

Advancing the Reform Agenda
Recommendations to the G-20
On
International Financial Institution Reform

Governance issues at the IMF and World Bank undermine the institutions' legitimacy, limit their effectiveness and raise questions of their relevance. The Group of Twenty nations (G-20) called for the comprehensive reform of the IMF and World Bank at their November summit meeting. The undersigned individuals urge G-20 leaders at their April 2 meeting in London to agree on a bold set of reforms for these institutions and to commit to provide them adequate new funding.

The London summit occurs at a time of severe distress in the world economy and financial system. Although our suggested reforms of the IMF and World Bank are but one component of the important actions that G-20 leaders should take in April, they would strengthen these vital international organizations and enhance international cooperation. The rationale for these changes and the specific recommendations follow.¹

Background

Governance problems lie at the heart of a number of important issues faced by the Bretton Woods institutions. Since their founding in 1944, the World Bank and IMF have seen only modest changes to their governance structures. Today, they no longer reflect global circumstances and the truly global nature of their respective mandates. The need for reform is almost universally agreed, and the specific issues are well known.

In parts of the developing world, governance issues at the World Bank and IMF have undermined the institutions' legitimacy. The Bank and Fund are seen as under the control of the United States and Europe. The fact that Europe names the leader of the IMF and the United States picks the head of the World Bank feeds the impression that they are run by the rich largely for their own benefit. Many times, developing countries do not substantively engage in discussions on policies and programs out of a sense that their 'voice' is too weak to impact the outcome. Borrowers do not readily take 'ownership' of World Bank projects or welcome IMF advice if the legitimacy of the institutions is in question. This hinders the ability of the institutions to promote global growth, reduce poverty and foster economic and financial stability.

Dramatic economic power shifts across the globe have not been accompanied by adjustments in vote share at the Bretton Woods institutions. Korea today has more than twice the economic output of Belgium, but Belgium maintains an IMF quota that is 50 percent higher

¹ These proposals were formulated following a February 2009 meeting in Washington attended by a group of experts on the IMF and World Bank. The meeting convened by the Bretton Woods Committee.

than Korea's. Similarly, the allocation of seats among the boards of executive directors does not reflect current circumstances. With 23 percent of world economic output, the United States appoints one director to both of the 24-member Boards of the Bank and the Fund, while Europe, with 33 percent, is represented by eight (and sometimes nine) chairs².

While some small steps have been taken recently at both the Fund and Bank to improve this situation, the current global economic and financial crisis creates a new urgency to overcome obstacles to more substantial change. The world is in critical need of effective global institutions that are relevant and deemed legitimate to both their clients and their funders. The G-20 should seize the day, adopt a bold reform package, and work with the relevant governing bodies to persuade members of the Bretton Woods institutions to advance these reforms and make the necessary changes in their Articles of Agreement.

Adherence to five governing principles will ensure a balanced and successful governance reform package for the IMF and World Bank:

- Countries' vote share at the IMF must be reallocated to reflect their current economic weight and importance to the international economy;
- Vote share at the World Bank must better reflect willingness of members to contribute to capital and concessional windows;
- Borrowing countries need to be given an enhanced role in the voting structure and decision making including more board seats;
- Opportunities to lead the international financial institutions must be universal and merit-based and not reserved for candidates from specific regions; and
- The institutions must be given the backing and financial support needed to accomplish their critically important missions.

Seven recommendations flow from these principles.

Recommendations

1. Reform the leadership selection procedures for the World Bank and IMF to make them merit-based, transparent and no longer driven by nationality.

The selection process for all senior positions at the World Bank and the IMF should be open to candidates from around the world. In particular, the practice in which Europe names the leader of the Fund and the United States names the head of the World Bank and the first deputy managing director of the IMF must finally be ended. Election to these positions should be transparent, merit based and subject to the double majority requirements proposed below.

² The number of European executive directors can vary slightly depending upon which country holds that chair in the rotation system for seats with multi-country constituencies.

2. *Institute a double majority for approval of major IMF and World Bank decisions.*

Approval of several key IMF and World Bank decisions, such as the appointment of a managing director for the IMF and a president for the World Bank should require both a majority of vote shares and a majority of the member countries voting. This change would give smaller countries most affected by policies and practices a larger role in decision making while still affording larger countries a degree of protection for their interests.

3. *Change the IMF's provision requiring an 85 percent vote for approval of key decisions, thus eliminating the single country veto.*

Certain decisions at the IMF require an 85 percent majority of vote shares, providing the United States alone with the ability to block major actions. Any compelling argument for maintaining a single country veto has long since disappeared. The threshold should be reduced to a level such as 80 percent, as part of a broader agreement in which Europe's combined vote share is reduced to something closer to that of the United States.

4. *Streamline the boards of executive directors of the World Bank and IMF and reduce the number of seats to a maximum of 20. Provide that all directors be elected by the countries comprising their constituencies.*

The Fund and Bank maintain boards of executive directors that have 24 members³. Five of the 24 directors are appointed by the countries who are the largest shareholders (the United States, Japan, Germany, France and the United Kingdom). The 19 remaining directors are elected by various groupings of other members of the Bank and Fund.

These boards are unnecessarily large and do not currently represent the diversity of their global membership. Reducing the number of seats from 24 to 20 or fewer will help streamline board operations and permit appropriate regional distribution while providing a framework for the consolidation of European representation. This consolidation, in turn, will allow for a more balanced representation of low and middle-income countries. It will be important in this process to protect the three World Bank board seats allocated to the 47 Sub-Saharan African countries.

5. *Adopt a new revised IMF quota formula that is both based on economic realities and gives developing and emerging-market countries a more appropriate share of the voting power. Similar reforms should be adopted in the World Bank voting structure, which are compatible with the Bank's development mandate and cooperative structure.*

³ The World Bank has recently approved the expansion of its board to 25 seats to make room for another seat for Sub-Saharan Africa.

Decision making and access to resources at the IMF are based on the members' quotas. However, quota adjustments have failed to keep up with the changes in members' economic strength, and this has undermined the Fund's relevance. For the Fund to regain the role envisaged by its founders, it will require a new, simplified and transparent formula to guide quota allocation.

One year ago, IMF members attempted to rebalance quotas and voting shares, but the outcome fell short of expectations and failed to promote a satisfactory balance between advanced economies and developing countries in the distribution of the institution's voting power. Additionally, the reform package failed to give small countries an adequate share of the vote. The G-20 should endorse a more comprehensive agreement within one or at most two years and work closely with the IMFC to achieve it.

6. Ensure that the IMF fully implements its mandate for multilateral surveillance with respect to exchange rates and other macro economic policies.

It is essential to the timely resolution of the economic and financial crisis that the IMF strengthen its multilateral surveillance effort. This includes firm surveillance on exchange rates; on policies that affect the rates of major currencies; and on systemic macroeconomic and financial risks. Importantly, to do this the Fund must establish its independence and demonstrate evenhandedness in its surveillance activities.

7. Provide additional resources to the IMF, the World Bank and the regional development banks.

The IMF has had to mount unanticipated rescue efforts for a number of countries, and more such help will be needed in the future. Demand for resources from the World Bank and the regional development institutions has grown dramatically with the economic and financial crisis. The poorest countries' problems have been greatly amplified, and even emerging market countries with lines into private capital markets have less recourse to funds.

The G-20 should support a sizable increase of IMF quotas and borrowing arrangements to enable the Fund to respond to current needs. Similarly, the G-20 should support capital increases and substantial replenishments for concessional windows at the multilateral institutions where appropriate.

Conclusion

As important and as needed are these improvements in governance, G-20 governments should go much farther at the London G-20 summit to combat the current recession and to strengthen both crisis management and crisis prevention. In this connection, they should agree to vigorous fiscal

stimulus efforts, wide ranging reform of the financial regulatory and supervisory framework, a standstill on all trade, financial, and industrial policies that would run counter to the letter and spirit of members' WTO commitments.

Acting in their individual capacities the following individuals have endorsed these recommendations:

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