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Thinking the *Unthinkable*

Combining the IMF and World Bank ?

BY FRITZ FISCHER

Changes in the two Bretton Woods institutions since their inception sixty years ago have led to various calls for reforms meant to reconfirm the basic mandates of the International Monetary Fund and the World Bank and to eliminate duplication of effort. But during the recent anniversary celebrations, the idea of merging the two organizations—suggested occasionally in the past[1]—was not mentioned. Yet upon closer reflection, a number of arguments can be made in favor of a reorganization that is less than a full-fledged merger and instead combines the two administrations and Boards under one roof.

Serious reform discussions should focus on governance issues, particularly the composition of the decision-making bodies. The present sixty-year-old system is outdated, giving too much representation to the industrialized country donors and not enough to the developing country recipients. Remedying these shortcomings could well increase the support for reform from the under-represented shareholders. The general climate for a proactive long-term reform approach should be favorable, as there is presently no sign of an immediate or looming financial crisis according to U.S. Treasury Undersecretary for International Affairs John Taylor.[2]

Fritz Fischer was German Executive Director for the World Bank Group (1991–1996) and also served as Executive Secretary of the Joint Bank/Fund Development Committee (1984–1987).

MICHELE IANNACCI

The **World Bank** *(left) and the* **International Monetary Fund** *are neighbors now. Would a closer relationship offer better results?*

IMF

SEA CHANGE SINCE THE POSTWAR ERA

The laudable intentions of the founders at the 1944 Bretton Woods conference were directed toward avoiding the tremendous shortcomings in the international system in the post-World War I period when the lack of effective multilateral mechanisms allowed governments to practice beggar-thy-neighbor policies, resulting in declining world trade hurting employment and living standards in many countries.

As World War II drew to a close, the United States led an effort to effectively organize the peace process. On the political side, the United Nations in New York was created. For monetary and economic issues, the Bretton Woods institutions were founded. The International Bank for Reconstruction and Development (more commonly known as the World Bank) was to assist in the rebuilding of war-torn Europe and Asia. The International Monetary Fund was meant to oversee the world's monetary system, promote stable exchange rates, provide balance-of-payments support, and assist in eliminating trade restrictions in goods and services which were still very much regulated in the immediate post-war period. At the time, the World Bank was considered more important and hence its president was supposed to always be a U.S. national, while—reflecting the dominance of Western Europe—the managing director of the IMF was traditionally a European.[3] Given their complementarity, the two new institutions were headquartered next to each other in Washington, D.C.

The forty-four founding countries—only three from the African continent—were represented on the decision-making boards by twelve executive directors. The independence of former colonial territories and the collapse of the Soviet Union have since raised membership in the IMF and World Bank to 184 states. The boards now have twice as many members. Yet one-third of the twenty-four executive directors (of both IMF and World Bank) still come from Western Europe, while the forty-seven sub-Saharan African countries share two seats and thus have limited influence in shaping the various assistance programs affecting the lives of their citizens. The emerging countries in Asia and Latin America are also under-represented.

The involvement of the World Bank in the reconstruction of Western Europe and Japan was of short duration, given their fast recovery and the boost by the Marshall Plan in Europe. At the same time, trade was increasingly liberalized and monetary controls lifted. As a result, the World Bank directed its attention toward developing and, since 1990, transition countries. The Fund for a while still loaned extensively to industrialized countries (nearly 50 percent in 1977[4]), but for the past twenty years has lent exclusively to the same countries the World Bank serves.

At the same time, the importance of the Bretton Woods institutions and their resources has been affected by dramat-

ic changes in the international environment. As a result of increasing economic globalization, international trade has doubled since 1970 and the stock of global financial assets has quintupled.[5] In short, the world has witnessed a sea change, and both the Bank and the Fund—often actively encouraged by major member countries—have engaged in constant reforms to adapt to the new circumstances and to maintain their relevance as leading institutions. Certain overlaps have been unavoidable as their activities have become more interwoven.

EXISTING COMMONALITIES BETWEEN THE BANK AND THE FUND

Against this background, combining the administrations of the IMF and World Bank would not appear too revolutionary. The two institutions are neighbors with the same working language, in contrast to corporate mergers that often span continents. Because of geographic vicinity they hold joint annual meetings prepared by a joint conference secretariat, and select a joint chairman. Nonetheless—and this appears as an illustrative example of unnecessary duplication—each institution publishes a separate "Summary Proceedings." In the Bank's edition the opening speech and the concluding remarks of the Fund's managing director are left out, whereas the Fund includes the speeches of the Bank president. It also should be noted that the two Annual Reports—the most authoritative documents—operate on two different time frames: The Bank's fiscal years spans July 1 to June 30, the Fund's May 1 to April 30.

Given the paramount importance of the Bretton Woods institutions, their high-level missions and the attention they deserve (and expect) totally occupy the political life in the country for the time of such visits.

The joint nature of the annual meetings also shapes the preparatory gatherings of the unofficial "trade unions," i.e., the G7, G10 (both representing industrialized countries), and the G24 (representing developing countries). The Joint Bank/Fund Development Committee of Governors has been a common body for more than thirty years. A joint library serves the two institutions, as does the health service and the credit union.

Moreover, the roster of member states is identical and so are more or less all the constituencies in the two boards. The admission of new members follows a tandem procedure. Once the IMF board has agreed and determined the quota share, membership in the Bank follows automatically. The procedures to assess the salaries of top management and the executive directors are also identical. In recent times, the heads of both institutions have on occasion addressed their member countries and the public together and conducted some joint trips. There are even some common instruments, like the Highly Indebted Poor Country (HIPC) initiative and Poverty Reduction Strategy Papers.

Last, it is worth noting that two founding members, France and United Kingdom, have always had one single executive director for both institutions. This not only gives the French and UK directors a valuable edge, but demonstrates clearly that it is well possible to serve on both boards and deal with two institutional cultures that are very different from each other.

OVERLAPS AND DUPLICATION

As both the Fund and the Bank now assist the same clients, certain duplications and overlaps cannot be totally avoided. In the present structure, both institutions have separate country departments, statistical and other data collections, commodity and trade experts, training centers, etc. Many Fund and Bank publications cover similar subjects. The IMF has its *World Economic Outlook,* and the Bank produces *World Economic Indicators*. In both institutions, two different boards with twenty-four executive directors on each side deal with the same borrowing countries.

While such duplication mainly challenges the coordination abilities of donor countries, the implications are more serious for the client countries as far as their often limited absorptive capacity is concerned. Both institutions now have resident representatives in most of the client countries. While the Fund's offices are very small, the Bank in recent years has systematically increased its operational presence in the field so that 30 percent of its staff is now based in country offices. Nonetheless, the number of missions is still

large, and high-level missions often come at times of crisis. This puts a great strain on the client countries, especially on the smaller ones,[6] since poor countries with weak administrative infrastructures also must accommodate visits from bilateral donors, regional development banks, UN organizations, and non-governmental organizations. Given the paramount importance of the Bretton Woods institutions, their high-level missions and the attention they deserve (and expect) totally occupy the political life in the country for the time of such visits. If the Fund and the Bank do not send joint missions, these countries often must go through this exercise twice within a short period of time. Moreover, client countries are forced to deal with different procedures, institutional cultures, and advice that is not always consistent.

On the level of governors, there is also a certain duplication, especially during the spring and annual meetings. Governors normally confer with senior management from both institutions and many also serve on two ministerial committees that meet twice a year. Thus, the International Monetary and Financial Committee (formerly the Interim Committee) of the IMF provides guidance to the Board of Executive Directors. Subsequently, the Joint Bank/Fund Development Committee meets. While the IMFC has its own IMF-related agenda, there is often an overlap of agenda items with the Development Committee in areas such as poverty, debt, trade, etc.

Originally, IMF assistance from its rotating fund was supposed to be short-term in nature. But it became evident that many developing and transition countries were witnessing external payments difficulties arising from structural problems, which by definition are longer term. In order to assist these countries effectively, the Fund over time developed an Extended Fund Facility which became more important in the 1990s. In addition, a Structural Adjustment Facility was created which in 1987 was incorporated into the Enhanced Structural Adjustment Facility. In 1999, this instrument was renamed the Poverty Reduction and Growth Facility (PRGF) and it provides "concessional loans" (as described by the Fund's Annual Report).

Although the volume of these operations (with a total of some US$3.7 billion in fiscal 2003) is only a fraction of the Fund's traditional stand-by lending operations (US$40.6 billion in fiscal 2003, of which some US$31. 5 billion was for Brazil alone), the IMF has at least partially moved into the mid- and longer-term development business which is traditionally the domain of the World Bank. The Bundesbank describes the changes: "For a small number of countries the IMF has actually become a quasi-permanent source of funds as they successively drew on the Fund's resources over lengthy periods."[7]

Often major shareholders exerted pressure on the Bank and the Fund to shoulder new tasks. Such requests, however, do not keep these governments from criticizing the institutions for not sticking to their original mandate.

Conversely, the structural circumstances in borrowing countries also induced the World Bank to extend the instruments for their operations. This applies in particular to the use of adjustment loans on a large scale in the 1990s. Adjustment loans (recently replaced by Development Policy Lending) were not earmarked for specific projects and were often hard to distinguish from the balance-of-payments assistance which the Fund provides. According to the Bundesbank, such adjustment loans in 1999 amounted to over 50 percent of total loans and to 63 percent for the IBRD alone (without IDA).

In all fairness, one must recognize that the constant adaptation of instruments is not always initiated by the institutions alone. Often major shareholders exert pressure on the Bank and the Fund to shoulder new tasks, and at times this appeared an easy path for policymakers since no additional taxpayer money was necessary from the shareholder country.[8] Such requests, however, do not keep these governments from criticizing the institutions for not sticking to their original mandate.

Lastly, it should be noted that the client countries themselves naturally welcomed any additional assistance. This then fueled generalizing media headlines such as: "The twins are too alike. It no longer makes

sense for the IMF and the World Bank to be separate entities."[9] Former U.S. Secretary of State George P. Shultz captured his criticism as follows: "The activities of the two organizations are becoming increasingly duplicative even though basically uncoordinated."[10] A respected voice from Asia, policymaker Toyoo Gyohten, deplores the "blurring of the demarcation lines," urges putting "a lid on the expansion," and hopes "to stop the turf war between them."[11]

The two institutions have been mindful of such criticism and have redoubled their coordination efforts. The Fund's recent Annual Reports devoted specific sections to "Strengthening IMF-World Bank Collaboration" (FY03) and "Review of Bank-Fund Collaboration in Program Design and Conditionality" (FY04). For FY03 it was stated: "A number of factors were impeding fully effective cooperation, such as differences in working structures, time frames for achieving goals, and lending arrangements and instruments." The last report notes that "there is scope for improvement" and "no room for complacency." It concludes: "Directors stressed that progress on Bank-Fund collaboration will remain a challenge, requiring steady implementation and sustained commitment, in particular by the country teams of each institution."

Against this background, the prospects of combining the two administrations and their boards merit serious consideration. There are numerous examples that such an approach can work well, although in the case of Bank and Fund one has to carefully weigh the pros and cons of such a large "multi-purpose agency"[12] before instituting far-reaching administrative reforms.

EXPERIENCES WITH COMBINED ORGANIZATIONS

The first case of a multifunctional organization worth mentioning is the Bank—which correctly refers to the World Bank Group. It started as the IBRD with financial resources largely borrowed from the capital markets and lent out on near-market terms. In 1960, the International Development Agency (IDA) was launched with resources from the budgets of various donors (replenished every three years), allowing interest-free loans of long duration to poorer countries. In its daily practice, the Bank handles these operations with the same staff. In 1956, the International Finance Corporation (IFC), the Bank's private investment arm, was created. The Multilateral Investment Guarantee Agency (MIGA) was added in 1988. While the two latter institutions have their own staffs, the World Bank President is *ex officio* their chairman.

A further example of three separate organizations of the same "family" is the European Community for Coal and Steel (founded in 1952), the European Atomic Energy Community (EURATOM), and the European Economic Community (both created in 1958). They were administered jointly for a decade before the different treaties were fused to create the European Community. Its finance agency, the European Investment Bank in Luxembourg—now the largest financial institution in the world—started as the "house bank" for its six founding members for infrastructure projects. It quickly extended its operations to developing countries in Africa, the Caribbean, and the Pacific (now seventy-seven countries) as well as other continents and Eastern Europe. All these activities are administered under one roof. Similarly, the German Kreditanstalt für Wiederaufbau (KfW) was originally founded to reinvest the reflows from the Marshall Fund into Germany's small- and medium-size industry. Later it was entrusted as the executing agency for the country's financial assistance to developing and transition countries. Recently, the KfW incorporated the DEG, the German IFC-type private investment agency. All these activities—very different in nature—are administered together.

OPTIONS FOR A BANK/FUND MERGER

Past calls for a merger have been made without specifying the necessary details, but the basic approach was a complete fusion of the Bretton Woods institutions under a new Articles of Agreement. These articles would formulate clear mandates for the future and would take into account the dramatic changes in the

> *Even such modest reform would require tremendous determination and careful diplomacy, given the strong vested interests, bureaucratic inertia, and different institutional cultures.*

economic and financial environment in the past sixty years. This would be an optimal solution. But carrying it through would constitute a Herculean task of unprecedented dimensions, and there is presently no "champion of change" or political momentum, and no chance for a statutory majority.

Such a full-fledged merger would also run the risk of largely paralyzing the Bank and Fund during the transition period. The outside world with its ongoing monetary and development problems could ill afford this. Therefore, it appears less contentious and disruptive to consider the possible benefits of a joint administration and one board of directors. But even such modest reform would require tremendous determination and careful diplomacy, given the strong vested interests, bureaucratic inertia, and different institutional cultures. On the other hand, one might well assume that the "founding fathers" of the Bretton Woods institutions—in assessing the tremendous changes in the international environment—might not have conceived of two separate institutions had they known that they would now *de facto* provide financial resources only to developing and transition countries.

CHANGE AND DOWNSIZING OF THE BOARD OF DIRECTORS

To increase the acceptance for such reforms on the part of the borrowing countries, simultaneous changes in the composition of the Board of Directors are essential, albeit very difficult. There is no question that the present composition no longer fits into the landscape of the 21st century. The G24 in their communiqué of October 1, 2004, expressed "strong disappointment" that after several years of dealing with this issue within the Development Committee, no progress has been made. The two institutions have printed many pamphlets on the need for "good governance" in client countries. But good governance begins at home. Leo Van Houtven, a former secretary of the Fund, has recently made interesting proposals to that effect.[13] In essence, they consist of having one chair each for the United States and—in parity—for the European Union. This approach (when realized against the strong resistance of several if not most European countries) would free a number of seats that could in part be given to African and emerging countries. At the same time, one should aim at a much smaller board of about fourteen members while substantially increasing the expert staff of the executive directors to improve their control functions. Experience clearly shows that the present board size of twenty-four frequently changing members is not conducive to creating the necessary "collective family spirit" and avoiding repetitive discussions.

According to Van Houtven, strengthening the board also means that its members should be senior, highly qualified officials, which is not always the case. One would add that directors should be appointed for a much longer duration than the current two years. It takes time to understand the inner workings and the culture of the organization. Too short a tenure substantially weakens the board's political oversight functions. In contrast, the staff of the Bretton Woods institutions is much more permanent and thus has an edge over a "rotating" board.

Such a substantial reform of the Board's quality and size would not only make the Board stronger but would also enhance the equity between borrowers and donors. As Van Houtven puts it: "It would create a compact and powerful decision-making instrument in which developing countries would hold a majority of the chairs while the industrial countries would retain a voting power majority, albeit reduced." This might counteract the possible fear by developing countries of being exposed to a new superstructure with a joint staff.

BASIC STRUCTURE FOR A COMBINED BANK/FUND ORGANIZATION

The approach of combining the Bank and Fund boards and administrations while maintaining their statutory independence would not touch on their basic mandates and would largely keep their present instruments intact. This includes the regulatory functions of the Fund as well as its important surveillance mechanisms (which encompass industrialized countries as well). With such a design, it would be easier to avoid overlaps and duplication and—most importantly—provide consistent advice. It would guarantee that the different instruments of the two institutions were much better attuned to both recipients and donors.

Of course, this approach would necessitate careful consideration about the appropriate "command structure" of such a combined body. Would the managing director of the IMF and the president of the World Bank maintain their positions and preside over the common board separately, depending on the agenda? Or would it not be more logical to introduce a new super-position? In this case, one might be inspired by the set-up of the IFC. It has its own building and a staff of 2,254. Its executive vice president—working under the president—is in charge of running the IFC and presents its operations to the Board.

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A structure with one head at the top would put an end to the present and much contested "tradition"—which many consider outdated—that the president of the World Bank is always a U.S. citizen while the managing director of the Fund must be a European. To find an appropriate name for the new structure also requires creativity and tact. But perhaps a working title might be "World Bank and Fund."

RATIONALIZATION EFFECTS AND OTHER ADVANTAGES

At first glance one would assume that a combined administration with one board would have great cost savings, which might be difficult to quantify at this stage. Burnham estimates that it would reduce the personnel and other costs in the administrative budget by at least 25 percent, and he points out that the costs for the administrative budget of the two institutions (which amounted close to US$3 billion in FY04) are "generally passed on to borrowers through the rates and fees charged on loans." Other potentials for savings appear more obvious: As both institutions have at present about one hundred country offices each, savings in this area as well as on missions would be substantial. The same applies to the elimination of twenty-four board members.

On the other hand, mergers of big enterprises have not always produced the expected synergy effects.[14] Such a new "World Bank and Fund" administration would—at the time of its creation—have a combined staff of over 15,000 (with about 10,000 for the World Bank and nearly 2,700 for the IMF, the rest are IFC and MIGA) which constitutes a great managerial challenge. Major institutional differences must be considered as well. The Fund has a very hierarchical, streamlined structure and—according to its "fire brigade" mandate—needs to act quickly. In contrast, the Bank is a large development institution with a longer time horizon and its "institutional culture" is very different from that of the Fund.

All in all, combining the Bank and the Fund deserves careful consideration, but the possible advantages of a joint administration might well outweigh the risks. The creation of a task force to look into such reforms appears warranted.

CHAMPIONS OF CHANGE

This then begs the question how to find the best "launching pad" for such reforms. The Group of Twenty might be such a suitable body. Founded in 1999, it comprises key industrial and emerging market countries and would be a good convener to start the process, which should also involve poorer developing countries. Within this grouping, the United States and the European Union as the two largest shareholders of the institutions could be the active "champions of change." Most of the Bretton Woods founding fathers belonged to their countries. They thus have sufficient good will and experience to initiate far-reaching reforms. Within the European Union, the United Kingdom—which has been particularly vocal in recent years in calling for substantial reforms—could play a similarly constructive role as it did in the Bretton Woods conference sixty years ago.

As mentioned at the outset, the waters are presently calm, creating a certain "window of opportunity" to launch a broad-based reform project. Combining the two administrations and having one single board for the IMF and the World Bank Group should be an option worth considering. ◆

NOTES

1. See especially James B. Burnham, "The IMF and World Bank: Time to Merge," *The Washington Quarterly,* Vol. 22.2, Spring 1999; George P. Shultz, "Merge the IMF and World Bank," *The International Economy*, Vol. 12.1, January/February 1998; and Lindley H. Clark Jr., "Let's Merge the World Bank and the IMF," *Wall Street Journal,* Jan. 4, 1990.
2. U.S. Treasury Undersecretary John Taylor during testimony before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, as quoted in IMF's Morning Press of May 20, 2004.
3. See James M. Boughton, "IMF at 60," *Finance & Development* (International Monetary Fund), September 2004.
4. Burnham, op. cit., page 103.
5. *Finance & Development,* September 2004, page 16.
6. Burnham, op. cit., page 6.
7. Bundesbank, *Monthly Report,* September 2000, page 21.
8. Shultz, op. cit.
9. *The Banker,* April 2000, page 10.
10 Shultz, op. cit.
11. Toyoo Gyohten, as quoted in *Emerging Markets,* World Bank/IMF Annual Meetings, October 2, 2004.
12. See preface of the Meltzer Report (2000), which by using this term dismisses a merger.
13. See Leo Van Houtven's "Rethinking IMF Governance," *Finance & Development,* September 2004; see also his paper: "Governance of the IMF," IMF Pamphlet Series, No. 53, August 2002.
14. See Bundesbank, op. cit., which speaks out against a merger.