Testimony of Karin Lissakers
Director, Revenue Watch Institute
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Committee on Banking, Housing and Urban Affairs
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on
Reforming Key International Financial Institutions for the 21st Century

Mr. Chairman, Members, thank you for inviting my testimony to the sub-committee today.

I am not new to the issue of IFI reform. During my tenure representing the U.S. on the IMF executive board in the l990s, the Clinton Administration embarked on an ambitious effort to redesign the international financial architecture, including the IMF and the World Bank. Large-scale debt relief for the poorest countries, escalating interest charges for IMF loans to encourage early repayment, a new financial data disclosure standard for all member governments, and a dramatic increase in the institutional transparency of the IFIs themselves were among the results. As President of the Bank, Jim Wolfensohn de-centralized and moved a large part of the staff out into the field.

However, some big institutional issues were left on the table. The most obvious reform that is long overdue is changing the way the heads of the two institutions are selected. The "convention" that Europe and the United States alone should decide the leadership of institutions with memberships of more than 180 countries each is an embarrassing anachronism. More importantly, it damages the effectiveness of the institutions and hurts the credibility of the West's commitment to proper governance. The convention should be done away with immediately, and an open, merit-based selection process put in its place. The U.S. missed an opportunity to break new ground with the selection of a successor to Paul Wolfowitz, making not even a nod in the direction of openness or choice. Some European states have promised to do better regarding Rodrigo de Rato's successor at the IMF, but I am skeptical they mean it. It looks to me as if the European candidate will sail through without serious competition. If I am right, then the members need to take up the issue soon, not waiting until the next vacancy when the pressure to get someone in place quickly will surely trump pressure for change. The U.S. and Europe need to get off their pedestals, and the rest of the world needs to keep up the pressure until there is a new and defensible process. The current one is a disgrace.

The other big – and related – change urgently needed is to redistribute quotas, voting shares and board seats to reflect global economic realities and to give the rapidly growing emerging market powerhouses like China, Korea, Brazil, Turkey, South Africa the influence *and* responsibilities in the global institutions commensurate with their economic standing.

The IFIs are mutual support and peer review mechanisms. The more globally integrated the world economy becomes, the more important having well functioning multilateral institutions will be. But members that are underrepresented will tend to look to other devices or go their own way. One can already see that the Asian countries have lost interest in the IMF and are more focused on their own regional arrangements and discussions. That is not good for global cooperation and does not serve U.S. interests, either.

The IMF is much less important now as a source of balance of payments financing for members. Consequently, its leverage, its ability to directly influence or pressure country policies is more limited; member governments have to *want* to listen to the institution's views. Countries like China or Turkey are more likely to pay attention if they see themselves as fairly represented in the institutions' decision-making and if they have a financial commitment matched to their economic strength. That is not currently the case. The serious misalignment of quotas and voting shares undermines the effectiveness of the institutions, including their effectiveness on exchange rate surveillance, a topic that is getting a lot of attention in Congress right now. I am not suggesting that quota adjustments alone will solve the problem, but they are necessary and helpful in reinforcing a cooperative international approach to problems like global financial imbalances.

The question of "voice", i.e. actual physical representation in the executive boards of the institutions, is also important, particularly for relations between the Bank and the Fund and developing countries. Important developing countries are under-represented in the 24-member boards. It is absurd, for example, that South Africa gets to hold an IMF board seat only once every couple of decades, because it is in a group of 19 African countries sharing one board chair. Meanwhile, European members occupy eight of the Board's seats even though, most of the time, most of the European representatives simply repeat the common positions they have agreed through the EU. It is long overdue for the Europeans to consolidate their representation in the IFI boards and vacate seats in favor of developing and emerging market countries.

With regard to the quality of the policy advice these institutions give to countries, I want to make a few observations related to the issues the Revenue Watch Institute concerns itself with, namely governance, poverty and conflict in extractive industry intensive economies.

Development economists agree that money alone, whether development aid or commodity windfalls, does not solve the problems of poverty and conflict. Institution building, governance and accountability are the real keys to economically successful, peaceful societies. And those are a lot harder to tackle than simply writing loans. Both the Fund and Bank have made significant strides in these areas. I think one can credit the Fund's efforts to help build independent, well-administered central banks with the dramatic improvement in monetary policy and lower inflation around the world. Likewise better fiscal management. In fact, a lot of emerging market countries have done better in recent years than the major industrial economies in managing their public finances.

Governance and accountability pose the biggest challenges to international intervention because they are inherently political and the IFIs are supposed to stay out of politics. The IFIs and their members now rightly treat governance as an economic issue and have taken steps link economic support to governance. But performance is uneven. We were pleased with the commitment Paul Wolfowitz made to toughening the Bank's anti-corruption policies, and we hope his successor will be equally forceful on that front. The Fund also now pays a great deal more attention to transparency and accountability issues, but more sustained, systematic efforts are needed.

Transparency and accountability issues are particularly acute in the resource-rich countries and especially in a time of high commodity prices. Both the Bank and the Fund have tried to tackle the so-called "resource curse" issues, and the G8 countries have repeatedly stressed their support for important initiatives like the Extractive Industries Transparency Initiative, which both institutions support.

Transparency – public information – is the best way to ensure public accountability. One very important and welcome policy change by the World Bank's investment arm, the IFC, concerning extractive industries (EI) revenue and contract transparency came into effect on January 1, 2007 as part of the overhaul of its environmental and social standards. As of the beginning of this year, the IFC now requires disclosure of payments made by oil, gas and mining company clients to host governments.[1] In addition, it requires disclosure of some contract information for "significant" new EI projects, i.e. the relevant terms of key agreements that are of public concern.

Unfortunately, the IFC has so far not provided any information on client compliance with these new requirements. It has only stated that, since September 2004, all EI clients have agreed to revenue transparency. Despite repeated requests from civil society groups, the IFC has not provided information on where this revenue payment information can be found on a project-by-project basis. On the issue of contract disclosure, the same situation prevails and, even worse, IFC staff has said it will not require disclosure of contract fiscal terms, which are clearly of "public concern". Improved oversight in this regard is critical, as transparency will help the IFI's to better achieve their development agendas and will also serve to help repair the mistrust of these important institutions that has set in within some quarters, particularly civil society in many developing countries.

[1] "IFC also promotes transparency of revenue payments from extractive industry projects to host governments. Accordingly, IFC requires that: (i) for significant new extractive industries projects, clients publicly disclose their material project payments to the host government (such as royalties, taxes, and profit sharing), and the relevant terms of key agreements that are of public concern, such as host government agreements (HGAs) and intergovernmental agreements (IGAs); and (ii) in addition, from January 1, 2007, clients of all IFC-financed extractive industry projects publicly disclose their material payments from those projects to the host government(s)."

Congress has a key role to play in the oversight of U.S. executive branch participation and policies in the IFIs. One clear example of the positive role Congress has played in the past is the "Pelosi Amendment" passed in 1989. This law requires the US executive director at an IFI to abstain from any vote on a loan that "would have significant impact on the environment" unless the board of directors and affected groups have been provided with an environmental impact assessment (EIA) at least 120 days prior to the vote. The enactment of the Pelosi Amendment led directly to the adoption of environmental assessment policies at all of the development banks. Congress should resist any effort to weaken this standard.

More recently, Congress played an important role through language on revenue and contract transparency that, for the past two years, has been part of the Foreign Operations Appropriations bill. The language directs the Treasury Department to not approve any assistance by an IFI for extractive industries in a country that does not have in place systems for transparently managing its EI revenues. This year, a strengthened provision has been included in the Senate Foreign Operations that recently passed out of committee. In a similar vein, the Senate will soon be considering House-approved language conditioning OPIC guarantees and financing for extractive projects on the transparency of payments by companies to beneficiary governments, and on the governments taking steps to make extractive revenue streams fully public. We look to the Senate to strengthen that provision. We also hope Congress later this year will approve legislation to require extractive industries to publish what they pay to foreign governments, as U.S.-based and foreign companies are already doing in countries that have adopted EITI. The IFIs can be much more effective if their policies and the policies of individual shareholders are consistent and mutually reinforcing.

Thank you.