourth amendment of the Fund's Articles that provides for a special "catch-up" allocation of Special Drawing Rights to countries that joined the IMF after SDRs were last allocated to members in 1981. The amendment was adopted by the membership in 1997 but cannot go into effect until the Congress consents. While there is clearly no liquidity "need" for

this special allocation, it is not large enough to have a measurable impact on global liquidity. The reluctance of Congress to ratify the amendment is based on anti-IMF and anti-globalization sentiment and simply serves as an example of why the United States is an unreliable international partner.

A new legislative framework

U.S. participation in the IMF is governed by the Bretton Woods Agreements Act, passed on 31 July 1945 (Public Law 79-171), and by subsequent amendments to this act. As the title implies, the Bretton Woods Agreements Act also governs U.S. participation in the World Bank.

Enacting a new law for each institution to replace the Bretton Woods Agreements Act of 1945 would be a powerful step underscoring a U.S. initiative to revitalize the Fund and the Bank. Reflecting the future roles of the two institutions sketched out in this essay, it would be desirable for the new acts to come out of separate committees, which implies dividing the continuing oversight function. Responsibility for the new IMF Act would logically remain with the Senate Banking Committee and the House Committee on Financial Services, while responsibility for the

new World Bank Act would logically move to the Senate Foreign Relations Committee and the House Committee on Foreign Affairs.³⁰ Replacing the Bretton Woods Act with two separate acts could be an extremely contentious process. Rather than being an argument against an initiative of this kind, this prospect underscores the importance of educating U.S. voters and their elected representatives about the purposes of the IMF and World Bank and how far U.S. policy has to change to show the rest of the world that we don't always have to do it "our way."

Paralleling these changes in the legislation governing the IMF and World Bank, it would be desirable to re-affirm the role of the Treasury Department as the lead agency on IMF matters, but to discontinue the Treasury's role as the lead agency on World Bank matters. The State Department would most naturally be designated as the lead agency for the World Bank (and the handful of regional development banks that the United States belongs to). If, however, the next Administration decides to create a "Department of Humanitarian and Development Assistance," this new department would logically become the lead agency for the World Bank (and the regional development banks).

FIXING THE WORLD BANK

Eight improvements in the governance and operations of the World Bank, which together are somewhat more radical than the ones proposed for the IMF, would be incontrovertible evidence that the United States is ready to move from being “the boss” to a senior partner in the management of the global economy. The first three “organizational” improvements are the most radical. The next three relate to governance and are relatively straightforward. The seventh one relates to operational matters, and the last one echoes the improvement proposed for the IMF of creating a new framework in U.S. legislation.

Moving the headquarters out of Washington

The most dramatic step the United States could take to promote a sense of global ownership in the World Bank, and to reinvigorate its mission, is to propose moving the headquarters out of Washington, DC.

In the aftermath of World War II and during the Cold War period, it was very much in the interest of the United States to have the headquarters of the Bank in our nation’s capital. In particular, this made it easier for the U.S. government to set the agenda. It also gave the U.S. Congress a sense of responsibility for the World Bank that helped to underpin the political support required to justify allocating substantial budget resources to the Bank.

These rationales no longer apply. The rest of the world is tired of having the Bank’s agenda set by the United States, and the rest of the world has been more willing to contribute funds to the Bank than the U.S. Congress has been for the past 15-20 years.

The major concern expressed about moving the World Bank is the crippling impact it will have on the economy of the capital region. But the impact would only be serious if the Bank picked up and moved overnight. Any sensible plan to relocate the headquarters will involve a gradual move over 5-10 years, a sufficient period for a seamless adjustment in a regional economy that has become quite diverse and robust.

Another concern is that without U.S. leadership the World Bank will drift and become less effective as an instrument for alleviating global poverty. Quite to the contrary, the Europeans can be expected to pick up the mantle of leadership and they are less prone to shifting priorities with the political winds. They are also less inclined to micro-manage the World Bank in the fashion of successive U.S. administrations and Congresses. Moreover, this concern discounts the value of good ideas. The rest of the world is likely to be more open to strong proposals brought to the Bank by the United States if they have reasons to be less suspicious of American motives.

Finally, a great benefit for the United States of moving the World Bank out of Washington would be to make it easier for people everywhere to understand how the Bank’s mission differs from the mission of the IMF, and to see the value of continuing to support both of them.

Deciding on the best location for the World Bank’s headquarters after moving out of Washington is a major political challenge, but the serious options narrow quickly. Europe has one unbeatable advantage over other regions: the European time zone is by far the best location for the headquarters of any global operation because only there does the work day overlap with the work day in all of the other major regions of the world. Several of Spain’s major cities look like

strong candidates by a process of elimination. Within Europe, the larger countries already have their fair share of major multilateral institutions. Spain also has the advantage of being closer to Africa, which will be the primary focus of the Bank's attention for some years to come. A geographically appealing but undeniably more controversial alternative to a Spanish city is Istanbul.³¹

Merging the pieces of the World Bank

One of the most anachronistic features of the World Bank is that it consists of three differently combined agencies: the International Bank for Reconstruction and Development (IBRD), the International Finance Corporation (IFC), and the Multilateral Insurance Guarantee Agency (MIGA). Most of the countries that are members of the IBRD are also members of the other two agencies, but not all. As a result their governance structure varies slightly. By statute, the president of the IBRD is also the head of IFC and MIGA, but each agency recruits its staff separately. (The operations of the International Development Association, IDA, are managed by IBRD staff.)

This curious arrangement is an historical legacy that is no longer necessary and creates operational inefficiencies. It came about because IFC and MIGA were created after the IBRD was well established, in 1956 and 1988 respectively, and at those moments not all of the IBRD's members wanted to join (and contribute capital to) the new agencies. Proof that this arrangement is unnecessary can be found in the fact that Inter-American Development Bank, the Asian Development Bank, and the European Bank for Reconstruction and Development were given charters that allow them to do the same kinds of operations as IFC and MIGA without creating separate agen-

cies.³² Evidence of operational inefficiencies is less one-sided. Fans of IFC and MIGA fervently believe that these agencies would be less effective if they were more integrated into the World Bank, because of the public sector bias of the IBRD's staff, and the technical nature of their work with private sector clients. This fear cannot be dismissed outright. On the other hand, the operations of the IBRD (and IDA) could benefit from the expertise of IFC and MIGA concerning private sector development.

In the context of moving the World Bank out of Washington, the alternative of spinning off IFC and MIGA warrants some consideration. Change along these lines would imply a totally separate governance structure for each one, i.e., a separate Executive Board and President, and possibly locating the headquarters of each agency in a different country. The advantages of spinning them off, however, do not seem compelling.

Enhancing the role of field missions

If the headquarters of the World Bank is simply relocated to another city without a fundamental change in its structure, then an important opportunity to improve the effectiveness of the World Bank will have been lost. A far better alternative is to cut back the size of the headquarters staff and beef up its field missions.

While the World Bank has strengthened its field missions significantly over the last 10-15 years, the case for going further rests on two pillars. One is the enormous progress in communications and information processing technology that has transpired and is expected to continue. As a result, communicating between the Bank's headquarters and its field missions, and between field missions, has become almost

as easy as communications between different offices within the headquarters. The second pillar is that the World Bank's effectiveness more than ever depends on having its ear close to the ground. Much of the "low-hanging fruit" in the field of development has been harvested. During the period ahead, the effectiveness of development interventions will depend critically on adapting them not simply to national cultures but to individual communities.³³ Adaptation of this kind is best done by staff members who are living in close proximity to these communities if not inside them.

Beefing up field missions and giving them more responsibility has several important administrative implications. One is that the World Bank will have to give a greater weight to language ability in its hiring, assignment, and promotion policies. Another is longer tours in the field, perhaps with five years being the normal minimum and ten years being closer to the average.³⁴

Compensation policies will have to be adjusted to ensure retention of high-quality staff (and their families) in field missions, and possibly to reduce the disparity in compensation between locally-hired staff and expatriate staff. If approached sensibly, substantial cost savings could be achieved in the process, as long as it is clear from the outset that the Bank is not trying to match all of the amenities now enjoyed by the staff members assigned to its Washington headquarters. An additional benefit would come from de-linking to a greater degree the compensation structure (salaries and benefits) of the World Bank from the compensation structure of the IMF.

Shifting the Bank's center of gravity toward its field missions will be opposed by some "experts" on the grounds that these missions will be "captured" by their host countries. This risk is acceptable, however,

in return for achieving a greater sense of ownership among the borrowing countries and overcoming the Bank's reputation for being paternalistic and arrogant.³⁵

Giving up the U.S. veto

The voting share of the United States in the World Bank is roughly the same as in the IMF, and the Bank's charter similarly sets the threshold for votes on critical matters at the same 85 percent level that makes the United States the only member with veto power.

The arguments that favor the United States giving up its veto in the IMF also apply to giving up its veto in the World Bank, only more so. To begin with, the World Bank is fundamentally less critical to U.S. foreign policy objectives than the IMF. In other words, the stability of the international financial system in the short term is more important than the alleviation of global poverty in the long term. Furthermore, for some time to come, it is impossible to imagine managing the international financial system without the active participation of the United States. By contrast, it is easy to imagine progress in alleviating global poverty without the same level of U.S. participation in the World Bank. Much of this difference exists because there are other multilateral development agencies that the United States belongs to, and because the United States has a relatively strong bilateral development aid program. Nothing comparable exists in the IMF's domain.

A critical point here is that the U.S. voting share in the World Bank can fall much further without jeopardizing vital U.S. interests than its share in a revitalized IMF can fall. From the current 16.38 percent, the U.S. voting share in the World Bank could fall as far as 10.0 percent and still leave a substantial margin over the next largest shareholder (Japan at 7.86 percent).³⁶ With a voting share of 10.0 percent the United States

would only require the support of Japan to block an action it opposes, assuming the supermajority threshold remains at 85 percent.

Selecting the president of the World Bank

The current head of the World Bank, Robert Zoellick, was appointed for a five-year term in mid-2007 following the resignation of Paul Wolfowitz (who lost the confidence of the membership at the end of his second year at the Bank). All nine earlier presidents of the World Bank were also American, nominated by the U.S. Government. No non-American candidates have been considered because of the tradition since the founding of the Bretton Woods twins of having an American serve as president of the World Bank and a European as head of the IMF.³⁷

The benefits to the United States of opening up the selection process for the president of the World Bank are similar to those associated with opening the selection process at the IMF, as described above. They might even be greater if the headquarters of the World Bank is moved out of Washington. This would actually improve the odds substantially of selecting an American president on the basis of merit. An American chosen in this fashion would have a much stronger mandate to lead the Bank than an American appointed in the traditional manner.

Restructuring the Development Committee and the World Bank Executive Board

Like the IMF, the World Bank has a ministerial-level policy committee (the Development Committee) and an Executive Board, each with 24 members and a constituency structure that closely but not exactly parallels the corresponding IMF body.

The most anachronistic feature of the Development Committee is that it is in fact a joint committee of the governors of the IMF and World Bank.³⁸ Formally, the membership switches back and forth every two years between the IMF Governors and the World Bank Governors, although the switch has virtually no practical consequences because the constituency structure of the two organizations is so similar. The Development Committee provides a marvelous illustration of how incapable the United States and the other G-10 shareholders have been of undertaking serious renewal of the Bretton Woods twins. In the past, a good reason for the joint nature of the Development Committee was to ensure the active participation of finance ministers from the G-10 countries instead of downgrading it to a forum for development ministers. Today, however, development issues are not so much centered on aid flows. With its own ministerial-level committee, the World Bank would be in a better position to have substantive discussions among sectoral ministers on the sector-specific issues that are at the top of the World Bank's policy agenda.

In any initiative by the next president of the United States to improve the governance of the World Bank, a few simple guidelines could help to ensure a satisfactory outcome:

- While a smaller IMFC and a smaller IMF Executive Board have obvious advantages, the advantages of shrinking the Development Committee and the World Bank Executive Board are less obvious.
- No compelling arguments exist for maintaining the current degree of parallelism in the voting shares and constituency structures of the Fund and Bank. The current structure, however, is more suited to the IMF than the World Bank. Therefore, seeking more substantial changes in the governance structure of the World Bank is a reasonable and feasible objective.

- While it is difficult to make a strong case for increasing the representation of small, low-income countries in the governance structure of the IMF, the arguments for beefing up their representation in the World Bank are compelling, given the extent to which the World Bank's activities focus on these countries.

The changing roles of finance ministers and central bank governors in the IMF were discussed above in connection with fixing the IMF. A similar issue of leadership orientation exists in the World Bank. The lead ministers from the Part I/high-income countries are currently a mix of finance ministers and development ministers, with the latter becoming more prominent in recent years. If the United States decides to re-assign responsibility for World Bank matters to the State Department, this could tip the balance further away from finance ministers and help to make the World Bank more oriented toward sectoral/structural issues and less focused on short-term results.

The World Bank's claim to leadership is seriously undermined by the high-profile involvement of the IMF in most of its borrowing countries.

The lead ministers from the developing countries in the Development Committee have been finance ministers or planning ministers, with the former becoming more prominent as the more advanced developing countries have become less aid-dependent and have trimmed back or eliminated their planning agencies. In a purely Bank-related Development Committee, more diversity in representation could enhance its role.

A final point about governance concerns the cycle of annual membership meetings and semi-annual Development Committee meetings. For decades the

IMF and the World Bank have scheduled their ministerial committee meetings back-to-back on the same weekend each spring and fall, and their annual meetings jointly on the same day in the fall. If the steps proposed above to separate the IMF and World Bank are given serious consideration, then the complementary step of separating these meetings also deserves consideration.

The annual meeting of the World Bank could be moved to the spring, back-to-back with the annual meeting of one of the regional development banks, perhaps with a different one each year in rotation. Then a fall meeting of the Development Committee might be held each year in the capital of a major donor country in rotation.

Refining the mission and operations of the World Bank

A high degree of consensus exists in the global community for keeping the World Bank focused on alleviating poverty. Improving the World Bank at this stage has more to do with how it operates than what it is trying to accomplish.

The World Bank calls itself the world's premier development institution, and it should be precisely that. But its claim to leadership is seriously undermined by the high-profile involvement of the IMF in most of its borrowing countries. Sharing responsibility with the IMF also becomes an excuse for poor results. Better accountability would be achieved if the IMF took much more of a back seat to the World Bank in low-income countries. The only vital collaboration the world needs now between the two Bretton Woods twins is for the IMF to respond promptly and meaningfully to requests from the Bank for help in areas where the IMF has greater competence. Even the area of macroeconomic

management should not be considered outside the purview of the World Bank. To avoid short-changing its low-income clients, and ducking its responsibilities, it is better for the Bank to bear the primary responsibility for providing macroeconomic policy advice to these countries. As the IMF trims its staff, a good number of its macroeconomists could move to the Bank, or be seconded to the Bank.

In the years ahead, the Bank will add the greatest value for its members by being able to mobilize expertise in a timely manner, not by making grants and loans. It is not necessary for the Bank to have on its staff the world's leading experts in every field related to development (or Global Public Goods). It will be essential for the Bank to have the ability to hire the right experts at the right time. Cross-country experience is also likely to be more important than academic achievement. Changes in the way the Bank organizes itself and hires staff will be required to achieve its full potential.

Four other issues deserve careful consideration in any effort to revitalize the World Bank: its role in coordinating aid, its mix of grants and loans, its commitment to middle-income countries, and its work on global priorities such as the environment.

Aid coordination. Over the years, the World Bank has used a variety of approaches to coordinate aid to individual countries from multiple donor agencies, such as consultative groups and consortiums. As countries become less aid-dependent, they tend to tire of these devices. In some cases the donors lose patience with the coordination process. It is unrealistic to think that there is a single approach to aid coordination that will work in most aid-receiving countries, and it is probably unhealthy both for donors to push the Bank into a coordinating role and for the Bank to assert a coordinat-

ing responsibility. At the same time, a new challenge has appeared: large-scale aid programs by private-sector philanthropies (e.g., the Gates Foundation), and by sector specific funds (e.g., the Global Fund to address HIV/AIDS, malaria, and tuberculosis). An ad hoc approach by the World Bank to aid coordination looks most attractive.

Grants vs. Loans. Until the Bush Administration launched a major initiative to shift much of its financing for low-income countries to grants, the World Bank supported these countries with concessional (long-term, low-interest) loans. While ultimately successful, the United States fought a lonely battle for more grant financing. The next U.S. president will have to decide how much further to go in this direction.³⁹ The U.S. position is widely seen to be driven more by ideology than practical considerations, but the resistance from other donor countries to giving more grants is not totally convincing either. The benefits to the United States of continuing to press for a larger share of grant financing appear small. The long-term interest of the United States is probably better served by "going with the flow" and accepting with good grace the mix that commands the greatest support among the major donors and the many recipients.⁴⁰

Lending to middle-income countries. The ability of middle-income developing countries to tap international capital markets on favorable terms over the past decade has prompted calls for ending World Bank lending to them. Particular attention has focused on China as its foreign exchange reserves soared past the \$1 trillion mark. From a narrow technical perspective, it is hard to justify Bank lending to these countries, but first of all the World Bank is a political institution not a commercial one. Second, it is a multilateral institution that has similarities to a cooperative or credit union. Third, in countries like China and India, World

Bank operations related to Global Public Goods (such as global warming) can have more of an impact than in smaller and poorer countries. The choice for the next president of the United States is simple: either to make an issue of Bank lending to middle-income countries or to use his political capital for some other purpose. Seeing little benefit to the United States from the first option apart from throwing its weight around, the second option looks preferable, especially given the diplomatic damage the next president will be attempting to repair.

Global Public Goods. The Bank's European shareholders and Japan have recently pressed the World Bank with some success to put its weight behind efforts to address broad issues that affect high-income countries as well as low-income countries, such as global warming, HIV/AIDS, and water scarcity. The United States has not opposed preliminary steps taken by the Bank in these areas, but has been more concerned with what the Bank can do in some narrower areas such as terrorist financing, drug trafficking, and failed states. Here also, the choice for the next U.S. president will be between backing activities that enjoy broad support from other countries or bending the will of other countries to steer the Bank in directions

of particular interest to the United States. As long as the United States remains the largest shareholder, it will make sense for the Bank to give extra weight to the priorities recommended by the United States. In the near term, however, given the exceptionally negative view of the United States prevailing in much of the world, a tactical pause could bring the United States closer to the time when more World Bank members will be inclined to support the United States rather than oppose it.

A new legislative framework

Here we simply repeat the proposal mentioned in discussing the IMF that a new law be passed that governs U.S. participation in the World Bank (and the regional development banks). It would replace the Bretton Woods Agreement Act of 1945, and a separate new law would govern U.S. participation in the IMF. Similarly, oversight of the World Bank (and the regional development banks) would shift to the Senate and House committees responsible for foreign aid, and the State Department (or a new Humanitarian and Development Assistance Department) would become the lead agency on World Bank matters in lieu of the Treasury Department.

BUILDING A BIPARTISAN CONSENSUS FOR A REVITALIZED IMF AND A REINVIGORATED WORLD BANK

We have sketched out a set of improvements in the IMF and World Bank that would make them more effective in contributing to a world order compatible with the long-term interests of the United States. In short, these are improvements that stress the global ownership of the two institutions and make them less beholden to the vicissitudes of political life in the United States. Ensuring that the Fund and Bank function less like conjoined twins and operate more independently of each other is a critical part of these improvements.

The proposed improvements cannot be implemented unilaterally by the U.S. government but will have to be negotiated with the 180-odd other countries that are members of the IMF and World Bank. Moreover, some of these improvements involve fundamental constitutional issues and will therefore have to be ratified by the membership. Everyone concerned about future of the IMF and World Bank understands that the biggest ratification challenge by far is the U.S. Congress. Given the nature of the issues, bipartisan support will be necessary and getting it will be an uphill battle.

For the next President of the United States, a bold initiative in this area has the immense attraction of offering very large diplomatic dividends for virtually no budget cost.

A first step in seizing this golden opportunity will be to raise the IMF and World Bank as an issue in the presidential election campaign that is now underway.

A second step will be for the new president to adopt a foreign policy that is perceived by the rest of the

world as less unilateral and more attentive to the views of others, especially rising economic powers such as Brazil, China, and India.

A third step will be to include fixing the IMF and the World Bank in the new president's program for the first 100 days.

A fourth and perhaps most critical step will be to identify, in consultation with key international partners, a promising process for negotiating a comprehensive package of changes. The default forum is presumably the G-8, supplemented as it has been recently to include a handful of leading emerging market countries. The drawback to this approach is the clubby legacy of the G-8. Inevitably the process will appear to be driven by the old powers.

When negotiations were held in the 1970s to move from a system based on fixed exchange rates to one based on floating rates, a special-purpose forum was created: the Committee of Twenty. The participants in the C-20 were senior finance ministry and central bank officials, with roughly half from developed countries (the North) and half from developing countries (the South). A similar special-purpose forum, if carefully structured, would have the advantage of being more legitimate and credible than a G-8-plus.⁴¹

Conceivably, the most broadly appealing forum for negotiating a package of improvements for the IMF and World Bank would be a new "Bretton Woods Conference," resembling the one in 1944.⁴² While a single conference for the purpose of negotiating improvements in both institutions has an obvious attraction, separate conferences would make more sense if the objective of separating the institutions is accepted. Otherwise, the wrong people will be doing the negotiations. Whatever forum is proposed, a criti-

cal part of the fourth step will be to ensure bipartisan support in the U.S. Congress for the broad objectives and the negotiating process.

The potential benefits of a breakthrough in this area are great. A revitalized IMF can reduce the frequency and severity of crises in the financial system of the kind that began in mid-2007 in the sub-prime mortgage market in the United States. A reinvigorated

World Bank can do much to alleviate the grinding poverty that is already a major source of instability and conflict and has the potential of being even more destabilizing. Without these two institutions actively and effectively engaged in building a more stable and prosperous world, the burden on the United States will be heavier and the risks of global disorder will be greater.

ENDNOTES

1. Co-location also creates a significant security risk. A terrorist act that disables one institution, for example, is likely to seriously disrupt the other.
2. Ralph Bryant, a Senior Fellow at the Brookings Institution, has described the IMF and World Bank as being “locked together.” (Seminar discussion on 23 January 2007.)
3. A GAO report in 2004 identified 67 legislative mandates directed at the IMF. (GAO-04-928R, 12 July 2004) Many of these apply equally to the World Bank.
4. A trend toward shrinking the central banking orientation of the IMF can be seen in its organizational structure. For decades, the Central Banking Department in the IMF was one three organizational pillars of the IMF alongside the Exchange and Trade Relations Department and the Fiscal Affairs Department. In the past 20 years, however, the Fund’s central banking experts have been reorganized several times until only a shadow of the Central Banking Department remains in the Monetary and Capital Markets Department (reorganized and renamed in 2006).
5. Krzysztof Rybinski, former Deputy Governor of the National Bank of Poland, has proposed a new G-8, based on population and GDP per capita at purchasing power parity consisting of Brazil, China, the European Union, India, Indonesia, Japan, Russia, and the United States. *Financial Times*, letters to the editor, 11 August 2008.
6. Zoellick’s performance during his first year as president is widely viewed as excellent or outstanding, but the diplomatic costs of having an American president will remain even if his performance remains impeccable.
7. Nancy Birdsall, President of the Center for Global Development, has suggested many excellent improvements, most recently in a paper co-authored with Arvind Subramanian (“From World Bank to World Development Cooperative,” October 2007).
8. Speech at the Davos World Economic Forum, January 2007.
9. Improved collaboration does not appear to be a cure for the problem. According to an editorial in the *Financial Times* on 1 March 2007, the Fund and Bank have committed themselves to specific steps to improve collaboration on 15 occasions since 1966. The latest occasion was inspired by the “Report of the External Review Committee on Bank-Fund Collaboration” published in February 2007.
10. Another option is a double-majority system requiring a majority of the member countries as well as a super-majority of votes for fundamental changes.
11. This section and the next draw on a recent paper by Ralph Bryant, Senior Fellow at the Brookings Institution (*Reform of IMF Quota Shares and Voting Shares: A Missed Opportunity*,” April 2008). The most serious deficiency in the new quota formula, noted by Bryant, is the refusal of the “old” (G-10) members of the IMF to include population as a quota variable.
12. The four countries are China, India, Mexico, and Turkey.
13. The 11 remaining countries needed to reach the total of 185 members have selected as their “IMF Governor” an official in the Prime Minister’s office or some other office, or they do not have an “IMF Governor” at the present time.
14. The prescribed number of Executive Board members is 20, but a special rule allows expansion for renewable two-year periods with an 85 percent vote of the membership.
15. Seven of these are members of the European Union: Belgium, France, Germany, Italy, Neth-

- erlands, Sweden, and the United Kingdom. The eighth is Switzerland. The number rises to nine when Spain rotates into the leadership of its constituency, which includes Mexico and Venezuela.
16. The United States could force the issue by voting against raising the number of Executive Directors from 20 to 24 the next time it comes to a vote. The current practice of having 24 members has to be renewed every two years. The arguments for reducing European representation to fewer than three seats are not compelling. The advantages of having separate Directors representing France, Germany, and the United Kingdom are substantial. This would not, of course, prevent them from voting together, as they often do already. Another solution could be to amend the IMF's Articles to eliminate the requirement that gives single-country seats to the countries with the five largest quotas. This requirement echoes the pattern in the U.N. Security Council of having five "permanent" members with veto powers. The IMF, however, is fundamentally different because it operates on the principle weighted voting instead of one-country-one-vote.
 17. *IMF Governance: An Evaluation.*
 18. A measure of this is the number of country reports discussed by the Executive Board in the second half of 2007. Eighteen reports were for systemically significant countries by almost any standard. Fifteen were for borderline countries. Sixty-eight (almost 70 percent) were for small, mostly low-income countries.
 19. Canadian central bank governor David Dodge is an exception. In a March 2006 speech, he called for the IMF to engage in "ruthless truth telling."
 20. According to a report in the *Financial Times* on 21 December 2006, Mervyn King, Governor of the Bank of England, said that "the stranglehold of the IMF's big creditors—the United States and major European countries—should be weakened so surveillance of member states can be more independent."
 21. One of the small steps that could be taken to liberate the IMF would be for the G-7 finance ministers to stop issuing communiqués in advance of IMFC meetings. Pre-IMFC meetings of the G-7 finance ministers could still play a useful part in the process of building consensus at the global level, but every meeting does not have to be memorialized in a communiqué. If the G-7 finance minister stopped issuing these communiqués, then the G-24 could stop issuing its countervailing communiqués and both groups might have more frank and productive discussions as a result.
 22. Jean Pisani-Ferry made this point eloquently in an op-ed in the *Financial Times* (13 August 2008): "Exchange rate arrangements and their implications for global macroeconomic management should thus be a priority topic for the international community and especially the International Monetary Fund. The Fund is looking for a renewed purpose: here is one that belongs to its core mission and where it has no substitute. Success, however, will only be possible if the G7 countries admit that the days when they were running the show are over."
 23. *Financial Times*, 11 April 2008 (reported in the IMF daily news digest).
 24. *Financial Times*, 25 January 2008.
 25. One of the recommendations of the External Review Committee on Bank-Fund Collaboration (see above) was to scale back the IMF's work on low-income countries. James Boughton, Historian of the IMF, has presented a case for the IMF to remain active in low-income countries, but it rests largely on the assertion that "the IMF does not and should not provide development finance." While loans from the IMF's Poverty Reduction and Growth Facility may not be "development finance" in some narrow, technical sense, they are clearly

not short-term balance of payments financing. ("Does the World Need a Universal Financial Institution?" *World Economy*, Vol. 6, No. 2, April-June 2005.)

26. One obstacle to scaling down the IMF's work in Africa is France, which has relied on its "special relationship" with the IMF to provide generous support to Francophone African countries. Another obstacle is the practice prevalent among African countries to appoint central bank governors as their "IMF Governors" instead of their finance ministers. The central banks in Africa have benefited greatly from the IMF's "free" technical assistance.
27. China and India, for example, would pay more attention to the IMF's concerns about their policies if it communicated with them in their national language. By the same token, IMF staff members could speak with more authority and sensitivity if they had worked for a period of a year or more on secondment in the finance ministries or central banks of the countries they are assessing.
28. Another fatal mistake in Camdessus' campaign was his position on an obscure provision, Article VIII.2.b., which could be interpreted to give the IMF the ability to overrule decisions by courts in member countries. Instead of accepting arguments that the provision was obsolete and could be dropped, Camdessus appeared to favor retaining it or even clarifying it to assert the IMF's priority over national laws. An amendment of the IMF Articles to give the Fund jurisdiction over capital movements is unlikely to be approved by the Congress due to financial industry opposition unless it includes the elimination of Article VIII.2.b.
29. Even better would be deleting the provision in U.S. legislation that requires Congressional approval for any sale of the IMF's gold holdings. No serious financial arguments exist for maintaining this requirement in today's global financial system; the present resistance comes from "gold bugs" who want the world to move back to a gold-standard exchange rate system.
30. No change would be necessary in the Senate and House Appropriations Committees. Appropriations for both the IMF and World Bank would logically remain in the respective Subcommittees on State, Foreign Operations, and Related Programs.
31. Muhammad Yunus, the Bangladeshi Nobel Prize winner who founded the Grameen Bank, when asked what he would do if President of the World Bank, answered: "I suppose the first thing I would do is move the headquarters to Dhaka." (Yunus with Alan Jolis, *Banker to the Poor: Microlending and the Battle Against Poverty*, Public Affairs, 1999)
32. An Inter-American Investment Corporation was created alongside the Inter-American Development Bank to undertake lending to the private sector, but the Bank itself also makes loans to the private sector.
33. The futility of many top-down development interventions has been neatly exposed in William Easterly's book, *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good* (Penguin, 2007).
34. The difficulty of changing the culture of the Bank is illustrated by a costly program, introduced by World Bank President Jim Wolfensohn a decade ago, that put a large number of Bank managers through a training program developed by the Harvard Business School, including a week spent living in a poor village. While many individual participants benefited personally from the program, the effort appears to have had no measurable impact on how the Bank functions today. One insider noted that the bulk of the managers who completed the training left the Bank within five years.
35. The World Bank could even go further and decentralize along the lines of the world's leading commercial banks that have created country of-

ofices with a high degree of independence from the headquarters and plenty of scope to adapt and innovate. The IFC has taken a step in this direction by adopting a regional structure. While there will be concerns about competition with the regional development banks if the World Bank moves in this direction, the experience in commercial banking suggests that the competition would be healthy.

36. The other major shareholders are Germany (4.49 percent), France and the U.K. (4.3 percent each), and then China, Saudi Arabia, Russia, India, and Canada (2.78 percent each).
37. A precedent for moving to open selection can be found in the OECD where the United States in 2003 let go of the tradition of reserving for an American the chairmanship of the Development Assistance Committee.
38. Its formal title is the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries. This curious structure is a legacy of the process of amending the IMF's Articles of Agreement in the 1970s when the floating rate system was adopted, and while the North-South Dialogue was underway in the United Nations.
39. In the Bank's fiscal year 2007, out of total IDA commitments of \$11.9 billion, \$2.2 billion (18.5 percent) were in the form of grants.
40. A variation on the same theme is to explicitly make IDA credits eligible for rescheduling and reduction in Paris Club operations that traditionally deal only with debt owed to bilateral official creditors. The extremely burdensome HIPC/MDRI process is a result of treating the World Bank as a preferred creditor and therefore exempt from granting debt relief. At this stage, the preferred creditor status of the international financial institutions could be strengthened by: (a) discontinuing all concessional lending by the IMF; and (b)

opening special windows in the multilateral development banks for loans that could be rescheduled along with traditional Paris Club debt. A move in this direction would be analogous to the introduction of collective action clauses in international bonds in 2003.

41. It is conceivable that initiating negotiations on improvements in the IMF and World Bank could be part of a larger package of foreign policy initiatives touching on other multilateral organizations such as the WTO. This possibility goes well beyond the scope of this paper, however.
42. Gordon Brown, U.K. Prime Minister, is on record supporting a new Bretton Woods Conference as far back as 2002 when he was Chancellor of the Exchequer. (Vijay Kelkar, "A Bigger and Better Fund," *Financial Times*, 29 August 2002)



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1775 Massachusetts Avenue, NW
Washington, DC 20036
202-797-6000
www.brookings.edu/global

