World Bank Reform: Proposals for the Next G-20 Summit

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Editor's Note: *This note was prepared for the high-level seminar, [International Financial Governance: Toward the London G-20 Summit], on February 9, 2009 in London. The purpose of the event was to exchange views with U.S., Canadian and U.K.-based experts and senior U.K. officials who are preparing for the April 2, 2009 G-20 Summit (officially referred to as "The London Summit 2009"). Johannes Linn worked at the World Bank from 1973 to 2003; in his last two positions he served as Vice President for Financial Policy and Resource Mobilization and as Vice President for Europe and Central Asia. He gratefully acknowledges helpful comments by Nancy Birdsall, Colin Bradford, Shigeo Katsu, Homi Kharas, Rachel Turner and James Wolfensohn and by the participants in the London meeting.*

Introduction

At this time of global crisis, the main priority is to act fast in reversing the tide of world-wide recession and its impact on those who can least protect themselves, including and especially the poorest in the developing world. The focus of the G-20 Summit on April 2, 2009 therefore should principally be on how to coordinate and commit to actions that will help achieve this goal. The crisis may also unlock opportunities for long-stalled reforms of global governance and global institutions and measures need to be put in place to prevent a recurrence of the crisis in the future. In these areas, the G-20 summit should aim to reach agreement on principles, to take a few steps that clearly signal commitment to a change in direction, and to initiate a time-bound process for longer-term change. As the communiqué of the just completed meeting of the G-7 finance ministers in Rome confirmed, the multilateral development banks, and especially the World Bank[1], have a critical role to play in supporting an effective response to the crisis in the developing world. It is therefore essential that the G-20 summit in April strengthens the capacity of the World Bank to play this role.[2]

Background

In contrast to IMF reform, the reform of the World Bank has not been an issue of debate nor been given much attention over the last few years. Since a major reorganization under President James D. Wolfensohn in 1997, the institution gradually adapted to changing conditions in developing countries, to changes in the global aid architecture and to changing perceptions of global economic, social and environmental challenges; but no fundamental reassessment of its role, its instruments, its organization or its governance has been carried out inside or outside the Bank.[3] The current crisis requires some immediate actions to assure that the World Bank plays

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[1] Throughout this note reference to "World Bank" includes all members of the World Bank Group as appropriate.
[2] Strictly speaking the April 2009 summit is called "The London Summit 2009." However, the participants will mostly be drawn from the membership of the G-20 finance ministers. See *International Financial Governance: Toward the London G-20 Summit*.
[3] Among the few exceptions are Nancy Birdsall, ed., *Rescuing the World Bank*, Washington, D.C.: Center for Global Development 2006, and Ngaire Woods, *The Globalizers*, New York: Cornell University Press, 2006. In the fall of 2008 President Zoellick appointed an external high-level commission led by former Mexican President Ernesto Zedillo to advise on World Bank Group governance reform.

an effective role in supporting other global actions, but it also offers an opportunity—and risks—in moving toward more fundamental reform.

This note presents a few key recommendations for World Bank reform as an input into the preparation of the G-20 summit agenda. The first two recommendations relate to actions that should and could be taken immediately; the next four recommendations require longer lead time of preparation, but the decision to set in motion the preparatory process should also be taken at the summit. A final recommendation relates to the broader management of the G-20 summit process in which the World Bank could also play a supportive role.

Immediate Actions

Recommendation 1: Immediate reform of leadership selection in the World Bank (as in the IMF) is critical.

An open, competitive and merit-based process for the President of the World Bank can and should be immediately agreed upon—with a commitment by all to honor this agreement also in its implementation. This should be done in parallel with a similar decision for the IMF. This change is a signal of greater inclusiveness and legitimacy and hence an obvious counterpart to the creation of the G-20 summit.[4]

Recommendation 2: The World Bank should play a principal role in providing quick-response funding for developing countries, and especially to the poorer countries, during the current crisis.[5]

- The Bank is well placed to offer crisis-response financial support to help maintain public investment and social programs, because of its long-standing practice of providing budget support, its track record with funding social safety nets, its traditional role in infrastructure finance, its capacity to support bank recapitalization and trade finance and its growing role in global public goods provision.
- These are all areas where efficient maintenance of developing country spending will be essential for short-term macroeconomic crisis management, for maintaining trade flows and preventing the collapse of banking systems, for mitigation of major social costs and for prevention of long-term developmental losses from the current crisis.
- The Bank should declare a "development emergency" and permit temporary changes in its operational rules to assure quick commitment and disbursement of funds[6], including:

[4] According to paragraph 25 of the Communiqué of October 2008 Development Committee, "[t]here is considerable agreement on the importance of a selection process for the President of the Bank that is merit-based and transparent, with nominations open to all Board members and transparent Board consideration of all candidates." While this is a step in the right direction, it does not represent a binding decision by the Board to proceed along these lines.

[5] So far, there is apparently limited demand from poorer developing countries for emergency assistance in response to the crisis. Aside from the fact that at the country-level, concessional resources have been constrained by existing allocations and operational rules, this can be explained by the delay in the real economy impacts relative to the financial impacts of the crisis and the fact that poorer countries are more severely impacted by the former than the latter. In 2009 undoubtedly the real economy impact will hit the poor countries with full force through multiple channels. The World Bank management should be requested immediately to carry out estimates of macroeconomic and social impacts of the crisis on development countries and their potential funding needs.

relaxing rules on counterpart funding; relaxing the rule restricting lending for budget support (especially for countries with good performance ratings); and opening up the possibility of using IBRD lending to poor countries (subject to the application of a strict debt sustainability framework) with an commitment from the World Bank's International Development Association (IDA) and/or bilateral donors of buying down the high interest rates when grace periods expire.

- In addition, under the "development emergency" the Bank's fiduciary and safeguards procedures should be put under emergency rules, as has been done in post-conflict situations, where fast-track project preparation and disbursement procedures have been successfully implemented without loss of ex-post quality of project implementation (as for example, in the case of the Bosnia-Herzegovina reconstruction program). Ex post monitoring should be applied to ensure that incentives for effective preparation remain in place.
- In order to avoid that the front-loading of commitments and disbursements will undermine IDA's capacity to assist poor countries, donors should agree to an early review of IDA's resources and a fast-track supplemental IDA replenishment if needed.
- For the International Bank for Reconstruction and Development (IBRD), the existing capital base allows an estimated additional lending of about $100 billion. However, special care will need to be taken to ensure that the rapid ramping up of lending does not undermine the financial viability of the Bank. A capital increase may eventually be necessary if the calls on IBRD-support exceed the Bank's prudent lending capacity. [7]

Longer Term Actions

Recommendation 3: The World Bank should in the future play a principal role in aid delivery, in aid coordination at the country level, in financial support for the provision of key global public goods and in providing the knowledge base for development.

The Bank has played such a role in the past and remains uniquely suited to play this role in a number of ways: it has a strong track record of quality delivery of aid programs and demonstrated capacity for aid coordination at the country level; it can effectively link global public goods provision to sensible country strategies in developing countries; it has the capacity to develop and support global public goods strategies at a global level; and it has a strong capacity for development research and policy analysis.

Recommendation 4: The decline in the financing role of IDA and IBRD needs to be reversed through appropriate changes in mandate, operational policies and funding of the World Bank.

There has been a long-term decline of the multilateral share in official development assistance, and of the World Bank (especially IDA) in multilateral aid, as part of the drastic increase in the fragmentation of the international aid architecture. For the Bank to exercise the principal role, as

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[6] Currently an estimated $60 billion are locked up in undisbursed funds in projects already approved by the boards of the multilateral development banks. See Homi Kharas's "The Financial Crisis, a Development Emergency, and the Need for Aid" for more detail.

[7] The possibility of pushing the capital base of IBRD beyond the usual limits ("sweating the balance sheet") was discussed at the London meeting. It would a bitter irony if the currently strong financial standing of IBRD were to be put at risk at a time when governments struggle to create stronger banks at home after having seen the disasters brought on by excessive risk taking in undercapitalized banking institutions.

envisaged in the third recommendation, some important changes in the mandate, operational policies and funding of the Bank are required:

- Mandate: The World Bank needs to stay engaged in middle income countries—along the lines of the European Investment Bank (EIB) in Europe; it needs to be given a greater and clearer role for promoting global goods on a global basis, including in advanced economies; and it should be given a clear mandate to take a lead role in helping to ensure effective aid coordination under the Paris Declaration.[8]
- Operational policies: The Bank should be allowed to adopt stream-lined operational modalities in middle income countries similar to the EIB, and should be given much more leeway in developing its risk mitigation instruments. The Bank should take on a lead role in ensuring that the simplification and harmonization of procurement, fiduciary, safe guards and reporting policies of all multilateral organizations—and of the official bilateral programs—be subjected to a time-bound program of implementation.
- Funding: The World Bank should be the principal agency through which incremental aid resources and global public goods funding are channeled. Creation of new funding windows and preferential treatment of windows other than the World Bank should be discontinued. They only add to the problem of fragmentation and to the reduction in the effectiveness of all aid and public goods funding flows. Any new funding for the Bank should be channeled into its principal financial windows (IBRD, IDA and IFC) not into new trust funds. The only exception to this rule could be a general purpose global public goods fund, similar to IDA.

Recommendation 5: As in the case of the IMF, an expanded mandate, reformed operational policies and increased funding for the World Bank have to be accompanied by changes in the governance of the Bank to ensure greater legitimacy and greater operational effectiveness.

- The Bank's governance structure traditionally has been dominated by parallelism with the IMF. This needs to be abandoned, given the significant differences in mandates, operational modalities and funding of the two institutions.
- The voice and vote of emerging market economies need to be strengthened in the IBRD. Voice and vote of the recipient countries need to be strengthened in IDA, along with maintaining an incentive for smaller donor countries to continue their above average support. This can be achieved by introducing a double majority rule. A greater voice for recipient countries will likely result in operational policies that are more responsive to the needs of the recipient countries as demonstrated by the experience of the EIB and the Andean Development Corporation (CAF).[9]

[8] In countries where governments are able to carry the lead coordination role, the Bank should support this along with other donors; in countries where government capacity to coordinate aid is weak, the Bank should take a lead in helping to build this capacity and in the meantime should take a lead in coordinating donor activities for best effectiveness.

[9] See also Nancy Birdsall, "Why It Matters Who Runs the IMF and the World Bank", *Working Paper* No. 22, Center for Global Development, Washington, D.C., October 2003, for argument along these same lines based on the experience of the Inter-American Development Bank.

Recommendation 6: World Bank reform requires careful preparation, not rushed and partial decisions, and needs to be considered as part of a broader reform of global aid and public goods architecture.

There is a risk that a rushed decision process will lead to band-aid solutions in the Bank's mandate, operational policies and funding mechanisms, not consistent with the long term goals of providing an efficient development and global public goods funding mechanism in response to the severe global economic, social and environmental challenges. Therefore a high-level, comprehensive, but time-bound reform process should be initiated under the aegis of the G-20 Summit which takes a serious look at how the key global institutions can be strengthened in the overall context of global governance, aid architecture and public goods reform.[10]

Postscript

Recommendation 7: The G-20 Summit process needs a technical secretariat. The World Bank should, along with the IMF, UN and WTO, provide staff and technical support for such a newly to be constituted secretariat.

The G-20 Summit needs administrative and technical support, if it is to become an effective global forum for dialogue and decision-making among the world's leaders. A secretariat is required for this purpose. It would support the traditional troika and Sherpa processes. A joint secretariat consisting of the IMF, UN, WTO and the World Bank (and possibly the OECD) should be set up to help prepare the G-20 summits and to monitor implementation of agreements.

[10] While the Zedillo Commission is a welcome initiative, its narrow focus on World Bank reform risks that it will not tackle the broader questions here noted, unless its mandate is broadened. Its role would also be strengthened, if it had the full endorsement of the G-20 summit.