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Building a global economy: the IMF, the World Bank and the WTO

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Structure of presentation

1. Theoretical framework.
2. The first global economy.
3. International economic fragmentation.
4. Rebuilding the international economy.
5. The new global economy.
6. Annex: Background material on the IMF, World Bank and WTO.

Basic approach:

Sketch out theoretical framework for thinking about why have international institutions like IMF, Bank, WTO in the first place.

Then look at how these theoretical considerations have interacted with the reality of the international economy, and how the institutions themselves have adapted to the changing environment.

Not focusing on institutional detail. This is available from the web sites of the three institutions, some of which is summarised in the annex.

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1. Theoretical framework

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Theoretical framework (1)

- IMF, World Bank & WTO are international public institutions designed to build and/or manage the international economy.
- Why not just rely on market forces / independent national policies? Concept of market failure – private market leads to outcomes that are economically inefficient.
- International economic interdependence creates spillovers (‘externalities’) from national policies into the international economy: Spillovers/externalities lead to coordination / collective action problems.
- Example: Financial panics and the role of lender of last resort.

IMF & World Bank & WTO are international public institutions designed to help promote global collective action – to build &/or manage the international economy.

Immediate question – why do we need to build such institutions? Why not just rely on market forces to provide an outcome, or at least the workings of national policies? One economic explanation is problem of *market failure*. Market failure arises when private markets fail to deliver appropriate outcome. (Note other explanations include political and historical ones.)

One source of market failure at *international* level is way that economic interdependence creates spillovers - externalities - from national policies that influence international economic environment. E.g. one country’s decision to change exchange rate policy (devalue, revalue) will influence the competitiveness of other economies; similarly, decisions to tighten or loosen domestic policy influence demand for imports, etc. Hence national welfare is a product not just of own national policies, but of policies elsewhere . . . & as get more international economic integration (‘globalisation’) get increase in number & magnitude of spillovers.

Externalities lead to possibility of collective action problems / coordination failures. E.g. in early 1980s the economies of the industrialized world tightened monetary policy to dis-inflate. But with each country tightening policy, the collective result was that each individual country tightened policy ‘too much’ once *global* monetary conditions were taken into account. Better to have had some form of coordination.

Example of coordination failure is an international financial panic, in which otherwise solvent economies can’t borrow, as each individual lender individually wants to rationally reduce his/her exposure, but collectively leads to worst outcome (prisoners dilemma game). Role for international lender of last resort / crisis manager to provide funds, stem panic, and overcome coordination problem. Trade-off with moral hazard – argument that presence of such institution encourages riskier behaviour on part of borrower / other lenders.

Another market failure relates to concept of a public good. Two features; *non-rivalry* - consumption by me doesn't stop consumption by you; and *non-excludability* – can't exclude an individual from enjoying the good. Result is difficult for private markets to provide due to free-rider problem. E.g. street sign / national defence. Many public goods local / national. But if cross borders e.g. international economic coordination, basic research into development/health care then *international* public good.

Can see international institutions as created to provide international public goods (e.g. World Bank provides policy advice, IMF overcomes coordination problems, WTO enforces MFN trade rules etc).

Three ways of interpreting changing international environment:

1. Guitian: Two general approaches to overcoming coordination problems; (1) rules based systems based on mutually agreed rules – international considerations dominate - predictable but rigid; (2) discretion based systems - national considerations dominate & focus is on flexibility of international environment. Evolution of the international economic system a story of recurrent swings b/w these two solutions.

2. Obstfeld & Taylor: economic policymakers face a policy 'trilemma': not possible for government to simultaneously peg its exchange rate, maintain open capital markets, & conduct independent monetary policy ('unholy trinity') Government can only achieve two of the three at any one time. E.g. fix exchange rate & open capital account, implies no monetary independence. As trade-offs change, so does the international monetary system.

3. Rodrik: political trilemma in world economy: must choose two from international economic integration, nation state, and 'mass politics'. E.g. if want international economic integration, sacrifice either mass politics (Argentine route until crisis) or nation states (EU-Federalist route)

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2. The first global economy

Begin by applying to first age of global capitalism . . .

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The first age of global capitalism

What an extraordinary episode in the economic progress of man that age was which came to an end in August, 1914 . . .The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep; he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages; or he could decide to couple the security of his fortunes with the good faith of the townspeople of any substantial municipality in any continent that fancy or information might recommend. He could secure forthwith, if he wished it, cheap and comfortable means of transit to any country or climate without passport or other formality, could despatch his servant to the neighboring office of a bank for such supply of the precious metals as might seem convenient, and could then proceed abroad to foreign quarters, without knowledge of their religion, language, or customs, bearing coined wealth upon his person, and would consider himself greatly aggrieved and much surprised at the least interference. But, most important of all, he regarded this state of affairs as normal, certain, and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous, and avoidable. John Maynard Keynes, The Economic Consequences of the Peace (1919).

Current age of international economic integration *not* historically unprecedented; period before WW1 also saw high level of integration – first age of global capitalism. Illustrated here by famous Keynes quote.

(Keynes was an adviser to the British government during WW1, and came to public attention with publication of The Economic Consequences of the Peace (source of this quote) which in effect argued that the allies policy of squeezing reparations out of Germany would lead to the collapse of the German economy. Keynes went on to write The General Theory of Employment, Interest and Money (published in 1936) a founding text of macroeconomics. Keynes also played key role in the Bretton Woods conference in 1944.)

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The pre-WW1 international economy

- International trading system provided by network of bilateral trade agreements signed after 1860.
- By 1880s free trade in retreat – but modest protectionism outweighed by other pro-trade factors, especially technology.
- International monetary system provided by combination of Gold Standard and Bank of England (rules based system).
- Trilemma involved sacrificing monetary autonomy for fixed exchange rates and capital mobility; also sacrificed flexibility for predictability; very early days for mass politics so Rodrik trilemma not yet biting?

How did the first global economy overcome international coordination / global public goods / market failure problems? No formal international institutions like IMF to provide global public goods such as international monetary system.

<u>International trade system</u> created by network of bilateral trade agreements, starting with the Cobden-Chevalier Treaty of 1860 between Britain and France. Crucial feature was a **Most Favoured Nation (MFN)** clause - if one party negotiated trade treaty with third party, then other party would automatically benefit from the treatment given to the most favoured nation. In early 1860s France negotiated series of treaties with almost every European economy except Russia, and benefits accrued to Britain and other trading partners. By 1880 protectionist pressures on rise again, but other lifts to trade (esp. falling transport costs due to technological advances such as railways, iron-hulled steamships) more than offset any drag.

<u>International monetary system</u> provided by combination of gold standard and Bank of England. After 1870s, collective action / coordination problem increasingly managed by gold standard arrangement - if played by 'rules of game' & didn't offset impact of gold flows - automatic adjustment mechanism (price-specie-flow mechanism). E.g. overheating economy - increase imports - payments deficit - sell gold - money supply contacts - economy cools - imports shrink. At same time sterling played increasing role as international currency used to settle trade payments.

Gold standard falls into category of rules based system, with relatively little discretion. Financial trilemma settled by sacrificing domestic monetary autonomy (under gold standard rules of game) in return for fixed exchange rates and capital mobility. Possible given only limited democratic representation and limited belief in ability/attractiveness of government stabilizing the economy –links back to the Rodrik trilemma.

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Economic integration and security

“. . .It is assumed that a nation's relative prosperity is broadly determined by its political power; that nations being competing units, advantage in the last resort goes to the possessor of preponderant military force…The author challenges this whole doctrine . . . it belongs to a stage of development out of which we have passed . . . the commerce and industry of a people no longer depend upon the expansion of its political frontiers; . . . a nation's political and economic frontiers do not now necessarily coincide; . . . military power is socially and economically futile, and can have no relation to the prosperity of the people exercising it; . . . it is impossible for one nation to seize by force the wealth or trade of another -- to enrich itself by subjugating, or imposing its will by force on another; . . . in short, war, even when victorious, can no longer achieve those aims for which people strive...” Norman Angell, The Great Illusion (1910).

Already, link starting to be drawn between health of international economy / level of international economic integration, and international security.

One famous example: Sir Norman Angell’s (winner of the Nobel Peace Prize in 1933) *The Great Illusion* was published in 1910, translated into twenty-five languages and sold over two million copies.

Basic thesis was that military and political power no longer gave a nation any commercial advantage since it was ‘an economic impossibility for one nation to seize or destroy the wealth of another’. Subsequently Angell has been interpreted as arguing that war was impossible because of the economic costs involved, but this seems to be a mis-reading: the ‘Great Illusion’ that he wanted to debunk was the idea that wars could be economically advantageous, when in reality they would be economically disastrous.

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2. International economic fragmentation

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The interwar period

- WW1 undermined monetary stability – huge public debts to fund war & reliance on inflationary finance.
- Great Depression as ultimate example of ‘market failure’ – economies not self-correcting; ‘beggar-thy-neighbour’ economic policies.
- Smoot-Hawley tariff (1930) & subsequent retreat from free trade / splintering of markets / rise of preferential trade blocs / collapse of world trade.
- End of liberal economic order – linkage between economic collapse, political extremism, and international (in-)security?

After WW1 was over, attempts to build a ‘New World Order’ largely unsuccessful – proved unable to resurrect international economy of first age of global capitalism. Legacy of WW1 was trade controls, collapse of private capital markets and monetary instability / inflationary pressures. Repeated attempts to re-establish gold standard may have unduly hampered domestic policy (‘golden fetters), and were anyway finally abandoned.

Great Depression as example of major market failure – undermined idea that economies were self-correcting (hence Keynes’ *General Theory*) – risk that free-market capitalism was doomed, to be replaced by state-led system (Fascist or Communist) unless government could somehow ‘safeguard’ economic stability & welfare (stabilization policy, welfare state).

In 1930 US President Herbert Hoover signed the Smoot-Hawley tariff act, despite formal protests by more than 30 countries. The measure increased tariff barriers and prompted retaliatory measures worldwide . Quantitative restrictions came to cover between 50% and 70% of world trade flows, and trade had fallen by two-thirds by 1933. As trade flows fell, the international trading system fragmented into preferential trading blocs. Example of externalities – both economic and political. Countries also pursuing policy of competitive devaluations – another example of collective action problems. So both trade and exchange rate policies headed down the route of ‘beggar thy neighbour’ policies.

By 1930s liberal economic order of pre-WW1 era lost: free trade replaced by protectionism and trading blocs; gold standard by floating exchange rates; and freedom of capital flows by exchange controls. World moved from rigid rules towards greater discretion/national independence. Monetary policy trilemma met by sacrificing fixed exchange rates, and political trilemma by sacrificing international economic integration.

Economic failure linked to rise of political extremism.

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3. Rebuilding the international economy

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Bretton Woods conference, 1944

- Rebuild international economy based on several key principles:
  - Liberal trading regime;
  - Open current accounts;
  - Capital account restrictions;
  - Fixed-but-adjustable exchange rates.
- Back to rules-based system, with two new institutions to manage the regime:
  - IMF for international monetary system;
  - World Bank for reconstruction / long-term economic development.
- But no ITO. Instead, GATT as 'provisional' solution . . . for four+ decades.
- And no rebirth of a truly 'global' international economy.

Lessons of interwar period seen as need to rebuild international economy as part of securing international security. As early as August 1941 Roosevelt & Churchill signed Atlantic Charter pledging restoration of a multilateral trading system. But key date = 1944 when Anglo-American policymakers meet at Bretton Woods Conference in effort to rebuild global economy on basis of rules and international cooperation. Competitive devaluations / 'beggar thy neighbour' polices seen as fundamentally destabilizing.

Bretton Woods (BW) system – a shift back to a rules-based international economy, and international institutions to manage the rules. Key principles included:

1. Commitment to liberal international trading regime based on nondiscrimination;
2. Free up current account (goods & services) transactions but
3. Maintain controls on capital account (financial) transactions
4. A system of fixed (pegged) but adjustable exchange rates

Two new institutions created to administer this system:

1. International Monetary Fund (IMF) created to administer the international monetary system
2. World Bank (International Bank for Reconstruction and Development, or IBRD) created to promote reconstruction of war-damaged economies

Intended to be a third – the International Trade Organization (ITO) - but failed to get off ground. Instead, trade governed by General Agreement on Tariffs and Trade, agreed in 1948. Located in Washington to try to bind US into international order (another interwar lesson).

Rodrik's trilemma? Compromised on limits to international economic integration.

Finally, note that BW did <u>not</u> restore the global economy, as world remained divided into at least two (capitalist, communist) and arguably three (third world) blocs.

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The IMF and the monetary system

- Lesson of interwar period that floating exchange rates destabilizing, and dangers of competitive devaluations.
- BW system therefore based around idea of fixed but adjustable exchange rates. Parities pegged to US$ / gold, but option of adjustment.
- IMF role to provide short-term financing for countries in temporary payments difficulties . . .
- . . . and to oversee exchange rate adjustment for countries with more fundamental payment problems.
- IMF operating in a world of fixed exchange rates and low capital mobility – ‘trilemma’ resolved by capital controls.

IMF was/is the institution with responsibility for ensuring the stability of the international monetary and financial system (system of international payments and exchange rates that enables international transactions to occur). Under BW, did this mainly by its role in supporting the exchange rate system.

As noted, one lesson of the interwar years was that need a system to prevent the ‘beggar-thy-neighbour’ competitive devaluations & restrictive trade policies of interwar period. BW system was a system of managed exchange rates. Basic idea was that exchange rates be fixed but adjustable. Parities for individual currencies were linked to the US dollar, which in turn was pegged to gold at the fixed price of US$35 / ounce.

Under this system if an economy ran into temporary balance of payments difficulties – external deficits leading to falling reserves - it could borrow short-term from the IMF. Borrowing would be subject to oversight/conditions (IMF ‘conditionality’) to make sure that the loan not mis-used. If payment problems deemed fundamental then the IMF would approve a change in the exchange rate parity (and provide supporting finance) role to support exchange rate parities by being ready to lend to members facing short term balance of payments problems.

IMF also committed to moving its members towards current account convertibility (i.e. goods and services trade) but not to capital account convertibility (financial assets). Partly due to scepticism about scope for private capital flows, partly due to destabilizing role such capital flows were believed to have played in economic crises of 1930s – ‘control finance to make world safe for trade’.

Hence BW system resolved financial trilemma by opting for fixed exchange rates and monetary independence for individual economies while restricting capital mobility. Not coincidentally, that allowed governments to target ‘full employment’ in an age of mass suffrage.

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The World Bank and reconstruction

- Assumption that interwar period had seen destruction of private international capital market . . .
- . . . hence need official capital flows to fund reconstruction of post-war world.
- International Bank for Reconstruction and Development (IBRD) created to channel official sector funds to countries undergoing post-war reconstruction, and to low income countries to boost development.
- IBRD subsequently joined by International Development Agency (IDA): two institutions collectively known as World Bank.

Along with the IMF, BW created another institution, the International Bank for Reconstruction and Development (IBRD).

IBRD response to assumption that the interwar years had destroyed the private international capital market. So countries seeking to rebuild their economies after the war would need access to official sector capital flows. As would poorer economies looking for assistance to jump start economic development. So solving market failure of missing international capital markets.

IBRD was envisaged as financial intermediary that would provide long-term finance for projects, initially mainly for reconstruction projects. As postwar recovery accelerated, it increasingly switched to project lending for developing countries.

All lending until 1960 on commercial or near commercial terms. But poorest countries couldn't access, so International Development Agency (IDA) established in 1960 to provide 'soft loans' (concessional lending) to the poorest countries. The two institutions are now collectively known as the World Bank.

Over time, the World Bank also became increasingly important as a supplier of technical assistance to developing countries, in effect providing the international public good of development 'knowledge'.

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The GATT and international trade

- General Agreement on Tariffs and Trade (GATT) entered into force in 1948, and in absence of ITO provided framework for world trade until 1994.
- Based on 3 basic principles:
  – Equal treatment (MFN and national treatment);
  – Negotiation ('rounds' of tariff reduction; reciprocity);
  – Predictable trading environment (binding, transparency).
- Key features:
  – Mainly tariff barriers;
  – Mainly industrial economies;
  – Manufacturing trade (Ag and TCF largely excluded).

Original plans called for an ITO to complement IMF & World Bank, but proposed charter rejected by US Congress. While discussions on ITO charter still underway, some economies decided to push ahead with trade liberalization. Resulting package of trade rules and tariff concessions became the General Agreement on Tariffs and Trade (GATT). On 30 October 1947 the GATT was signed by 23 nations at the Palais des Nations in Geneva & entered into force on 1 January 1948. Failure of ITO left GATT as only multilateral framework governing world trade until 1994/95 and its replacement by the WTO.

3 basic principles of GATT:

(1) Trade without discrimination, based on (a) Most-favoured-nation (MFN) treatment: treat all trading partners equally, and (b) National treatment: treat foreign and locally-produced goods and services equally.

(2) Freer trade through negotiation: reduction of barriers to trade through 'rounds' of trade negotiation. Linked to idea of reciprocity, rather than economists ideal of unilateral liberalization.

(3) Predictability of trading environment: (a) 'Binding' commitment not to reverse liberalization without consultation and compensation; (b) Transparency e.g. by regular surveillance of members trade policy through trade review mechanism.

Features of system

(1) Focus on reducing tariff barriers to trade.

(2) Concentration on manufactured trade: agriculture and TCF largely left to one side.

(3) Focus on advanced / developed economies . . . developing countries allowed to 'free ride' on system.

Again therefore, facilitating international economic integration, but also limiting that integration to some extent – a theme of the BW era.

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The fall of Bretton Woods

- By 1970s the formal Bretton Woods system was no more.
- Vietnam War + Great Society Program funded through inflationary macro policies in US led to large trade deficits & speculative pressures on US$.
- Rising capital mobility undermined exchange controls at same time as theoretical case for fixed exchange rates increasingly challenged.
- December 1971 Smithsonian Agreement - devaluation of dollar & severed link with gold: by 1973 world of floating exchange rates & capital mobility.
- Back to more discretionary system . . . and a different answer to the trilemma.

Still debate over exactly why the formal BW system (in sense of exchange rate arrangement) broke down. Some explanatory factors include . . .

Expansionary macroeconomic policies in the US linked to financing Vietnam War and Great Society program led to growing US trade deficits and rising speculative pressures on dollar. Also, in system of fixed exchange rates US inflation exported to rest of world leading to further pressures on parities

At same time, 1960s and 1970s era of growing financial market innovation (e.g.. birth of Eurodollar market) and resultant growth of capital mobility eroded BW defences of exchange controls.

Also, case for fixed exchange rates under increasing theoretical challenge, with argument that floating exchange rates would better insulate economies and allow more independence in economic policies. And increasing belief in benefits of financial as well as trade openness.

Collapse of Bretton Woods exchange rate system came in 1971 when Smithsonian Agreement allowed US$ devaluation and snapped the dollar-gold link. Followed by 1973 with generalised floating of major exchange rates against the dollar. (NB. At regional level, Europeans still pursued fixed rates and East Asia an informal dollar bloc, now sometimes described as BW2.)

End of BW ushered in era of floating rates – and still there today.

Again if think of trilemma; post BW had domestic monetary autonomy and free capital mobility, hence sacrificed fixed exchange rates. Now have world in which major currencies float, national governments pursue own policies, and can get major currency fluctuations.

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Reinventing the architecture

IMF

- Designed for world of limited capital mobility & fixed exchange rates: living in world of capital mobility & floating rates. Focus changed to helping developing countries with macro imbalances.

World Bank

- Bank increasingly focused on financing for infrastructure & microeconomic projects in developing countries, then 1980s debt crisis also saw focus on economic policies.

GATT

- Uruguay Round launched in 1986 - rethink international trading regime.

The 1970s and the fall of the Bretton Woods system meant that the IMF's original purpose no longer relevant; been created to provide financing for developed economies in world of limited capital mobility and pegged exchange rates. 1970s heralded world of capital mobility and floating exchange rates.

IMF re-invented itself with increased focus on lending to developing countries to help with economic crisis (adjustment to 1973 and 1979 oil shocks, and then 1980s debt crisis). But still kept role as guardian of international financial stability.

World Bank also did some rethinking. Still project finance focus, but increasingly evident that success/failure of individual projects linked to macroeconomic policies, especially again after 1980s debt crisis. Issue of overlap with IMF work.

Also efforts to rethink the world trading system. The Uruguay Round (launched in 1986 and not concluded until 1994) brought biggest reform of world trade system since creation of GATT, culminating in the creation of the World Trade Organization (WTO), a fully-fledged international institution as originally intended with the ITO. The Uruguay Round also expanded the mandate of the international trading system to cover services, IP, textiles and agriculture. It also moved the multilateral trading system to a 'Single Undertaking' concept – idea that WTO commitments would be binding on all members, ending period of 'free riding' by developing countries.

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4. The new global economy

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The birth of a new global economy

- Fall of Berlin Wall and collapse of Soviet Union brought 400 million people into world economy.
- Secured victory for (some form of) market capitalism over socialism / communism in battle of ideas . . .
- . . . with important demonstration effects in emerging markets (e.g. India).
- International economy truly ‘global’ for first time since WW1:
  - discretion over rules;
  - floating exchange rates to resolve financial trilemma;
  - debate on political trilemma.

Fall of Berlin Wall and collapse of Soviet Union brought some 400 million people into the World economy. It also secured victory for global capitalism over socialism / communism in the battle of ideas, with important demonstration effects in emerging markets like India.

These geopolitical changes were reinforced by technology (sustained falls in cost of communications) and policy decisions in both developed and developing countries (a general move to free up markets/cut back role of state in economy). Both changes made international economic integration ‘easier’ . . and hence deeper.

Result was that the international economy could be described truly ‘global’ for the first time since the start of WW1.

Backdrop to this global economy:

1. System still based more on discretion than on rules;

2. Monetary trilemma still resolved by sacrificing fixed exchange rates at a global level;

3. Political trilemma – source of debate between advocates of ‘world government’ (sacrifice nation state) and mass politics (Freidman’s ‘golden straitjacket’ that removes economic decisions from politics – independent central banks, fiscal rules, privatisation etc). Latter winning?

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Dealing with successes and failures

Successes

- Deeper international integration of markets for goods, services and financial assets.

- Emergence of major new economic players (China, India).

Failures

- States left behind by / opted out from new global economy – failed & failing states.

Many of today's most important international economic policy challenges involve dealing with both the successes and the failures of this new global economy.

The *successes* are most apparent in the growing international integration of markets for goods, services and financial assets (the labour market still being very much a laggard).

They are also visible in the rise to prominence of new economic players in these markets, and in particular in the emergence of China as a great manufacturing and trading power at the start of this century, along with the recent arrival of India's services-based development model.

Taken together, these trends are leading to a fundamental restructuring of international trade and capital flows, shifts in the international division of labour, and a geographic redistribution of international economic power.

The *failures* take the form of those economies that have been 'left behind' by (or in some cases opted out from) the new global economy: failed and failing states, and weak and impoverished ones, which – in an increasingly integrated world – are seen as having the potential to be systemically destabilizing.

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Challenges for the IMF

- Focus on international monetary & financial stability: macro management in emerging markets; some coordination; growing role as international lender of last resort?
- Dealing with success . . . a world of greater – and potentially more volatile – private sector capital flows.
- Absorbing lessons from Asian financial crisis (1997/98) on contagion, EWS, over-reach etc.
- Also lessons from Russia (moral hazard) Argentina & Brazil (commitment, resources, concentration risk).
- Who runs the IMF? Quotas and representation issues following rise of Asia.

Role of the IMF in the new global economy? Focus today still ensuring international monetary & financial stability, particularly via support/advice for emerging markets. Also some – limited – role in international economic coordination. Finally, moving increasingly towards international lender of last resort role, or at least international crisis manager.

Last development linked to increased magnitude of private sector capital flows – greater risk of capital account (financial) crises. Scale & speed of market reaction now greater - especially since greater market integration leads to contagion effects & systemic risks.

Asian crisis raised questions about IMF's future. According to critics, IMF missed warning signals, got policy advice wrong *before* (capital a/c liberalization) and *after* (structural reforms, excessively tight policies), and exceeded its remit (dictating too many policy changes in too many areas). Elements of truth in much but not all of this – Fund now looking at Early Warning Systems (EWS) and doing more monitoring of global capital markets; also reviewed policies on capital account and on lessons from crisis. But critics sometimes forget correlation not causation – IMF is in economies because they are in trouble, not other way 'round!

More questions after Russia (the 'too nuclear to go bust' bet), Argentina (lending US$14b – as part of a US$40b package – when collapse seemed inevitable) and Brazil (sheer scale of resources, accounts for +30% of total Fund lending). Conflicts b/w those pushing for tougher conditionality and those pushing for greater legitimacy/ownership of Fund programs by borrowers? Raised issue of moral hazard again for borrowers and lenders. Also Brazil + Turkey + Argentina = about 65% of Fund lending in 2002/3: concentration risk.

Finally, issue of representation. IMF run by members, but on *weighted* voting system. Increasingly claimed IMF too biased towards old 'Atlantic' economy. Under current weights, Western Europe (and ME and Africa) over-represented relative to rising economic power of East Asia. EU has 31% of votes, US 17% and ASEAN+3 just 13%. (Share of +3 alone in world GDP is over 17%.) MD traditionally a European.

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Challenges for the World Bank

- Leading development institution – therefore closely connected to any economic solutions to failed states.
- Getting the focus right: who should the Bank lend to?
- Measuring ‘success’ – when does Africa ‘turn the corner’?
- Easterly critique – Bank faces problems of the aid business (measurement, conditionality, evaluation, incentive structure).
- Debate over how much say for borrowers.

What about the role of the World Bank? As the global economy’s leading development institution, it should be responsible for dealing with the failures of the new global economy – failed and failing states – with clear linkages to international security issues.

Should the Bank still be making loans to investment grade borrowers like China, or to resource rich economies like Russia? Original justification to substitute for missing private capital. But now have huge liquid international capital markets that can be accessed by most middle income developing countries.

Alternative is for the Bank to focus all of its attention on those economies that still have problems accessing international finance, such as its IDA facilities for very poor countries.

Issue here is that after years of development lending, it’s hard to argue that delivered an improvement in economic performance for many of ‘worst’ cases. Thus Bank has been promising that Africa will ‘turn the corner’ for at least two decades . . . but turnaround never comes (Still, need to keep in mind that we don’t know the counterfactual – things might have been worse).

William Easterly critique: Dealing with standard ‘problems’ of the aid business: stress on disbursement rather than final objective (poverty reduction/economic growth); failure to enforce conditionality (Kenya under Daniel Arap Moi gets 21 IMF and Bank adjustment loans 1980-2000 despite repeated poor performance); reluctance to submit to evaluation. Note peculiar incentive structure – spend one group of people’s money on different group of people, with intended beneficiaries virtually no say in how money gets spent.

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Challenges for the WTO

- Four factors make progress in multilateral system difficult:
  - Growing WTO membership roll;
  - Shifting global balance of power;
  - Changing focus of WTO / nature of trade;
  - Tougher issues left on table.
- Fear that multilateral process close to stalling, especially after Seattle, Cancun . . .
- Rise of preferential trading arrangements as alternative – but building blocs or stumbling blocs for world trade?

Four factors seem to be making progress under the multilateral process increasingly difficult:

1. Rising membership. From the original 23 signatories to the GATT in 1947, the number of member economies rose to more than 100 during the Tokyo Round, and then to 123 in the Uruguay Round. Now 148 members and heading for 170. In parallel with rising membership, increase in length of Trade Rounds e.g. last successful round completed was Uruguay Round, from 1986-1994. Growing membership roll plus consensus makes progress tough.

2. Growing membership also associated with rise of new trading powers, especially in East Asia. More countries now have strong interest in how trading system operates, which again makes reaching agreement more difficult, as does the ‘single undertaking’.

3. International trade policy now reaching ever deeper into national economies. Issues of competition policy, of IP, and of investment. At same time, trade itself getting deeper into national economies – for example growing tradeability of services means increasing number of white collar works exposed to international competition. Inevitably, politically contentious.

4. ‘Easier’ trade issues (reducing tariffs on manufactured goods) now almost completed. Leaves tougher issues like agriculture.

Consequence - fear that progress on multilateral trade liberalization near to stalling. Failure to start new round at Seattle, near-run thing with Doha, and then debacle at Cancun with compromise stitched together at Geneva last year lead to fears about health of WTO.

Countries now looking for alternatives – hence spread of preferential trade agreements. But are they building blocs or stumbling blocs for global trade system? WTO is worried that it’s the latter . . .

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Annex: Background material on the IMF, World Bank, and WTO

Nearly all of the following information is from the official web sites of the IMF (www.imf.org), the World Bank (www.worldbank.org) and the WTO (www.wto.org).

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The IMF

The purposes of the IMF are set out in Article I of the Articles of Agreement.

1. Promote international monetary cooperation;
2. Facilitate the expansion and balanced growth of international trade;
3. Promote exchange rate stability (including avoiding competitive devals);
4. Assist in the establishment of a multilateral system of payments;
5. Make resources available to members experiencing balance of payments difficulties.

The IMF came into existence in December 1945, when the first 29 countries signed its Articles of Agreement. The IMF (or Fund) currently has 184 members.

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Functions of the IMF

1. **Surveillance**
   Detailed appraisals of member economies (usually annually) & policy advice; assessments of global & regional developments & prospects (World Economic Outlook and the Global Financial Stability Report 2x pa).

2. **Technical assistance & training**
   In areas including fiscal policy, monetary & exchange rate policies, banking & financial system supervision & regulation, & statistics.

3. **Financial support (lending)**
   Loans to countries experiencing balance-of-payments problems to help rebuild international reserves, stabilize currencies, & restore growth. Concessional loans to poor economies through the Poverty Reduction and Growth Facility (PRGF).

IMF lending facilities include:

Stand-By Arrangements (SBA). The SBA is designed to help countries address short-term balance-of-payments problems and is the facility that provides the greatest amount of IMF resources. The length of a SBA is typically 12–18 months, and repayment is normally expected within 2¼–4 years.

Extended Fund Facility (EFF). The EFF is targeted at more protracted balance-of-payments problems that require fundamental reforms to the structure of the economy. The length of an EFF is 3 years and repayment is normally expected within 4½–7 years.

Supplemental Reserve Facility (SRF). The SRF is to meet for very short-term financing on a large scale – as would happen in the case of a sudden loss of market confidence (cf the 1997-98 Asian crisis). Countries are expected to repay loans within 2–2½ years, but may request an extension of up to six months.

Compensatory Financing Facility (CFF). The CFF is to assist countries experiencing either a sudden shortfall in export earnings or an increase in the cost of cereal imports caused by fluctuating world commodity prices.

Poverty Reduction and Growth Facility (PRGF). The PRGF provides assistance to low-income countries at a concessional interest rates. All other IMF facilities are based on the IMF's market related interest rate, plus a surcharge for larger loans.

An IMF loan is typically provided as part of an '**arrangement**' stipulating specific policies and measures the member economy will implement in order to resolve its balance of payments problem. The economic program underlying an arrangement is produced by the country in consultation with the IMF, and is presented to the IMF Executive Board in a '**Letter of Intent**.' Once approved by the Board, the loan is released in phased installments as the program is carried out.

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Who runs the IMF?

- The IMF is run by its 184 members
- But not one member one vote: weighted voting system
- Votes linked to quota size, which in turn linked to economic size
- US has largest quota and largest bloc of votes (17.1%)

According to the Fund itself . . . (selected excerpts)

‘The IMF has a weighted voting system: the larger a country's quota in the IMF—determined broadly by its economic size—the more votes it has. But the Board rarely makes decisions based on formal voting; rather, most decisions are based on consensus among its members and are supported unanimously.’

Countries pay quota subscriptions when they join the IMF, or following periodic reviews – at least every 5 years - in which quotas are reviewed and increased. (Last review in January 2003 with no quota increase proposed).

Quotas are intended broadly to reflect members' relative size in the world economy (formula includes GDP, current account transactions, and reserves): the larger a country's economy in terms of output, and the larger and more variable its trade, the higher its quota tends to be. e.g. The United States has 371,743 votes (17.1% of total), and Palau has 281 votes (0.013 %).’

Access to financing is also related to quota size.

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Structure of the IMF

Board of governors

Highest decision-making body. Each member country has one governor (typically MoF or Central Bank governor). Meets annually.

International Monetary and Finance Committee (IMFC)

24 governors. Provides guidance to Executive Board on conducting IMF business. Meets twice a year.

Executive Board

Conducts day to day business of the Fund. Comprises 24 Directors (5 appointed, remainder elected by members or groups of members) and chaired by the Managing Director.

IMF Staff

Managing Director heads the IMF staff and is assisted by 3 deputy MDs

The member economies run the IMF through a structure based on a board of governors, the IMFC, and the Executive Board, which conducts day to day business.

By tradition the MD of the IMF is a European.

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The World Bank

The ‘ World Bank’ comprises two organizations:

1. International Bank for Reconstruction and Development (IBRD)

2. International Development Association (IDA)

The World Bank *Group* includes in addition . . .

3. The International Finance Corporation (IFC)

4. The Multilateral Investment Guarantee Agency (MIGA)

5. The International Centre for Settlement of Investment Disputes (ICSID)

The ‘ World Bank’ comprises two organizations:

International Bank for Reconstruction and Development (IBRD)

Established in 1945 and has 184 Members. IBRD aims to reduce poverty in middle-income and ‘creditworthy’ poorer countries by promoting sustainable development through loans, guarantees, and (nonlending) analytical and advisory services.

International Development Association (IDA)

Established in 1960 and has 165 members. Aim is to provide highly concessional (interest-free loans and grants) to the world’s poorest countries that have little/no access to market borrowing.

The World Bank *Group* includes in addition . . .

The International Finance Corporation (IFC)

promotes private sector investment by supporting high-risk sectors and countries.

The Multilateral Investment Guarantee Agency (MIGA)

provides political risk insurance (guarantees) to investors in and lenders to developing countries.

The International Centre for Settlement of Investment Disputes (ICSID)

settles investment disputes between foreign investors and their host countries.

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Who runs the World Bank?

- The Bank is run by its members (184 in the case of the IBRD)
- Like the IMF, not a one member one vote organization
- Voting power linked to number of shares of stock held, with number of shares roughly linked to size of economy
- largest shareholders is US, with 16.4% of votes

According to the World Bank’s web site . . . (selected excerpts)

‘The organizations that make up the World Bank Group are owned by the governments of member nations, which have the ultimate decision-making power within the organizations on all matters, be they policy, financial, or membership issues.

In the case the International Bank for Reconstruction and Development (IBRD), there are 184 member countries, nearly all the countries of the world. The International Development Association (IDA) has 165 members, the International Finance Corporation has 177 members, the Multilateral Investment Guarantee Agency has 164 members, and the International Centre for the Settlement of Investment Disputes has 140 members.

Under the Articles of Agreement of IBRD, to become a member of the Bank a country must first join the International Monetary Fund (IMF). Membership in IDA, IFC and MIGA are conditional on membership in IBRD.

Like all corporate organizations, each of the agencies of the World Bank Group has shareholders; these are the member countries. Every shareholder is allocated a certain number of votes linked to the size of its shareholding. The votes include a specified number of membership votes (which is the same for all members) and additional votes based on the number of shares of the stock held.

The number of shares a country has is based roughly on the size of its economy. The United States is the largest single shareholder, with 16.41 percent of votes, followed by Japan (7.87 percent), Germany (4.49 percent), the United Kingdom (4.31 percent), and France (4.31 percent). The rest of the shares are divided among the other member countries.’

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Structure of the World Bank

Board of governors

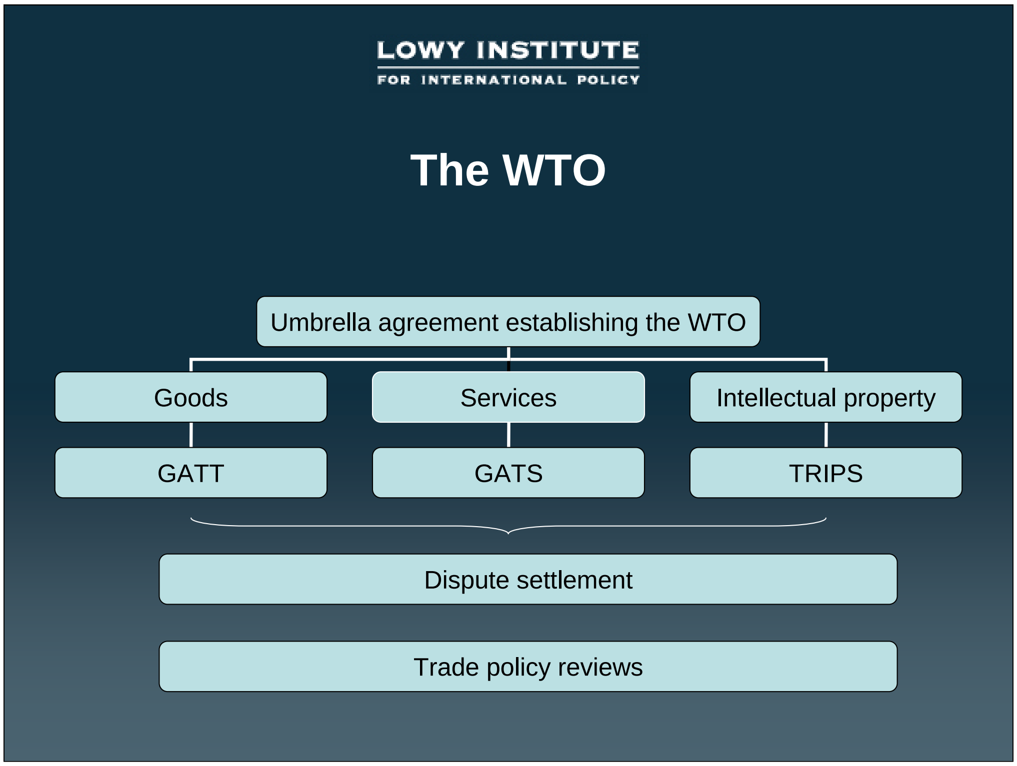
Each member country appoints one Governor and one Alternate Governor in accordance with the Bank's Articles of Agreement. Articles vest all powers of the Bank in the Board. Board meets annually.

Executive Directors

Conduct day to day business of the Bank. The 19 Executive Directors function in continuous session and meet as often as the Bank's business requires.

President

The president is, by tradition, a national of the largest shareholder (US). Elected for a five-year renewable term, the president chairs meetings of the Board of Directors and is responsible for overall management.



The WTO replaced the GATT as an international organization at the end of the Uruguay Round, but the General Agreement itself still exists as the umbrella treaty for trade in goods.

The WTO is a set of rules that provide the legal framework for international commerce.

Beneath the umbrella WTO agreement (the agreement that establishes the WTO itself) sit the three agreements that cover the three broad areas of international commerce covered by the WTO: goods (GATT), services (GATS) and intellectual property rights (TRIPS).

The agreements on goods and services are also supported by extra agreements and annexes that detail special requirements for specific sectors / issues, and by detailed schedules (lists) of commitments. Under GATT these generally take the form of binding commitments on tariffs for goods; under GATS, they are commitments stating how much access foreign service providers are allowed.

These measures are underpinned by the WTO's dispute settlement mechanism and trade policy reviews.

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Who runs the WTO?

- WTO again run by its members
- Decisions taken by consensus
- Unlike IMF or World Bank, no weighted voting structure
- Where consensus not possible, the WTO agreement theoretically allows for voting
- Vote being won with a majority of the votes cast and on the basis of "one country, one vote".

According to the WTO . . . (selected excerpts)

'The WTO is run by its member governments. All major decisions are made by the membership as a whole, either by ministers (who meet at least once every two years) or by their ambassadors or delegates (who meet regularly in Geneva). Decisions are normally taken by consensus.

In this respect, the WTO is different from some other international organizations such as the World Bank and International Monetary Fund. In the WTO, power is not delegated to a board of directors or the organization's head.

Since decisions are made by consensus, without voting, informal consultations within the WTO play a vital role in bringing a vastly diverse membership round to an agreement. One step away from the formal meetings are informal meetings that still include the full membership, such as those of the Heads of Delegations (HOD). More difficult issues have to be thrashed out in smaller groups. A common recent practice is for the chairperson of a negotiating group to attempt to forge a compromise by holding consultations with delegations individually, in twos or threes, or in groups of 20-30 of the most interested delegations.

The "Green Room" is a phrase taken from the informal name of the director-general's conference room. It is used to refer to meetings of 20-40 delegations. These meetings can be called by a committee chairperson as well as the director-general, and can take place elsewhere, such as at Ministerial Conferences. In the end, decisions have to be taken by all members and by consensus.'

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Structure of the WTO

Level 1:
Ministerial conference

Level 2:
General Council
Dispute Settlement Body
Trade Policy Review Body

Level 3:
Bodies reporting to General Council

Level 4:
Subsidiary committees to higher level councils

According to the WTO . . . (selected excerpts)

‘The countries make their decisions through various councils and committees, whose membership consists of all WTO members. Topmost is the ministerial conference which has to meet at least once every two years. The Ministerial Conference can take decisions on all matters under any of the multilateral trade agreements.

Day-to-day work in between the ministerial conferences is handled by three bodies: (1) The General Council (2) The Dispute Settlement Body (3) The Trade Policy Review Body. All three are in fact the same — the Agreement Establishing the WTO states they are all the General Council, although they meet under different terms of reference. Again, all three consist of all WTO members. They report to the Ministerial Conference.

Three more councils, each handling a different broad area of trade, report to the General Council: (1) The Council for Trade in Goods (Goods Council) (2) The Council for Trade in Services (Services Council) and (3) The Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS Council).

Six other bodies report to the General Council. The scope of their coverage is smaller, so they are “committees”. But they still consist of all WTO members. They cover issues such as trade and development, the environment, regional trading arrangements, and administrative issues.

Each of the higher level councils has subsidiary bodies. The Goods Council has 11 committees dealing with specific subjects (such as agriculture, market access, subsidies, anti-dumping measures and so on). The Services Council’s subsidiary bodies deal with financial services, domestic regulations, GATS rules and specific commitments.’