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.