Commonwealth Economic Papers No. 24

The Bretton Woods Institutions: A Commonwealth Perspective

A paper for the Commonwealth Secretariat by
Graham Bird and Tony Killick

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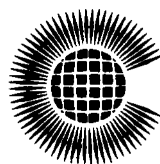

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The cover photograph depicts the Sacred Infirmary of the Knights of St John of Jerusalem, Valletta, Malta. This historic conference centre was the venue for the Commonwealth Finance Ministers' Meeting, 27-28 September 1994

Foreword

The Commonwealth Perspective

Commonwealth Finance Ministers, representing 51 countries, which include members of the G-7, some of the poorest countries and a number of small states, had a very useful exchange of views on the role of the International Monetary Fund (IMF) and World Bank, at their last annual meeting in Valletta, Malta (26-28 September 1994). This paper by Prof Bird and Mr Killick on 'the Bretton Woods Institutions (BWIs) and the Commonwealth Perspective' was prepared for the Commonwealth Secretariat as a background document on the subject and contained a number of proposals which enriched Ministers' discussions. Given the proximity in time of the two meetings, many of the ideas in the report were also carried forward to the Special Seminar, in Madrid, 29-30 September, to help celebrate the 50th Anniversary of the Bretton Woods Conference. The report is now being published as a contribution to the wider debate on the future role of the IMF and World Bank, during the lead-up to the review of these institutions by the G-7 at their next Summit, in Halifax, Canada, the Group of 24, and the World Bank's Development Committee meeting.

The object of the Bretton Woods Conference was to fashion a financial and monetary system that would avoid the disastrous depression of the type experienced in the 1930s and promote prosperity worldwide through the growth of world trade and investment, the generation of a high level of employment and real income, and the development of the productive resources of all countries. The intellectual creativity of Keynes and White was matched at that time by a vigorous spirit of internationalism, in establishing an innovative institutional framework to help the world economy achieve sustainable progress. The setting up of the BWIs contributed to a remarkable period of growth in the 1950s and 1960s through a system of stable exchange rates and a liberal trade environment. However, the system eventually came under considerable strain resulting in the breakdown of the Bretton Woods system in 1971.

The present system of floating exchange rates has been a mixed blessing. Although it has provided flexibility, it has also brought much volatility and some misalignment with fundamentals. There has also been asymmetry in global adjustment. This has made macroeconomic management more difficult and contributed to instability of export earnings. It is, therefore, timely that the paper contributes to the continuing high-level debate by exploring ways of evolving a more orderly global exchange rate system.

There has also been a rapid growth and globalisation of capital markets. This has transformed the process of international liquidity creation, but it has tended to be pro-cyclical and has raised distributional concerns. The

Mexican crisis has vividly demonstrated the vulnerability of open economies to sudden shifts in capital flows and expectations. Recent developments in capital markets have given added significance to some of the proposals contained in the paper about ways of strengthening international policy-co-ordination as a means of achieving greater stability in the international financial system. In this regard, the paper explores the merits of an enhanced role for the IMF and an international decision-making system that better reflects the growing importance of developing countries in the world economy. It also supports the proposal for a special facility within the IMF to assist economies afflicted by sudden outflows of short-term capital.

Commonwealth Finance Ministers welcomed the significant contribution made by the BWIs to the promotion of development and the policy debate. They recognised that both institutions had undergone much change, but felt that there was need for continuing reform. The report discusses the influence of the BWIs on development, paying particular attention to the design and impact of Fund/Bank-supported adjustment programmes on Commonwealth countries. It examines ways of giving a greater focus to poverty alleviation in the design of these programmes, and of dealing with the question of 'ownership', an important determinant of their sustainability. Conditionality without ownership can be a recipe for failure. The report also maintains that the adjustment/financing balance has shifted too far in favour of adjustment. In this connection, it contains a proposal for new allocations of SDRs to augment conventional IMF credits at a subsidised rate of charge. In addition, it examines options for dealing with the emerging problem of multilateral debt, an issue which was addressed specifically by the British Chancellor of the Exchequer in his call for multilateral debt relief for the very poorest debtors.

The economic changes that have taken place in the last decade or so are not merely quantitative in nature, though they are formidable enough in that respect. They are also qualitative individually, and even more so collectively. Production, trade and capital markets have all become more globalised. A serious review of the role of the main institutions has, therefore, become indispensable if we are to strengthen our capacity to manage the world economy and set it on a more orderly path. This paper has made a notable contribution to the ongoing debate on a number of key issues that require pressing attention.

Sir Humphrey Maud
Commonwealth Deputy Secretary-General
(Economic and Social Affairs)

Executive Summary

Against the background of changes that have occurred since their creation 50 years ago, this paper surveys issues concerning the future of the Bretton Woods Institutions (BWIs). Much has happened to the world economy in this time and there are doubts whether the Fund and Bank have adapted adequately. We concentrate on two subject-areas: Part II examines systemic issues of international exchange rate and policy co-ordination; the shifting finance-adjustment balance; and the changing roles of the BWIs in the international system. Part III deals with their influence on developing countries, particularly the effects of their adjustment programmes. Part IV looks forward, to changes that should be introduced to improve the existing 'system'.

i. Systemic issues

The move to exchange rate floating in the early 1970s, unaccompanied by effective international policy co-ordination, brought an end to the original Bretton Woods system but has been a mixed blessing, with much volatility and some misalignments. Similarly, the rapid growth of international capital markets has transformed the process of liquidity creation but has been pro-cyclical and brought less than universal benefits. Major new economic powers have emerged in Asia and Latin America, whose economic importance, however, has been inadequately reflected in the governance of the BWIs.

Have the Bank and Fund adapted adequately?

Strengthened **international policy co-ordination** would be one way of achieving greater stability in the system. This could have negative effects too, but the balance of the argument favours co-ordination. However, agreement on the general principle usually breaks down over the specifics of how co-ordination should be achieved. A balance has to be struck between two conflicting principles: the need for all affected countries to be involved and the practical desirability of limiting the number of active participants. A balance between these would be best achieved through a more democratic IMF.

The **adjustment-financing balance** has shifted too far in favour of adjustment in the last two decades, with the retreat from the international financing of contingencies particularly regrettable. This has especially disadvantaged low-income countries which do not enjoy access to world capital markets. This is a good time to revive the idea of an SDR-aid link. Low-income countries should receive new SDR allocations to augment conventional IMF credits at a subsidised rate of charge. The BWIs could also act

to ease the vulnerability to shocks of middle-income countries but they would need greater resources. Quota increases should be made more automatic, determined by an objective formula, and the Fund could augment its own resources by borrowing on capital markets. The present proliferation of IMF facilities should be consolidated into three: stand-bys, extended arrangements, and compensatory and contingency lending, with all Fund lending to low-income countries on highly concessional terms, subsidised by grants from more prosperous members or by gold sales.

A range of concerns have been expressed about BWIs

ii. The BWIs and economic development

The BWIs impinge directly upon development in two principal ways: through the productivity of the financial (and technical) assistance they provide, and through their influence on the policy choices of developing-country governments. A wide range of criticisms has been levelled against them: that they harm vulnerable groups and damage the environment; that they are ideologically biased; that they are adding substantially to the debt problem; and that they are structurally ill-suited and too inflexible to promote welfare in developing countries.

The evidence paints a less stark picture, however. A substantial proportion of Bank development projects are well-designed but there have been cases of serious environmental damage and the proportion of unsatisfactory projects has been rising. Structural adjustment programmes (SAPs) are associated with lowered investment but improved export performance and have little impact on growth in either direction. It is easy to exaggerate the effects of SAPs, and to underrate the beneficial effects of BWI influence on the economic policy environment.

Given the 'conditionality explosion' of the past 15 years, **why do SAPs have such apparently weak effects?** The tendency for conditionality to undermine government 'ownership' of SAPs is a major explanation, with implementation of reforms strongly linked to the extent to which governments regard programmes as their own. 'Home grown' programmes have many advantages and the BWIs should reorient their modalities to ensure that SAPs are domestically designed, and be more willing to refuse credits for governments not serious about rectifying policy mistakes. This reorientation would raise aid effectiveness and the catalytic effects of SAPs.

There remains only limited **consensus about development policies**, in particular concerning the role of the state. This arises in such areas as the deregulation of agriculture, privatisation of state enterprises, and industrial policy. On the last mentioned, the World Bank's denial of the effectiveness of industrial interventions by governments of East Asian countries appears biased. Overall, the evidence suggests the BWIs have reacted too far and too ideologically against past inefficient state interventionism.

There have been complaints about adverse **effects of SAPs on poverty** but here too the evidence is not strong. SAP distributional effects are complex. Some of the poor often *are* put at risk, particularly those in towns, but SAPs can also bring benefits to them and hardships caused by the initial economic crisis are often misattributed to SAPs. Measures can be taken to protect the vulnerable but not all governments reveal much

desire to do so. The BWIs must share the responsibility, however, and, although they have improved their policy stances, it seems overall that rather little may have actually been achieved thus far and that neither institution is yet systematically adopting a cost-minimising approach to SAP design, nor setting its efforts within an anti-poverty strategy.

The evidence shows that BWI lending is adding substantially to the **debt problems** of some low-income countries. Despite innovative efforts by the BWIs to refinance past debts and bring greater concessionality to new lending, their capacity to provide relief has been inhibited by their preferred lender status. Past approaches to the multilateral debt problem have shifted much of the burden to bilateral creditors/donors but there are growing constraints on these and if the BWIs are to retain their preferred lender status (ruling out the rescheduling or writing-off of past loans), more of the spotlight is bound to fall on greater use of their own resources (reserves, gold stocks) to provide increased relief.

iii. A New Bretton Woods?

The social utility of the BWIs has been called into question by growing discrepancies between the present-day global economy and the world for which they were designed. So what kind of arrangements might improve this situation? First, they should reaffirm the premises of the 1944 meeting: the desirability of rules-based global co-operation in pursuit of equitably shared global prosperity, and of the necessity for international interventions if this goal is to be secured. Second, however, they should take note of the great increase that has occurred over the past half-century in the coverage, efficiency and power of market forces, particularly capital markets. Any new public international agencies (or reform of the existing BWIs) would have to be justified in terms of the failings of the contemporary market-based system. Despite the undoubtedly large benefits that have resulted from the freeing of trade and capital, three market failures can be identified: (1) *instability* in trading and financial flows; (2) *incomplete financial markets*, e.g. for financing adjustment in low-income countries or for some development projects; (3) *persistent gross international inequalities and absolute poverty.*

There are various possibilities for tackling **instability**, including adoption of exchange rate target zones, maintained by enhanced international co-ordination of macroeconomic policies; the discouragement of speculative short-term capital movements by taxing spot foreign exchange transactions; and the creation of an international insurance scheme, or contingency financing fund, to assist countries which suffer from unforeseeable external shocks or natural disasters.

Is there a gulf between today and the world for which BWIs were designed?

The problem of **incomplete financial markets** can be tackled by augmenting the resources of the BWIs (see above). However, we do not support suggestions of merging the lending operations of the Fund and the Bank, which would add to existing problems of monopoly power and unwieldiness; nor, in a market failure context, do we agree that the Bank should channel more of its financing to private enterprises. Public capital should meet public needs, of which there remain many.

On **international inequality and poverty**, there is a special problem with

Global problems require representative international authorities

the continent of Africa, whose problems are unlikely to be solved as an outcome of profit-maximising movements of capital and know-how. Equally, there are no grounds for believing that market forces will satisfactorily resolve the persistence of large-scale poverty. The BWIs (and other aid donors) therefore need to strengthen their anti-poverty efforts (see above). However, giving priority to the poverty problem has an important implication for the Bank: it is unlikely to make its best contribution by working through central governments, and will require more freedom to operate much more at the grassroots level, e.g. through the vehicle of NGOs.

The above suggestions imply the need for creation of international *authority* to match increased interdependence: 'rules with teeth' to achieve greater cohesion in national macroeconomic policies; to administer the proposed taxation and insurance schemes; to lend for adjustment and for public-interest projects; and to administer multilateral aid. The most obvious deficiency of present arrangements is in the area of policy co-ordination. One possibility is for the IMF to be given greater powers in this area. An alternative is to make a fresh start. Either way, the principle should be observed that international problems require properly constituted, representative and accountable international authorities. An exclusive group like the G-3 or G-7, cannot satisfactorily perform this role, with all the inherent conflicts of interest that arise.

However, major systemic reform appears unlikely at present. In the meantime, desirable incremental reforms include an up-grading of the IMF's co-ordination powers, perhaps backed by the sanctions of the newly created World Trade Organisation. The World Bank also has a potentially important role in strengthening aid co-ordination, which is weak at present. It should also constantly have in mind that the central purpose of aid is to reduce poverty, and retain a lead position in finding more effective ways of achieving this purpose. Global environmental issues offer another area in which the Bank can make a significant contribution, as a conduit through which developed countries offer financial incentives for developing countries to pursue environmentally friendly policies.

1. Background

To the extent that there can be said to be an international financial system, the IMF and World Bank are at its centre, siblings of the creation at the 1944 Bretton Woods conference of a new international economic order, to avoid repetition of the self-destructive policies of the inter-war years.

They are siblings but not identical twins. They have common memberships and their structures of governance are essentially the same, but they were intended to play distinctive, complementary, roles. The Fund was to act as a monetary institution, working for exchange rate stability, managing international liquidity and providing temporary financial support to members facing balance of payments (BoP) disequilibria. It was also expected to ensure high levels of employment and sustainable non-inflationary growth. Industrial countries were expected to be its chief borrowers. The Bank's task, on the other hand, was to support post-war reconstruction and long-term development; its initial customers were expected to be countries whose economies had been ravaged by World War II and subsequently what we now call developing countries. Its lending was expected to be for specific projects.

However, the BWIs have more than memberships in common, based on the common premises of the desirability of balanced, multilateral international trade; of the potency of international co-operation in pursuit of an equitably shared global prosperity; and of the efficacy of public agency interventions in this pursuit.

In the promotion of freer, multilaterally based trade and payments the BWIs (with GATT) can claim reasonable success. In other respects the record is more patchy. The 1960s were their heyday. The BW system was then associated with strong world economic growth, expanding world trade, low unemployment and low inflation. Not without challenge, the Fund remained the focus for international monetary reform during the 1960s. Since then, however, it has had difficulty in sustaining the relevance of its original mission in the face of the abandonment of pegged exchange rates in 1973 in favour of floating rates for the major currencies; by the *de facto* privatisation of international liquidity creation, which now appears beyond the control of any official agency; and by a borrowing clientele which, until the collapse of European communism brought it new customers, came to be comprised almost exclusively of developing countries. Thus, in 1992/93 21 members of the Commonwealth – all developing countries – made use of Fund credit. Moreover, while experiences with floating

In 1992/93, 21 Commonwealth members made use of Fund credit

Decision-making has passed to an exclusive Group

rates have been problematical, there has been a general economic slow-down and there continue to be periods of global economic turbulence. The decision-making centre of gravity has passed to a far more exclusive Group of the leading three, five or seven (or now eight with the addition of Russia?) industrial countries, which have steadfastly denied the Fund real influence through its powers of 'surveillance'. Trends towards regionalisation, particularly with the European Community and the European Monetary System, have further shifted the centre of gravity away from *global* agencies like the BWIs.

At the same time, the siblings have grown closer together and the old division of labour has become eroded. The logic of dealing largely with developing countries has pushed the Fund towards longer-term lending and less exclusively monetary programmes. And the Bank has entered the arena of macroeconomic policy through its 'structural adjustment' lending. However, the economic effects of BWI adjustment programmes have been the subject of much controversy. While both institutions have sought to adapt to changing circumstances, a great deal more needs to be done.

The widening gap between the world for which they were created and as it is today – and doubts whether the BWIs have adapted adequately to this changing environment – have led to calls for a radical rethink of international arrangements, reflected in the title of a 1983 Commonwealth Study Group report: *Towards a New Bretton Woods.* In consequence, the 50th Anniversary of Bretton Woods and its institutions is being treated as more than a celebration, as an opportunity for re-evaluation.

Kenneth Clarke's Multilateral Debt Initiative

Commonwealth Finance Ministers, meeting in Valletta, Malta (26-28 September 1994), agreed that tackling the debt problem was one of the best forms of help for the poorest developing countries. Ministers called for further measures to reduce the debt of these countries to sustainable levels, including full implementation of the Trinidad terms. They also recognised that the special problem of multilateral debt had to be addressed in a constructive manner. In that connection, Ministers warmly welcomed the proposals by the British Chancellor for responding to the problems faced by some of the poorest countries with exceptionally high levels of multilateral debt. Previous British initiatives on debt have also been launched at Commonwealth Finance Ministers Meetings. Nigel Lawson introduced his proposals on relief for low-income country debt in Barbados (1987) and John Major launched the Trinidad terms in Port of Spain (1990).

Mr Clarke recognised that bilateral debt continued to be the largest component of the debt of the poorest, most indebted countries. Securing full Trinidad terms, therefore, had to be of the highest priority. However, the Chancellor of the Exchequer acknowledged that for some countries Trinidad terms alone were not enough. Many countries owed debt to other creditors, including the multilateral institutions.

Mr Clarke's proposals called on all the international financial institutions to take a fresh look at how they could best tackle the problems of their poorest and most indebted shareholders. The solutions, he believed, should be guided by the following principles:

- First, the problem of multilateral debt had to be tackled in a way which reinforced the vital contribution of the international financial institutions to development. There could be serious problems if multilateral debt was simply written-off or rescheduled. It was necessary to maintain the good financial standing of all the international financial institutions so that they could continue to help their members and on-lend on the finest terms.
- Second, special help should be concentrated on those countries following sound economic policies in accordance with an IMF programme.
- Third, loans must be granted on terms which the borrower could afford, and which gave the borrower time to implement reform. This suggested that concessional lending over a longer period might often be the best way forward.

The World Bank was the largest provider of development assistance and the largest creditor. It already had well-established channels for helping the most indebted, notably with the provision of credits on soft terms through IDA. Mr Clarke encouraged the Bank to consider further ways in which it might help those of the poorest countries which had significant levels of non-concessional World Bank and commercial bank debt. In this connection, he welcomed the review that was being undertaken of the IDA debt buy-back arrangements. He also called on the Bank to consider whether there was scope for further improvement to its existing fifth dimension facility.

Mr Clarke also recognised the need for the regional development banks to see how far they could join in this endeavour. This applied to the Inter-American Development Bank, the Asian Development Bank and particularly to the African Development Bank, given the high indebtedness of many African countries. The latter, in particular, needed to establish a vigorous lending policy that ensured that finance was not provided to countries on terms they could not afford. Mr Clarke welcomed the recent move towards agreement on a fifth dimension facility for poor countries undertaking economic reform which had outstanding African Development Bank non-concessional debt.

The IMF was playing a key role in assisting developing countries through both its lending and policy advice. The Chancellor emphasised that continued Fund involvement was vital. He recognised however, that its assistance should be on terms which countries could afford. In this connection, he underscored the effectiveness of ESAF as a mechanism for lending to the poorest countries. He believed, however, that there was scope for improving it still further. He had two aspects in mind. First, he attached high priority to increasing access under all IMF facilities, including ESAF; but noted that this would not be a sufficient approach for the poorest countries with multilateral debts that were at a level judged to be unsustainable, even after full Trinidad terms on their bilateral debts. For them, taking on further debt on ESAF terms was not a solution. Something different was needed. This should be targeted at those countries, including several members of the Commonwealth, which had displayed a credible and durable commitment to economic reform, but which continued to face an overall level of debt judged to be unsustainable, including a significant level of indebtedness to the IMF.

For the very poor and heavily indebted countries, the Chancellor proposed that:

- Support would be provided through a special new ESAF window, which would increase the grace period and maturity of their ESAF borrowing (thereby reducing the net present value of their debts); this would give countries a longer time to repay, giving greater certainty of coping with repayments.
- Assistance would be made available after a sustained period of Fund programmes.
- These changes in ESAF would be financed by carefully considered and phased sales of a small part of the IMF's gold reserves – the proceeds of which would be invested and the returns on that investment would be used for financing the ESAF subsidy. The underlying investments would form part of the Fund's reserves, so ensuring that its financial soundness was not compromised.

The Chancellor, at the Development Committee meeting in April 1995, put forward proposals for dealing with World Bank debt. For those with a heavy burden of IDA debt, to consider introducing differential terms allowing the very poorest to receive financing on grant terms and for those heavily burdened by non-concessional World Bank debt, a carefully targeted scheme for meeting principal payments under the "fifth dimension facility".

II. Systemic Issues

i. Lessons from the past as a guide to the future

A number of lessons may be drawn from the recent past to help inform future policy. First, flexible exchange rates have been both volatile in the short run and subject to misalignment over the long run. These features carry with them potentially significant costs even in a world where hedging against exchange rate risks is available. Counter-trade may be encouraged, as also the inefficient allocation of resources worldwide. The associated uncertainties may lead to decision delays, with adverse implications for investment, growth and employment, and the danger of a ratchet effect on protectionism, with the consequences of currency overvaluation for protectionism not being symmetrically offset by the trade liberalising effects of undervaluation.

The lack of policy co-ordination fostered by flexible exchange rates has itself contributed to volatility and misalignment, and has allowed large fiscal imbalances to develop which have had destabilising global ramifications. Moreover, the costs of unco-ordinated policies have spilt over to developing countries. The consequences of unco-ordinated monetary contraction amongst G-7 countries at the beginning of the 1980s for global economic activity and interest rates contributed significantly to the Third World debt crisis. And it may be no coincidence that the early 1990s, like the 1930s, were characterised by economic recession, rising unemployment and a slowdown in world trade.

The costs of unco-ordinated policies have spilt over to developing countries

Evidence for the superiority of market-based BoP financing is no more compelling. Private capital markets have exhibited pro-cyclical waves of feast and famine, have resulted in financial flows not clearly related to variations in the marginal productivities of capital across countries but to financial returns and expectations, and have incorporated strong regionalisation effects. The capital transfer patterns of the 1970s and 1980s do not, therefore, instil great confidence nor provide a satisfactory basis for the future. If private agents possessed the perfect foresight with which they are sometimes credited, the debt crisis would not have happened. Moreover, the market fails not only on *efficiency* grounds but in terms of *equity*, since the financing needs of many low-income countries are largely ignored by it.

The global environment in which the BWIs now function is hence very different from the one for which they were originally designed. There is greater interdependence between countries, via

trade and finance and the globalisation of markets (not least via transnational corporations); hugely increased mobility of capital (following the removal or breakdown of capital controls); financial innovations in lending instruments; and the communications revolution. There is also the emergence of powerful new economies in South East Asia and, potentially even more important, the prospective emergence of others such as China; changing geopolitical allegiances, with a more complex mosaic emerging than in the days of the Cold War; the massive problems facing countries in transition; and some proliferation of international economic institutions, including the new World Trade Organisation (WTO).

The Commonwealth offers a unique forum for debate on reform

Another important change arises from the growing importance of developing countries both within the world economy and as members of the BWIs. Nearly 130 of the 178 members of the IMF are classified as 'developing countries' and the contribution of these to world output growth, when valued in purchasing power parity terms, rose from 32% to 37% during 1983-92. Moreover, the ability of some countries in Asia and the Western Hemisphere to achieve relatively rapid growth in the early 1990s despite a global slow-down suggests that developing countries have some independent growth and may be able to play a 'locomotive' role.

A final difference is that gaining agreement on international monetary arrangements is more difficult than in 1944, when a small number of like-minded intellectuals was able to push through policy reform. Subsequent attempts to induce fundamental reform have been unsuccessful. However, because the Commonwealth includes within its membership large industrial countries as well as small and very poor developing countries, it straddles other inter-country groupings such as G-5, OECD, and G-24, and it therefore offers a useful forum in which reform may be debated, since a full range of country interests is represented.

In the remainder of Part II we concentrate on two related systemic issues. The first is policy co-ordination. This seeks to minimise the incidence of BoP disequilibria by eliminating macroeconomic mismatches and by orchestrating responses to asymmetrical supply-side shocks. However, even at its most successful, co-ordination will not eliminate disequilibria altogether, so the second issue is how to deal with disequilibria when they arise. Here we examine the balance between adjustment and financing, and investigate ways of modifying the balance which has evolved in recent years. In the concluding Part IV we revert to systemic issues, to discuss questions of institutional change.

ii. The international co-ordination of macroeconomic policy

The fundamental case for policy co-ordination is simple and appealing. In an inter-dependent world one country's actions have external effects on other countries. Ignoring these spill-overs results in sub-optimal decisions and the externalities need to be internalised into decision-making processes. Co-ordination involves modifying national policies to reflect international economic inter-dependencies and seeks to maximise joint welfare. Global problems of recession and unemployment may be best handled by globally co-ordinated policy since attempts to deal with such prob-

lems in isolation will encounter BoP constraints. At the same time, co-ordination highlights the potential unsustainability of some countries' policies, incompatibility between objectives (e.g. where all countries are simultaneously seeking to strengthen their BoP), the problems of 'global overkill' (where taken in aggregate, policies are excessive) and the 'fallacy of composition' (where a policy that may be effective when pursued in isolation will be ineffective, or less effective, when pursued simultaneously across countries).

Against this, critics argue that co-ordination impedes necessary exchange rate realignment, with adverse effects for financial markets, and diverts attention from the need to attend to domestic policy. Economic welfare, they suggest, is maximised when behaviour is competitive.

What does the evidence show? The BW system incorporated a form of rule-based co-ordination and that structure collapsed. However, the appropriate conclusion from this is that the *form* of co-ordination was too rudimentary, ignoring issues relating to the conduct of fiscal and monetary policy. A more recent failed experiment with policy co-ordination was the European Monetary System and its Exchange Rate Mechanism. Does the collapse of this in 1992/93 call into question the wisdom of co-ordination? Again, the answer is no. What it illustrates is the need, first, to identify carefully the exchange rates to be defended, since otherwise the commitment will lack credibility and, second, to allow rates to be realigned when there is a shock (e.g. German reunification) which creates fundamental disequilibria at the original rates. While policy co-ordination tries to minimise BoP disequilibria, any scheme for co-ordination must recognise that these will never be completely eliminated and incorporate a mechanism for dealing with disequilibria when they arise.

Apart from the evidence from co-ordination experiments, various studies attempt to estimate the benefits and costs of co-ordination. Although some have identified only insignificant positive gains and some even losses, the models from which these results emerge are often based on quite restrictive (and unrealistic) assumptions. Where benefits are discovered, they are not limited to the industrial countries that undertake the co-ordination, but spill over to other country groups. Indeed, developing countries are sometimes apparently the principal beneficiaries from policy co-ordination amongst industrial economies. Of course, as noted above, North-South interaction is two way and the mutuality of interests as between North and South is significant. It is in the interests of industrial countries to encourage economic growth and development in poorer countries and policy co-ordination can play a significant role here.

The North and South have mutual interests in policy co-ordination

Support for enhanced policy co-ordination came from Commonwealth Study Groups in 1983 and 1991 and the same principle has recently been endorsed by the Bretton Woods Commission chaired by Paul Volcker, which recommends that, 'the major industrial countries should give co-ordination a higher priority than they have' (1994, p.3). However, the crucial problem is in moving from general principles (where there appears to be little disagreement) to operational modalities. In the case of the Volcker Report, this problem is reflected by using elastic phraseology which talks about a 'broad improvement' and 'greater convergence' in national macroeconomic policies, as well as 'responding appropriately' to changes in international economic

conditions. The Report also suggests that '*in time*, this system could *possibly* involve flexible exchange rate bands' (italics added). A little more boldly, the Report proposes that industrial countries, 'should establish a more formal system of co-ordination involving firm and credible commitments to support policy improvements and avoid excessive misalignments and volatility' (p.5). However, when the details of more formal systems are proposed, disagreement invariably surfaces. For example, the Volcker Report has expressed admiration for the detailed proposals for policy co-ordination put forward by Williamson and Henning (1994) as an 'intellectual feat' but dismissed them as 'too elaborate'.

Rule-based policy co-ordination is preferable to ad-hocism

The danger, then, is that policy co-ordination will be vulnerable to a Catch-22 syndrome: what is practical will be ineffective and what would be effective is impractical. The guidelines for policy co-ordination need to be sufficiently well-defined to be clear and effective, and at the same time avoid being too intrusive, thereby seeking to maximise the degree (or at least the illusion) of 'national sovereignty' retained by individual countries. Either way, it is preferable as a regime feature to have co-ordination based on guidelines (rules) rather than on discretion, although the latter will be required as an over-ride to the system to deal with unanticipated shocks.

A key design issue is whether target zones (or exchange rate bands) are vital in inducing convergence in macroeconomic policy. The current view within the Fund seems to be that, although there is a two-way relationship, it is the co-ordination of fiscal and monetary policy which is strategically the more important. According to this view, problems with exchange rates arise largely from inadequate macroeconomic policies rather than from the nature of the exchange rate regime itself. An alternative view is that target zones which permit nominal rates to change in order to reflect changes in fundamental equilibrium rates none the less provide a focal point around which macroeconomic policies may be co-ordinated. However, suggestions that the ERM could, in effect, be globalised, at least amongst the world's three major monetary poles (the G-3), encounter the objection that a higher degree of collective determination is needed than exists now and is likely to exist in the foreseeable future.

A further important design feature relates to dealing with free-rider and time-inconsistency difficulties. How is compliance to be monitored and enforced? Peer pressure for the pursuit of appropriate policies may be insufficient. It has not in the past prevented countries from pursuing policies which have imposed external costs on others. Although more formal policy co-ordination would increase peer pressure, other mechanisms may be needed. In the case of surplus countries one idea would be to reactivate in one form or another, the almost forgotten 'scarce currency clause'. Through this mechanism the Fund could integrate its enhanced co-ordination role with the activities of the new WTO. In the case of those deficit countries which do not borrow directly from the Fund, additional pressures could be exerted via measures to interact more closely with private capital markets and to be more open in providing information (see below).

However, there are problems not only in the design of co-ordination but also in the modalities through which it takes place. These two aspects are connected by considering the *deepening* and

widening dimensions of co-ordination. Should it involve relatively few countries but go into depth or should it be less detailed but involve more countries? The answer to this question in turn connects economic and political elements, since co-ordination needs to be sufficiently detailed to make it work (loose commitments to 'co-operation' will be operationally meaningless) but at the same time has to carry sufficient international support for it not to be frustrated.

How many countries should be involved in the design of internationally co-ordinated policy? One principle involved is that negotiation becomes more difficult the larger the number of actors involved. This counsels limiting co-ordination to a small group of countries. A second principle suggests that governments will be more committed to guidelines restricting their policy freedom if they feel that they have been involved in the negotiating process, and will be suspicious of any process which excludes them (see Part III on 'ownership').

The nature of co-ordination is also significant, since if it were to be discretion-based and of a fire-fighting type it would almost certainly need to be limited in its coverage. Where it is rule-based, however (aiming to be preventive rather than curative), a wider constituency may be involved in its design. Co-ordination may need to be more complex and multi-layered than is implied above, however. Circumstances may exist, for example, where inflationary pressures amongst G-7 countries validate increasing interest rates. These clearly have effects on highly-indebted developing countries because the cost of servicing external debt will increase and capital outflows may be induced. Moreover, if rising interest rates slow the growth of the world economy this will weaken the export markets of developing countries. Part of co-ordination should therefore be to insulate such countries from the consequences of damaging side-effects. Co-ordination of macroeconomic policy therefore has indirect implications for compensatory and contingency lending (see below).

Bearing in mind the twin principles introduced above, as well as the need for compensatory measures, there is a strong argument for policy co-ordination to be organised within the IMF; an *international* agency would then be orchestrating the *international* co-ordination of policy. This is also the conclusion reached by the Volcker Commission, which rejects the G-7 alternative on the grounds that 'the G-7 process is not an institution, a continuing body, or an executive entity.' The Commission also sees problems with the G-7's broad agenda, extending to political and security issues, and its relationship with non-G-7 countries. On the other hand, giving the tasks to the IMF 'whose major shareholders are the major industrial countries, that has the flexibility, the legitimate authority and much of the necessary expertise' would 'restore the original focus of the Fund' (p. 8). We agree.

The case for enhancing the Fund's surveillance role

But does the Fund's organisational structure lend itself to the task of co-ordinating policy? Williamson and Henning (1994) propose a Fourth Amendment to the IMF's Articles, a reconstitution of the Interim Committee into an International Monetary Council, and a new subcommittee of the Executive Board which would meet at least quarterly to exercise surveillance over countries' compliance with agreed guidelines. Others have suggested dismantling both the Interim and Development Committees altogether and replacing them with international

steering committees, based on G-3 members. However, although this suggestion complies with our first principle, it fails to meet the second. Given their growing importance in the world economy, developing countries must be fully involved in the policy co-ordination process.

Even outside the issue of co-ordination, the increasing membership of the Fund raises important questions of governance and democracy. At present, a few countries are able to dominate decision-making and frustrate the wishes of the majority of members. The increased economic importance of developing countries has received scant recognition in the decision-making of the BWIs, which appear increasingly undemocratic in their structures of governance. For example, Commonwealth countries comprise about 27% of the membership of the IMF and command just over 18% of the votes, only fractionally greater than the voting share of the United States which comprises a mere 0.56% of the Fund's membership and which exerts enormously greater influence.

At the same time, the increasing size of the Executive Board has been seen as diminishing its effectiveness and the establishment of smaller executive subcommittees as desirable. It will be important however that such changes are representative of the Fund's changing membership, with rotation having been suggested as one means through which this might be achieved.

The South's growing importance means it must be involved in decisions

The world economy in general benefits from stable economic growth, orderly foreign exchange and financial markets, liberal trade, full utilisation of capital and labour, and smooth adjustment to disequilibria. Since the collapse of the BW system many of these objectives have been unrealised. It is in this context that policy co-ordination offers an opportunity for systemic improvement, as well as an opportunity for the Fund to reassert its pivotal role in global economic affairs. This general goal should unite Commonwealth countries, even though it may be expected that points of view will differ as to the detailed arrangements through which the goal may be best achieved.

iii. The adjustment–financing balance

The past two decades have witnessed a large shift in the balance between adjustment and financing as means of dealing with BoP deficits. In response to the first oil shock in 1973 the Fund established an Oil Facility to provide additional financial assistance to countries encountering oil-related deficits. It changed its mind as other shocks occurred, including the second oil shock of 1979 and the debt crisis of 1982-83, and opted for responses requiring much more adjustment. The Oil Facility was allowed to lapse, no new allocations of SDRs have been made since 1981, and the Compensatory Financing Facility was deliberalised from a low-conditionality to a high-conditionality facility. When modified in 1988 to include a contingency element and to become the Compensatory and Contingency Financing Facility (CCFF) its high conditionality status was retained, even strengthened; these changes also survived a subsequent review in 1993. Contingency planning has been taken by the Fund to require building up larger reserves in deficit countries through pursuit of still more contractionary adjustment policies, even though this could lead to real exchange appreciation. Despite recent efforts to

strengthen the contingency-orientation of programmes, there has been a more general trend towards emphasis on adjustment and conditionality amongst lenders and donors.

There are clearly circumstances in which adjustment is essential: when disequilibria are non-transitory and related deficits are unsustainable in the long-term. In such cases postponing adjustment will make matters worse. However, where BoP deficits are temporary and self-correcting, adjustment is inappropriate as a policy response, except as a means of reducing vulnerability to temporary shocks, and external financing is superior. Developed country governments, including those of the United States and Britain, have used this logic to claim that their current account imbalances do not matter since they are ephemeral and can be financed by international borrowing because of strong credit worthiness.

But does the theory only apply to developed countries? Should developing countries faced with non-permanent shocks, such as harvest failures in Africa or hurricanes in the Caribbean, be expected to tighten macroeconomic policy in consequence? Either event would induce the temporary export shortfalls against which the CCFF was originally designed to insure. The only significant difference between the country groups relates to their creditworthiness. This is an area where the market fails. Systemically, the Fund as a BoP institution should provide compensatory and contingency finance to allow domestic policy to be implemented in a more stable and less disrupted way, while the World Bank should provide the longer term development assistance which allows exports to be diversified. It makes little sense for poor countries to protect themselves against unforeseen shocks by building up large stocks of unproductive international reserves. All this does is to make *certain* now the sacrifices that *may* have to be made in the future.

Temporary shocks require compensatory financing, not adjustment

In any case, adjustment and financing are not pure substitutes. Any BoP programme will incorporate a package of adjustment and financing. Where the adjustment component focuses on supply enhancement and structural change, rather than on demand contraction, the process will take longer and in the interim more external finance will be required to support it. Of course, if as a result adjustment is more effective, the longer term need for BoP financing will be lowered; there is an intertemporal trade-off between financing now and in the future. Inadequate external finance may therefore damage the chances of effective adjustment, not least where it reduces the commitment of governments that have to implement the adjustment policies. In this sense external financing and effective adjustment are complementary.

The role of the BWIs in encouraging an optimal blend of financing and adjustment will vary given the diversity of country circumstances, such as those in the Commonwealth. For fully creditworthy countries the BWIs will not need to provide finance, and the IMF may seek to persuade them to place greater emphasis on adjustment through Article IV consultations. For middle-income developing countries on the margin of creditworthiness, the Fund's catalysing role could, in principle, be important, while co-financing and guarantees could be provided by the World Bank Group. Here the BWIs should attempt to support private capital markets and enhance the creditworthiness of borrowing countries.

Here too there are important links between financing and adjustment. The

Volatile capital flows require two approaches

Fund's catalytic effect (which both theoretical and statistical analysis suggests is much less significant than is often claimed) could be strengthened by improving the effectiveness of Fund-backed adjustment programmes. Interaction with private capital markets could take place in other ways. Although private markets and the BWIs share many interests, such as the pursuit of stable financial conditions and 'sound' economic policies, there has not always been a mutually supportive relationship between them. It has proved difficult for the Fund to influence, let alone regulate, private capital flows. Without resorting to capital controls (which, even if they were desirable, are probably impractical), two broad approaches exist.

The first is to design an international framework which seeks to stabilise private capital flows. This is the logic behind proposals that the Fund should more formally 'certify' market lending to developing countries or that countries should formally pre-commit themselves to accept Fund-backed programmes in the event of certain situations. It is also what lies behind the suggestion that the Fund should make available more detailed country information and enter into direct consultations with market participants. After the 1982/83 debt crisis the Fund attempted to exert more influence over private capital flows by briefing commercial bank steering committees and through a policy of concerted lending. But it has been reluctant to become systemically involved with private capital markets, even by way of offering general (non-country-specific) guidelines on country risk analysis. However, with private capital flows becoming increasingly important and given the potential and actual volatility of market flows, now is an appropriate time to reassess this position. A second approach would be to compensate countries after the event for the volatility in capital flows which they experience. A specific proposal which advocates this approach is evaluated below.

For low-income countries, such as those in Sub-Saharan Africa, the BWIs need to stand in place of frequently absent private capital. Even the Volcker Commission, which urges the World Bank Group to focus much more on orchestrating private finance, recognises that the Bank's role needs to be substantially different in low-income countries, where increased highly-concessional finance is needed. While the problems faced by low-income countries are undoubtedly serious, it is wrong to assume that they are intractable and that it is beyond the scope of the BWIs to offer effective assistance. There is an array of policies that could usefully be adopted, including the reintroduction of quick-disbursing and low conditionality compensatory and contingency financing (via a modified CCFF), the wider use of subsidies to finance concessionary lending by the Fund across all its lending windows, the extension of debt relief to alleviate the problem of African debt, and new allocations of SDRs. These are not new ideas. Many of them (along with others) appeared as recommendations from the 1983 Commonwealth Study Group. Inaction reflects a past lack of political will rather than an absence of proposals. The mid-1990s, however, may offer a more conducive environment than the 1980s, when such forms of international economic intervention were out of step with the dominant economic and political paradigm. Moreover the prime global concern is now more with unemployment and recession than with inflation, and these are symptoms of deficient rather than excess liquidity.

As a specific example, the arguments assembled against an SDR-aid link when it was first proposed in the 1970s lack force in the 1990s. The inflationary consequences of SDR allocations are now accepted as insignificant and the dangers of damaging the SDR as an international reserve asset are no longer relevant. Concern over the fact that SDRs are exempt from Fund conditionality could be overcome by using SDR allocations to augment conventional Fund-backed programmes, where they would still alter the financing-adjustment balance in favour of short-term financing and longer term adjustment. Objections that the near-commercial rate of charge on the net use of SDRs eliminates the benefits to recipients are not persuasive, for many low-income countries have no access to commercial markets or can only borrow at considerably higher rates than carried by SDRs. In any case, the benefits to recipients can be raised by subsidising the charge they pay. Although the Interim Committee has deferred a decision on the Fund Managing Director's recent recommendation for a new SDR allocation, there remains a strong chance of eventual acceptance. While the consensus that is emerging focuses on a special SDR allocation for the former socialist countries, low-income countries should also receive new allocations, a substantial proportion of which would be to Commonwealth countries.

In addition to support from the BWIs, market-related opportunities also exist for reducing low-income countries' vulnerability to commodity instability. More aggressive use of futures and options markets could transfer some of the risk associated with export concentration. The BWIs could usefully provide technical advice on the scope for such self-help.

The rationale for protecting adjustment programmes from the effects of 'outside' shocks does not only apply to low-income countries. The experience of middle-income developing countries during the 1980s and 1990s reveals how domestic macroeconomic management may be disturbed by swings in the availability of private capital. During the 1980s a number of proposals were put forward for schemes which would have effectively capped interest rates. More recent suggestions advocate devising a quick-disbursing credit mechanism to ameliorate sudden changes in private capital flows, especially when these are beyond the control of the countries concerned. The additional credit would supplement countries' own prudential reserve accumulations but would enable the cost of such provision to be shared between the countries themselves and the international financial institutions. The Fund would in this instance offer a second line of reserves. The principal proponents of such a facility see it as a low conditionality source of credit, but the Fund would only countenance the idea if it was linked to adjustment programmes.

Use of futures and options

A problem here is that providing 'second line' credit to better-off developing countries could crowd out 'first line' credit to low-income countries. If the BWIs have limited resources, it is important that they use them in ways that meet both efficiency and equity criteria. It would be preferable for the BWIs to instead explore ways in which they could dampen sudden changes in private capital flows. This might be achieved by strengthening the catalytic effect and making more information available (see above). It could also be achieved by the Fund taking on a larger role in regulating private financial markets and by the BWIs encouraging optimal matching between the financing needs of developing countries and the instruments through which finance is supplied by private capital markets. A stark mismatch in this respect

contributed to the debt crisis in the early 1980s, and the better match achieved in the early 1990s, when private capital has surged back into some Latin American economies, has led some observers to conclude that the new flows will be more stable – a conclusion which may, however, be premature.

Taking on additional financing commitments of course has implications for the BWIs' resources. Ways will have to be found either for targeting these, focusing a fixed lending capacity in a more concentrated fashion, or for raising the lending capacity of the institutions. The appropriate response may indeed differ between the BWIs. For the Fund, there is a strong case for making quota increases more automatic and for relating such increases to economic proxies for the size of the problems with which the Fund is attempting to deal (such as a sharp fall in the value of world trade). Although it remains appropriate to finance a public agency such as the Fund by subscriptions, borrowing from capital markets could also be used to supplement Fund resources. By acting as an intermediary between eventual borrowers and capital markets, the Fund could help stabilise the flow of private finance to developing countries. Dangers that Fund borrowing would crowd out World Bank borrowing have surely been overstated.

The need for additional resources would be minimised if the BWIs followed the principles of compensating for market failure implied in the above discussion. These would mean that they would underpin, stabilise and complement the role of private capital in the more creditworthy developing countries in ways that maximised private flows over time and minimised their own, but stand prepared to substitute for private capital in low-income countries, where, in absolute terms, the demand for finance is small.

As part of this reorientation, the past proliferation of lending windows should be reversed. Streamlining access could be achieved by rationalising the range of Fund facilities. At present, these incorporate credit lines which are little used (the Buffer Stock Financing Facility and the CCFF) or have overlapping purposes (ESAF and the Extended Fund Facility). Proposals for yet more facilities are inappropriate on this criterion, although the Fund should retain the flexibility to introduce *ad hoc* initiatives in response to sudden crises, in the manner of the Oil Facility. For the facilities which exist at present, however, a better arrangement would be to consolidate them into three: stand-bys, extended arrangements, and compensatory and contingency lending (without any overall reduction in lending levels). Stand-bys could continue to rely on conventional stabilisation measures. Extended arrangements would focus on longer term structural adjustment packages (and have a permanent status, unlike ESAF) and be closely integrated with World Bank SAPs via Policy Framework Papers.

Compensatory and contingency lending would involve quick-disbursing low-conditionality finance, although possibly with a pre-commitment element to implement more far-reaching programmes if BoP problems do not improve. All Fund lending to low-income countries should then be provided on highly-concessional terms, which could be financed by subsidies or gold sales.

There would also be a case for the Bank to adopt, and have funded, a credit window offering terms intermediate between the present IBRD and IDA terms, for countries with a similarly intermediate creditworthiness. The present stark dichotomy between the near-commercial IBRD terms and the high-grant-element IDA terms is a poor fit to the spectrum of creditworthiness found in the developing (and ex-socialist) world.

III. The BWIs and Economic Development

i. Overview

The BWIs impinge directly upon the development of the countries to which they lend in two principal ways: through the productivity of the financial (and technical) assistance they provide, and through their influence on the policy choices of the governments of those countries. Indirectly, as shown in Part II, they also impinge through such influence as they have on policies within industrial countries, and on the workings of the international trading and financial 'system', but we confine ourselves here to their direct effects.

They impinge but to what extent do they improve? A wide range of criticisms has been levelled in the past, from different points on the spectrum. It has been complained that:

- World Bank projects have had a bias towards large scale, have produced weak results, particularly for the poor, and have done environmental damage.
- IMF stabilisation programmes have been inappropriately designed for developing-country conditions, have imposed excessive costs in terms of lost output and employment, diminished welfare of vulnerable groups and political destabilisation, and have not induced compensating economic benefits.
- The approaches to policy in the adjustment programmes of both BWIs have been doctrinally biased towards monetarist and market-based approaches, and have taken a too exclusively negative view of the role of the state. Alternatively, others have argued that, because they deal almost exclusively with central governments, the BWIs have exerted a pro-state centralising influence, supporting public actions where private enterprises or NGOs would do better.
- The BWIs' lending operations (particularly those of the IMF) and preferred creditor status add substantially to the debt problems of low-income countries; and the post-1982 global debt management policies in which the BWIs were active participants imposed one-sided costs on debtor countries. Alternatively: the growth and increased efficiency of world capital markets has rendered the BWIs' lending operations largely redundant, causing public capital to compete inefficiently with private markets, and creating severe moral hazard problems.
- Many of these alleged negative effects arise because the BWIs are structurally ill-suited to

BWIs impinge, but do they improve?

the tasks of promoting welfare in developing countries, and they have been unable to adapt adequately to changing global economic realities. In the case of the IMF, it is alleged that there is a fundamental mismatch between its design as a short-term monetary institution and the long-term structural nature of developing countries' payments problems. In the case of the Bank, its cumbersome centralised structure impedes it from reaching the poor.

This is a considerable catalogue of criticisms, several of which were made in the 1983 Commonwealth report. Some of them are taken up in succeeding sections. In the following paragraphs we confine ourselves to briefly reviewing the evidence relating to the productivity of past BWI lending.

SAPs have done poorly in Sub-Saharan Africa

First, **World Bank projects**, which even at the peak of structural adjustment financing still comprised the bulk of its lending. There is unfortunately no consensus on the economic, social and environmental effects of Bank projects nor any solid body of independent evidence on them. Widely differing views are held. Earlier Bank *ex post* evaluations generally reported fairly high proportions of projects achieving satisfactory rates of return, while also drawing attention to imperfect implementation and/or diminishing sustainability over time. However, others have criticised these results as biased or methodologically suspect (Riddell, 1987).

Recently, much attention has been paid to a 1992 report by a Bank Task Force (the *Wapenhans Report*) reporting a sharp rise in the proportion of projects judged to be in serious difficulty, from 11% in 1982 and 13% in 1989 to 20% in 1992, and with only 63% of projects completed in 1991 regarded by Bank staff as satisfactory (see also Wapenhans, 1994). In consequence, various projects were cancelled (including a reported $1.3bn-worth in India) and major changes announced in project management structures. As to environmental damage, while the more sweeping allegations are much exaggerated, there have been well-publicised controversial cases, including various projects in the Amazon. In fact, the Bank admits that it is only in the past few years that it has begun to give environmental considerations much weight in project decision-making.

One reason why even apparently well-designed projects do not yield expected developmental benefits is that they often function within an unsupportive policy and institutional environment. Growing realisation of this was a major motive for the Bank's move into 'structural adjustment' lending in the 1980s. This then brings us to **the effectiveness of adjustment programmes**, for these are intended to improve the policy environment.

Remaining with the Bank for the moment, various empirical investigations point to broadly the same conclusions: that **Bank structural adjustment programmes** (SAPs) are associated with accelerated growth of export volumes and some improvement in the BoP; reduced levels of investment; and no significant change in economic growth, positive or negative.

Another consistent finding is that SAPs have done particularly poorly in Sub-Saharan African countries. Nooter and Stacy (1990) utilised in-depth studies of seven African countries, concluding that only three of the seven (Ghana, Guinea and Madagascar) had implemented satisfactory adjustment

measures. Of the three, only the Ghanaian programme has since remained on track. An internal evaluation of experiences with adjustment lending (World Bank 1992b, Chapter 1) found markedly weaker results for African and other low-income countries than for middle-income adjusting countries. Another Bank study has the frank title, 'Why structural adjustment has not succeeded in Sub-Saharan Africa' (Elbadawi *et al*, 1992). Most recently, a Bank report on *Adjustment in Africa* (1994a), while concluding that steady implementation of adjustment measures had resulted in improved economic results, judged only six African governments to have made large improvements in their macroeconomic policy stances since the early 1980s (Burkina Faso, The Gambia, Ghana, Nigeria, Tanzania and Zimbabwe), although the Nigerian situation has since changed. Only in Ghana did the report rate macroeconomic policies by the early 1990s as better than 'fair'.

What now of **the effects of IMF programmes?** The main results of a survey by Killick *et al* (1992a and b) were that:

- Fund programmes (like those of the Bank) are generally associated with a strengthening in countries' export and BoP performances but that this result was not strongly correlated with the extent of programme implementation.
- Inflation was not much affected, with disinflationary and price-raising effects tending to cancel out.
- GDP growth was also not much affected, in either direction.
- Fund programmes were liable to have appreciable effects on the distribution of income but these were complex and varied between countries. There was no evidence that Fund programmes had resulted in systematic political destabilisation. In fact, IMF support may have had the contrary tendency, by supporting incumbent governments.
- Since 1980 half of IMF stand-by programmes have broken down before the end of their intended life, a proportion which rose to 61% in 1991-93 and as at April 1993 only five out of a total of 25 ESAF programmes had been completed within the originally intended period. There was much other evidence of incomplete programme implementation.
- Programmes did not appear associated with large changes in fiscal and monetary policy outcomes, although they *were* associated with substantial and sustained exchange rate depreciations.

Reform programmes are essential for sustained growth

The Fund has recently published a review of its experiences with ESAF programmes (Schadler *et al*, 1993). While apparently conveying satisfaction with general outcomes, this evaluation did not establish any link between programme implementation and economic results. It also contained evidence suggesting ESAF programmes may result in reduced growth rates, when compared with SAF programmes (Killick, forthcoming).

The records just summarised thus provide ammunition for both the BWIs' critics and their defenders: their programmes appear to contribute only modestly to improving economic performance, but there is little evidence of any large damage. The conclusion of a senior member of the Fund's research staff sums it up and is also valid for the World Bank's SAPs (Khan, 1990): '... one would be hard-pressed to extract from

existing studies strong inferences about the effects of Fund programs on the principal macroeconomic targets.'

Quite apart from the large methodological difficulties of arriving at firm conclusions about programme effects (especially the basic imponderable of what would have happened in the absence of a SAP), supporters of the BWIs can also object that this type of research overlooks the less tangible influence of both institutions on policies in developing countries, through their advice and publications, described above as the second major way in which the BWIs impinge upon economic development. This is a valid defence. As argued later, the stabilisation and adjustment promoted by the BWIs are necessary for the successful adaptation of economies to external shocks and changing needs.

Their influence on the general climate of opinion as well as on the specifics of policy, is undoubted. IMF Managing Director Camdessus can plausibly claim there to have been a 'silent revolution' in developing country attitudes towards macroeconomic management, and to this the Fund's advice and persistence have made a large contribution. Similar claims could be made for the influence of the World Bank, not least through its research and publications programmes.

Has there been a silent revolution in attitudes?

In the remainder of Part III we take up some of the more specific areas of concern about BWI adjustment programmes in developing countries: about the effectiveness of conditionality; the balance to be struck between the public and private sectors; the impact of the BWIs on poverty; and their contributions to low-income countries' debt problems.

ii. The paradox of strong conditionality but weak results

The past one-and-a-half decades have seen a cascading of BWI conditionality, with World Bank structural adjustment lending conditions adding to the stipulations of the IMF. Bank data (1992a, Table A1.2) show the annual average of adjustment-related loans in Africa alone to have increased from three in 1980-82, involving $190 million, to 15 in 1991, involving nine times as much ($1,732 million). Its SAP conditionality is wide-ranging and its staff's tendency to be over-ambitious in programme stipulations has been regularly identified as a weakness in internal Bank evaluations. This self-criticism has not, however, prevented an ever-increasing number of policy conditions, with the same source showing the average number of binding policy stipulations per SAP as rising from 21 in 1980-88 to 35 in 1989-91. A specific but not exceptional illustration is provided by a Bank report on a Commonwealth African country which is still trying to rebuild its public administration. This sets out a total of *eighty-six* specific policy commitments for 1991/92 to 1993/94, of which *seventy-nine* should have been undertaken or initiated in FY 1991/92 alone.

There has also been a similar tendency in the IMF, most notably in its ESAF programmes. There has been extensive use of preconditions and the average number of performance criteria per programme rose from under six in 1968-77 to nine-and-a-half in 1984-87 (Polak, 1991). Furthermore, there has been evident, but not transparent, cross-conditionality between the BWIs, with the Bank commonly requiring an IMF programme to be in place before it is willing to approve a structural adjustment credit.

In the face of this proliferation, the question arises why programme effects are not stronger than those reported in the previous section.

Various factors contribute. It is not feasible for the staff of the BWIs to obtain and absorb the vast amount of information about the workings of each of the economies in which they are lending, for them to be able to design optimal adjustment programmes. There are problems with insufficient staffing (largely at the insistence of G-7 shareholders) and high turnover. Quite often an inadequate amount of supporting finance is available. There are problems with political interference in country lending decisions by major-shareholder governments. There are frequent and major problems with what the BWIs call the 'political will' of governments to implement the measures they have promised, but what might more helpfully be thought of as the internal political conditions bearing on programme execution. To this can be added the problem of implementation overload resulting from the cascading of conditionality just described. Even more important, there is the supervention of adverse terms of trade and other 'shocks', which often knock the best-laid adjustment programmes awry.

We suggest, however, that what the Bank calls 'ownership' is even more crucial: the extent to which a government regards a programme as its own, which it has a commitment to implement. Surprisingly little attention has been paid to the findings of a Bank report (1992a) which found that the extent of government ownership predicated the satisfactoriness of SAP outcomes in three-quarters of all cases, with most 'deviant' cases explained by exogenous shocks. Ownership was high in most programmes achieving good outcomes and low in most unsatisfactory programmes. In the absence of ownership, governments evade commitments and regress when opportunities arise.

'Ownership' of programmes is crucial

Conditionality, being essentially coercive, undermines ownership. Its imposed nature can result in resentments by the ministers and officials who must implement the measures – and live with their consequences. In some cases, public perceptions of imposition can undermine programme legitimacy and strengthen opposition to reform. The BWIs deny that programmes are imposed but we suggest that the degree of imposition is more common than they are willing to admit. This was strongly suggested by evidence in the Bank study just cited, showing that government ownership was judged by *Bank staff* as 'low' or 'very low' in half of programmes and 'very high' in only a fifth. The problem is particularly acute in the smaller countries with weak bargaining power: the negotiating position of a government such as India's (whose current reform programme appears to have been largely home-designed) is altogether more favourable than that, say, of Zambia or Guyana.

There are large advantages to 'home grown' programmes. Being a product of domestic political and policy-formation processes, they more faithfully reflect domestic goals and priorities, and are less likely to be sabotaged during implementation. Ideally, the programme is consensual, based on wide consultation and public information. Even with more controversial programmes, the government will have considered how the resulting social costs and political opposition are to be managed – something the BWIs are not well equipped to do. By definition, such programmes are tailor-made to suit local circumstances, and they tap a superior knowledge of local

Home-grown programmes have proven their worth in East Asia

conditions. The probability of sustained government commitment to the chosen path of reform is enhanced.

A recent comparative study of the liberalisation of cereals marketing in various African countries (Coulter, 1994) provides an interesting microeconomic illustration of the importance of ownership. Mali's experience was found to be the most positive – a result attributed to 'the more secure macroeconomic and policy environment, and a high degree of consensus about the reform within Mali, between the Government and the donors, and between the various donors supporting the process.' This experience is contrasted with less positive outcomes in Kenya and Malawi, where the reforms are described as having been instigated by the BWIs 'in the face of considerable government reluctance.'

At another level, there are the remarkable adjustment successes of the East Asian 'miracle' countries (for example, South Korea's successful response to its large debt problems of the mid-1980s) *whose efforts owed little or nothing to BWI adjustment programmes.* Indeed, in important and well-known ways most of them departed from BWI orthodoxies. The same is true of the reform process in China. These countries worked out *for themselves* approaches which appeared best suited to their own traditions and circumstances, and these succeeded in combining successful adjustment with improving income distributions.

The implication of this line of argument is that the BWIs and major shareholders should more fully recognise the limitations of conditionality as a way of utilising financial assistance for adjustment reforms. The emphasis should rather be upon 'policy dialogue' and persuasion. The BWIs should refuse to play the 'paper conditionality' game; their staff should be assessed on the quality of the lending they undertake, not the volume.

A further implication is that the BWIs should be willing to say 'No' more often to governments with weak commitment to reform and should insist that programmes be prepared by the borrowing governments. The willingness of governments to draft their own 'letters of intent' should be a minimum obligation; they should *never* be prepared by BWI staff in Washington. Where countries have difficulty in doing this, appropriate technical assistance should be made available, preferably of an independent nature so as to avoid conflict of interest.

This suggested reorientation would have a number of additional consequences:

1. There would be a shift of financial resources away from reluctant adjusters and client states. This would release more for the committed adjusters, raising aid effectiveness.
2. If it is correct that domestically designed adjustment programmes would be more effective, they should induce larger additional inflows of foreign capital, private and public (as apparently exemplified by the 'home grown' East Asian and Latin American programmes).
3. It would be important not to confuse unwillingness to adjust with the limited technical capabilities of some developing-country governments. Technical assistance to enhance such capabilities should be even more freely available. *But:* it should be independent of the BWIs, so as to minimise conflict-of-interest problems; and it should *never* be imposed. Imposed advisers are no

more effective than imposed policy reforms, as forcefully conveyed by the World Bank Vice-President responsible for Africa (Jaycox, 1993):

> Donors also relied too heavily on foreign experts, even when qualified Africans were available. This did little to foster a receptive environment for the transfer of skills. In fact, it was often bitterly resented. Over-reliance on technical assistance also brought many difficulties. Expatriates were frequently chosen for their technical skills rather than their ability to pass on those skills. This, coupled with operational difficulties, pulled foreign consultants into operational support at the expense of capacity building.

4. Greater reliance on domestically designed programmes would require the BWIs to be more pragmatic and pluralistic in their assessments of the adequacy of the programmes submitted.

5. Greater country selectivity would necessitate greater restraint on the part of major-shareholder governments in lobbying on behalf of favoured applicant governments. Hopefully, the end of the Cold War would facilitate such restraint.

The suggested shift towards insistence on ownership would, moreover, be strongly consistent with the rhetoric of the Bank's recent 'vision statement', setting out its own view of the future adaptation of the Bank (World Bank, 1994c), which emphasises selectivity, partnership and client-orientation. The IMF, on the other hand, has been notably silent on such matters.

iii. The limitations of the policy consensus

There is today more agreement about the desirable orientation of development policies than ever before. Most would now agree that the BWIs have been correct to press for adjustment in the face of turbulence in the world economy, the accelerating pace of structural and technological change, and the often perverse effects of past government interventions on economic life. There is ample evidence of the decisive influence of the policy environment as a determinant of countries' economic performance and the importance, therefore, of getting policies right. The importance of tackling the foreign exchange constraint, with all its implications for investment, capacity utilisation and human welfare, is self-evident. Similarly, there is accumulating evidence that rapid inflation, usually born of monetised budget deficits, impedes growth (e.g. Fischer, 1994) and worsens inequalities.

Many governments now agree that the BWIs are right to urge that priority should be given to macroeconomic management, implying fiscal and monetary discipline; liberalising and deregulating the economy to allow markets to work more effectively; the often undesirable effects of a multitude of policy interventions by an overstretched state; and (to quote the 1994 Volcker Report) to 'provide an institutional and policy environment in which the private sector can flourish – in ways that alleviate poverty and meet other critical development goals.'

BWIs are right to press for adjustment in the face of rapid change

However, the extent of consensus should not be overstated. In particular, there remain considerable disagreements about where

the balance should be struck in the respective roles of the public and private sectors. There are persistent complaints that the BWIs place too much reliance on what can be achieved through market forces and are excessively negative about what the state can and should do.

Various Commonwealth examples can be given. In the area of the **liberalisation of agricultural services**, the recent (1994a) World Bank report on Africa urges that 'the elimination of agricultural marketing parastatals is high on the adjustment agenda' but there remains much controversy about both the desirable extent and pace of liberalisation. Here a great deal hinges on the availability of private enterprise and capital to take over from (or compete with) state corporations, and the extent of ensuing competition. For example, Cromwell (1992) concludes from her examination of the liberalisation of seed services in Eastern and Southern Africa that:

None of the reforms have actually increased effective competition in the seed sector, according to the available evidence. On the production side, where public sector monopolies have been disbanded they have been replaced by private ones... On the distribution side, private sector traders do not appear to offer any better service than public sector outlets, at least in part because in most rural areas they enjoy an element of monopoly power because of the poor level of rural infrastructural development... (p.81)... *general macro-economic and agricultural sector reforms fail to tackle the more fundamental structural reasons for underperformance in the seed sector* (p.9).

A balance must be struck between public and private sectors

The movement towards **privatisation** is not, of course, limited to agricultural marketing. It is the classical cockpit within which controversies about the roles of the state and private sector are being played out. The BWIs are strongly in favour; others are less sure. A study of privatisation in Jamaica, Kenya, Malawi, Malaysia, Papua New Guinea, Sri Lanka and Trinidad and Tobago (Adam *et al*, 1992) draws out the difficulties of adopting blanket 'pro' or 'anti' positions on this. It had worked quite well in Jamaica and Malaysia, they found, less so in Kenya, Sri Lanka, Malawi and Papua New Guinea.

Here, too, the breadth of the private sector and availability (and nationality of ownership) of private capital were key determinants, as also was the size and development of domestic capital markets. It is no accident that Jamaica and Malaysia are relatively 'developed' by comparison with most of the other countries studied. The credibility of the government, the state of public opinion towards privatisation, the clarity of programme objectives (especially as between maximising receipts for the Exchequer and promoting economic efficiency), and the capacity of the state to enforce public regulation of newly-privatised concerns were further important influences. The authors attribute the relative lack of success in Sri Lanka, for instance, to limited competition within the private sector, low state capacity to regulate private monopolies, and the narrowness of the capital market and low domestic savings rates (in addition to the difficulties created by the civil disturbances).

Controversies about the place of the state also surface in the connection with **industrial policy**. The essential question here is whether this should largely be confined to trade liberalisation, relying on the efficiency-raising and export-expanding effects of increased openness, which is broadly the position taken by the BWIs. In this context, there has been

much controversy about a recent (1993a) World Bank report on the East Asian 'miracle' countries. These countries, most notably South Korea, co-ordinated investment decisions at the national level and supported infant industries with the ultimate aim of penetrating new export markets.

Governments went beyond protection, however, and provided various support services, in the areas of information, technology and marketing. However, the Bank study dismisses these interventionist approaches, claiming that the resulting pattern of industrialisation in South Korea would have occurred in any case and that the various interventions imposed substantial costs on the South Korean and other economies. Others have strongly rebutted the Bank's critique, pointing out that South Korea's textile and garment sectors are far larger than would be predicated by market conditions, and that there are good reasons for disputing whether industrialisation could have been so successful had it been left to market forces. Nevertheless, a similarly free-market line is taken in the Bank's more recent *Adjustment in Africa* (1994a) report. BWI adjustment programmes rarely contain much by way of an industrial policy apart from the liberalisation of trade and investment regimes, but critics contend that in low-income countries industrial firms often do not have the managerial and technical capacity to be able to stand up to, and take advantage of, greater openness, with the heightened competition from imports it brings.

In summary, then, the suspicion is that the BWIs have reacted too far and too ideologically against the inefficient state interventionism of the past. There is also a suspicion that they sometimes try to achieve an unrealistic pace of adjustment, imposing avoidable social costs and political management problems.

iv. The BWIs and poverty

The reduction of poverty is an essential component of any adequate view of economic development, so we should now examine the impact of the BWIs on the poor. Here again, we start with the effects of their adjustment programmes.

During the course of the 1980s it became apparent that, like short-term stabilisation, structural adjustment was by no means painless. There was growing concern that a disproportionate share of the burden may be falling on the most vulnerable – a concern culminating in a widely publicised call by Unicef for *Adjustment with a Human Face* (Cornia *et al,* 1987).

Writing in the mid-1980s, the Unicef team was concerned at the insensitivity of both the Bank and Fund to the distributional consequences of their programmes. At that time the standard IMF position was that it was a matter for governments to attend to the distributional impact of programmes and that the Fund should not involve itself in such matters. It was as good as its word, for a review of 30 stand-by programmes implemented during the 1960s and 1970s found that only one contained provisions to protect the poor against possible adverse consequences (Killick *et al,* 1984).

This position has gradually changed. Fund missions now commonly discuss distributional aspects with governments when preparing programmes and the Policy Framework Papers prepared in connection with SAF/ESAF programmes are required to 'identify measures that can help cushion the possible adverse effects of

An unrealistic pace of adjustment could impose avoidable costs

certain policies on vulnerable groups.' An increasing number of programmes now contain safety-net provisions, although the chief examples so far have been in Eastern European countries. Two recent events illustrate the Fund's changed attitudes. First was the provision in the recently agreed expansion of the ESAF that programmes should pay greater attention to social safety nets, including contingency provisions. The second development was the announcement by the Managing Director of the Fund, in connection with the devaluation of the CFA franc, that the IMF would accept budgetary subsidies on some basic foods (and even on petrol) to protect the poor from the price-raising effects of the devaluation.

The Bank has gone through a similar transition. When structural adjustment lending was introduced there was a shift away from priority given to poverty reduction as had been the case with Bank policies in the 1970s. Early SAPs emphasised macroeconomic measures and the Bank's 1990 *World Development Report* (p.103) admitted that 'when structural adjustment issues came to the fore little attention was paid to the effects on the poor.'

This neglect was reflected in its programme conditionality. Kakwani *et al* (1990) found that only 1% of total SAP policy conditions related to 'subsidies' and 'social sectors' – by no means all of which were necessarily favourable to the poor, especially as regards subsidies. It has been estimated that social policy reforms accounted for under 3% of all SAP conditions up to 1987. Like the IMF, the Bank has since softened its stance, however, including the introduction of a special 'Social Dimensions of Adjustment' programme in 1987. The Bank has reported that the share of adjustment loans which include social sector conditionality has increased from under 5% of all SAPs in 1984-86 to almost 30% in 1990-92. Addison (1993) also reports that poverty-related provisions are now more frequently included in programmes, sometimes as preconditions for release of loan tranches. The Bank's recent 'vision statement', *Learning from the Past, Embracing the Future*, identifies reducing poverty and improving living standards as its overarching objective.

The Fund and the Bank have softened their stance on social issues

What, now, does the evidence on the poverty effects of BWI programmes show? Killick's 1994 survey reaches the following conclusions:

1. The issues are too complex and the obscurities too large to permit simple generalisations.

The database for research remains deplorably inadequate. Moreover, the impact of SAPs varies across different poverty groups. There are likely to be major differences in results as between urban and rural poor, with larger burdens being borne by the former, who tend to be the more affected by retrenchments, and cuts in subsidies and government services. The poorest of the poor, being marginalised, are less at risk. It is 'the not quite so poor' who are most at risk – and who stand the best chances of gaining.

2. The poor often are put at risk by the provisions of SAPs.

There are documented cases of programmes having poverty-worsening effects. The living standards of the poor can be eroded by measures, such as devaluations and price deregulation, which raise prices. Reductions in government subsidies for food and other items hit the real incomes of the poor, even though they typically receive only a modest share of such subsidies. Loss of jobs is also a threat, as is the depression

of the real wages of those who remain in work.

3. However, the negative effects of adjustment programmes have commonly been exaggerated.

Devaluation and other export promotion measures can create new employment and raise smallholder incomes. These and other measures are also likely to raise the cost of capital relative to labour, helping to create employment. Improving the efficiency of public sector service delivery helps the poor who use such services. The same applies to reducing the protection of domestic manufacturers. It is partly a matter of timing: the 'pain' comes first and the 'gain' later; there can be long time-lags before living standards begin to improve. Because there are both adverse and beneficial effects, studies find mixed results and no simple statement like, 'adjustment is bad (or good) for the poor' can be sustained by the evidence.

The inaccurate attribution to adjustment of hardships which are actually the result of the initial economic crisis helps explain the unduly bad press received by SAPs. The widespread belief that adjustment programmes result in particularly deep cuts in social spending is an example of this. Research on the incidence of government spending cuts shows that social services are among the more protected categories. There have been serious declines in health and education services in Africa and Latin America in response to fiscal crises, but most studies do not find a connection between these declines and the adoption of SAPs.

A further reason for doubting that SAPs result in major impacts on the poor is that they do not directly affect the prime sources of poverty: the distribution of assets and political power, access to services, and a pattern of demographic dependency which perpetuates poverty. Concentration on SAPs diverts attention from the more fundamental causes of poverty.

4. Properly understood, adjustment is a necessary condition for an effective long-run attack on poverty.

Structural adjustment should be seen as a response to a *permanent* need to keep abreast of changing patterns of world demand, output and competitiveness, technological change and unforeseeable shocks. No nation can sustain economic growth unless it can adapt and in poor countries growth is indispensable if poverty is to be eradicated. The policy task is one of achieving structural adaptation in a cost-minimising manner.

Quite apart from its obvious effects on investment, employment opportunities and incomes, growth can benefit the poor by easing the fiscal constraint – broadening the tax base, raising revenues and easing the credit situation. Improving the flow of services to the poor ceases to be a zero-sum game, making it politically easier. But trickle-down cannot be relied upon. Growth has to take forms that increase the access of the poor to productive assets and income-raising services. A special effort has to be made to include the *very* poor in the benefits of adjustment and economic expansion.

The East Asian economies are exemplars of pro-poor approaches to adjustment, although they had little recourse to the BWIs and departed from standard 'Washington' prescriptions. These countries have been the adjusters *par excellence:* adapting continuously and of their own volition to changing circumstances, diversifying and transforming their productive structures, *and achieving these results while reducing poverty.* Income

Adjustment is necessary for the attack on poverty

distribution and a wide range of welfare indicators have improved considerably, with major improvements in life expectancies and in access to water, food and shelter.

5. National governments have the prime responsibility for protecting the poor during adjustment.

BWI programmes are politically sensitive because of their impact on the distribution of income. Existing policies reflect the distribution of power within a country. Even the most perverse policies bring wealth to some, and beneficiaries resist attacks on their privileges. Similarly, the common bias towards urban dwellers reflects the greater power of those living in the towns.

Policies based on the existing distribution of power therefore often have large inertial force. A coalition for reform has to be assembled and nurtured. Adjustment thus requires political skills and leadership. The politics of compensating losers rarely favours the poor, almost never the *very* poor. The difficulties are the more acute because some governments reveal little concern for the poor.

6. Nevertheless, the BWIs must also share the responsibility.

The spread of adjustment programmes means that the BWIs also have obligations to protect the vulnerable. Despite past insensitivity, these are obligations which the Fund and Bank now acknowledge. Both, as we have seen, have altered their positions, but many doubt the extent to which the changes in message from the top have affected actual operations in the field – doubts accurately reflected in the Commonwealth Secretariat report on mitigating the social costs of adjustment presented to the Kuala Lumpur Finance Ministers meeting in October 1991. Overall, it seems that rather little may have actually been achieved thus far and that neither institution is yet systematically adopting a cost-minimising approach to SAP design, nor setting its efforts within anti-poverty strategies.

Governments must protect the poor during adjustment

Looking beyond the effects of SAPs, the Bank has been through distinct cycles in the priority it has given to poverty alleviation. Under its first presidents the Bank adopted a rather narrow bankers' viewpoint but during the 1970s, under Robert MacNamara, there was a major reorientation in favour of social sector and other pro-poor projects. During the 1980s, as shown above, the poverty-alleviation objective was effectively downgraded again, but recently the Bank has again turned more of its attention to the poverty task.

How much difference these ebbs and flows have made to the poor is unclear. There are a number of problems. *(a) Everyone* finds it very difficult to reach the very poor, and a Washington-based institution has no comparative advantage in that task; aid in general does not have a very good record in reaching the poor. *(b)* Most of the poor live in rural areas and virtually all evaluations are agreed that agricultural and other rural development aid projects have among the lowest success rates. *(c)* There is an oil-tanker effect which makes the Bank's project selections only slowly responsive to changes in management policy, creating a gap between formal policy and actual practice. *(d)* The centralised structure of the Bank, with the great bulk of its staff still Washington-based, is an obstacle to reaching the poor effectively, even at one remove by working through NGOs (Clements, 1993), for there is now a consensus that effective anti-poverty action requires a highly decentralised, participatory approach. The Bank's

management has clearly signalled a higher priority for poverty alleviation and is making efforts to translate this into effective action (World Bank, 1993b) but it, and the Fund, need to go further, e.g. in making it a minimum programme requirement that essential social services to vulnerable groups be maintained and in setting specific safety-net provisions into the context of a broader anti-poverty strategy.

v. The BWIs and the debt problem

Substantial progress has been made in reducing the debt burdens of low-income countries, particularly with the adoption of the so-called 'enhanced-Toronto' terms. Moreover, a bilateral creditor consensus is apparently emerging on the need to travel further down that road, reflected in the Communiqué of the July 1994 G-7 summit. At the same time, however, the BWIs (together with other multilateral agencies like the African Development Bank) have long been criticised for not contributing adequately to debt-relief efforts.

The multilateral aspect of low-income countries' debt problems is of growing importance and the debt policies of the BWIs are thus coming under increasing scrutiny. The agencies themselves have been reluctant to engage in public discussion of this topic but a recent (1994b) Bank paper has admitted that 'the large and growing level of multilateral debt could be seen as a sign that there is a multilateral debt-service problem on the horizon.'

The facts relating to 'severely indebted low-income countries' (or SILICs) point strongly in that direction:

The share of multilaterals in total SILIC debt is rising, and in 1985-92 accounted for 35% of the total *increase* in SILIC debt. The servicing of these debts represents a growing claim on debtor resources, with the share of total debt servicing attributable to the multilaterals rising from 16% in 1985 to 30% in 1992. Guyana, Tanzania, Uganda and Zambia are among the countries with particularly heavy multilateral debt burdens.

Multilateral debt problems are becoming important

A substantial problem of country arrears to the BWIs and other multilaterals has emerged and is persisting, where previously it was almost unknown.

These manifestations have occurred despite innovative efforts by the BWIs to refinance past debts and bring greater concessionality to their new lending. The capacity of the BWIs to provide greater relief has been inhibited by their preferred lender status. Moreover, the IMF's Rights Accumulation Programme, to deal with the problem of arrears, is not working well, so that Sierra Leone is the only low-income country which has been able to clear arrears by this means (although other ways have been found in some other cases).

Past approaches to the multilateral debt problem have shifted much of the burden of relief to bilateral creditors/donors, some of whose aid budgets, however, have been cut and who are resistant to further erosion of the genuinely bilateral components of their programmes.

If the BWIs are to retain their preferred lender status (ruling out the rescheduling or writing-off of past loans), more of the spotlight is bound to fall on greater use of the BWIs' own resources to provide greater relief: the Bank's accumulated prudential reserves (of ca. $20 bn) and the Fund's gold stocks ($35-40 bn).

IV. Conclusion

Instead of attempting a summary, we conclude by reverting to our initial suggestion that the social utility of the BWIs has been called into question by the growing discrepancies between the present-day global economy and the world for which they were designed, and ask what kind of arrangements a 'new Bretton Woods' might create.

First, it should reaffirm the premises of the 1944 meeting: the desirability of rules-based global co-operation in pursuit of equitably shared global prosperity, and of the necessity for interventions by international agencies if this goal is to be secured.

Second, however, it should take note of the great increase that has occurred over the past half-century in the coverage, efficiency and power of market forces, particularly international capital markets. Any new public international agencies (or reform of the existing BWIs) would have to be justified in terms of deficiencies in the system that has grown up, i.e. in terms of 'market failures'.

Already, the BWIs provide important public goods, such as stability and rules, as well as a degree of equity, to at least partially compensate for the deficiencies of markets and national governments.

Despite the undoubtedly large benefits that have resulted from the freeing of trade and capital markets, three failings can be identified, to which there should be international responses: (1) *instability* in trading and financial flows; (2) *incomplete financial markets*, e.g. for financing adjustment in low-income countries or for development projects which promise high economic or social but sub-commercial financial returns; (3) *persistent gross international inequalities and absolute poverty*.

INSTABILITY:

Instability can be tackled in a number of ways. One option is to move towards reduced volatility of major-currency exchange rates through a system of target zones, maintained by enhanced international co-ordination of macroeconomic policies, discussed in Part II.

Another is to discourage speculative short-term capital movements by introducing a modest uniform international tax on spot foreign exchange transactions, as proposed by James Tobin. This would both increase the down-side costs of speculation and provide governments greater autonomy in their interest rate and other macroeconomic policies.

Another possibility is the creation of an international insurance scheme, or contingency financing fund, to assist countries which suffer from unforeseeable external shocks or natural disasters. The retreat from international contingencies financing over the past 15 years has reduced both the efficiency and equity of the international system.

INCOMPLETE FINANCIAL MARKETS:

Two types of market failure suggest themselves here, for which international public funding is desirable: the financing of adjustment programmes by non-creditworthy countries (especially low-income ones), along the lines discussed in Part II; and the financing of development projects which will not attract private capital, because of high risks, externalities and other gaps between social/economic and financial profitability.

The BWIs, of course, already seek to fill these gaps and it has sometimes been suggested that the lending operations of the Fund and Bank should be merged (although creating a large concentration of monopoly power does not usually bring many user-benefits, and many believe the Bank is already too unwieldy). Another suggestion, taken up in the Volcker Report, is that the Bank should find ways to channel more of its lending to the private sector. However, if a market failure approach is taken it is not clear why the World Bank (or the EBRD or CDC, for that matter) should enter into an area apparently well provided for by private capital, unless it can be clearly shown that such finance will meet publicly desirable goals that would not be satisfied by private capital. For the most part, public capital should meet public needs, of which there remain many.

INTERNATIONAL INEQUALITY AND POVERTY:

Great progress has been made by many 'underdeveloped' countries during the lifetimes of the BWIs but this has been uneven. There is a special problem with Africa, which has not benefited from the general progress and there are few grounds for believing that this problem could be solved as an outcome of profit-maximising movements of capital and know-how. Equally, there are no grounds for believing that market forces could satisfactorily resolve the persistence of large-scale poverty.

The desirability of public action to tackle these problems is the classic market failure case for concessional development aid, of which the IDA lending of the World Bank is a prime example. However, as is increasingly recognised, giving priority to the poverty problem has an important implication for the Bank and other aid agencies: they are unlikely to make their best contribution by working through central governments, and will require the freedom to operate much more at the grassroots level, e.g. through the vehicle of NGOs.

The above suggestions imply the need for creation of international *authority* to match increased interdependence: 'rules with teeth' to achieve greater cohesion, or convergence, in national macroeconomic policies; to administer the proposed taxation and insurance schemes (the one, perhaps, funding the other); to lend for adjustment and for public-interest projects; and to administer multilateral aid.

The most obvious deficiency of present arrangements is in the area of policy co-ordination. One possibility, discussed at some length in Part II, is for the IMF to be given greater powers in this area. The principle should be observed that international problems require properly constituted, representative and accountable international authorities. It cannot be satisfactory for some exclusive group, such as the G-3 or G-7, to claim this role for itself, with all the inherent conflicts of interest that arise.

No doubt, it will take a long time (and probably a major crisis) to achieve major systemic change. In the meantime, for all their shortcomings, the BWIs (together with the proposed WTO and the UN) are the best agencies of interna-

tional co-operation the world has got. If systemic change is ruled out but incremental adaptation of the existing BWIs is possible, how might they best be adapted?

If there were acceptance of the desirability of improved policy co-ordination, including some element of exchange rate management, a substantially upgraded role for the Fund beckons. The theoretical case that economic welfare will be sacrificed if countries act in isolation is strong but any co-ordination system will have to overcome the problems that theoretical analysis identifies, of free riding, time inconsistency and short-term pressures for non-compliance. The form of co-ordination therefore needs to be one that can be readily monitored and which can impose genuine penalties on non-compliers. To carry this role through, the Fund would have to build very substantially on its current largely ineffective surveillance and consultation activities. However, countries may be more prepared to accept limits on their own behaviour if they believe that the behaviour of other countries is being similarly constrained. One possibility here is that the WTO, whose remit (by contrast with that of the GATT Secretariat) extends beyond border trade measures to involve it deeply in member-state policies which impinge upon trade, might orchestrate punitive trade action against countries that renege on commitments or refuse to abide by the co-ordination rules.

At the same time, BWI/WTO liaison will need to promote the expansion of world trade. That the heyday of the BWIs was associated with trade liberalisation and expanding trade suggests interdependence between the spheres of interest of the BWIs and the WTO. Adjustment is generally easier to achieve in conditions of growing world markets. In turn, trade expansion is easier to achieve where foreign exchange and financial markets are orderly and governments are not preoccupied with inflation or unemployment.

Whereas the Fund's co-ordination task applies to macroeconomic policy, the World Bank also has a potentially important role in co-ordinating aid. Many studies of the effectiveness of aid have identified co-ordination failures as a significant weakness. It should also constantly have in mind that the central purpose of aid is to reduce poverty, and retain a lead position in finding more effective ways of achieving this purpose. Global environmental issues offer another area in which the Bank can make a significant contribution, as a conduit through which developed countries offer financial incentives for developing countries to pursue environmentally friendly policies.

The BWIs will be better placed to perform the roles described in this paper if their legitimacy is more widely accepted and if their aims and objectives are better understood. Greater democracy in decision-making and openness are important here. Recent Fund and Bank decisions, albeit under pressure, to make publicly available documents that were previously confidential indicate a tentative move towards more openness that may help offset the institutional inertia that comes with age, and expose them to closer, better informed scrutiny. In principle, however, the BWIs can be anything that their shareholders want them to be. The challenge is primarily one for their shareholders.

Appendix: The Literature

We here cite a limited number of references which extend some of the themes raised in the text.

Part II

The changing systemic role of the BWIs has been catalogued in a number of places. Two useful surveys are Feinberg (1987) and Gwin and Feinberg (1989). A more recent overview which focuses on the IMF is Bird (forthcoming). Much background material is also contained in the useful Staff Review of the Bretton Woods Commission (1994).

On the international co-ordination of policy, accessible reviews of the theory and practice are Artis and Ostry (1986) and Horne and Masson (1988). Succinct modern statements of detailed proposals may be found in Williamson and Bergsten (1994), and Williamson and Henning (1994), where operational arrangements are also discussed. Institutional issues are also examined in Dobson (1994). A lively presentation of the critics' view of co-ordination is Feldstein (1988). Much quoted (and criticised) examples of attempts to measure the effects of policy co-ordination are Oudiz and Sachs (1984) and Frankel and Rockett (1988). A discussion of interactions between the North and South is undertaken in Mohammed (1994), and attempts to estimate these linkages appear in McKibbin and Sundberg (1993), as well as in McKibbin and Sachs (1991), Allen, Currie, Srinivasan and Vines (1992) and Allen and Vines (1993), who focus on the effect of changes in US fiscal policy. Governance issues covering the BWIs are discussed in the case of the Fund in Kafka (1994) and Finch (1994), and in the case of the World Bank by Naim (1994).

On the adjustment-financing balance, Corden (1991) provides a clear presentation of the 'new' theory of the balance of payments, and Bird (forthcoming) offers a fuller discussion of the economic principles underlying adjustment-financing trade-offs and low-conditionality support. A critical overview of the deficiencies of the capital transfer mechanism of the 1970s and 1980s is contained in Llewellyn (1990), and Bird (forthcoming) develops the theme that market failure serves to define a role for the BWIs. An economic analysis of SDR allocation which also touches on issues of political economy is available in Bird (1994). A report written for the Commonwealth Secretariat by the same author deals with the questions of financing the Fund and IMF quotas (Bird, 1987).

Evolving relations between the World Bank and the IMF are touched on by Williamson and Henning (1994) and developed more fully by Kenen and Eichengreen (1994). A schematic

analysis of the available options is presented in Bird (1994a); see also Bird (1993).

Part III

There is an extensive empirical literature on the effects of Bank and Fund programmes. Khan (1990) offers a valuable discussion of the methodological problems and surveys the literature on the effects of IMF programmes. Killick *et al* (1992a and b) offer a more recent survey and additional evidence of their own. Polak (1991) offers an authoritative account of trends in IMF conditionality. The best independent source on the effects of World Bank SAPs is Mosley *et al* (1991); see also Corbo and Rojas (1991). Substantial in-house Bank evaluations are provided in World Bank (1992a and b). Results in Africa are presented in World Bank (1994a) and Elbadawi *et al* (1992). The Bank's (1993a) report on the East Asian 'miracle' countries is discussed in a special edition of the journal *World Development*, 22(4), April 1994; and by Fishlow *et al* (1994).

The seminal work on the BWIs and poverty is the Unicef *Adjustment with a Human Face* study by Cornia *et al* (1987). An OECD study by Bourguignon and Morrisson (1992), with its associated country case studies, is substantially the best empirical investigation of adjustment-poverty connections. Killick (1994) offers an up-to-date survey of the substantial literature. See also the World Bank (1993b) for a recent account of its anti-poverty work.

The best publicly available source on the multilateral debt problem is provided by Mistry (1994): an over-argued critique of the BWIs which, however, sets out valuable data and important arguments. The best BWI treatment of this topic is in World Bank (1994b) but, although not a classified document, this remains unpublished.

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