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

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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".