

## ■13

# Bretton Woods Institutions

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The Bretton Woods institutions are often described as the “sister institutions” of the United Nations. Of all the specialized agencies, the World Bank and the International Monetary Fund (IMF) have generated particularly heated debate and criticism, particularly over the past two decades. This chapter explains how that has come about, what the institutions do, why it has become contentious, and how it relates to the activities of other UN organizations.

## **An Overview**

What do the World Bank and the IMF do?<sup>1</sup> They were born to fulfil distinct roles, as detailed below. But by the end of the twentieth century, their work had changed dramatically. The World Bank’s core task is development assistance. The IMF’s core task is to promote international monetary cooperation through surveillance and lending to countries with short-term balance of payments difficulties. In the latter role, the Fund’s work overlaps heavily with that of the Bank in three areas. First, both institutions are involved in managing financial crises, such as in East Asia and Latin America in the late 1990s where the Fund took a lead, but the World Bank played a key back-up role. Second, lending for development in the poorest, often war-torn parts of the world is another role. Here the World Bank has taken the lead, but with the IMF ever-present in setting down the macroeconomic framework for assisted countries. Finally, both institutions have been involved in transition economies such

as Russia and the former Soviet republics where they have been expected to help foster transition from centrally planned to market-oriented economies.

The work of the Fund and Bank deeply affects that of other UN organizations, not least because the Fund and Bank set the economic parameters within which virtually all other assistance to a country and aid programming must fit. That said, there is little effective coordination among the Fund and Bank and other UN bodies either at headquarters or on the ground. This is surprising given that all members of these organizations have agreed global objectives such as the Millenium Development Goals (MDGs). However, there are few if any incentives for agencies such as the Fund or Bank actively to cooperate with other organizations or to alter their behavior so as actively to achieve global goals. In practice, each international agency is driven by its own discrete bureaucratic pressures, incentives, and standards of success. And in this the IMF and World Bank have some special characteristics which make them different from other UN organizations.

Several features distinguish the IMF and World Bank from other UN organizations. First, membership of the Fund and Bank is conditional. Countries must belong to the IMF in order to be members of the World Bank. In turn, membership of the IMF requires countries first to accept specific terms and responsibilities – such as surveillance of their exchange rate arrangements by the IMF. A second difference lies in the finances of each agency. The core budgets of the Fund and Bank do not depend on regular contributions from member states. Each organization derives income from their lending operations and investments they have made with prior income. This gives them scope for independence from their member countries.

Governance in the Fund and the Bank is different from other UN agencies. Neither has a one-country, one-vote system. Voting is weighted according to the size

and openness of each member's economy as reflected in a series of formulae (which are not immune from political manipulation). There is also a difference in the nature of the board which runs each institution. The day-to-day work of the Fund and the Bank is governed by a Board of Directors who represent member countries but are paid by the institution and directed to work as officers of the organization.

For countries that work with the Bank and Fund, there is also a great difference in the staff. IMF and World Bank personnel are not hired according to formal or informal quotas to ensure that all countries are represented. The institutions pride themselves on having a meritocracy of a non-nationality-based appointment system that attracts highly trained graduates from the world's top economics and finance departments. The exception is the senior management in each organization. The heads are political appointees (a European in the case of the IMF, an American in the case of the Bank), and so too are the most senior management appointments hugely influenced by powerful shareholders.

Unlike other UN institutions, the Fund and Bank are situated in the capital of the U.S. government in Washington D.C. and work exclusively in English. This, combined with the fact that they draw a large proportion of their staff from graduate programs in North America makes the Fund and Bank the most "Anglo-Saxon" of the current generation of international organizations.

The working relationship of Bank and Fund to the United Nations system is a very loose one. Although they are specialized agencies of the UN system, in fact they are more like distant cousins than sisters. The lack of any real coordination between them and other agencies is repeatedly cited across the literature on development assistance. For this reason, the UN Secretary General and the panel he convened to look at the UN system, focused on the need to strengthen coordination among

different UN and the IMF and World Bank.<sup>2</sup> These aspirations are worthy but face a significant obstacle – namely, that while the governance, funding, and operations of the Fund and Bank are separate to those of the UN system, there are few incentives for real coordination.

The financing and governance structure of the IMF and World Bank give them a degree of potential autonomy from member governments which other UN agencies do not enjoy. Yet this has not insulated them from political influence, nor from public criticism. Left-wing groups denounce the Fund and Bank as tools of US imperialism. Anti-globalization websites accuse them of enforcing global capitalism. Meanwhile, right-wing think-tanks accuse the Fund and Bank of supporting corrupt elites and governments which ‘cripple their economies, maul their environments, and oppress their people’ and criticize them as part of the evil of over-weaning government projected into the world economy. Somewhere between these extremes the IMF and World Bank work in scores of countries across the world – reaping both some successes and some failures. Their sixty year evolution helps to explain how and why.<sup>3</sup>

## **The Creation**

The IMF and the World Bank were founded while the Second World War was still raging. In 1944 at Bretton Woods, New Hampshire a global conference of “one and a half” parties took place.<sup>4</sup> The goal was to establish global economic rules which would prevent a replay of the Great Depression and its aftermath. The United States led the negotiations. It was already emerging from the war with a clear military, technological, and economic superiority over its Western allies. The United Kingdom

constituted the other “half” party, due not just to its position in the alliance at the time but also to the fact that it was represented at Bretton Woods by the internationally renowned economist John Maynard Keynes. The contribution of the other 43 countries at the conference has been memorably described by Harold James as weaving consensus, harmony, and agreement in an atmosphere of cordial cacophony as if under the spell of a magician (the UK and US roles).<sup>5</sup> [T1]

The new system planned at Bretton Woods put the IMF at the heart of a new monetary system, managing a system of fixed but adjustable exchange rates and lending on a strictly short-term basis to countries facing short-term balance of payments crises. Investment in the post-war economy would be facilitated by the International Bank for Reconstruction and Development (IBRD but more commonly the World Bank) which would raise capital in money markets and lend it at advantageous rates to war-torn and developing countries.

The original Bretton Woods plan was at first subsumed by the Cold War. The Marshall Plan announced in 1947 provided the United States with a more immediate bilateral way to ensure stabilization, investment, and reconstruction in Western Europe. Nevertheless, by the 1950s both the IMF and the World Bank were modestly assuming a place in the international economy. The IMF was managing a fixed exchange rate system and making short-term loans to assist countries with balance-of-payments deficits. The World Bank was channelling funds from private capital markets to developing countries by issuing top-rated bonds on world financial markets and lending on the money for specific development projects.

In ensuing decades, the role of both institutions changed dramatically. The World Bank expanded its resources and moved steadily away from pure project lending into more policy-based lending. Over time the institution acquired three new

arms. In 1956 the International Finance Corporation (IFC) was founded to mobilize private investment through syndications, underwritings and co-financing. In 1960 the International Development Association (IDA) was established to provide long-term credits at concessional rates to the poorest country members of the World Bank. In 1988 the Multilateral Investment Guarantee Agency (MIGA) was formed to stimulate foreign direct investment by providing guarantees against political risk, armed conflict, civil unrest and so forth. Meanwhile in the 1970s under the presidency of Robert McNamara, the Bank began to express its core objectives in terms of redistribution with growth and basic human needs. Rural development projects were added into the overarching modernization and growth-promoting priorities of the institution.

Over this period, the IMF's fortunes fluctuated. In the 1960s, concerns about global liquidity led members to create a new virtual reserve asset managed by the IMF and called the Special Drawing Right (SDR). It never took off. The move was soon superseded by an opposite problem—the excess of dollars in the international financial system. Unable to back a surplus of dollars with its gold reserves, on 15 August 1971 the United States suspended the gold-convertibility of the dollar. In one swoop the IMF's central role as manager of a fixed exchange rate system disappeared. The IMF then attempted unsuccessfully to take a lead role in negotiations over what kind of exchange rate regime would replace the Bretton Woods system. By 1973 major industrialized countries together embarked on a new system in which countries could opt to float their currencies, relying on demand and supply in the foreign exchange market to determine the value. It was not until 1978 that the new system was formally recognized by an amendment to the IMF's Articles of Agreement.

The events of the early 1970s have limited the Fund's subsequent role in respect of non-borrowing members to surveillance. This entails monitoring and reporting on the exchange rate policies of member states and thereby helping to assure a stable international exchange rate system. In practice the IMF staff work with their own information as well as the economic data provided by member countries, to compile reports on each member's economic policy and performance. These reports are then presented to the Board of Governors. They rarely have an impact on the stronger wealthier members of the institute.

### **Changes in Mission since the 1970s**

Several challenges have altered the work of the IMF and World Bank since the 1970s. The four highlighted below are the debt crisis of the 1970s, the challenge of transition in centrally-planned economies, the new financial crises of the 1990s, and the long-term challenge of facilitating development in some of the poorest most conflict-ridden countries of the world.

#### *The Debt Crisis of the 1980s*

The IMF and the World Bank underwent further change in the 1980s. The debt crisis, which began in Latin America in the early 1980s, drew them into a new role.

Throughout the 1970s they had been marginalized as lenders to countries who could instead borrow from commercial banks anxious to recycle the massive surpluses of the Organization of Petroleum Exporting Countries (OPEC) and a new excess of liquidity within international capital markets. The IMF initially responded by expanding access to its resources, particularly to countries with no access to

commercial finance. The Bank undertook more policy-based lending and expanded its focus to include rural development.

The festival of lending ended when the U.S. Federal Reserve increased interest rates in 1979. Suddenly indebted governments found that their creditors would not roll over their loans. The borrowers could not meet their debt repayment obligations. Several large commercial banks were on the brink of failure. The IMF and World Bank were called upon to make loans to the debtors to ensure that they would repay their over-exposed creditors and therefore avert an international banking crisis. The conditional loans required borrowers to undertake stringent measures to stabilize and ensure adjustment in their economies in order to access credit from the Bretton Woods Institutions.

Conditionality in the first phase of the debt crisis emphasized stabilization. This meant that governments were required to reduce inflation, to rationalize and stabilize the exchange rate, to increase interest rates, to reduce public sector expenditure and investment, to increase taxation, and to eliminate subsidies. These are the staple requirements of IMF conditionality. They are reinforced by requirements made by the World Bank in its structural adjustment loans which require governments to liberalize trade and minimize tariffs, to privatize state-owned industries, to encourage foreign investment, and to deregulate their economies. Taken together the conditionality of the IMF and World Bank came to be labelled the “Washington consensus.”<sup>6</sup>

### *Facilitating Transition at the End of the Cold War*

In the early 1990s the institutions took on a new challenge: transforming the former Eastern bloc economies. The end of the Cold War left Western policy-makers

attempting to secure both economic and security goals in what had been the Soviet sphere of influence. These “transition economies” posed significant new challenges to both institutions and led to a rethinking of the role of institutions in the process and goals of policy-reform. Privatization, for example, had long been pushed by both the Fund and Bank as a way to reinvigorate investment and production in formerly state-managed sectors. In Russia, it became apparent that an effective rule of law and transparency were necessary prerequisites for privatization to produce the hoped-for results.

Criticized by borrowing countries as well as their major industrialized country members for the inadequacy of their efforts in Russia and elsewhere to promote transition and economic growth, the “conditionality” of the Bretton Woods institutions became broader. A wide raft of good governance measures were included which aimed at strengthening and modernizing the institutions of government, rooting out corruption, and bolstering the rule of law within countries. The expanded set of activities has elsewhere been described as “mission creep,” highlighting the way that the complexity of transition pushed each agency into new tasks beyond their core competency.<sup>7</sup>

### *Coping with Financial Crises in Emerging Economies in the 1990s*

By the end of the 1990s, both the Fund and the Bank were being called upon to manage a slew of new financial crises. In 1995 the Mexican peso went into free fall catalysing a crisis in Mexico in spite of its extraordinary decade-long program of economic reform. In 1997 the dangers of contagion were highlighted when a crisis in Thailand soon spread even to the relatively sound and prospering economy of South Korea. The East Asian financial crisis was followed in 1998 by Russia, then Brazil,

Turkey and Argentina. Common to each country's plight was an initial liberalization which had permitted a very substantial inflow of short-term investment, often into a very poorly regulated banking sector. When market confidence teetered, short-term capital fled the country, leaving a massive repayments crisis for the government.

The first resort in managing the financial crises of the 1990s was for the IMF to make large loans to try to stem the crisis of confidence in a country. The World Bank was subsequently deployed to make longer term loans and to try to ensure that social safety-nets were put in place to protect the most vulnerable from the harsh adjustment resulting from the first round of crisis management. The experience of the crises led to a very public questioning of the role of the institutions and the down-side of liberalization and globalization. The starkest reminder of this was the massive anti-globalization street demonstrations which came to accompany the Annual Meetings of the IMF and World Bank from the late 1990s onwards.

In the wake of the financial crises of the 1990s, by 2002 the most powerful members of the IMF were forced to discuss in earnest a more robust and rule-based mechanism for dealing with financial crises which would more deeply involve the private sector. Several official and commentators were calling for some form of international bankruptcy or standstill provision.<sup>8</sup> However, as the crises receded, so too did any official resolve to identify or rectify gaps in the international financial architecture.

The street protests of the late 1990s highlighted not just the plight of emerging economies. One of the most powerful motivating factors behind public engagement in the work of the IMF and the World Bank was their perceived failure to assist the poorest and most heavily indebted countries within the world economy.

*The Debts of the Poorest and Most Heavily Indebted Countries*

Throughout the 1980s and 1990s, both the Fund and the Bank had become deeply embroiled in lending to the poorest and most highly indebted countries in the world economy. The un-repayable debts of these countries had been rescheduled throughout the period leaving the lion's share owing to the Fund and Bank. Both institutions were concerned to prevent members going into arrears on their loans and thereby eroding the institutions' own resources. This was one push towards a new strategy.

By the late 1990s there was considerable public and political pressure for the IMF and the World Bank to do more to alleviate suffering in the world's poorest and most heavily indebted countries. The political pressure was intensified by the activities of non-governmental organizations such as the umbrella group Jubilee 2000, which campaigned for debt relief. The result was a succession of official debt relief announcements made within the framework of the highly indebted poor countries initiative (HIPC) based in the Bretton Woods Institutions.

The debt strategy aimed to reduce the debts of the poorest countries as well as to alleviate poverty within them. Traditionally the latter task had been more part of the mission of the World Bank than that of the IMF. By the late 1990s, both institutions were linking new forms of debt relief to poverty alleviation. HIPCs wishing to avail themselves of greater debt relief were required to submit to the IMF and World Bank poverty reduction strategy papers (PRSPs) formulated through a process of national consultation and participation.

The new poverty reduction strategy requirement brought to bear the lessons both institutions had learnt from their experience with good governance conditionality. Ownership and participation had to be at the core of any reform process for it to be effective. In other words, to increase the effectiveness of reforms

you had to engage, consult, and devolve responsibility to key groups within the society or country undertaking reform. For each of the IMF and the World Bank such a lesson was a deep challenge to their traditional ways of thinking and working, requiring them to spend more time in the field, deploying staff more as facilitators rather than as policy experts. This brought the Bretton Woods twins into closer than ever contact with counterparts from other UN organizations. Yet coordination among agencies has been very slow to emerge. This is amply illustrated in the area of post-conflict development assistance.

### *Post-conflict Reconstruction*

In the wake of conflicts such as that in Iraq, Afghanistan, Bosnia-Herzegovina, and in the West Bank and Gaza, the Fund and Bank have found themselves thrust into a coordinating role, conducting needs assessments, auditing aid efforts, and advising on post-conflict economic policy. This role has brought new challenges to each institution and has brought them into yet closer contact with other UN agencies.<sup>9</sup> Coordination among international agencies has always been a thankless task. In spite of good intentions, formal agreements and much rhetoric about working better together, the group of important actors—UN agencies, the Bretton Woods institutions, and bilateral donors—have found effective coordination nigh impossible. For example, even in Bosnia-Herzegovina where the major donors (themselves overlapping groups) – the World Bank, the European Community, most of the G7, and the Netherlands – agreed with the government to have an externally appointed “aid coordination board” and a small, specialist “reconstruction task force” within Bosnia-Herzegovina, actual coordination proved extremely difficult.

The United States had played the most important political role in the peace negotiations, and developed its own coordination mechanism that would include a political Steering Board of the Peace Implementation Council and an Economic Task Force (ETF) comprising the donors. Eventually Washington and the UN Office of the High Representative succeeded in having their structure accepted. However, fifteen Islamic countries also formed the Assistance Mobilisation Group under the OIC (AMG/OIC) but they were not made part of the ETF. As a result their contributions to the multilateral aid programmes declined. Finally, while the Bosnia-Herzegovina government created a Reconstruction Cabinet, its coordination efforts suffered from political disputes over the state structure with Ministers from Republika Srpska (RS) refusing to participate in donor meetings and Bosnians and Croats in the federal government unable to find consensus on the coordination mechanisms.<sup>10</sup>

Coordination is an area in which the Bretton Woods institutions have special roles. The IMF has long *de facto* coordinated conditionality – mostly because it sets down terms in the absence of which most other agencies will not lend. Lacking has been any correlate coordination of the delivery of assistance, including even basic coordination among donors and lenders as to what reporting requirements a country must conform. The World Bank's Comprehensive Development Framework announced in 1999 sought to enhance coherence across sectors (economic and social policies) as well as inclusion and coordination among the various actors involved in any one country's development strategy – under the leadership of the recipient government. The joint IMF and World Bank PRSPs are another attempt to formulate a wider development strategy through a more inclusive process, as have been Sector-Wide Approaches (SWAs).

The work of the Bretton Woods institutions in post-conflict situations highlights a common problem within the UN system. Effective coordination among international organizations rarely occurs. This is not an accident nor the deliberate strategy of the international organizations themselves. It reflects powerful interests in non-coordination. These include: competing interests at the national level (between government agencies, private companies, non-governmental organizations, interest groups, and the desire to gain public support for highly visible aid efforts); public accountability concerns (including budget pressures to disburse, national auditing requirements of donors and so forth); disagreements among donors about goals as well as policies (such as the recent disavowal by the UK's Department for International Development of the conditionality of the IMF and World Bank); and the desire of powerful states to expand the number of goals or policy mechanisms that are available in order to reduce the reliance on any over-arching institutional arrangements.

## **Measuring Success and Failure**

There are several yardsticks for measuring the success or failure of the Bretton Woods institutions. The narrowest yardstick is that used by the institutions themselves – their internal and independent evaluations. A broader yardstick is offered by the strategic objectives laid out in each institution's Articles of Agreement.

The IMF's Independent Evaluation Office (IEO) has documented mistakes made in process or analysis by the IMF as well as by governments with which the organization has worked. One reason for failure is poor advice. In reports published in 2002 and 2003 the IEO highlighted problems in programs designed by the IMF.<sup>11</sup> Another reason for failure is political. Borrowing governments prove either unwilling

or unable to implement conditions to which they have signed up. The Fund has attempted to overcome this problem by bolstering the ownership and participation of borrowing governments in the design of conditionality.

Reviews of the World Bank's lending are conducted in an ongoing fashion by the Bank's Independent Evaluation Group (IEG), which produces an Annual Report on Development Effectiveness (ARDE) as well as a large number of evaluations covering most of the Bank's activities. These reports highlight failures to achieve major relevant goals, institutional development, and sustainability in Bank-sponsored policies or projects. Critics of the Bank point to the percentage of loans that register unsatisfactory on one, two, or three of these criteria, and a high-level review commissioned by the Bank itself reported in 1992 that nearly forty percent of borrowing countries had "major problems" with at least 25 percent of their projects.

A much broader yardstick for measuring the success or failure of the Bretton Woods institutions is provided by their Articles of Agreement. Both are charged with enhancing stability and growth in the world economy. The Fund's contribution to this has been as a forum for cooperation among states, as a framework for surveillance over exchange rate systems, and as a short to medium-term lender to countries with debt problems so as to prevent international financial crises. The Fund's success in these broader goals has been hailed in several studies and in its own histories. Fund critics allege that it has pursued these objectives in ways which have consistently ignored or further impoverished the poorest and most vulnerable members of developing countries.

The Bank has contributed to global growth and stability by lending to developing countries at rates and in quantities permitted only because the Bank pools the credit-ratings of all of its members. Poorer countries thus gain from sharing the

strong credit ratings of other non-borrowing World Bank members. The Bank's critics allege that Bank lending has had adverse effects on poverty, the environment, and human rights.

## **Contemporary Debates**

In 2006 the IMF and World Bank face a new challenge. Each has come to depend upon income earned by lending money. But in 2006 their largest borrowers were looking elsewhere for finance. If the trend continues, fewer clients and less lending means that each institution must reconsider what they do, for whom, and at whose expense. These questions touch on key contemporary debates about the institutions.

### *Governance*

Since the Bretton Woods Conference in 1944, the governance structure of the IMF and World Bank has been contentious. Back then the United Kingdom and United States wrestled not just over how much power different countries should have and where the headquarters should be located, but also over whether a full-time resident board should oversee the work of each organization. In recent years the debate about the governance of the institutions has focused on whether the voting power of developing countries should be increased,<sup>12</sup> and how to insulate the Boards from direct political pressures applied by major shareholders.<sup>13</sup>

At present each organization has an Executive Board on which all members are represented. The Executive Board sits in almost continuous session and makes decisions on the day-to-day work of each institution. It is composed of officials from economic agencies within member states. They are called Executive-Directors. Their

bosses—the Ministers of Finance and Central Bank Governors from each country—meet only once a year as the Board of Governors.

Representation on the Executive Board is not equal. Only the largest shareholders in each organization—the United States, Japan, Germany, France, and the United Kingdom—along with China, Russia, and Saudi Arabia, have their own seats on the Board. The other sixteen Executive Directors are elected for two-year terms by groups of countries, known as constituencies represented by just one Executive-Director. For example, twenty-one African countries are represented by one Executive Director in the IMF, and twenty-two African countries by one Executive Director in the World Bank. This has led to calls for increasing the voice of African countries such as by increasing the staff in their offices or giving them another seat on the Board.

A second contentious issue is voting power and how it is allocated. Even though the Boards work by consensus, all of their work and indeed, the work of the staff, is underpinned by an awareness of voting power. Each country has a weighted number of votes which depends on their “quota,” which is determined by formulae which translate relative weight in the world economy into a share of contributions and votes (and in the IMF, access to resources). Although the notion of a formula implies a technical allocation of votes, this is not strictly the case.

The allocation of quotas has always been deeply political. Raymond Mikesell was the man who was asked in 1943 to determine the very first allocation of quotas within the IMF. He describes how he was simply told by the U.S. Secretary of the Treasury to give the United States a quota of approximately \$2.9 billion; the United Kingdom (including its colonies), about half the US quota; the Soviet Union an amount just under that of the United Kingdom; and China somewhat less. The U.S.’s

Thomas G. Weiss and Sam Daws (eds), *Oxford Handbook on The United Nations* (Oxford University Press, 2006).

major concern was to ensure that military allies (President Franklin D. Roosevelt's Big Four) should have the largest quotas, with a ranking on which the President and the Secretary of State had agreed.<sup>14</sup>

Quota allocations continue to be deeply political with Asian countries particularly aggrieved that voting power has been slow to reflect changes in their economic weight in the global economy. The current voting power is found in Figure 13.1.

[insert Table 13.1 here]

Only one member state has an individual veto power over major decisions. While most decisions require a simple majority, there is a special category of decisions which requires an 85% majority. What this means in effect is that the US has a veto power over those decisions because it is the only member with more than 15% of votes. Even as the US share of votes in the organization has declined, it has preserved this veto right by increasing the 'special' majority required and by increasing the number of decisions requiring that majority. Although on occasion other countries have grouped together to veto decisions, they rarely do so. EU countries have a caucus within the institutions but they seldom coordinate their positions. Similarly, developing countries only rarely act collectively. As a result, the United States remains the only member with an effective and practiced veto power.

Power and influence within the Bretton Woods institutions also derive from the way that members exercise their voice. Washington is not only the largest single vote-holder in the Fund and Bank, it is also the most vocal member of the Boards of both institutions. To cite a Senior Treasury official's testimony to a Congressional Committee examining the IMF: "Representing the largest, most influential member, the US representatives speak on virtually every issue coming before the Board."<sup>15</sup>

Focusing further on the IMF, the U.S. capacity to speak on all issues in the institution derives from the considerable resources which lie behind U.S. representation. While many countries have one or two officials at the Fund, Washington has at least three dozen U.S. Treasury officials regularly involved in working with, thinking about, and offering advice concerning the IMF, as well as officials within the U.S. Federal Reserve. Such officials make frequent direct contacts with the management, staff, and the Offices of Executive Directors within the Fund, either individually or in groups, also using bilateral relations, the G-7 framework, and

other multilateral forums to garner support for positions within the IMF. This behind-the-scenes work means that when Washington does raise an issue within the Fund's Board it can do so "without triggering counterproductive reactions and a hardening of positions."<sup>16</sup>

In respect of the World Bank, the United States has a similar structure with an Executive Director's office within the Bank supported by the office of international development, debt and environmental policy within the Treasury, with input from USAID and the State Department. The U.S. Department of Commerce also maintains a liaison office at the World Bank to inform and advise U.S. companies on bidding for contracts arising out of World Bank loans. It is supported in this by at least eight other government agencies including: the U.S. Trade and Development Agency; the U.S. Trade Representative; the Departments of State, Homeland Security and Transportation; the Export-Import Bank of the United States; the Overseas Private Investment Corporation; and the Foreign Agricultural Service.

Finally it bears noting that whilst the Executive Boards are supposed to be the political masters of the Fund and Bank, controlling the work and policies of the organizations, in practice, this formal control is very light-handed. Board members face a heavy workload and therefore many issues are barely touched by the Directors. This leaves issues such as the administration and organization of the institutions very much in the hands of the management or senior bureaucrats. This does not, however, mean that political influence is averted.

The staff who prepare everything that comes to the Board are overseen by the head and senior management of each organization. In theory the whole Executive Board decides the head of each organization. In practice, however, the World Bank always gets a president nominated by the United States, a tradition dating back to

early days when it was thought vital if the institution were successfully to float bond issues within the US markets. The IMF always gets a Managing-Director nominated by Western Europe. In recent years, these conventions concerning headships have attracted increasing critical attention. Lower down the chain of command, however, similar conventions also continue in force. The Deputy Managing-Director of the IMF is always an American and most senior appointments in both organizations are made after the U.S. view is ascertained. All that said, this informal power of appointment does not necessarily confer control.

Political appointments in each organization have not always produced obedient servants. Certainly, the overall perspective of any successful candidate is never incongruent with the views of the major appointing shareholders. However, individuals in these jobs can wield influence based on their charisma, ideological legitimacy, administrative competence, expert knowledge, previous association with the organization, negotiating ability, and ability to persist. Their formal powers derive from the fact that the head of each of the IMF and World Bank chairs Executive Board meetings, sets the agenda, directs the discussion, and sums up at the end. They also have the power to appoint and dismiss officers and staff.

Perhaps the most significant constraint and mechanism for overt and covert political influence within each of the IMF and the World Bank concerns resources.

### *Funding the Budget*

The issue of who pays for the IMF and World Bank has long concerned all of its members. In the current context, when it looks as though income earned from lending may decrease, the issue is spotlighted yet more.

Many walking past the large prestigious-looking offices of the IMF and World Bank in the heart of Washington, D.C. wrongly believe that the U.S. government is paying for their air-conditioning, economists, car-parks, and overall running costs. To the contrary however, the overheads and running costs of the institutions are paid for out of income which derives mainly from payments by developing and transition country members who borrow money from the institutions. Each institution earns both income from lending in any year, as well as income from the investment of income earned in previous years.

Unlike the United Nations and other members of the UN system, the Bretton Woods institutions do not depend upon annual subscriptions or levies from member states. As a result, in theory they should be more independent of direct political pressures exerted by those with the power to withhold contributions. However, each institution has some funds which do rely on contributions. In the World Bank these include the IDA, which is the soft-loan facility of the World Bank, and the special Bank trust funds such as that created for debt relief in the 1990s. In the IMF any increase in general resources or quotas require political agreement from members, as do special agreements called the general arrangements to borrow (GAB) and the new arrangements to borrow (NAB).

### *The IMF's Resources*

It is often assumed that there is a simple congruence between funding for the IMF and the largest say in the organization. This is misleading. The largest shareholders in the IMF enjoy the lion's share of the votes but the actual expenses of running the institution are not paid for from contributions by the wealthiest countries, but largely from the charges it levies on borrowers and from investment income.

The largest shareholders are so called because they contribute subscriptions of capital which form the IMF's core assets. Each country contributes according to their 'quota' which roughly reflects the size of their economy relative to others (as discussed above). For this reason, the United States is often described as the largest shareholder. It contributes 17.67% of the capital subscriptions in the IMF. Since 1968 it bears noting that Washington and all other creditors have been remunerated for providing this credit and indeed this is a serious expense for the Fund. Furthermore, the US benefits from the fact that all countries have to provide 25% of their quota in "reserve assets," gold or the US\$, and this makes it easier and cheaper for the United States than for other countries.

The "quota system" directly links money and votes. It determines how much a country contributes to the Fund's core assets as well as that country's voting power and credit limits. The United States contributes 17.67% of capital subscriptions and enjoys 17.33% of votes on the Executive Board. It is this symmetry that leads some to think that the United States contributes most of the IMF's resources. This perception ignores, as detailed above, the fact that the Fund's operational income accrues from its lending to transitional and developing countries, not to mention the fact that creditor countries are remunerated for providing credits.

At least every five years, there is a review of the Fund's quotas, which inevitably results in the U.S. Congress demanding changes in the IMF. How does this come about? Normally, each year member countries pay an automatic subscription to the Fund, which does not require political approval or debate within any member country, including the U.S. Congress. However, an increase in subscriptions does require political approval. Hence, it offers members an opportunity to express their views on the direction and work of the institution.

In practice, the U.S. voice (or better said, voices) in quota increase debates is always the loudest. In part this is because any increase in quota requires an 85% majority, and so Washington enjoys a veto. Normally the U.S. government agency in charge of looking after the IMF is the Treasury Department (with input from other departments and the Federal Reserve). However, a quota increase requires the approval of the U.S. Congress, which, once engaged, leads inevitably toward a much broader debate. For example, over the 1990s the Congress attempted to influence Fund conditionality over issues such as worker rights, the role of the private sector, human rights, and military spending. In 1998 in negotiations over the U.S. share of a 45% increase in Fund quota, the U.S. Congress established an International Financial Institution Advisory Commission (the "Meltzer Commission") to recommend future American policy towards the IMF, as well as the World Bank and other multilateral economic organizations. The resulting report proposed deep changes in each of the IMF and World Bank.

### *The World Bank's Resources*

The IBRD is the main arm of the World Bank Group and lends to developing countries at market-related interest rates. This main body has extraordinary

independence in its financial structure. It does not require regular contributions from members. It does not need to ask the U.S. Congress for “top-ups.” With the backing of paid-in capital subscriptions from member countries, the Bank raises its lending resources on the financial markets. It sells AAA-rated bonds and other debt securities to pension funds, insurance companies, corporations, other banks, and individuals around the world. The Bank’s paid-in capital subscriptions, which are essentially guarantees provided by governments, have never been called upon. Furthermore, they amount to less than 5 percent of the Bank’s funds, a proportion which is diminishing over time.

However, it is important not to underestimate the capital subscriptions which are the core assets of the Bank. The members’ subscriptions are a prerequisite for the Bank’s activities. They permit the Bank to borrow at the lowest market rates available applying the sovereign credit of its rich shareholders—in the form of their capital guarantees. Like a credit club, the Bank disperses the risks of lending, whilst aggregating its capacity to borrow money.

The United States contributes 16.9 percent of the paid-in capital subscriptions. The flipside of this contribution is that the US enjoys 16.52 percent of votes on the Bank’s Board and a veto over all decisions requiring an 85-percent majority. Yet U.S. influence within the Bank extends well beyond the picture these facts depict. This is because of what occurs in another arm of the Bank.

The IDA was created in 1960 to make concessional loans to the poorest developing countries. The IDA’s finances are different to the IBRD. Specifically, it relies upon governments agreeing and providing it with periodic replenishments. As a result, the funding of the IDA opens up political negotiations within and among member governments each time it needs replenishment.

The U.S. contributes 20.86 percent of IDA funds, with the next largest contributors being Japan 18.7 percent, the United Kingdom and France at 7.3 percent. As provider of a fifth of the funds of the agency, the United States doubtless has great influence within the IDA. However, its actual influence reflects more than its level of contribution. Specifically, a U.S. exit or reduction in commitment to the IDA would affect other contributors and therefore have a devastating effect on the agency. This effect was further magnified during negotiations on the fifth replenishment of the Fund when it was agreed then that all other members could reduce their own contributions pro-rata by any shortfall in U.S. contributions. This *pro rata* provision ensured an evenly shared burden across contributors. However, it has also enhanced the impact of any threat by Washington to diminish its contribution. For if the United States does so, all other contributors can follow suit. For these reasons, Washington has long enjoyed a disproportionate degree of influence within the IDA.

However, this influence in IDA replenishment negotiations has been used to leverage influence across the Bank as a whole. Even though the IDA itself accounts for only about 25 percent of IBRD/IDA total lending, there have been several instances in which Washington has used threats to reduce or withhold contributions to the IDA in order to demand changes in policy in the World Bank as a whole. For instance, during the late 1970s, the Bank was forced to promise not to lend to Vietnam in order to prevent the defeat of IDA 6, and in 1993 under pressure from Congress, the United States linked the creation of an Independent Inspection Panel in the World Bank to IDA 10. In effect, the United States has used its grip on the IDA to shake the whole of the Bank, literally the “tail” has been used to wag the dog.

Finally, there is a new way in which the finances of the Bank are introducing political influence. Increasingly it is using co-financing and trust funds arrangements.

By the financial year 1999, disbursements under these arrangements had increased by 17 percent to account for nearly a half of all World Bank disbursements. Both trust funds and other forms of co-financing give a much more direct control over the use of resources to donors whose Trust Fund Administration Agreement with the Bank governs how the funds are used. It bears noting, however, that this does not mean that trust funds have become a conduit of exclusively American influence. Indeed the U.S.'s contribution in 1999 was less than that of the Netherlands and Japan, and for a period it was not a contributor to the HIPC Trust Fund (the Bank's largest) which meant it did not exercise direct influence over that fund. More generally, the growth of trust funds and co-financing arrangements signals the potential for increased bilateral and selectively multilateral control over Bank lending, but not necessarily an enhancement of Washington's influence.

By far the most politically influential work of both the IMF and the World Bank lies in their loans and policy advice to developing countries. It is worth investigating the degree to which the political influence so far discussed translates into control over the decisions of either institution in this regard.

#### *The Beneficiaries and Conditions Governing Grants and Loans*

A final issue of debate concerns what the Bretton Woods institutions should do and at whose behest. In theory the surveillance, advice, lending practices and policies of the IMF and World Bank are a strictly technical affair. The Articles of Agreement of each institution declare that politics should play no role in their lending. Any member country can propose a loan for the Bank or Fund to consider. The staff carefully prepare the proposal in close negotiations with the borrower. A detailed proposal goes to the Board and a successful proposal requires a simple majority of votes. No one

country can veto a loan. Ostensibly all cases are decided on technical and economic grounds. Indeed, the Articles of Agreement of both the Fund and the Bank set out deliberately to curb potential political influence.

The Articles of Agreement of the IBRD state clearly in the first article the apolitical character of the undertaking:

The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I.

Likewise the staff of the Bank and the Fund must owe their duty entirely to the Bank and to no other authority. Members states must refrain from all attempts to influence any of the staff in the discharge of their functions.

Does all this mean that the lending of the IMF and World Bank is not subject to political considerations? In reality, the Executive Boards are influenced by political considerations in making their lending decisions. Furthermore, the staff and management of the institutions in working with members to propose loans do so with an eye to the political possibilities and constraints awaiting them in Washington, D.C. Indeed, studies demonstrate that the lending record of both the fund and the Bank during the Cold War clearly reflect the desire of Western allies to shore up sympathetic regimes and to limit Soviet influence in the Third World.<sup>17</sup>

That said, in order to do their job, Fund and Bank staff rely on good relations forged with sympathetic interlocutors in lending countries. Powerful shareholders may well push and shove on the Executive Board and demand or block speedily

disbursed loans. Over the longer term, however any loan proposal must be negotiated and detailed by the staff and presented to the Board of the Fund or the Bank for approval. In preparing the loan, officials from the Bretton Woods institutions must persuade governments to share data and to enter into detailed negotiations on a wide range of areas. The conditionality which results is not usually the result of overt political pressures. Although a case such as the IMF's agreement with South Korea in 1997 in which U.S. political pressures played a key role in shaping the details of the agreement presents an obvious exception. More usually the content of conditionality agreements is shaped by the staff and management of the Fund or Bank, and in particular by the prevailing economic theories, beliefs and orthodoxies within those institutions. This requires us to examine more deeply the nature of expertise and knowledge within the Bretton Woods institutions.

Several thousand economists sit in offices in the headquarters of the IMF and World Bank, all within a couple of hundred metres from each other. All this collective brain power, applied to a wealth of information about most economies in the world, and state-of-the-art theorizing about economics cannot fail to have a dynamism of its own. For some the so-called Washington consensus on policy reforms forged by the IMF and World Bank throughout the 1980s and 1990s demonstrates the way their technical capacity can be brought to bear on key questions of economic policy. Others argue that this "expertise" is itself based not just on research but equally on political interests and influences.

Subtle forms of political influence are exercised in a number of ways. It has long been the case that countries wishing to influence a project or loan make their views known to senior management and let them percolate down to staff working with a country. In the early days of the IMF, it was said that "the US voice in the

Fund was decisive....The practical question in those years, in any prospective large use of Fund resources, was whether the United States would agree—and the answer was usually obtained by direct inquiry.”<sup>18</sup> Direct inquiries still occur, or at least informal soundings among powerful Board members with direct interests in a particular loan or country. This behind-the-scenes politics within the IMF and World Bank reverberate throughout the institutions. When staff know that their senior managers will be unwilling to take particular kinds of recommendations to the Board, they will naturally not want to waste their time preparing such recommendations. The work of the institutions becomes invisibly bounded by the known preferences of powerful members. That said, the staff and experts of the IMF and World Bank do not do all of their work directly under the gaze of U.S. officials.

The staff of the Bretton Woods institutions often work far away from Washington, D.C. gathering information and negotiating deals with governments in the capital cities of borrowing countries. The nature of their work takes them not just physically but also mentally out of reach of the Executive Board and their most powerful government members. As experts, they can only do their job of collecting confidential data from governments if they succeed in persuading or coercing governments to trust them and give them access. This sometimes even means that senior staff have to promise confidentiality to government officials, keeping secrets either from other staff members or from the Executive Board. The result is that the staff and management gain control over information which the Executive Board does not have. Furthermore, once the staff put a proposal to the Board, it is rarely if ever amended. Rather the Board will simply say “yes” or “no” for any amendment would unpick long and careful negotiations between the staff and government officials in a

borrowing country. In this way, control of the details of loan proposals remains in the hand of the staff and management of the organizations.

## **Conclusion**

As critics have become steadily more powerful, the Bretton Woods institutions have had to confront a widespread perception that they lack legitimacy and effectiveness. Critics certainly differ - from left to right, from globalists to localists, from modernizers to anti-globalizers. That said, from the US Congress-appointed Meltzer Commission to local grassroots organizations, they all tend to share a couple of core premises such as that the Bank and the Fund do not effectively alleviate poverty and that they are poorly governed.<sup>[T2]</sup>

The effectiveness of the institutions in the twenty-first century is limited by two key factors. First, their resources, however large they appear in comparison with those of other UN organizations, look increasingly meagre when compared to burgeoning global capital markets. This strictly limits their capacity to affect or influence those markets through their own lending behavior or actions. Small surprise then that in 2002, the IMF tried to establish a new form of sovereign debt resolution mechanism, and the Bank is making much of its capacities as a knowledge bank rather than a lending bank. Second, both institutions have encountered profound difficulties in trying to implement deeper sets of conditions on their borrowers. In both institutions this has led to a new rhetoric highlighting the need for participation and ownership in borrowing countries. They are still searching for ways to translate this into a workable *modus operandi*.

The legitimacy of the Bretton Woods institutions has been placed under scrutiny by its developed and developing country members alike. At the behest of

their members, both institutions have become more accountable. The Fund and the Bank now each have a more-or-less independent evaluation unit assessing how well their programs are working. There is much greater access to documents about what they do and how they are doing it. The World Bank has an Inspection Panel that can adjudicate claims that Bank staff have acted outside of the Bank's rules and guidelines. The Fund's member countries have yet to consider establishing such an oversight mechanism.

Yet both institutions still face the accusation that they are insufficiently accountable. This is largely because the voices of those they most profoundly affect—poorer countries and poor people within those countries—remain marginal and without influence within the respective decision-making processes. These groups have long argued that they need a greater voice in institutions which so profoundly and asymmetrically affect them. Their call for reform remains unheeded by the powerful industrialized countries that would need to step aside—or at least back a little—in order to make this possible.

**Table 13.1: Voting Power Allocations for the IMF and World Bank** (as at 24 May 2006)

<b>Country</b>	<b>IMF Voting Power</b>	<b>IBRD Voting Power</b>
United States	17.08%	16.39%
Japan	6.13%	7.86%
Germany	5.99%	4.49%
France	4.95%	4.30%
United Kingdom	4.95%	4.30%
Italy	3.25%	2.78%
Saudi Arabia	3.22%	2.78%
China	2.94%	2.78%
Canada	2.94%	2.78%
Russia	2.74%	2.78%
The Netherlands	2.38%	2.21%

## Notes

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<sup>1</sup> Official documentation from the organizations is available on their websites [www.imf.org](http://www.imf.org) and [www.worldbank.org](http://www.worldbank.org).

<sup>2</sup> High Level Panel convened by the UN Secretary-General, *A More Secure World: Our Shared Responsibility*, (UN, 2004) paragraphs 277-278

<sup>3</sup> The material draws from Ngaire Woods, *Encyclopedia of Government and Politics*, 2<sup>nd</sup> ed., (London: Routledge, 2005), Chapter 62.

<sup>4</sup> This early history is recounted in Harold James, *International Monetary Cooperation since Bretton Woods* (Oxford: Oxford University Press 1996); Richard N. Gardner, *In Pursuit of World Order: U.S. Foreign Policy and International Organizations* (New York: Praeger, 1964); and Devesh Kapur, John P. Lewis, and Richard Webb, *The World Bank: Its First Half Century*, 2 vols. (Washington, D.C.: Brookings Institution, 1997); and Edward Mason and Robert Asher, *The World Bank since Bretton Woods* (Washington D.C.: Brookings Institutions, 1973).

<sup>5</sup> James, p.53.

<sup>6</sup> See John Williamson, ed., *Latin America Adjustment: How Much Has Happened?* (Washington, DC: Institute for International Economics, 1990); and John Williamson, "The Washington Consensus Revisited," in *Economic and Social Development into the XXI Century* ed. Louis Emmerij (Baltimore: Johns Hopkins University Press, 1997), 48-61.

<sup>7</sup> See Ngaire Woods, *The Globalizers: The IMF, the World Bank, and their Borrowers* (Ithaca, N.Y.: Cornell University Press, 2006), chapter 5.

<sup>8</sup> See, for example, Anne Krueger, "International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring," speech to the National Economists' Club Annual Members' Dinner at the American Enterprise Institute, Washington, D.C., 26 November 2001.

<sup>9</sup> See Adele Harmer and Joanna Macrae, eds., *Beyond the Continuum: The Changing Role of Aid Policy in Protracted Crises*, Humanitarian Policy Group Report 18 (London: Overseas Development Institute, 2004).

<sup>10</sup> Elizabeth Cousens, "From Missed Opportunities to Overcompensation: Implementing the Dayton Agreement on Bosnia," in *Ending Civil Wars: The Implementation of Peace Agreements*, ed. Stephen John Stedman, Donald Rothchild, and Elizabeth Cousens (Boulder, Colo.: Lynne Rienner, 2002), 531-566.

<sup>11</sup> Independent Evaluation Office, *Evaluation of Prolonged Use of IMF Resources* (Washington, D.C.: IMF/IEO, 2002), and *Fiscal Adjustment in IMF-Supported Programs* (Washington, D.C.: IMF/IEO, 2003).

<sup>12</sup> Ariel Buirra, ed., *Reforming the Governance of the IMF and World Bank* (London: Anthem Press 2005).

<sup>13</sup> Centre for Economic Policy Research, *Independent and Accountable: A New Mandate for the Bank of England*, CEPR Reports (London: Centre for Economic Policy Research, 1993), or more recently Mervyn King, "Reform of the International Monetary Fund," speech given at the Indian Council for Research on International Economic Relations, New Delhi, India, 20 February 2006.

<sup>14</sup> Raymond Mikesell, *The Bretton Woods Debates: A Memoir* (Princeton, NJ : International Finance Section, Department of Economics, Princeton University, 1994).

<sup>15</sup> Timothy Geithner, Under-Secretary of Treasury for International Finance, “Statement to U.S. House of Representatives,” 21 April 1998, [www.house.gov/htbin/fe\\_srchget/comms/ba00/42198tre.htm](http://www.house.gov/htbin/fe_srchget/comms/ba00/42198tre.htm).

<sup>16</sup> Ibid.

<sup>17</sup> Strom Thacker, “The High Politics of IMF Lending,” *World Politics* 52, no. 1 (1999): 38-75.

<sup>18</sup> Frank A Southard, *The Evolution of the International Monetary Fund*, Essays in International Finance, no. 135 (Princeton: International Finance Section, Department of Economics, Princeton University, 1979), 19–20.

[T1]Which other countries or players were present? Of consequence?

[T2]A couple of sentences referring back to the harshest critics would be helpful here at the outset of the conclusion.