

Australian G-20 Secretariat Background Note
Prepared for the
Meeting of the Group of Twenty Finance Ministers and Central Bank Governors
Melbourne, 18-19 November 2006
Reform of the Bretton Woods Institutions

Introduction

Reform of the Bretton Woods Institutions (BWIs) has been an enduring issue for the G-20 since its inception. Last year's *G-20 Statement on Reforming the Bretton Woods Institutions* underlined the importance of improving the governance, management and operational strategies of the IMF and World Bank, and aimed at providing support to BWI reform.

This focus reflects the importance the G-20 attaches to the IMF's role in maintaining international financial stability, promoting sound macroeconomic policies and assisting with balance of payments adjustment, and to the World Bank's role in poverty reduction. Improved representation and voice enable the BWIs to act with greater legitimacy, authority and therefore effectiveness in carrying out these key roles. Effectiveness is also enhanced by ensuring that key policies and instruments reflect members' changing needs.

Building on earlier work, G-20 members, individually and collectively, made an important contribution during 2006 to the historic outcome on quota and voice reform agreed by IMF Governors at the Singapore Annual Meetings in September.

This meeting of G-20 Ministers and Governors provides a key opportunity to maintain and build momentum to successfully complete the second stage of quota and voice reforms in a comprehensive and timely manner. It allows the G-20 to consider how it can contribute to the shaping of IMF and World Bank strategic directions—their policies and instruments and division of responsibilities — and to necessary reforms to World Bank governance.

IMF quota and governance reform

The IMF Governors' resolution adopted on 18 September 2006 provides a solid basis for comprehensive IMF quota and voice reform. The first stage of reform gave an increase in quota to the four most clearly under-represented countries. While this stage is important, completion of the second stage of reform—including a new quota formula, a further series of quota increases for under-represented countries, and enhancements to the voice of low-income countries—is critical to protect and enhance the legitimacy and effectiveness of the IMF.

An important element of the IMF resolution is that it sets clear deadlines for decisions to be made on the second stage of reforms. IMF Governors have agreed to determine second-stage reforms by the 2007 Annual Meetings and no later than the 2008 Annual Meetings (with Executive Board agreement on a new quota formula requested by no later than the Spring 2008 IMFC meeting).

Central to the second stage of reform is the new quota formula and ultimately a further, more comprehensive, set of ad hoc quota increases. IMF Governors consider that the new quota formula should provide a simpler and more transparent means of

capturing IMF members' relative positions in the world economy. They believe that, as a means of achieving this objective, consideration should be given to placing significantly higher weight on GDP, together with ensuring that other variables, in particular the openness of members' economies, also play an important part.

It would be useful to approach these issues by first considering the purposes IMF quotas should fulfil in the modern globalised economy and how these purposes relate to economic weight. (Currently, quotas determine—to varying degrees—voting power, contributions, and access to Fund resources.) A related issue is whether the objective of simplicity argues for a relatively 'pure' quota formula in terms of measuring economic weight. This would suggest that objectives such as constraining or protecting aggregate voting shares of particular groups of countries should be met through adjustments to the quotas produced by the formula rather than through the formula itself.

The above considerations could then inform discussion of the variables to be included in the new quota formula and the weight to be attached to each variable.

There will also be potential for the G-20 to contribute to IMF discussion on the size and distribution of the further increases of quotas, aimed at achieving a significant further alignment of quotas with relative economic positions, that will follow agreement on the new quota formula. The implications for aggregate voting shares of various groups of IMF member countries will also need to be considered.

Linked to these further increases in quotas is agreement on at least a doubling of basic votes and subsequent protection of the share of basic votes in total voting power. The G-20 could usefully explore what might be needed to achieve greater convergence of positions on the quantum of increase in basic votes.

In its October 2005 statement, the G-20 expressed the view that selection of Fund and Bank senior management should be based on merit and ensure broad representation of all member countries. The IMF Executive Board is considering whether further steps are needed to ensure a fully transparent process for selecting the IMF Managing Director. It would be appropriate for the G-20 to monitor this work and to seek to extend it to the position of World Bank President and other senior management positions in the Fund and Bank.

Similarly, there is potential for the G-20 to monitor issues concerning the role and effectiveness of the IMF and World Bank Executive Boards, given the Managing Director's challenge to the IMF Board to strike a better balance between broad oversight and involvement in details, and possible consideration of this issue as part of Bank governance reform.

Reform of IMF and World Bank key policies and instruments

While the G-20 has a continuing role in progressing governance reform, the group may also wish to devote more time to helping shape BWI responsibilities, policies and instruments—as it has in the past. Drawing on the current issues facing the institutions and the G-20's comparative advantage, two issues which would seem to be high priorities are strengthening the Fund's surveillance framework and issues surrounding a potential new liquidity instrument for emerging market economies.

Surveillance is at the heart of the Fund's role in the international monetary system. The Fund is undertaking a range of initiatives with the goal of increasing the effectiveness of this work. These include: a greater focus on financial and capital market issues; the new multilateral consultation approach; reviewing the 1977 Decision on Surveillance over Exchange Rate Policies; further consideration of a more formal remit for surveillance; and streamlining bilateral surveillance processes and raising the profile and influence of Article IV reports. Achieving progress on some of these issues will require consideration and clarification of the objectives of surveillance, the Fund's role as a 'confidential policy adviser', issues of accountability and independence, and how to ensure even-handedness in the Fund's approach.

The objective of a new liquidity instrument would be to reduce the likelihood of crisis in eligible countries and, if they do face a crisis, provide substantial resources in a timely way to reduce the extent of the crisis. Design issues include how to reconcile the need for quick access to resolve a crisis, conditionality that is relevant to the circumstances when a crisis occurs, and how the instrument might work to prevent a crisis.

The External Review Committee on Bank-Fund Collaboration was established by the IMF Managing Director and World Bank President in March 2006. Its Chairman, Mr Pedro Malan, will discuss the work of the Committee with Ministers and Governors in this session. The Committee's report is expected to be finalised by the end of 2006 and to be considered by the IMFC in April 2007.

The World Bank President has set a number of key priorities for the Bank, including strengthening its performance in relation to: poverty reduction in Africa; governance and anti-corruption; middle-income countries; and global public goods. If time does not permit appropriate discussion of World Bank policies and instruments at this meeting, these important issues could be taken up in more detail in the next year.

World Bank governance reform

While attention to date has focused on quota reform at the IMF, it is clear that appropriate governance arrangements at the World Bank are essential for its credibility and effectiveness.

On 18 September 2006, the Development Committee asked the Bank to work with its shareholders to consider enhancement in voice and participation in the governance of the Bank, acknowledging the measures already taken by the Bank to enhance capacity in Executive Directors' offices and capitals of developing and transition countries. The World Bank President has also pressed the importance of these issues.

While the G-20 is well-placed to contribute to the emerging debate on Bank governance reform, a question remains as to how this is taken forward. One option is to begin G-20 discussion only after the Bank itself has identified a list of priority issues in response to the Development Committee's request.

*Australian Treasury and Reserve Bank of Australia
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