

Governance of the Bretton Woods Sisters: Making Progress on the Agenda*

Edwin M. Truman
Senior Fellow
Peterson Institute for International Economics

The International Monetary Fund (IMF) and the World Bank are intergovernmental institutions. They are political in every sense of that word, from their structure to their culture. They are owned and directed by their member governments. Governments are political by construction. Consequently, we in the private sector—in think tanks, in non-governmental organizations, or as private citizens—often are frustrated because these institutions are, and should be, principally responsible to governments and only through them to us, the interested and concerned general public, even in cases where the responsiveness of member governments leaves a great deal to be desired.

Along similar lines, it is profoundly misleading and potentially dangerous to analogize about the governance of the Fund and the Bank by reference to either private corporations (whose principal objective is to maximize profits for the benefit of their shareholders) or to central banks (whose objective can be reasonably well defined along a spectrum involving full employment and price stability and which need to be protected from excessive political interference). It is misleading because these institutions at best have a changing mix of multiple objectives, and it is dangerous because over-simplification and excessive insulation would lead either to stalemate or irrelevance. Member countries will never agree entirely on the institutions' goals—*what* they should do—and will never step back from trying to influence *how* they try to achieve those goals. Of course, their many objectives should be defined as clearly as possible, and the institutions should strive to be as efficient as possible. We should care, starting with our governments, about the institutions.

In the world in which the Fund and the Bank operate, governance issues are complicated by the profound lack of consensus among member countries about what each institution should do and how it should do it. In the case of the Fund, the principal issues are a lack of consensus about the nature of the globalized economy and financial system, the Fund's surveillance role relative to its lending role in this context, and the Fund's role in providing global public goods, such as

* This short essay is informed primarily by consideration of the governance challenges at the International Monetary Fund. Many of the issues for the World Bank are similar. However, for the record, my view is that it has been a mistake in the past to have as much parallelism between the Bank's and the Fund's governance, and going forward that is even more true. There needs to be more governance distance between the sisters.

improved information flows. In the case of the Bank, there is a similar lack of consensus on these issues but also a lack of consensus about how the Bank fits in with other development institutions (and with the Fund) and what its role should be with respect to the big public-good issues such as climate change, health, and the environment.

In principle, one can address governance issues without settling issues of scale and scope of mission, but this is difficult, especially given the political context in which these institutions operate. Lack of consensus on missions contributes to perpetuation of the status quo, even when many agree that the status quo is no longer appropriate. However, in what follows, I set to one side mission issues and assume, some would say naively, that governance issues can be successfully addressed independently.

With this simplification, governance issues are reduced to the moving parts of the institutions and how they relate to each other. The moving parts are the member governments, the government official principally responsible for the institution (as governor), informal committees of governors such as the International Monetary and Financial Committee (IMFC) of the Fund and the Development Committees of the Bank and the Fund, and the members of executive boards, management, and staffs. Issues of voice and vote, accountability and transparency, and responsibility and efficiency exist at—and between—each level.

Today, the Fund in particular faces a deep problem of legitimacy about its governance. This undermines its capacity to accomplish many of the tasks most of us think are, or should be, assigned to it.

Interestingly, most of the items on my list of governance reforms for the IMF are ultimately the responsibility of the member governments as a whole, meaning at the top, in the sense that collective political action is required to bring about change.

Reform Management Selection – Legitimacy and governance reform start at the top. The selection of the IMF’s managing director as well as the deputy managing directors should be chosen via an open, merit-based selection process. (The president of the World Bank should be similarly chosen. The same should apply to the heads of the regional development banks, but that should not hold up governance reform at the Fund and Bank.) As has been championed by Nancy Birdsall, the selection of the managing director should also be subject to a second (double) majority of member countries to provide a greater sense of involvement to smaller countries with small quota-based votes. These are political decisions and require decisions at the head-of-government level.

Consolidate Executive Board Representation – European representation on the IMF executive board should be reduced from its current nine (potentially 11) seats to no more than four, and the size of the executive board should be reduced from 24 back to 20 seats.¹ The first seat added once the board’s size drops below 20 presumptively should be reserved for Africa. The IMF’s Articles of Agreement should be amended to stipulate that executive directors must be elected, which should facilitate the consolidation of European representation. These are largely political decisions that must be made at the head-of-government level. Note, however, that the cost of

¹ I include in this calculation the seats now led by Switzerland and Russia.

IMF governance would be reduced with fewer executive director offices, and the efficiency of the executive board would be increased.

Revise the “New” Quota Formula – A new quota formula, which is intended to guide the distribution of quotas, which in turn determine voting power, was adopted in the spring of 2008. It is fundamentally flawed because it points in the direction of a larger combined quota for the traditional industrial countries than at present.² It should be replaced with a formula that points in the opposite direction. If trade is included as a variable, intra-EU trade should be eliminated. The revised formula also should be implemented via a large (on the order of a doubling) increase of IMF quotas that accomplishes a shift in voting power from the traditional industrial countries to the rest of the membership of at least 10 percentage points. These are technical issues, but the political impetus for them must come from the top. Once the outlines of an agreement are firmly established, the technicians can devise the appropriate formula.

Reduce Special Majorities – The 85 percent voting requirement for selected decisions by the Fund should be reduced from 85 percent to 80 percent.³ This would remove the capacity of the United States acting alone to block these actions. A political decision would be required by the president to make this change, and it is likely to be acceptable only in the context of a political commitment by the European authorities to see the number of their executive directors reduced to a maximum of four and their combined voting share shrink over time to less than 20 percent.

Replace the IMFC with a Council – Some argue that the governance of the Fund would be enhanced by replacing the IMFC, which technically only has advisory powers, with a Council that would have formal decision-making power. The thought is that this would enhance the sense of responsibility of the governors of the Fund who sit on the IMFC/Council for the strategic direction of the Fund. I personally think that this is likely to be a case of leading a horse to water and being unable to make it drink, unless other attitudinal changes occur. However, by itself this reform would do no harm. As a formal matter, the decision could be made by the governors.

Revamp the Role of the Executive Board – The role of the executive directors and executive board should be revamped from one of day-to-day oversight to one that covers only broader strategic decisions. The role of management (and indirectly staff) should be enhanced by placing with management the responsibility for many decisions, for example on programs and surveillance judgments, subject to ex post review and criticism by the executive board. At the same time, the transparency and accountability of members of the board vis-à-vis the countries that elect them should be increased and codified. Some of these decisions—many more sensible suggestions can be enumerated along similar lines—may require amendment of the IMF’s Articles of Agreement. However, most could be implemented by agreement between the executive board and the management of the Fund.

At bottom, these IMF governance reforms require an enhanced recognition by the governments that are members of the Fund of the role and contributions of the institution in a dangerous,

² The new formula was in large part ignored in reaching a decision on a modest set of selective increases in IMF quotas.

³ I would have no strong view on the question of whether other special majorities should be reduced. Any agenda needs to leave a few degrees of freedom.

globalized world. The current global economic and financial crisis may provide the impetus for such greater political and policy appreciation and understanding. Even the darkest clouds may have silver linings. In the end, the member governments *are* the Fund, and they have to want change.

To close on a provocative pair of points, where does this leave civil society and NGOs? I see their important role in the governance of the Bretton Woods sisters as starting and largely ending with the member governments. On the one hand, they should stop urging member governments to tear down the Fund unless those interests truly believe that the world is better off with less rather than more global governance. In addition, member governments should review the many implicit and explicit mandates on executive directors in the Fund and Bank that require them to use their voices and votes to promote narrow economic interests (for example, with respect to funding steel mills) or broader social objectives (for example, environmental standards). These are important issues. The practices and policies of the Bretton Woods sisters in these areas should be open to criticism and change, but it is necessary to achieve a better balance between accomplishing these institutions' principal assigned responsibilities and achieving a longer list of laudable goals.