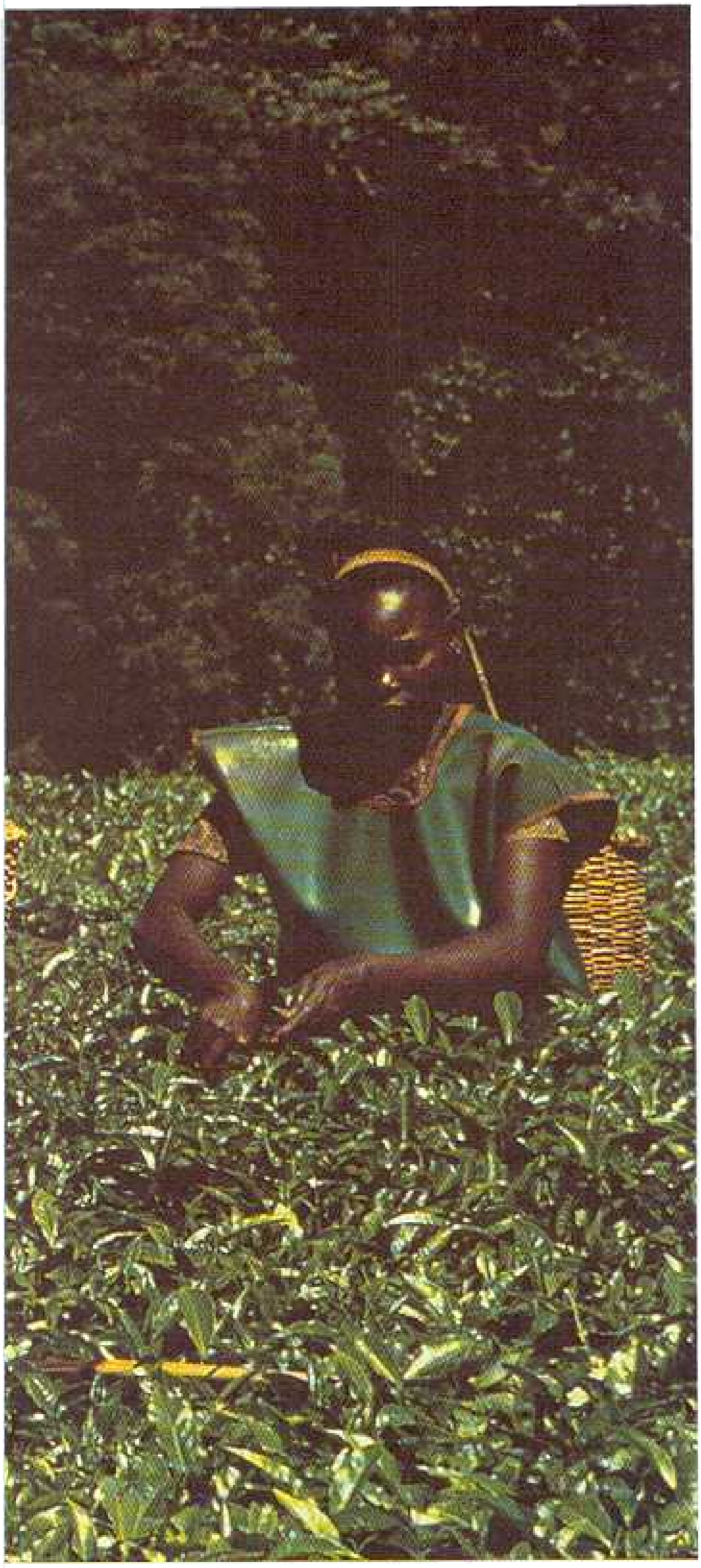
Money and

With the worldwide commodity glut, Africa alone has lost US$50 billion in reduced earnings since 1980.
A country like Kenya relies on its tea crops for much of its export earnings.

Capital ~ the Bretton Woods institutions



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- *The global economy*
- *Monetary management*
- *Development policies*
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The birth of the international financial institutions, known as the Bretton Woods institutions, in the 1940s was a direct response to the dismal experience of the 1920s and 1930s. The world had witnessed the Great Depression in the years following 1929. The global economy had gone through many traumas – from banking failures to monetary instability, trade protectionism and extraordinarily high levels of unemployment.

Many of those who surveyed the wreckage of the global economic system during the dreary days of the Second World War – especially Lord John Maynard Keynes, the dominant economic thinker of that time – came to a simple conclusion: the world's economic system needed some honest referees. The global system could not be left to the mercy of unilateral action by governments or to the unregulated workings of international markets. It needed multilateral institutions of economic governance which could lay down some agreed rules by which all nations would conduct their affairs. Thus emerged the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD or the World Bank), and, at a later stage, the General Agreement on Tariffs and Trade (GATT).

The starting point was the United Nations Conference on Money and Finance held at Bretton Woods in the United States, in July 1944. At this conference Lord Keynes (representing the United Kingdom) and Harry White (a member of the US delegation) were the towering intellectual figures, setting the stage for a more orderly global economic transition after the Second World War.

With memories of the Great Depression still fresh in their mind, the battle cry at the Bretton Woods conference was: 'Never Again!' Unemployment had been heavy - so the new objective was full employment. Trade and investment rules had broken down – so the new objective was to prevent beggar-my-neighbour policies. The international monetary system had collapsed – so the new objective was to maintain stable currencies with agreed procedures for adjustment. Unilateral national policies had created world economic chaos – so the basic idea was to fashion new institutions of global monetary and economic governance, with clear objectives and with changes in global policies engineered through a broad international consensus.

The structure emerging out of the Bretton Woods Conference was supposed to rest on four pillars of multilateralism:

- the IMF: to maintain global monetary stability, primarily through the mechanism of fixed but adjustable exchange rates.
- the IBRD: to reconstruct the war-torn economies of Europe and Japan and to stimulate the growth potential of the less developed regions in the Third World.
- the International Trade Organization (ITO): to stabilize international commodity prices and to manage a liberal trading regime.
- the UN: to maintain peace between nations as well as to encourage social and human development within nations.

While the first two pillars of this global economic system emerged in a fairly strong form, the other two pillars were shaky right from the start. The ITO, with its broader mandate, was never established. Instead, the GATT was set up in 1948 to police the world trading system, joined later, in 1964, by the UN Conference on Trade and Development (UNCTAD) which generated some pressure – largely unsuccessful – for commodity price stabilization. The UN system was never given the role of a development agency that was originally envisioned. The UN development system never received adequate financing leading to an ineffective and inefficient role, and the alleged inefficiency of the UN led to a further erosion of its financial support.

An analysis of the five decades since the Second World War shows that the Bretton Woods institutions had a major influence on the global economic environment, particularly in the first 25 years. This influence has been on the wane in the last 25 years and the Bretton Woods institutions have been increasingly marginalized in global economic governance. Their influence on economic management in the developing world, however, remains quite significant.

'global policies'

In the first 25 years after the Second World War (1945-70), industrial countries grew nearly twice as rapidly as in any comparable period before or since. In Western European countries, national output increased by 4.4 per cent a year in the 1950s and 4.8 per cent in the 1960s. The corresponding annual growth rate in the US was 3.2 per cent and 4.3 per cent, and in Japan it was 9.5 per cent and 10.5 per cent respectively. Even the developing countries grew at a satisfactory rate during this period, normally five to six per cent a year. These healthy rates of growth in Gross National Product (GNP) bear a striking contrast to the rather pallid growth of recent decades.

Many factors contributed to the strong world growth performance in the first 25 years under the Bretton Woods institutions. Of course, the more liberal trading regime set up under the GATT rules helped considerably. The annual export growth rate in the 1950s and 1960s was nothing short of spectacular: 16.5 per cent in Japan, 12 per cent in West Germany and 5.3 per cent in the US. Such robust trade growth kept feeding rapid economic expansion.

The good economic performance during this period was also assisted to a great extent by global monetary stability established under the IMF rules.

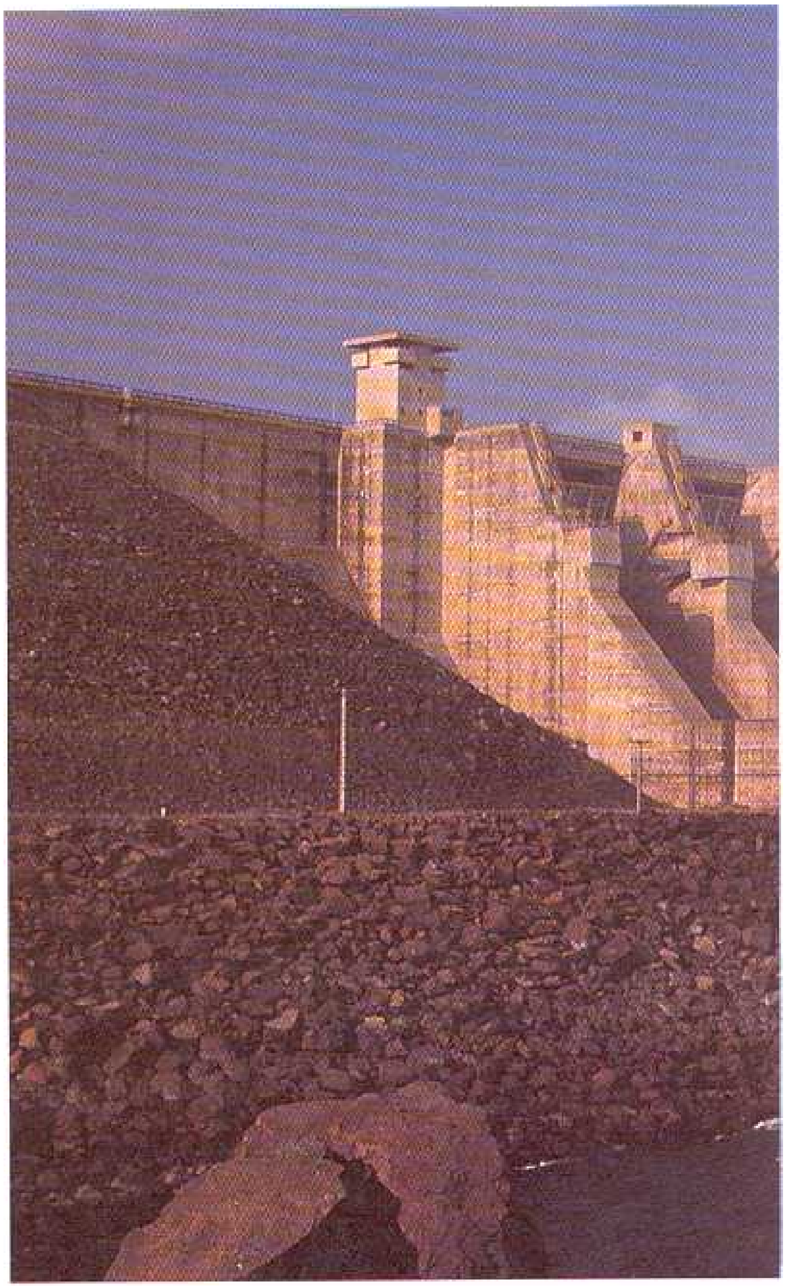
Fixed exchange rates were established by all nations, which could be changed only in consultation with the IMF. Whether in rich or poor nations, the IMF rules had a major influence on domestic monetary policies.

In these first 25 years the spotlight was often on the IMF and the GATT. The task of reconstruction and development in Europe and Japan was taken over largely by the Marshall Plan, with the World Bank playing only a limited role in this effort. The Bank's influence grew significantly in the developing countries but this was a development of the last three decades, particularly after the addition of a new soft loan affiliate in the shape of the International Development Association (IDA) in 1960 to provide concessional finance to low-income developing countries.

There were several reasons for the relative success of the Bretton Woods institutions in the first 25 years of their existence. The world economy was run by a relatively small number of countries which enjoyed overwhelming influence in the weighted voting structures of these institutions. The US emerged after the Second World War with a national output which was about 50 per cent of the world output, so it was in a position to lay down the global rules of the game and keep the management of the Bretton Woods institutions firmly in line. At the same time, a good deal of growth was possible as the closed economies of pre-war and war days were opened up to global competition, and as new technologies developed during the war were applied to civilian industries.

These favourable trends disappeared in the 1970s and 1980s. The collapse of the influence of the Bretton Woods institutions started in dramatic fashion in 1971 with a decision by the US to abandon the regime of pegged but adjustable exchange rates and to opt instead for a floating rate for the dollar. The world entered a new era of exchange rate instability. The stable monetary regime introduced through the IMF was no more.

Many other global developments began to undermine the influence of the Bretton Woods institutions during this period. There was an increase in the number of international players with economic influence on the global scene - for instance, the Organization of Petroleum Exporting Countries (OPEC), Japan, West Germany, the developing world - yet the management and voting structures were too slow and too rigid to respond to such shifts in global economic power. The US share of global output fell from 50 per cent to 20 per cent, yet its desire to control Bretton Woods institutions showed



no comparable decline. At this stage, direction of global economic policies started shifting into the hands of the Group of Seven industrial nations

(G-7), often bypassing the framework of the Bretton Woods institutions.

There has been a dramatic marginalization of the Bretton Woods institutions in global economic governance in the past two decades. By now, these institutions police only the developing world. They have practically no role in the industrial nations or in the global economy as a whole. It is important to understand what was the original vision for these institutions and how the present reality contrasts with that vision before considering some proposals for their orderly reform. The Bretton Woods institutions constituted a remarkable initiative on behalf of mankind. They need to be reformed rather than allowed to die.

A hydroelectric plant.
Large-scale infrastructure projects have on occasion pitted local communities against government in developing countries.

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The International Monetary Fund

The IMF in its present form is merely a pale shadow of Keynes' original vision.

Keynes proposed a Fund equal to one-half of world imports, so that it could exercise a major influence on the global monetary system. In practice, the IMF today controls liquidity equal to two per cent of world imports. It is too insignificant to exercise much global monetary discipline at a time when speculative private capital movements of over one trillion dollars cross international borders every 24 hours.

Keynes envisioned the IMF as a world central bank, issuing its own reserve currency (the bancors) and creating sufficient international reserves whenever and wherever needed. By now, Special Drawing Rights (SDRs) constitute only three per cent of global liquidity. The world economy is dollar-dominated. For the world monetary system, the actions of the heads of the US Federal Reserve Board and the German Bundesbank are far more important than the actions of the Managing Director of the IMF – a long distance from the original Keynesian vision.

Keynes regarded balance of payment surpluses as a vice and deficits as a virtue, since deficits sustained global effective demand and generated more employment. This led him to advocate a penal interest rate of one per cent a month on outstanding trade surpluses. The situation today is exactly the reverse: deficit nations, particularly those in the developing world without a reserve currency of their own, come under tremendous pressure for real adjustment. There is no symmetry by way of corresponding adjustment pressures on the surplus nations.

In the Keynesian vision there would be no persistent debt problem, as surpluses would be used by the IMF to finance deficits. No separate International Debt Refinancing Facility was needed. Nor would the poor nations be obliged to provide a reverse transfer of resources to the rich nations (as they are doing now) to earn their legitimate requirement of growing international reserves: these reserves would have been provided by the international currency issued by the Fund. But an automatic mechanism for meeting the liquidity requirements of developing countries has been replaced in practice by punitive measures for dealing with debt problems and for fulfilling prudent international reserve requirements.

The heart of the IMF-led global monetary system was fixed exchange rates. That system died in the early 1970s with the de-linking of the US dollar from gold and with the introduction of floating exchange rates. All attempts since then to introduce a modicum of stability in the volatility of exchange rates have proved largely futile.

'the IMF in its present form is merely a pale shadow of Keynes' original vision'

The World Bank

Has the World Bank stuck closer to its original vision than the IMF? The World Bank was supposed to stand between the global capital markets and the developing countries and to recycle market funds to them by using its own creditworthiness, as well as by gradually building up the creditworthiness of these nations over time so they could have direct access to the private markets.

In some respects, the World Bank has done better than originally expected. It has helped raise market funds at lower cost, for longer maturity periods, and for some social sectors that private markets would not have touched, such as education, health, population and nutrition. It introduced the IDA in 1960 to subsidize its lending to poorer nations. Established as a bank, it has tended to become a development agency.

Where the World Bank is beginning to fail is in the transfer of any significant resources to developing nations. Recently its net resource transfers, including the funds of the IDA (the Bank's soft loan agency), have been negative, to the extent of one to two billion dollars a year. In fact, by now the Bank is recycling the repayment of its own debts rather than any new resources.

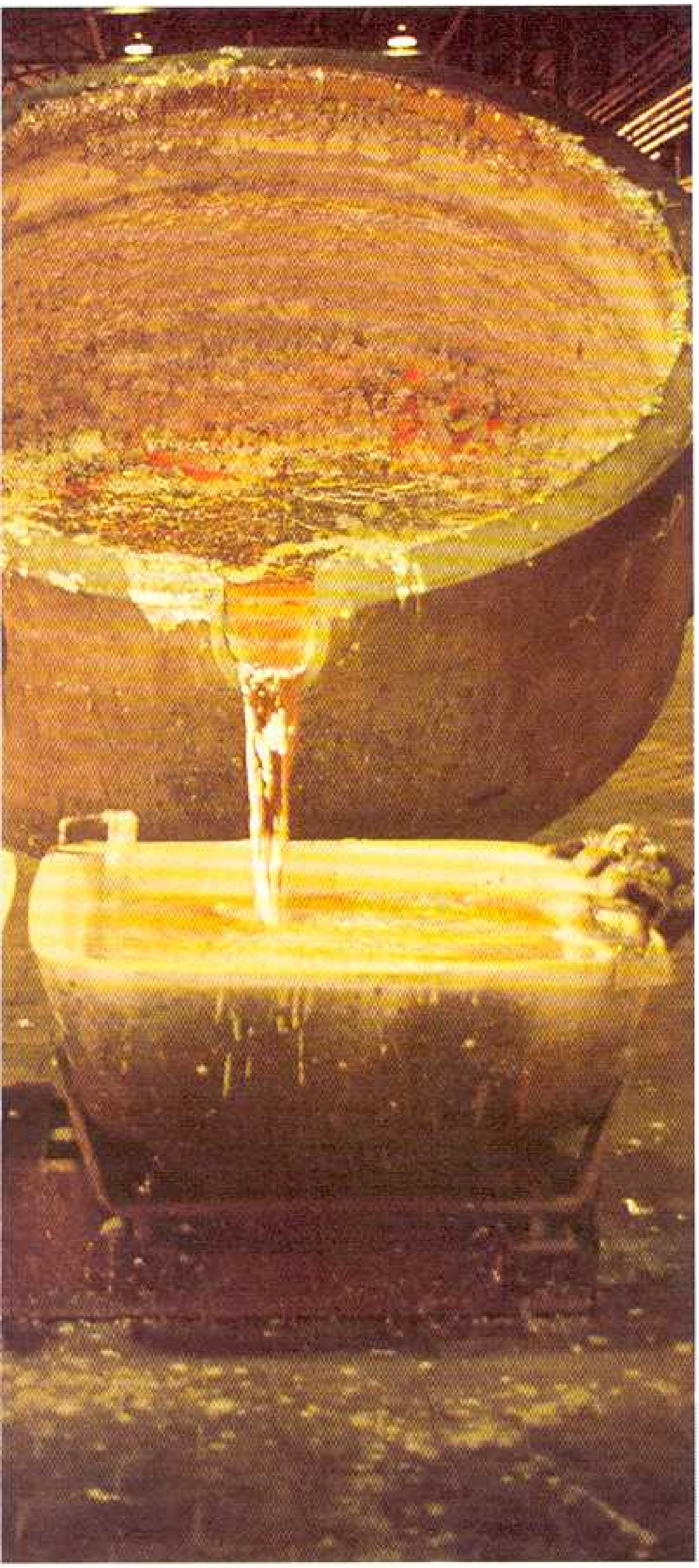
Private lending to developing countries has increased rapidly, and that is certainly a good development. But three-quarters of this private market lending is still to about 10 relatively well-off economies in Latin America and Southeast Asia. What about the other 117 developing countries? The Bank's role has been a modest one in these countries, and negative net resource transfers by the Bank to some poor nations have raised real questions about its development mandate.

The Bank was supposed to build up the creditworthiness of individual developing countries and enable them to walk with confidence into private capital markets. Except for South Korea, the Bank does not have many successes to boast of. Thanks to a severe global debt problem, most of its clients emerged in the 1980s with lower creditworthiness than they had enjoyed in the 1970s.

The resource profile of the Bank is inadequate in relation to the poverty profile of the developing world. According to the Bank's own estimates, the number of absolute poor in the developing world has been increasing. Yet in real terms IDA finance available per poor person has been shrinking. This is not a fault of the Bank management but of its donors who have refused to see the implications of such an imbalance.

The original Keynesian vision envisaged the World Bank as an institution for expansion of global growth and employment levels, rather than as an instrument for deflationary policies. One of the most scathing criticisms of the Bank in the developing countries these days is that it gets greatly browbeaten by the IMF in prescribing demand management and deflationary policies, particularly as a condition for its structural adjustment loans.

World Bank loans have encouraged the growth of industry in developing countries.
An aluminium smelter in Ghana.



The GATT

The third pillar of the Bretton Woods system, the GATT, has become even further removed from the original Keynesian vision than the IMF and the World Bank.

Keynes envisioned an ITO, which would not only maintain free trade but also help stabilize world commodity prices. That is why he linked the value of his world currency (the bancors) with the average price of 30 primary commodities, including gold and oil. In practice, the GATT excluded primary commodities altogether and only belatedly has an effort been made in the Uruguay Round of negotiations to include agriculture and tropical products in the global trade package.

The actual operations of the GATT system reflect the same disparity in global power structure as do the two other Bretton Woods institutions. The South and the former socialist bloc are opening up their markets; the North, according to a recent study by the Organization for Economic Cooperation and Development (OECD), has been restricting its markets during the 1980s and adopting greater trade protectionism.

The GATT has not been able to prevent beggar-my-neighbour policies or trade wars between powerful nations.

One distinguishing feature of the GATT is that overall it embraces at present only a small fraction of the total world production entering trade markets - excluding as it does primary commodities, gold, oil, textiles, services, capital flows, labour flows, intellectual property resources, etc. However, the new World Trade Organization (WTO) is likely to reverse this trend of the growing marginalization of the international trading regime.

"severe global debt"

Fatal flaws

There are two aspects of this 50-year evolution which should particularly concern us.

First, the IMF and the World Bank are no longer institutions of global governance; they are by now primarily institutions to police the developing world. In fact, no real institutions of global, economic, monetary and financial management exist today. The WTO may be an exception. But so far as the IMF is concerned, isn't it somewhat charitable to call a 10 per cent money manager – with influence only on the monetary policy of developing countries responsible for about 10 per cent of global liquidity – an International Monetary Fund? And isn't it somewhat optimistic to describe an institution recycling negative net financial transfers to the developing countries as the World Bank?

The plain truth is that, as global interdependence has increased, institutions of global governance have weakened. We are back to *ad hoc* improvisations by rich nations, either unilaterally or through a loose coordination by G-7, the grouping of the seven most powerful industrial nations.

A basic question today is whether we need Bretton Woods institutions only to influence the policies of the developing countries, which account for one-fifth of global output and one-tenth of global liquidity, or whether we need them as genuine institutions of global governance. Some of the criticism of these institutions in the enlightened lobbies of the Third World arises out of a perception that the industrial countries are largely independent of the discipline of the Bretton Woods institutions. Moreover, the industrial countries not only set their own rules, they also set the framework within which Bretton Woods institutions and developing countries can operate.

Second, the founders of the Bretton Woods institutions were searching for expansionary economic policies after a prolonged period of global deflation. Full employment was on top of the international agenda in the 1940s. In recent decades it seemed that world leaders, particularly in the industrial nations, became more preoccupied with inflation than with jobs. The pendulum is now beginning to swing once again and jobs are moving to the top of the policy agenda.

The developing countries, unfortunately, have to live with the consequences of changing policy agendas in the industrial world. Most of them have been subjected by the Bretton Woods institutions to deflationary policy conditionality when their real need was for expansion of jobs and output. The demand management school often won over the

“the seven most powerful industrial nations”

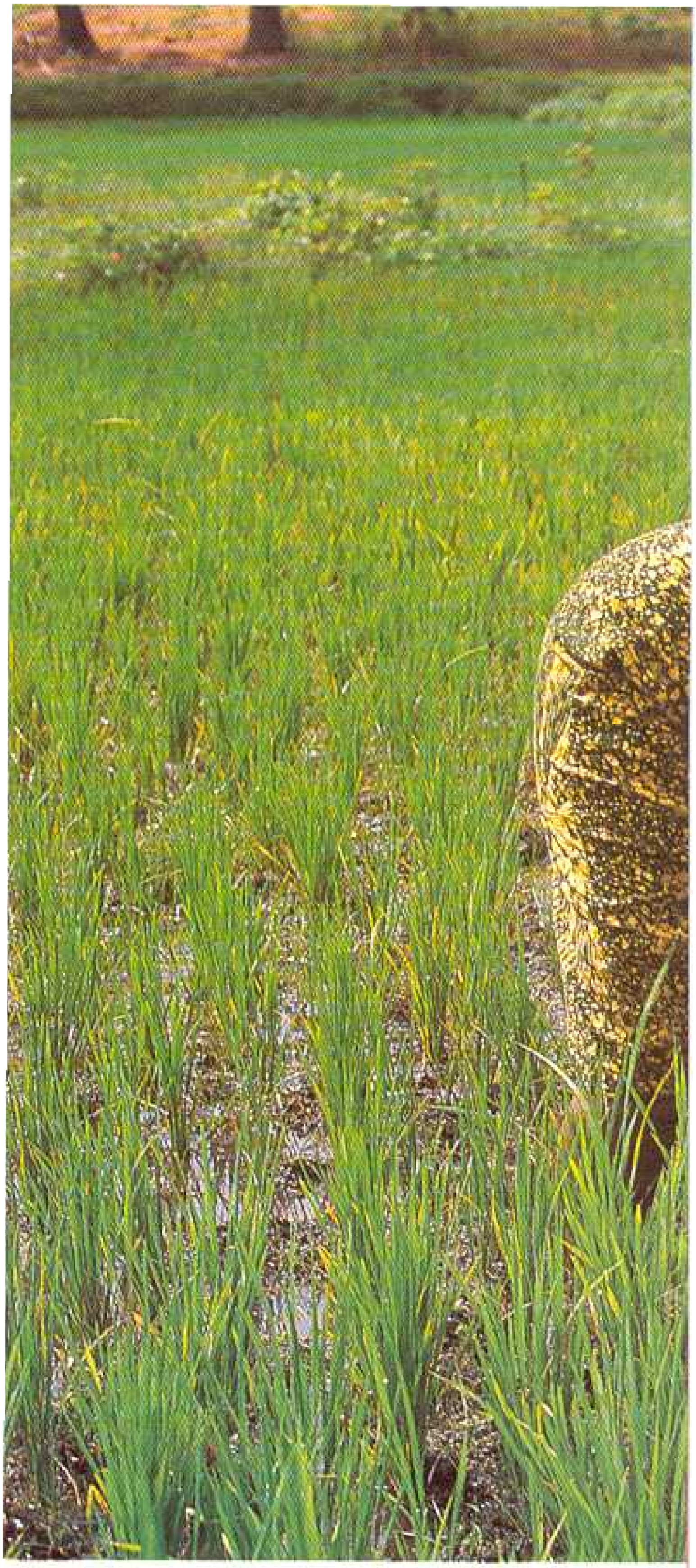
supply expansion school. This was also because adjustment through supply expansion often takes a longer period and much larger resources than the Bretton Woods institutions could afford.

This is not to suggest that demand management is unnecessary. It may sometimes even be a pre-condition for sound supply expansion policies. After all, budgets must be balanced and borrowing must be curtailed. But the Bretton Woods institutions compounded their error of over-emphasizing demand management by accepting wrong policy choices for slashing budgetary expenditures. It does not take a genius to figure out how to balance budgets without unbalancing the lives of the people. There are many low-priority budget items. Military expenditures exceed expenditures on education and health in many developing countries. Budgetary subsidies to the rich often far exceed such subsidies to the poor. Yet education and health expenditures have been cut ahead of military expenditures during periods of adjustment, and food subsidies to the poor have been slashed in preference to cutting tax and interest rate subsidies to powerful landlords and industrialists. The social and human costs of the adjustment programmes have been unnecessarily high and the Bretton Woods institutions have been blamed for the consequences.

This image of political insensitivity has been rather unfair to both the IMF and the World Bank. It is not seriously credible that officials of the Bretton Woods institutions chuckle over the harsh human conditionality of their loans. One expert who has watched this game of mirrors from both sides – as a staff member of the World Bank for 12 years and as the Finance and Planning Minister of Pakistan for eight years – states that what really happens is that the governments of developing countries find it politically convenient to squeeze the poorer and weaker sections of their societies and to pretend that it is a part of external conditionality.

But the Bretton Woods institutions must accept their own part of the responsibility. They must pressure governments to cut their military spending rather than their social spending – something they have started doing only in the last few years. They must analyse subsidies to high and low income groups in a national budget and stand firm in slashing subsidies to the rich elitist groups in a society before subsidies to the poor are touched. They must at least encourage transparency of information and an open policy dialogue by giving various policy options for balancing budgets in their economic reports, with an analysis of their impact on various income groups in that society. They must spend as much time discussing politically sensitive issues of land reform and credit for all as they do now on distorted prices in an economic system.

These are not easy issues. They require skilful engineering and political alliances for change within the system. But unless the Bretton Woods institutions are willing to take some political heat on these issues, the cause of the poor – which is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Many developing countries are struggling to repay loans to the World Bank.
A woman weeding rice seedlings.

always poorly defended in their own systems – will go by default. In any case, if the Bretton Woods institutions are already taking so much abuse for human costs which they do not wish to cause, they may as well get more directly involved in the discussion of these politically sensitive areas.

There are many policies of the Bretton Woods institutions which require urgent re-examination and reform – from their conditions imposed for structural adjustment loans to their weighted voting structures. But whatever else is done, we must first rescue the Bretton Woods institutions from the swamp of global irrelevance into which they have been sinking fast in the last 50 years.

One of the central questions today is whether we should leave the fate of the global economic system to the *ad hoc* coordination of G-7 or to the free workings of the international markets, or whether we need a minimum of global economic management through professional analysis and consultative processes within international financial institutions.

It is rather alarming that such a question needs to be asked once again. Keynes and White thought they had settled this issue in 1944 by persuading the international community to reject unilateralism in favour of multilateralism. The experience of the 1920s and 1930s was never to be repeated.

As we celebrate the 50th anniversary of the Bretton Woods institutions, let us pause for a moment to review their original purpose. And let us think quite seriously what we need to do to shape these pale relics of a forgotten past into institutions of genuine global governance in the 21st century. In the next century, we need the IMF to evolve into an International Central Bank and the World Bank to become an International Investment Trust. And if these institutions are not up to this challenge, we may need to reinvent new institutions of global, financial and economic management.

It will be far better to build on the existing structures than to search for an entirely new edifice. We must recognize that an evolutionary change is our best hope. In this spirit, what reforms can we consider to reposition these institutions for the challenges of the 21st century?

Let us take the IMF first. We do need a global institution that can ensure sound economic management and global monetary stability. Such an institution should be able to perform five functions:

- help stabilize global economic activity
- act as a lender of last resort to financial institutions
- calm the financial markets when they become jittery or disorderly
- regulate banks and financial institutions with an international scope
- create and regulate new international liquidity.

These five functions are the proper role of a world central bank. Even if we de-emphasize the last function – of creating an international reserve currency – as it may be over-ambitious at this stage, the other four functions lie at the very heart of sound macro-economic management and must be carried out by the IMF if it is to reclaim its legitimate role in the global monetary system.

Whether or not we will eventually move towards a world central bank in the 21st century is an issue likely to excite a good deal of debate in the next decade. In a way, such a development is inevitable. But that is the ultimate goal. In the meantime, we should consider some cautious steps – and eminently logical ones – which can initiate a reform of the IMF in the right direction.

First, we must seriously consider a new issue of SDRs – in the range of 30 to 50 billion SDRs. This extra dose of global liquidity could help fuel world economic recovery at a time when global inflationary pressures are low, primary commodity prices have hit rock bottom and most industrial countries are reducing their budget deficits. There could also be innovations in the distribution of SDRs, with industrial countries passing on some of their allocations to developing countries through overdraft facilities.

Second, the Compensatory and Contingency Financial Facility (CCFF) of the IMF needs to be changed in several directions. There should be no quota restriction, so that a country could obtain full compensation for a shortfall in its exports. The loan period needs to be extended so that countries would not have to repay before the contingency is over. Even more important, it is somewhat illogical to attach policy conditionality to borrowing. If a country is reeling from external shocks outside its control, why add the shock of IMF conditionality as well?

Third, in collaboration with the Bank for International Settlements (BIS), the IMF should acquire some regulatory control over international banking activities. The IMF should also be applying the proposed 'Tobin Tax' of 0.5 per cent on international currency transactions to curb excessive speculation, if this eminently sensible proposal begins to catch the imagination of the international community. This would not only give the IMF some control over international flows of capital which are sweeping across global markets with hurricane force, it would also yield enormous revenue – about $1.5 trillion a year – which could help finance World Bank and UN development operations. Global prosperity would be taxed in an invisible and non-discriminatory manner to finance an attack on global poverty.

Fourth, the IMF needs to acquire a greater role in global macro-economic management – reviewing the policies of all countries, whether or not they are active borrowers, and particularly having some influence on the macro-economic policies of major industrial powers. One possible mechanism may be for the IMF to persuade the BIS to link the level of

‘moving towards a world central bank - it be the goal’

reserves that banks are required to hold against loans to these countries to the IMF's evaluation. This would affect the industrial countries' ability to raise funds from private banks and give the IMF substantial leverage over their policies.

These four steps would be only an initial move in the direction of IMF reform. They are not a blueprint for converting the IMF into a world central bank. These proposals are offered in the hope that it may be possible to move on some of them in the current environment.

Let us turn now to the World Bank. There are several areas of reform which are appropriate at this stage.

First, the Bank is by now certainly the finest institution in advising developing countries on economic growth policies. Where it needs to develop much greater sensitivity and expertise is in linking economic growth to human lives, in analysing the distribution and sustainability of growth, and in examining more participatory patterns of development. The issue is not growth *per se*. To address poverty, economic growth is an imperative. But what type of growth? To benefit the masses, growth opportunities must be more equitably distributed. And they must be sustainable from one generation to the next. The World Bank certainly talks about these issues. But its critics allege that its embrace of the issues of sustainable, people-centred development is less than enthusiastic. It regards such issues more as an irritation than as central themes. We could all gain a great deal if the Bank were to turn its professional rigour to the emerging concerns for sustainable human development.

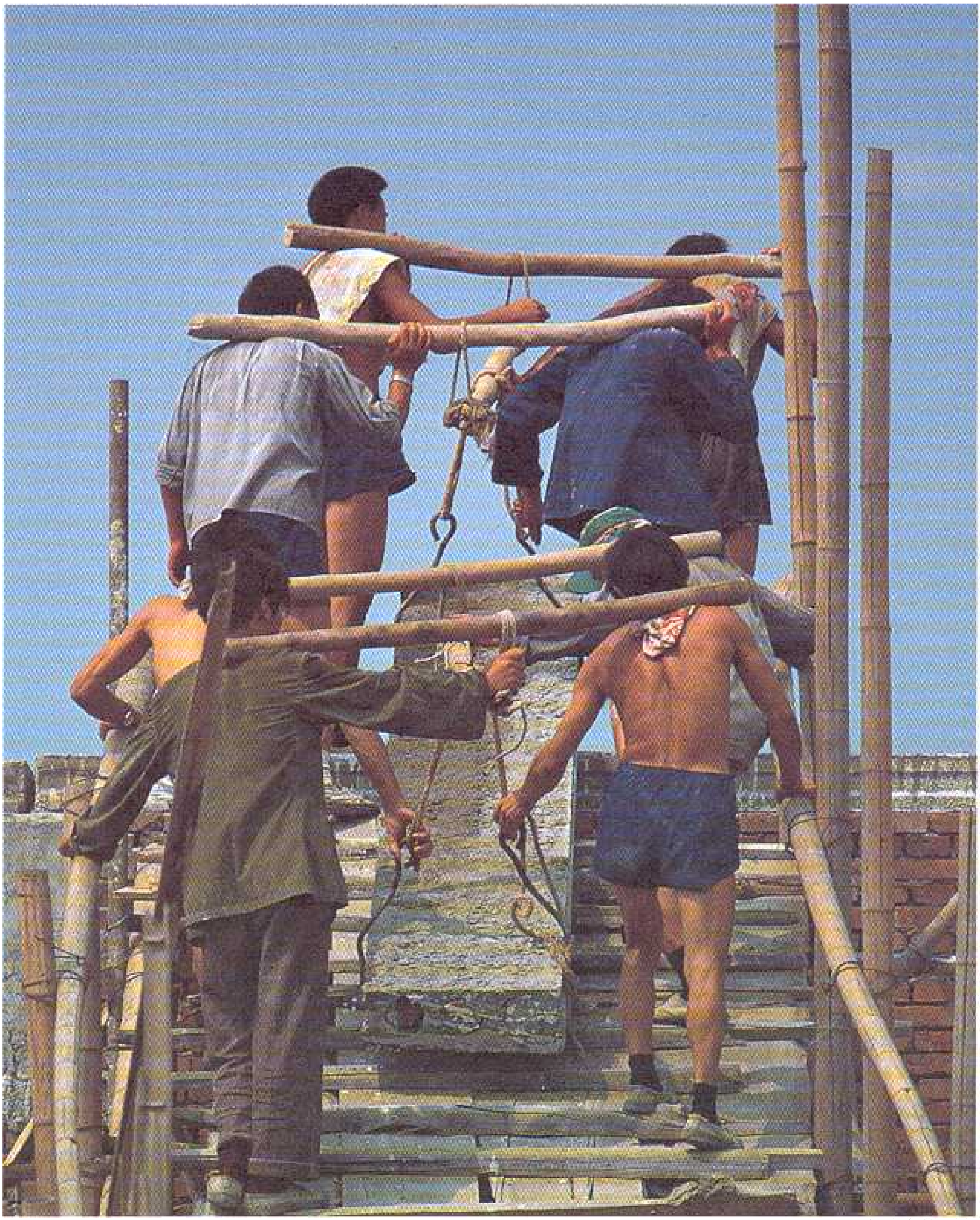
Second, the Bank must find new ways of recycling much larger resources to the developing countries. We are reaching the end of an era where legislatures in the rich nations will keep voting larger IDA resources. In the 21st century we shall have to start looking for more innovative ways of raising global financing to address the issues of global poverty. Such proposals as the Tobin Tax, or an international tax on non-renewable energy or on the armament trade, or proceeds from environmental emission permits – which are still regarded with a good deal of healthy scepticism – are the kind of proposals which

Many African countries are rich in minerals and resources. A mine in Zambia.

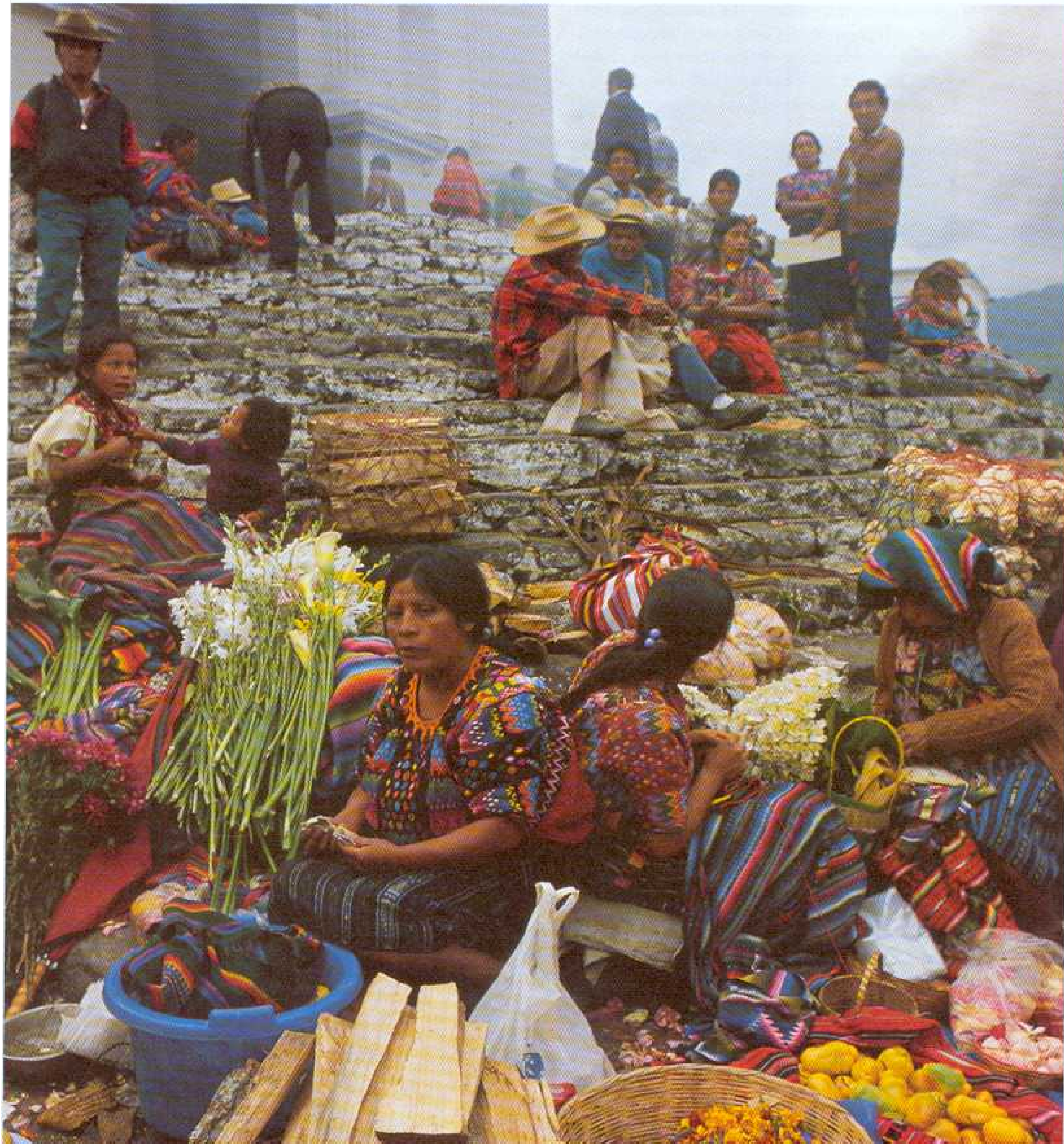
© Ron Giling/Panos

"what type of growth?"

may move to the centre of the international debate when it is recognized that the new compulsions of global human security require some form of global financing. The Bank has been fairly conservative in its approach to new financing sources: in fact, after the launching of the IDA in 1960, it has considered no significant innovation in its approaches to funding. Many of its well-wishers would like to see the Bank as a leader in exploring new avenues for raising international finance.



Construction work in Chengdu, a city in western China. *© Alain Le Garsmeur/Panos*



From agricultural peasant markets to metropolitan capitals of finance, commerce has been recognized as a major force in determining the future development of humanity.

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Third, the Bank must start considering prudent ways to restructure its own debts. The Bank has advised all other creditors to restructure their debts to developing countries, but expressed an inability to reschedule its own debts because of its Charter limitations and its concerns about its triple-A credit rating in the capital markets. The result is obvious: the Bank will end up owning more and more debt of its member countries, its net transfers will decline significantly, and after some time it will be recycling its own debts rather than any new resources. It has already reached that position with several developing countries. The Bank must begin to convince its contributors and the capital markets that it has to act as a development agency, not a global moneylender, and that prudent rescheduling of debts must be a part of its operations.

Fourth, the Bank must take on the role of an international investment trust – selling bonds to nations with a surplus and lending the proceeds to developing countries. Developing countries could borrow from the trust on terms appropriate to their level of development. The newly industrializing countries could pay commercial rates, while low-income countries would pay less – a subsidy that richer members of the international community should be persuaded to cover. If some of the proposals regarding international fees or taxes prove to be acceptable to the international community, a pool of resources would become available for such a subsidized recycling of market funds.

"it is time to begin designing the global institutions of the 21st century"

The founders of the Bretton Woods institutions and the UN were neither inhibited nor timid 50 years ago. When bombs were still raining on London, John Maynard Keynes was preparing the blueprint of the Bretton Woods institutions. When Europe was still at war, Jean Monnet was dreaming about a European Economic Community. When the dust of war had still not settled, the Marshall Plan for the reconstruction of Europe was taking shape. When the hostility of nations was still simmering, the hopeful design of a United Nations was being signed by the leaders of the world, led by President Truman.

We must admire the vision of those people today – and their courage to innovate. We see little of this intellectual ferment these days even though we have seen some unprecedented changes in the global environment – from the fall of the Berlin Wall to the end of apartheid in South Africa. The unthinkable is already becoming the commonplace. And yet our sources of creativity are curiously passive regarding the future shape of global economic governance. Maybe it is time to begin designing the global institutions of the 21st century.