

Governing the Global Economy: Strengthening Multilateral Institutions

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Introduction

The good news in the global economy is that the past two decades have seen globalization proceed apace with unprecedented economic growth in several parts of the world. To date, sound economic policy has made hyperinflation a rarity. Rising commodity prices are fueling growth in sub-Saharan Africa. Formerly poor countries are emerging as major players in the world economy.

The bad news is that the world economy is currently looking *more precarious, more unequal, and less governed* than it has been in previous decades. In part this is because governance within the global economy has not kept up with globalization and growth. This paper examines practical measures which could refashion and reinvigorate the role of institutions in governing the global economy so as to better manage the precariousness, the inequality, and the lack of engagement in multilateralism from which many countries are currently suffering.

The precariousness of the global economy is currently underlined by the teetering crisis in Europe and the United States emerging as a result of the subprime mortgage market collapse and its immediate effects on the financial sector. The US and EU are large economies whose prosperity affects all others. For example, a slow-down in either will soon reduce growth rates in China posing both economic and political problems within that country as well as its surrounding region. As national governments and central bankers fumble for solutions to the growing financial crisis, a spotlight has been shone on the inadequacies of global economic institutions. They have failed to regulate international finance effectively in the past, and they do not seem to be at the center of robust intergovernmental efforts to regulate it in the future.

Inequality in the global economy has been growing both within and across countries in spite of commitments to ensure that globalization would bring benefits to all. Growing inequality

across the world economy is a sign of a serious failure of global governance. Back in 1944, the founders of the International Monetary Fund (IMF) and World Bank sought to ensure the “balanced” growth of international trade and to help governments to raise “productivity, the standard of living and conditions of labor in their territories” (as spelled out at the time in the purposes of the World Bank). Subsequently, globalization was held up as the tide which would raise all boats. Yet extreme inequality within and among countries has persisted.

Within countries, inequality is rising. Having fallen for many years before 1950, it has risen since 1970,¹ and between 1988 and 1998, in particular, it rose substantially.² Data from the UN Millennium Project show that while some 80 percent of the world’s population lives in countries in which inequality is rising, only 4 percent of the world’s population live in countries in which inequality is narrowing.³

Similarly, the gap between rich and poor countries also seems to be widening.⁴ Although population-weighted studies tell the opposite story,⁵ if China and India (comprising around 40 percent of the world’s population) are excluded, even these studies show that inequality among countries is increasing. This is most obvious in Africa. Collectively, African countries’ share of world trade fell from 6 percent in 1980 to less than 2 percent in 2002. It is now rising largely due to the dramatic increase in commodity prices which channels windfall gains to a small number of African oil and commodity producers. In many of these countries, the new gains are unlikely to lead to a reduction in poverty.

In short, globalization is having an uneven impact which current global arrangements seem to be doing little to mitigate. The urgency of reforming institutions so as to deal more effectively with this is recognized by wealthy states who have committed themselves to work towards a more inclusive form of globalization. The risks of not so doing include ongoing poverty, rising conflict,

1 Francois Bourguignon and Christian Morrisson, “Inequality Among World Citizens,” *American Economic Review* 92, no.4 (2002): 727-744.

2 Branko Milanovic, “Can We Discern the Effects of Globalisation on Income Distribution? Evidence from Household Surveys,” *World Bank Economic Review* 19, no.1 (2004): 21-44.

3 United Nations Development Programme (UNDP), *United Nations Human Development Report*, 2005, p.55.

4 Lant Pritchett, “Divergence, Big Time,” Policy Research Working Paper no.1522 (Washington, DC: World Bank, 1995).

5 Bourguignon and Morrisson, (n.1 above).

DO WE NEED OLD-FASHIONED INTERNATIONAL INSTITUTIONS?

The rationale for international public institutions (i.e., multilateral or intergovernmental organizations) is a straightforward one which mirrors the need for public institutions at the national level. Institutions are necessary for managing market failures at the global level and producing global public goods. International cooperation facilitated by institutions permits collective action among states. Without institutions and without cooperation, states will pursue individually-rational goals which lead to disastrous consequences for all, such as global warming, the rapid spread of conflict, the inadequate containment of infectious diseases, or the deepening and broadening of financial crises. Historically this is what occurred in an earlier era of “globalization”—the decades of exuberant

power is heightening political anxieties and risks in the industrialized countries including fears that Russia and China will use their newfound economic power to pursue geostrategic goals. International forums within which new and old powers can discuss and negotiate these issues are vital. In sum, multilateral institutions are necessary both to deal with new global challenges as well as to adapt to a power shift in global politics. That said, a powerful caveat is in order. National and local government is mostly far more effective and accountable than global governance. The rationale for global action has to be that of collective action, i.e., that only when states act collectively can they achieve mutually-held goals.

THE CRISIS IN EXISTING INSTITUTIONS

The past year has brutally exposed the weaknesses of key international agencies. Collapsed trade negotiations under the auspices of the World Trade Organization have led some to declare the current round of trade talks “comatose” and even “dead.” As oil prices escalate, wreaking havoc in both poor and wealthy economies, and as fears abound about the activities of the national oil companies of emerging economies, the International Energy Agency looks ill-equipped to manage a response: its membership of twenty-seven states does not include the large emerging countries such as China and India, and even among its membership it has a limited remit. The International Atomic Energy Agency is struggling to deal with issues of nuclear proliferation, not to mention standards in a nuclear industry which is increasingly global and in which ownership is shifting away from the experienced and stable arrangements of old.

In global finance, the IMF is in disarray. “A rudderless ship adrift on a sea of liquidity” was Barry Eichengreen’s description in 2006.⁸ The institution faces both a crisis of seeming irrelevance and of illegitimacy. The IMF’s fee-paying clients vote with their feet and build up their own reserves to avoid using the institution. One result is that the IMF is having to retrench within its own walls, at the same time as it faces new criticisms for not adequately foreseeing and warning of recent financial crises. In an era of

increasing commitments to aid and development assistance, the World Bank has until very recently looked curiously marginal in the plans of major donors who have created a proliferation of new agencies—at national and international levels—over the past two decades. Only under the new presidency of Robert Zoellick has the Bank succeeded in replenishing its concessional lending arm, the International Development Association (IDA).

As governments grapple with a crisis in multilateralism, several kinds of reform proposals have emerged. The WTO, we are told, should be opened up to give its poorest members more access to the informal processes of negotiation and aid-for-trade expansion. In the IMF some additional votes have been given to China, Mexico, Turkey, and Korea and discussions are underway about how to give the poorest countries a louder voice at the decisionmaking table. In the World Bank, the abrupt resignation of the former President, Paul Wolfowitz, has led to a new president taking stock of what the institution needs. In the International Energy Agency some are advocating broadening its membership as well as its remit.

These proposals all present wider participation as a way to make global institutions more legitimate or effective. In the remainder of this working paper, I will argue that deeper reform is required, analyzing in turn each of the three core institutions of global economic governance: the World Trade Organization, the International Monetary Fund, and the World Bank.

Rethinking the World Trade Organization

At the center of global trade relations sits the World Trade Organization. The organization is currently at an impasse at least in part because too many countries in the global trading system do not believe the current trade round reflects their interests. Furthermore, they now have power of veto. Previously, powerful countries, in particular “the quad” (the United States, Japan, Canada, and the EU), called the shots. Now, a group of emerging

⁸ Barry Eichengreen, “The IMF Adrift on a Sea of Liquidity,” in *Reforming the IMF for the 21st Century: Institute for International Economics Special Report 19*, edited by Edwin M. Truman (Washington, DC, 2006), chapter 25.

and developing countries (the G20) have made it clear that the trade negotiations must take note of their interests. Smaller groupings are also more organized and more vocal.

The stalemate in international trade negotiations affects all countries. Without a multilateral agreement, small countries find themselves thrust more rapidly into bilateral negotiations within which their position is very weak. However, even the largest and most powerful countries have strong interests in the multilateral round. Satisfactory bilateral deals cannot be struck with many of their most important trading partners (e.g., the United States with China or India). Without a multilateral deal, the large countries must invest enormous amounts of time and resources into bilateral negotiations with those countries which are willing. The result is a patchwork of agreements which adds layers of complexity to the global operations of their major companies. For all these reasons a multilateral agreement is important even if it is at present elusive.

The blockage in trade negotiations is the result of deep disagreements about what global trade agreements should cover (and what they should not); what kinds of trade policies best advance economic growth; and how and where trade rules are made and enforced. Each of these areas requires attention if global trade governance is to help redress the problems outlined at the outset of this paper. Specifically, a sound trade agreement could mitigate the current precariousness of the global economy, assuring countries of access to markets at precisely the moment when each country might otherwise seek to use protectionist policies. Second, a good trade agreement could play a constructive role in reducing global inequality by facilitating and supporting economic growth and opportunities among communities and countries that are at present at the bottom. Last but not least, a stronger, reformed WTO and reinvigorated multilateralism is a necessary prerequisite for better governing trade.

NARROWING THE SCOPE OF TRADE RULES

For many people in developing countries, the WTO rules which govern international trade look unfair. During trade negotiations in the

1980s, large industrialized countries arrived at an agreement which suited them. At its core was an unequal *quid pro quo*. Developing countries signed up to binding commitments on the issues of most interest to industrialized countries who in return promised to act at a later stage on the issues of most concern to developing countries.

Wealthy countries are still refusing to open their markets in agriculture. This matters to developing countries because it covers so much of what they produce. In the European Union barriers are used to keep other countries' agricultural products out. In the US a massive farm program is deployed to subsidize farmers, making it difficult for any other country to compete. Instead of being able to rely upon open markets, poor countries must rely on special discretionary deals or bilateral agreements that Europe and America control and can use to divide and rule.

While agriculture is not liberalized, huge negotiating resources and time are being invested in widening the scope of WTO rule in other areas. In part this was a strategy adopted in the Uruguay Round when the US and Europe pushed for a "single undertaking" which meant that member countries had to accept everything or nothing. This laid the path for railroading through an expanded trade agenda, including a range of issues to which developing countries had in the past objected, such as intellectual property protection.

An ever-wider trade agenda is very difficult for poorer countries which must spend heavily on compliance and risk enforcement actions against them if they do not. Furthermore, the scope of new rules directly affects their capacity to gain from globalization.

DO NOT KICK AWAY THE LADDER FOR POOR COUNTRIES

Scholars of growth and development have long debated the role of trade policy in promoting prosperity in developing countries. Although in recent years industrialized countries have insisted that developing countries should liberalize rapidly and thoroughly—and entrenched this in binding WTO rules—this is not the way that they themselves industrialized and grew. Britain, Germany, America, Canada, and Japan each deployed tariffs and industrial policies to promote

rapid industrialization, as have South Korea, Taiwan, China, and Vietnam more recently.⁹ The key point here is that trade management policies do not necessarily lead to growth—they can be deployed badly. However, it is hard to think of any successful, rapidly growing country which has not used such measures. It would seem, therefore, that developing countries are being asked to do what no other country has succeeded in doing: to rapidly industrialize without industrial policies.

The current trade order traps poorer countries in a pincer movement. On one side, access to markets in nonindustrial goods such as agriculture are closed or permitted only on a discretionary basis, and new barriers are being erected such as when the US imposed levies on Brazil, China, Ecuador, India, Thailand, and Vietnam on the grounds that they were selling shrimps too cheaply in the US (a so-called anti-dumping action). On the other side, policies to actively promote industrialization are proscribed.¹⁰ Sharp limits are imposed on access to technology through tough intellectual property rules which economists argue will increase dependence and lower welfare.¹¹

Fair rules must recognize the very different starting points of countries. They must permit less developed countries to use the kinds of policies rich countries used to get to the top and to give them breathing space—or to use a golf analogy, a higher starting handicap—to enable them to compete. This more nuanced application of rules requires better quality information and enforcement.

FAIRER ENFORCEMENT OF THE RULES

The World Trade Organization had one startling new feature in terms of global trade rules. The organization adopted a dispute settlement

procedure which did not permit powerful countries to veto rulings, as the previous system had. Instead, the new WTO would have an Appellate Body which would make definitive rulings which could be overturned only by a consensus of members.

In theory, the new trade dispute mechanism offers all countries a much fairer adjudication of disputes. However, not all countries are in a position to bring a case in the first place. Four significant barriers exist.

The first barrier is political. Few small countries are prepared to jeopardize relations with larger allies or trading partners by bringing forward a dispute. Put simply, they have a lot to lose and not much to gain. They could lose discretionary trade access, aid, or military or geostrategic assistance: indeed, no aid-dependent country has ever brought a dispute to the WTO. If they were to bring a dispute and win, they would win only the right to apply retaliatory actions against their larger partner, the results of which could be more costly to them.

A second barrier concerns the information required to catalyze a formal dispute. Gathering information which highlights the grounds for a dispute is costly and tends to be done by well-funded business groups. Countries without such groups do not get to first base. In the US and EU, wealthy private firms and industry associations develop the litigation agenda and pursue and defend issues before the WTO. The pre-litigation work is costly and time-consuming and governments do not do it themselves.¹²

A third barrier exists with respect to actually

Three steps towards a trade institution which would reduce precariousness and inequality, and improve multilateral governance:

1. limit the scope of trade talks, resisting pressures from mercantilist interests to push into new areas, and ensuring progress on the elements which most affect poorer countries;
2. ensure trade rules are framed and applied in a way which permits poorer countries to industrialize and benefit from globalization in a sustainable way;
3. strengthen and widen the role of the WTO in monitoring and enforcing trade rules (particularly in respect of large markets).

Reconfiguring the International Monetary Fund

The IMF could and should play a crucial role in reducing the precariousness of the global economy, in reducing inequality, and in providing a forum for effective multilateral governance in the global economy. However this will take shifts both in its operations and in its governance structure.

REINVIGORATING MONETARY COOPERATION

The precariousness of the global economy was euphemistically described by economists (until very recently) as a “stable disequilibrium”—a global economy in which growth in emerging economies (especially China and Asia) has led to them exporting more and more to the rest of the world and using the proceeds to buy more and more US dollar-denominated financial assets. This permitted the US to enjoy “unusually” low interest rates, a “surprisingly” strong dollar, and an “unprecedented” imbalance in the current account (meaning that the US is importing much more than it is exporting to the rest of the world).¹⁷ The stable disequilibrium has now cracked and

been replaced with a spreading financial crisis. Both the disequilibrium and the current crisis highlight the need for a governance system which can better manage growth, reserves, and imbalances in the global economy.

At the same time, it has become more difficult for the IMF to play a constructive role. In part this is because the IMF’s authority has diminished. The IMF’s formal authority over exchange rates was swept aside in the 1970s when the US and other major exchange rates were floated. This has left the IMF with a weak capacity to engage in “surveillance” dialogues with member countries and report on their policies. In wealthy and powerful member countries of the Fund (whose policies have the largest impact on all other countries in the global economy) these dialogues have very little effect.¹⁸ The IMF’s authority has also diminished as new economies have emerged, amassed their own reserves, and disengaged from the IMF. Mexico, Brazil, China, and India—to name but four—no longer depend upon IMF financing or approval and this has both weakened the role of the institution’s dialogues with these members, as well as deprived the institution of the income earned from lending to them (more on this below). Finally, changes in global finance have also made the IMF’s role more difficult. New derivative-driven financial instruments have increased systemic risk at the same time as reducing the IMF’s capacity to alleviate it.¹⁹

What does all this mean for an IMF role? It underscores two important roles the IMF needs to play—as well as the need for governance reform. The first role lies in monetary cooperation or the IMF as a forum within which countries can forge mutually agreed upon and effective rules and in which they can possibly pool reserves. The IMF needs to be an effective “machinery for collaboration” (to quote the IMF’s Articles of Agreement). All countries have an interest in such a forum if it is appropriately structured.

For example, without multilateral monetary cooperation, a large number of emerging countries

17 Mohamed El-Erian, *Reforming the IMF for the 21st Century: Institute for International Economics Special Report 19*, edited by Edwin M. Truman (Washington, DC, 2006), chapter 26.

18 Domenico Lombardi and Ngaire Woods, “The Politics of Influence: An Analysis of IMF Surveillance,” *Review of International Political Economy* (forthcoming 2008).

19 El-Erian (n.17 above).

are adopting very costly “self-insurance” policies. This means taking huge amounts of dollars out of their economy to keep in reserve so that they can buy and sell their own currency when the need arises and insure themselves against contagious crises. The costs of this self-insurance approach were explored by the IMF in its 2003 *World Economic Outlook*. The alternative is a global reserve system with an institution at its core to provide assurance on rules and compliance to all participants. That institution, however, would need to command the confidence of all its members that the institution was as much “theirs” as their own reserves.

The IMF as an effective machinery for collaboration is equally important for discussions on exchange rates among major economies. The United States has an interest in being present in discussions between the European Union and China on exchange rates, as does the EU when the US is negotiating with China. The IMF is supposed to foster such multilateral discussions, in essence being a club in which all members have pledged to work with the organization to promote stable exchange rates and to avoid manipulating exchange rates or the international monetary system to their own (unfair) advantage. However, in practice the IMF is not used by its members as a forum in which exchange rate arrangements are candidly discussed. Nor do the IMF’s processes of surveillance promote this.²⁰

Further hindering the institution is the fact that many of its newer members lack confidence in the institution as an even-handed monitor and enforcer of agreements. Many countries see the IMF as an institution which exports the values and standards of a small group of wealthy countries, imposing them on all other countries. Lost is the sense of a multilateral organization as a forum for debate among all countries and in which all members can commit to mutually agreed restraints.

For the IMF to be a forum of monetary cooperation among all countries will require powerful countries to commit to transforming the

organization. It requires that the IMF be strengthened as an effective and politically-trusted institution to which countries could commit.

ADDRESSING INEQUALITY AND HELPING COUNTRIES DEAL WITH SHOCKS

One of the most important roles the IMF can play for most of its members is to help them—through advice, lending, and cooperation—to deal with the “excesses” of global markets and the shocks (over which individual countries have no control) which can capsize their economies. For example, a financial crisis originating in Asia or in the United States can send devastating tremors through other economies. So, too, can a shift in the value of the dollar or the euro, in which so many countries are paid for their exports, reverse their fortune. Global commodity markets can send reeling the price of cocoa or coffee on which entire economies rely. Trade access can suddenly be curtailed where countries rely on discretionary arrangements. And finally, aid from wealthy countries can fail to materialize or suddenly be altered to require new conditionalities, upturning the best-laid plans of governments.

The IMF could play an important role in helping countries face these external shocks. However, it needs to radically and rapidly update its toolkit. It needs to be able to offer members advice and support which is practical and tried-and-tested rather than ideological and prescriptive. For example, the IMF has moved very slowly on the issue of capital account liberalization. In the face of its members’ disbelief in the IMF’s view of liberalization (particularly after the East Asian crisis), the IMF’s own economists closely examined and reported on the vulnerabilities which can result from capital account liberalization.²¹ Yet the IMF continued to press members with a fairly undifferentiated prescription for liberalization.²² The organization needs to share among its members alternative views such as the practical experience of countries like Malaysia, Singapore, India, and South Africa that used prudent

20 Lombardi and Woods (n. 18 above).

21 Eswar Prasad, Kenneth Rogoth, Shang-Jin Wei, and M. Ayhan Kose, *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence* (Washington, DC: IMF, 2003).

22 IMF Independent Evaluation Office, “Evaluation of IMF’s Approach to Account Liberalization” (Washington, DC: IMF, 2004).

measures to buffer the effects of the 1997 Asian financial crisis.²³ It needs to show that it is not a servant to governments with large, open financial sectors that have a clear commercial case for strongly pushing for liberalization.

Unlike the economics departments of the best universities in the world, the OECD, or the research departments of large banks, the IMF has practical experience working with economic policymakers across 184 countries. It is that practical experience it needs to share with its members in a nonideological way.

The IMF could play an important role in redressing global inequality. One key part of this role should be offering practical advice to governments—based on the experiences of other IMF members—such as on how they might best manage and regulate their relations with global capital and financial markets, and how they might pursue adjustment during a crisis in a way which does not further exacerbate inequality.

REFORMING THE GOVERNANCE OF THE IMF

Reforming the governance of the IMF is a vital prerequisite for the IMF to be an effective part of the multilateral system. A stack of proposals have been written about IMF reform. Few address the underlying shift in realities taking place in the global economy. Global financial stability no longer depends exclusively upon US decisions or the US ability to work in concert with allies such as in the G7—it now depends equally on decisions made in China and other major holders of global liquidity. This means that the IMF needs to reconfigure itself to gain the confidence of members who have long felt underrepresented in the IMF. Those members will not even use what voice they already have within the institution until radical reforms are undertaken.

The governance of the Fund is currently being reviewed. Much attention has been paid to the way voting power is allocated in the agency. A formula has always been used to ensure that large, open economies get a large proportion of votes. This formula has been analyzed and revised

several times. Recently some small adjustments were made to allocate a small voting power increase to each of China, Korea, Mexico, and Turkey. However, these revisions have little bearing on the overall legitimacy and credibility of the organization which is what is really in question.

What is difficult about reforming the IMF is that there is no obvious forum in which to discuss its reform. In the wake of the East Asian financial crisis this was recognized and a new group formed—the G20—which extended the G7 by adding some emerging economies to the group. It is this group which has promoted the reforms currently being undertaken. However, it is probably too beholden to the G7 to go much further.

Reform is difficult for an institution which until recently was looked upon with some envy by other international institutions. The IMF has been depicted as the Rolls Royce of multilateral institutions with a small elite staff, a technocratic, effective board, senior management chosen by the major powers, and no dependence upon ongoing funding contributions from members. UN agencies, by contrast, have always looked shambolic, unwieldy, and unmanageable. In 2008 however, the IMF's structure may be aesthetically pleasing, but it looks ill-matched to its key tasks. It needs a structure which reaches out to key emerging economies that have decided not to use the IMF as their back-up insurance but instead to use their own stockpiling of reserves, or regional arrangements. The G7 and IMF need to ask themselves, What kind of IMF would gain the confidence of Asian and other emerging economy members?

Four reforms stand out as important in capturing the confidence of countries without whom the IMF cannot achieve its goals.

(i) *The Headship*

The first concerns the headship of the organization. The Managing Director (MD) of the IMF chairs the board and holds all the senior management and staff to account. Until now,

23 Ngairé Woods, ed. "Special Issue: Understanding the Pathways through Financial Crises and the Impact of the IMF," *Global Governance* 12, no. 4 (October-December 2006).

the MD had been appointed from a small group of European countries in consultation with the United States—a crucial element of the 1940s “deal” that formed the IMF and World Bank.²⁴ These same countries not only appoint but also decide whether to reappoint the MD after a five-year term. The result is to skew the accountability of the organization as a whole towards the small group of countries involved in leadership selection.

In every recent appointment of the MD this process has come under scrutiny and criticism. This led the boards of both the IMF and World Bank to convene a Committee to consider the leadership selection process in each organization and to recommend some rudimentary improvements. These were not adopted by either board. More recently in the IMF, prior to the election of the current MD, the board adopted a resolution to treat all candidates equally regardless of nationality in all future selections, and then, in keeping with the long-standing convention, appointed a European.

In the twenty-first century the process of appointing the MD—and the consequences for who *de facto* holds the reins of the IMF—will have to change if the institution is to capture the confidence of emerging economies. An obvious way to take the process forward is to build on progress made, bolstering a transparent process with more than one candidate, and applying a decisionmaking rule which encourages consultation and participation in the decision (more on this below).

(ii) Voting power

A second key element of reform concerns the allocation of voting power within the IMF. Back in 1944 the IMF was designed to reassure a nervous USA to guarantee its participation. Formal voting power was arranged to reflect the economic

by giving all countries an equal allocation of “basic votes.” The combination of basic votes and a formula to calculate differential stakes in the global monetary system is a good starting point for thinking about how to engage the current membership of the IMF. Many current proposals for reform note that basic votes have been left to wither on the vine (now accounting for a much smaller proportion of overall votes) and quotas in no way reflect actual economic power.

Missing to date has been a process for reapportioning basic votes and rewriting the formula for voting which includes emerging economies as equal partners. Quota reviews have been undertaken—such as that done at the behest of a Managing Director (with the consequent accountability problems specified above). The IMF’s oversight body—the International Monetary and Financial Committee (IMFC)—comprising senior government officials now needs to engage properly with the issue and agree to constitute a representative group to authoritatively rewrite the formula.

(iii) The Board

A third element of reform concerns the small resident Board of Executive Directors which runs the day-to-day activities of the IMF and is based in Washington, DC and chaired by the Managing Director. The US and the other largest stakeholding governments each have their own representative on the board, while all other members sit in groups who elect a director who must then represent first and foremost the interests of the organization rather than the countries who had voted for them. The board makes decisions on the basis of a consensus underpinned by a majority of voting power. Special categories of important decisions would require a special majority (such as a 75 percent majority), which ensures the US has a veto over those decisions.²⁵

The IMF is well-served by a small board which can make effective decisions. However, the way the IMF board currently works might best be described as semi-representative, semi-technocratic, and semi-efficient. It neither makes

majority voting rule would also require them to forge wider alliances of members to gain agreement from 50 percent of the membership.

A more radical proposal for reforming the IMF is to replace the resident IMF board with a council of senior policymakers who would meet periodically. Attractive in this idea is the fact that it would bring “heavyweights” from national capitals to the decisionmaking forum of the IMF. However, the consequence of a nonresident board (without the fourth change discussed below) would be that the day-to-day operations of the IMF would continue to run out of Washington, DC, with no ongoing, international, publicly-visible oversight. The fact that the IMF is headquartered in Washington, DC, with US veto power, an English-speaking staff, and strong US influence over senior appointments, makes the institution an American one in the eyes of most of the world. The resident board is the thin veneer which gives the organization some multilateral character. For the board to become a nonresident one—an idea with many merits for promoting high-level international cooperation—the other key elements of governance would need to change.

(iv) Location

A fourth reform therefore concerns location. One approach is to consider moving the IMF’s headquarters out of Washington, DC, relocating it in a capital that does not have the power of the United States.

authority has already shifted from the IMF to the region.

Alongside a decentralized IMF which would serve members by pooling and disseminating information and standards, the institution would have a center which operated as the multilateral forum for discussions and negotiations on global monetary cooperation and financial stability. For this, the center would need to be structured so as to command the confidence of all members. That confidence would also bolster the extent to which the IMF in-region was a welcome and trusted adviser.

In sum, better managing globalization requires cooperation on monetary and financial policies. A multilateral forum is required within which countries can agree to shared arrangements and rules on exchange rates and on preventing and managing financial crises amid an ever more complex world of global finance. The IMF has the potential to be both an active multilateral forum for cooperation, as well as a trusted adviser to member governments, but only if its governance structure is overhauled.

Three steps towards a monetary institution which would reduce precariousness and inequality and improve multilateral governance:

1. reinvigorate the IMF as a “machinery of collaboration” for cooperation on exchange rates and emergency financial assistance;
2. retool the IMF to offer tried and trusted advice to member states on how to better manage their vulnerabilities to global finance;
3. overhaul the governance of the IMF (starting with the headship, decision-making, structure and workings of the board, and the location of IMF authority).

Reinforcing the World Bank

The World Bank sits at the heart of the global development assistance system. The logic for this is impeccable. A multilateral aid agency permits countries to pool their aid efforts. In theory this should mean more effective, better informed development assistance with fewer transaction costs. The World Bank should permit the global development assistance regime to do better, permitting rich countries to facilitate growth and human development in poor countries more effectively than through individual national aid agencies. However, the Bank needs the confidence of both its borrowing and nonborrowing members in order to more fully and effectively play this role. It needs deep local knowledge and it needs to bring to bear its practical experience and advice with respect to three difficult trade-offs: security (and urgent make-do assistance) versus development (and longer-run sustainable programs); accountability to donors versus government ownership; and modernization versus the safeguarding of environmental and social values. Yet more importantly, the Bank needs more squarely to address the international constraints on countries seeking to develop. Within the Bank, possible directions of change have already been outlined, however, they are highly contested within the Bank’s own management and by some of its powerful shareholders.

REBALANCING THE BANK’S PRIORITIES

In recent years, some parts of the World Bank have strived to move beyond policy advice anchored in a model of liberalization and deregulation. Rooted in the structural adjustment of the 1980s, the Bank’s previous strategy had been to deregulate, liberalize, and wait for growth. It used in too unbalanced a way studies which backed up the recipe,²⁷ even as scholars both within and outside the Bank highlighted flaws in this approach.²⁸

27 Such as David Dollar and Aart Kraay, “Trade, Growth and Poverty,” Policy Research Working Paper Series no. 2615 (Washington, DC: World Bank, 2000); David Dollar and Aart Kraay, “Growth is Good for the Poor,” *Journal of Economic Growth* 7, no.3 (2002): 195-225.

28 Branko Milanovic, “The Two Faces of Globalization: Against Globalization as We Know It,” *World Development* 4, no.4 (2003): 667-683; William Easterly, Ruth Levine, and David Roodman, “New Data, New Doubts: Revisiting ‘Aid, Policies and Growth,’” Working Paper Series no.26 (Washington, DC: Center for Global Development, 2003); Dani Rodrik and F. Rodríguez, “Trade Policy and Economic Growth: A Skeptic’s Guide to the Cross-national Evidence,” Working Paper Series Issue 7081 (Cambridge, MA: National Bureau of Economic Research, 1999).

Crucially, as highlighted in a recent independent evaluation of World Bank research, the Bank's use of such research too often slipped quickly from research to advocacy. This cannot but erode trust in the Bank's advice. To quote the report:

research was used to proselytize on behalf of Bank policy, often without taking a balanced view of the evidence, and without expressing appropriate skepticism. Internal research that was favorable to Bank positions was given great prominence, and unfavorable research ignored.²⁹

In theory the World Bank has experience and expertise across a large number of countries and sectors which give it an unrivaled capacity to produce pragmatic and experience-derived advice. To realize this capacity it must learn from the recent past. The Bank has long been criticized by its members for failing adequately to investigate and learn from other approaches to growth and development. Oft-cited is the attempt by Japan to have the Bank study the East Asian development model: the resulting report had little effect.³⁰ Seen from the vantage point of many developing countries, the Bank's work still too closely echoes the trade and policy preferences of the United States and its ideological predilections and is not responsive enough to the political and economic needs of its borrowers. This handicaps the Bank's role in the face of new investments and aid flows from countries with clearly different growth models, such as China, the Gulf States, Venezuela, and Brazil.

A yet more serious problem with the Bank's focus on adjustment and liberalization in individual countries has been the correlate marginalization of more global issues and constraints on development. Missing from the Bank's priorities have been serious multilateral efforts to reduce the vulnerabilities faced by countries trying to integrate themselves into global markets and pursue sustainable development. Key among these factors—over which

individual countries have no control—are sudden destabilizing shifts in commodity prices, energy prices and aid flows, and climate change as well as issues better dealt with by the IMF, such as capital flows and exchange rates. In effect, the Bank's approach has been to exhort governments of small, poor economies to paddle faster in the face of external forces including volatility in capital and investment flows (caused by contagion and crises in other countries); in commodity prices (historically the most volatile of all prices³¹); in energy prices; in exchange rates; and in aid disbursements. Periodically these issues have been raised in the Bank but they have never become the subjects of serious multilateral attention. Yet the Bank is unique among institutions to research these issues, to offer potential solutions, and to coordinate international action on them.

The Bank has been retooling and rethinking its research and policy advice so as to become a more trusted adviser to its borrowers. It needs to continue to review the conditions on which it lends and to shift the way it produces and disseminates knowledge. It needs to refocus and leverage its role as a multilateral institution to offer solutions to the challenges posed by genuinely international dimensions and constraints on development.

COORDINATING AID AS A TRUSTED INTERMEDIARY³²

The World Bank is at the center of an international development assistance regime that is notoriously fragmented, duplicative, and cluttered with a large number of donors tripping over each others' bilateral rather than multilateral efforts. As mentioned, in theory, the World Bank, by pooling information and resources, should vastly reduce transaction costs on both sides of the aid relationship.

Perversely, the major donors such as the United States, Japan, and the United Kingdom, do not rely on the World Bank. Instead they sustain and expand their own separate aid agencies and

29 World Bank, "An Evaluation of World Bank Research 1998-2005," (Washington, DC, 2006).

30 Dani Rodrik, "King Kong Meets Godzilla: The World Bank and the East Asian Miracle," Discussion Paper Series no.944 (London: CEPR, 1994).

31 Commodity prices at times exhibit 50 percent standard deviations in price changes: Kenneth F. Kroner, Devin P. Kneafsey, and Stijn Claessens, "Forecasting Volatility in Commodity Markets," Policy Research Working Paper Series no. 1226 (Washington, DC: World Bank, 1993)

32 The paragraphs in this subsection draw from Ngairé Woods, "Power Shift: Do We Need Better Global Economic Institutions?" (London: Institute of Public Policy Research, 2007).

processes, creating a cacophony of donors making different demands on over-stretched governments. The governments of these countries speak daily to developing countries through dozens of megaphones including their own national agencies and special initiatives alongside several multilateral agencies (the UNDP, World Bank, IMF, World Health Organization [WHO], WTO and so forth). The result is that already over-stretched government officials in very poor countries are forced to spend most of their time and staff strengthening and maintaining external relations with donors and doing their bidding.

More perversely still, even when donors use the World Bank, they encumber it with special demands, special funds, and additional procedures. This practice can be traced through the increasing use of “trust funds” in the World Bank. These are funds given to the Bank for a particular use—often supplementary to the institution’s core work. As described by a former UK government aid official, “we construct an elaborate mechanism for setting priorities and discipline in the Bank, and then as donors we bypass this mechanism by setting up separate financial incentives to try to get the Bank to do what we want.”³³

At the highest level, donors have engaged in a discussion about how they might better coordinate, harmonize, and align their aid efforts.³⁴ That said, the rate of progress on the ground has been glacial. For example, one area in which donors have agreed to streamline their efforts is public financial accountability. Reporting in 2004 a joint assessment completed by the World Bank, European Commission, and the UK’s Department for International Development (DFID) highlighted the scale of the challenge, reporting too many different audits taking place, and the heavy transaction costs being imposed in-country, which are related to the inadequate sharing of information among international development partners.³⁵ These findings highlight the yawning

gap between the talk about coordination and ownership, and actual donor practices, which are neither coordinated, nor linked to instruments or institutions within aid-receiving countries.

One concrete result of donors’ commitments to coordination and ownership has been the unleashing of competition among aid agencies over who should “lead” on coordination and ownership. The OECD/DAC (the Development Assistance Committee) won out as the forum for the debate. From a practical point of view, the World Bank is well-placed to take the lead, having led on the Poverty Reduction Strategy Process (PRSP) and developed its role from there. Snapping at its heels, however, the UNDP is keen to lead in preparing national development strategies and formal mechanisms for dialogue. The result is a somewhat perverse situation in which officials from DFID, the World Bank, the IMF, the UNDP, and other bilaterals seem to be arguing over who should have the lead role in generating a “country-led” strategy. Meanwhile, in Paris, donors create elaborate concordats for high-level cooperation and coordination among themselves. Squashed out is a genuine space for countries to take a lead in formulating their own solutions.

The Bank has the potential to be a good multilateral forum on development assistance, as well as to harness the benefits of pooling the delivery of development assistance. The recent replenishment of the Bank’s IDA—not just the largest ever set of contributions by governments but including new donors—gives ample proof of this. However, leveraging this into a more coherent multilateralism on aid will require the Bank first to command the confidence of both donors and aid-recipients. Donors will cling to their own programs if they see in the Bank’s program the political vision of individual shareholders, such as the United States. For this reason governance reform within the Bank is vital.

33 Masood Ahmed, “Votes and Voice: Reforming Governance at the World Bank,” in *Rescuing the World Bank: A CGD Working Group Report and Selected Essays*, edited by Nancy Birdsall (Washington, DC: Center for Global Development, 2006), p.90.

34 Organization for Economic Cooperation and Development (OECD), “Harmonization, Alignment, Results: Report on Progress, Challenges and Opportunities,” Background Paper for the High-Level Forum on Aid Effectiveness, (Paris, February 28 - March 2, 2005); OECD, *Shaping the 21st Century: The Contribution of Development Cooperation* (Paris, 1996).

35 R. Allen, S. Schiavo-Campo, and T. Columkill-Garrity, *Assessing and Reforming Public Financial Management: A New Approach* (Washington, DC: World Bank, 2004).

REFORMING THE GOVERNANCE OF THE WORLD BANK

To guard against undue political influence, the Bank was born with constitutional guarantees against political interference both in its funding and in its governance structure. Those guarantees were rapidly pushed aside when the Bank was headquartered in Washington, DC, and it became clear that the US Executive Director's approval would be a *sine qua non* for any loan.³⁶ However, the Bank has transformed since its birth. Its funding structure no longer relies heavily on the United States, and other countries have become major shareholders and stakeholders in the Bank. Meanwhile, its governance has not caught up. Indeed, the Bank has moved even less than the IMF has on changing its governance. Three particular items of reform stand out as important.

(i) *The Headship*

The headship of the World Bank, like that of the IMF, is a crucial issue. Although the IMF has progressed some way toward opening up the head selection process, the World Bank has not. Indeed, the last two selections of presidents led to the appointment of US administration insiders cementing the sense that the Bank is tightly bound up with the US political administration. The original rationale for an American presidency of the Bank was impeccable. The Bank needed to command the confidence of both the American political system (for confirmation of the Bank's Articles of Agreement) and of Wall Street (where the Bank would raise funds). Subsequently, however, Bank funding and activities have come to rely far less on US and other guarantors and far more on the Bank's own net income (from fee-paying borrowers), its investment income, and the investment grade it has built up from its loan portfolio. There is no longer a reason to make the World Bank more accountable to the US than to any other government. Indeed, the assurance problem has shifted to emerging economies who need luring to the Bank both as fee-paying clients and as donors in their own right. The Bank recently hired a Chinese national as its chief

economist, Joseph Lifu Yin. However, this does not overcome the accountability bias inherent in a US-appointed (and reappointed) president. Clearly, a first step towards preparing the Bank for a more active role in global cooperation is to revise its headship selection process.

(ii) *Decisionmaking*

Decisionmaking rules have also been left unchanged in the World Bank. There has as yet been no discussion of shifts in weighted voting or the Bank's formula for calculating quotas and votes. Although the IMF has proceeded with modest reforms, the World Bank has not. The weighting of votes in the World Bank is a historical curiosity. The Bank simply inherited a slightly modified version of the IMF's quota structure. Yet, its mission (or missions) is different. Stakes in the World Bank should reflect the agency's purposes: where the Bank acts as a coordinator of development assistance, the relevant stakes are related to donorship. The World Bank needs a properly constituted, representative group to assess and propose a weighted voting structure which makes sense of the stakes which are relevant to the Bank's own activities.

The success of the replenishment negotiations for the Bank's concessional lending fund (the International Development Association) bears noting. The negotiations had stalled during President Wolfowitz's tenure at the Bank and have been carefully pieced back together under the new president, Robert Zoellick. The addition of China and Egypt (among others) as new donors highlights a degree of confidence in the IDA, as does the record pledges to increase its funding.

(iii) *The Board and Location of Headquarters*

The role of the Board and the location of the Bank comprise the third and final important element of a reformed governance structure. Like the IMF, the World Bank has a resident board as well as a Board of Governors. However, the resident board works rather differently from that of the IMF. Much of its work is devolved to committees through which the Bank has taken a

36 Ngairé Woods, *The Globalizers: the IMF, the World Bank, and their Borrowers* (Ithaca, NY: Cornell University Press, 2006), chapter 1.

more active role such as in overseeing quality management and development effectiveness. The quality oversight role is important since “success” in the World Bank’s work is difficult to assess because the organization’s mission is a wide-ranging one. Many of its goals are long-term and difficult to measure. The Bank should not be crowding out private financing and an overly high success rate might suggest that the Bank was taking too few risks. For all these reasons the board’s oversight role is important, albeit charged at present with far too much micromanagement of lending.

Missing from the World Bank is a forum for longer-term agenda-setting and genuine multilateral cooperation on development assistance. Neither the resident board nor the Board of Governors has worked as a strong agenda-setting presence or forum for multilateral cooperation. The evidence of this lies in the fact that most multilateral discussions on development assistance have been undertaken in the OECD Development Assistance Committee, even though many see this group as inadequately representative. More recently, a new forum has been created by the UN—the Development Cooperation Forum.

One area in which the Bank has altered its governance has been in its decentralization. The Bank has devolved significant authority in some cases to its country offices, bringing the Bank’s development lending and advisory work closer to country priorities. In several cases this has proven to be a very successful strategy. Building on this, the Bank’s package of governance elements could be configured better to earn the trust of members whose cooperation it requires, as well as to invigorate the Bank as a forum for cooperation on development assistance.

In sum, the World Bank could and should play a key role in better managing economic growth among and within countries to ensure that the global economy is less precarious and less unequal. It could do this by focusing its research and priorities not just on more pragmatic and experience-based policy advice but equally on addressing global constraints over which individual governments have no influence, such as volatility in commodity prices, energy prices, aid disbursements, and climate. An overhauled World Bank

could be a forum for effective multilateral cooperation and governance of these issues.

Three steps towards a development institution which would reduce precariousness and inequality and improve multilateral governance:

1. re-orient the Bank’s research and other policies toward more pragmatic and experience-based development policy advice and toward addressing the global constraints on development over which individual governments have no control;
2. further develop the Bank’s role as a trusted intermediary for aid coordination;
3. overhaul the governance of the Bank (starting with the headship, decision-making apparatus, the structure and location of the board).

Conclusions

This working paper began with the observation that the global economy is looking more precarious, more unequal, and less governed than it has in previous decades. I have argued that better governance would reduce precariousness and inequality in the global economy and that each of the WTO, the IMF, and the World Bank has a crucial role to play in this.

A WTO focused on the needs of all of its members would narrow the agenda of trade-negotiators to a smaller set of goals which are genuinely shared by all countries. It would support international trade rules (and the implementation of rules) so that the ladder is not kicked away from countries attempting to use tried-and-tested policies which accelerate industrialization. Finally, the WTO should play a more active role in disseminating information, and in monitoring and enforcing trade rules—particularly with respect to trade partners of unequal size and bargaining power. Governed in these ways, global trade arrangements could better support stability and development beyond the small group of industrialized countries which

have traditionally dominated trade rules and their enforcement.

The IMF is a necessary forum for multilateral negotiations on monetary policy as well as financial stability. It could also play a key role in offering information, advice, and support to members buffeted by global forces beyond their control. Yet the institution is too widely perceived as an exporter of US or G7 standards, values, and ideological predilections. A useful IMF would need a radically transformed structure, including a shift in the geographical location of its headquarters, a decentralization of its authority, operations, and information-gathering, and a retooling so as to offer practical tried-and-tested advice to needy members. The obstacle to reforming the IMF is the lack of a trusted and authoritative forum within which the reform

could be negotiated and agreed. That said, a transformed IMF could mitigate the impact of external shocks which exacerbate precariousness and inequality in the global economy.

Finally, the World Bank was created to assist in ensuring growth across all parts of the global economy and to assist in ensuring that prosperity reached all people within societies. It can play that role in today's global economy. However, an overhauling of its governance is required if the Bank is to keep up with shifts already occurring in the world of aid, investment, and policies within emerging and developing countries. Like the IMF, the Bank must be reconfigured so as to command the confidence of key new stakeholders if it is to be a trusted multilateral forum within which countries are prepared to negotiate and to cooperate on issues of global development.

Further Reading

Barton, John H., Judith L. Goldstein, Timothy E. Josling, and Richard H. Steinberg, *The Evolution of the Trade Regime*, Princeton, NJ: Princeton University Press, 2006.

A history of the contemporary trade regime which looks at the politics, law, and economics, analyzing how each has shaped the current regime and highlighting the ways it is failing adequately to adapt to new challenges and its new, broader membership.

Hurrell, Andrew, *On Global Order: Power, Values, and the Constitution of International Society*, Oxford: Oxford University Press, 2007.

A wide-ranging reflection on the nature and sources of order in a globalizing world which illuminates the different cultural, historical, and geopolitical starting points for thinking about power and purpose in global politics.

Milanovic, Branko, "Global Income Inequality: What it is and Why it Matters?" DESA Working Paper No. 26 (ST/ESA/2006/DWP/26) August 2006.

Discusses how to measure global inequality among citizens of the world and analyses the relationship between globalization and global inequality before presenting ideas about global redistribution.

Rodrik, Dani, *One Economics, Many Recipes: Globalization, Institutions, and Economic Growth*, Princeton, NJ: Princeton University Press, 2008.

Explores the different ways countries can successfully develop and integrate into the world economy and the implications for current global, regional, and national institutions.

Truman, Edwin, *Reforming the IMF for the 21st Century*, Special Report 19, Washington, DC: Petersen Institute for International Economics, 2006.

A wide-ranging set of articles by economists, policymakers, and other commentators on the workings of the IMF and the challenges facing the global economy and how the IMF might better respond to them.

Woods, Ngaire, *The Globalizers: the IMF, the World Bank and their Borrowers*, Cornell University Press, 2006.

Analyzes the political pressures, bureaucratic habits and economic ideas which have driven the IMF and World Bank from their creation to the present day: specific case studies illuminate how and why their mission expanded in the 1980s and 1990s, and the book concludes with an analysis of how the institutions might be reformed.

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