Development and Global Governance

Edited by Roy Culpeper and Caroline Pestieau

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Glossary

BIS	Bank for International Settlements
BWIs	Bretton Woods Institutions (World Bank, IMF)
CFA	Communauté Financière Africaine
CIDA	Canadian International Development Agency
C-20	Committee of 20 Finance Ministers who met to discuss the future of the BWIs after 1973 breakdown
EMS	European Monetary System
ESAF	Enhanced Structural Adjustment Facility (IMF)
ESSC	Economic and Social Security Council (see Stewart)
GAB	General Arrangements to Borrow (IMF)
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GFIs	Global Financial Institutions (see Stewart)
G-3	Group of Three (U.S., Germany, Japan)
G-7	Group of Seven (G-3 plus Canada, France, Italy, United Kingdom)
G-10	Group of 10 (in fact 11: G-7 plus Belgium, Netherlands, Sweden, Switzerland)
G-24	Group of 24 (eight each from Asia, Africa and Latin America and Caribbean), counterpart to G-7 in relation to BWIs
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association (World Bank)
IDEA	International Development and Environmental Association (see Patel)
IDRC	International Development Research Centre
IFIs	International Financial Institutions
IMF	International Monetary Fund
MOBs	Multilateral Development Banks
NAM	Non-Aligned Movement
NGO	Non-Governmental Organization
NICs	Newly Industrializing Countries
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
SAF	Structural Adjustment Facility (IMF)
SDR	Special Drawing Rights (IMF)
TNCs	Transnational Corporations
WTO	World Trade Organization

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Introduction

On May 2, 1995, a group of 30 experts met in Ottawa to discuss the interrelationships between development and the governance of the international economy. They came from all parts of the world Mexico, India, the United States, the United Kingdom, Sweden, Denmark, Uganda, Pakistan, Chile, Indonesia, and, of course, Canada. The group comprised researchers, academics, and members of non-government organizations. Officials from departments of the Canadian federal government, the International Monetary Fund, the World Bank and the United Nations also participated. A complete list of participants and their institutional affiliations is included in this volume.

The timing and the agenda of the meeting were carefully chosen with a view to the G-7 Summit meeting to take place in Halifax just a month later. The theme for the Halifax Summit the Reform of the International Financial Institutions (IFIs) had itself been chosen at the previous (1994) G-7 Summit in Naples. Nor was this set of issues coincidental. The year 1994 marked the 50th anniversary of the Bretton Woods conference and the founding of the two centrepieces of the post-war international economic order, the International Monetary Fund (IMF) and the World Bank. But the anniversary was marked less by celebration than by sombre reflection. Development fatigue had overcome many donors (including the World Bank) confronted by economic stagnation or decline in much of sub-Saharan Africa, after almost three decades of development assistance. Moreover, at the end of 1994, international financial markets were rocked by a major crisis, centred on the Mexican peso, far beyond the ability of the IMF to resolve, that soon drew in other Latin American currencies and even the Canadian and U.S. dollars.

Against this backdrop of huge and intractable problems, it was not surprising that interest in, and expectations from, the Halifax Summit mounted rapidly during the first half of 1995. The G-7 had long had a keen interest in the affairs of the Bretton Woods institutions (BWIs). They had also been seen as the group of shareholders exercising a controlling interest in the affairs of the BWIs perhaps unfairly, since the seven countries command slightly less than 50 percent of the votes in those organizations. Nonetheless, it is true that the views of the G-7 carry considerable weight in the IMF and the World Bank; thus, a Summit meeting dedicated to reform of the IFIs could be an occasion for significant, even radical, change. In the event, such expectations were misplaced.

The purpose of the seminar in Ottawa was to broaden the policy debate in the run-up to the G-7 Summit. It did this by focusing on the views of developing countries and their increasingly important role in a rapidly changing global environment, as a   counterweight   to the industrial-power biases of the United States, Europe and Japan.

The discussion was organized around seven   core   papers, which had been circulated in draft before the meeting. This volume also presents synopses of the rich exchanges between participants stimulated by the core presentations. On many important issues, members of the group were in substantial agreement; on others, they displayed a spectrum of views. It is hard to reproduce in print the cut-and-thrust of oral debate, so that what appears here is a well-edited version of what was actually said. The text is therefore *not* a comprehensive transcript of the proceedings, but rather a summary of the highlights.

What follows in the remainder of this introductory chapter is, first, a brief summary of the seven core presentations. Next, there is a synthesis of the various discussions, highlighting points of agreement and disagreement. Since the introduction was written after the Halifax Summit, the subsequent section examines its principal outcomes, and contrasts them with the conclusions of the Ottawa seminar. A concluding section draws on insights from the discussions to make some observations about the road ahead for reform of the international financial system and its institutional infrastructure.

The Core Presentations

Professor Gerald Helleiner led off the day s discussions with a *tour d horizon* of the issues confronting G-7 policy makers and those gathered at the seminar. In his paper he draws attention to the fact that increasingly, the emerging markets represent the world s most dynamic export markets, providing a   buffer   against recession in industrial countries. This fact is as yet poorly understood or even acknowledged in the developed world, and Helleiner argues that the rise of these developing countries has crucial implications for the governance of the global economy. The developing world is increasingly under-represented in the world s key deliberative councils; moreover, Helleiner maintains, the global community as a whole is dangerously under-governed with regard to its collective economic welfare and security. Thus, global macroeconomic management deserves the highest priority, along with the provision of development finance for the poorest countries, and the more equitable participation of developing countries in the international economic system. However, Helleiner emphasized that he saw the upcoming Summit meeting at Halifax not as a window of opportunity opening for a brief time, but the beginning of a *process* of reform which would take time but be more universal in its participation.

Dr. I.G. Patel draws heavily on the Commission on Global Governance, on which he recently served. He argues that both the governance and financing of international institutions deserve urgent attention. For example, he advocates adjusting the voting power at the Bretton Woods institutions to a purchasing power parity basis. That would undoubtedly increase the relative weight of the developing countries. He maintains there is already such a rich menu of proposals to improve the governance of international organizations that what is now required is a deliberate timetable, covering the next five years, to give approval to and implement specific measures. Patel s view of global governance goes far beyond the international institutions, to include both multinational corporations (which should adopt internationally acceptable codes of conduct) and NGOs (which should be made more accountable). On financing, he suggests that the notion of charges for use of the world s common-property resources (such as the seas) may have greater appeal than taxes.

Dr. Azizali Mohammed argues that the IMF should be transformed into a world central bank. The rationale of Mohammed s proposal is to create a responsive capacity in the international monetary system with which to respond to speculative and destabilizing attacks against particular currencies. Current tools available at the national level (through capital controls) or international level (through the limited resources of the IMF) are simply not adequate to counter the enormous speculative flows that private markets can now mobilize. Mohammed suggests that the IMF needs to be able to create liquidity in the international monetary system, rapidly and in large amounts, just as central banks do in domestic systems faced with crisis. A completely fungible Special Drawing Rights (SDR), which private agents would also be able to hold, would be necessary for the IMF to function as a world central bank. Mohammed argues that such a system would avoid the financial constraints and monetary disturbances imposed by bilateral swaps and other cooperative arrangements involving the currencies of other member countries.

Continuing to focus on the IMF, **Dr. Ariel Buira** emphasizes the anachronistic and politically biased nature of the allocation of votes in the Fund. For example, he points out that Brazil, Spain and Mexico have larger CDPs but fewer votes at the Fund than Belgium, the Netherlands and Switzerland. In short, Buira finds power at the Fund too concentrated among the C-7. He also documents the decline in the size of the Fund *relative* to total world trade. He attributes blame to the industrial countries for the Fund s diminishing importance its retreat away from the centre of the international monetary system to being a specialized development agency. He urges a restoration of the IMF s historic role. That would enable it to exercise real surveillance over the industrial countries policies, whose impact on the international economy is profound. But for this to happen the power structure must change to give greater weight to the developing countries.

Dr. Frances Stewart looks at the pervasive changes in the international economy over the last 50 years that have effectively marginalized the Bretton Woods institutions, and she contemplates the kinds of international financial institutions that the world will need in the 21st century. She maintains that the IFIs of the future will need, *inter alia,* to deal with macroeconomic policy coordination among the main economic powers, to be able to create SDRs more spontaneously, to oversee and regulate capital markets and multinational corporations, and to develop and implement global environmental, labour and social standards. She proposes a new Economic and Social Security Council (ESSC) at the United Nations, parallel to the current Security Council, with a similar structure of permanent and rotating members. The mandate of the ESSC would be to establish policy on issues such as macroeconomic coordination, SDRs, environmental, labour and social standards, and oversee the work of a reformed IMF, World Bank and World Trade Organization. Stewart ends by suggesting that a change in economic philosophy away from rigid market-oriented doctrines is necessary to make the reform program workable.

Professor Nguyuru Lipumba turns our attention to the problem of long-term finance for development by focusing on sub-Saharan Africa. He criticizes the lack of ownership of economic reform programs by African countries, which leads to mistakes in sequencing and structure of reforms as well as to conditionality, which is unrealistic and bound to fail. He thus finds the meagre results of structural adjustment programs (SAPs) not surprising. But a growth rate of 2 percent per capita under the most successful programs to date is unlikely to reduce poverty in the region to any extent. Lipumba then argues that a long-term poverty reduction strategy is needed through productivity enhancement in agriculture, still basic to the livelihood of most Africans, and through human resource development. Further, he maintains the time has come to go beyond trade liberalization prescriptions to consider industrial strategy and regional integration, although he warns that an Asian tiger strategy of bureaucratically guided markets is not feasible in most African countries. He does, however, agree that the private sector should be actively encouraged. Finally, he appeals for deep and rapid debt relief and for the rationalization of diminishing aid flows (with top priority in both cases to Africa).

The final paper by **Cristián Ossa** and **Barry Herman** argues that *de facto* international monetary and financial management by the G-7 needs to be replaced by more truly multilateral and durable mechanisms. They suggest, for example, a Permanent Council of the IMF with decision-making powers and in which developing countries would have more genuine influence, instead of the present Interim Committee which has little real power and generally defers to the G-7. Given the Mexican peso crisis, which indicated market failure on a spectacular scale, the authors call for enhanced international oversight, regulation, surveillance of increasingly unruly and unpredictable markets and a central role for an enhanced IMF. Turning to Official Development Assistance (ODA) flows, which suffer declining political support in donor countries, Ossa and Herman argue for a new model of aid, one not based on assistance but on cooperation to advance collective goals such as poverty reduction and environmental security. Finally, the authors address new sources of development financing including Tobin taxes and (echoing Patel) charges on international resources, but they caution that these are likely to be inadequate for the task and that traditional budgetary allocations will still be necessary.

Discussion: Salient Conclusions

The discussion throughout the day generated considerably more light than heat; and, even where opinion was divided, the differences were illuminating. There follows a summary of the main conclusions of the discussion first, on the key problem areas in the international economy, and next, the solutions advocated by the group.[1]

The three key problems identified with regard to the international economy and warranting urgent attention were, first, **instability and uncertainty in exchange and capital markets**. Financial flows are overwhelming real flows in the global economy, and threatening employment and output levels in both developed and developing countries. Moreover, greater interdependence acts as a transmitter of instability; for example, rising U.S. interest rates helped to precipitate the Mexican peso crisis, which in turn dragged down the U.S. dollar.

Second, **the methods of governance and the mandates of the IFIs were seen as outdated**. The world has changed rapidly and profoundly in the 52 years since the Bretton Woods institutions were created. There was a large amount of agreement that the IFIs are as a result ill-equipped to deal with the challenges and realities of today s global economy. At the same time, they have grown considerably in size and complexity. Hence their governance has come into question. At issue is their representativeness and their responsiveness to the needs of members and of people generally. This can be gauged by the fact that their decision making is inordinately skewed toward the G-7 and GECD countries. In addition, their lack of accountability and of transparency and the difficulty of monitoring them were criticized. Also at issue is the equity and symmetry with which they deal with various member countries, the rich and powerful compared with the rest.

Third, **long-term financing for development through official channels is not only inadequate but also declining, even on optimistic projections**. While the decline is the most acute in the United States, even the most stalwart providers of ODA such as Sweden and Canada have cut back their aid programs. Consequently, available official finance for international public goods is likely to be increasingly and hopelessly inadequate.

If these are the key problems, what kinds of solutions should be advanced, not only at the G-7 Halifax Summit, but also over the next few years? First, there was wide agreement that **the IFIs need to be strengthened to be able to deal adequately with the instability of exchange rates and of the capital market**, the current realities of the global economy. Here the role of the IMF is crucial. The Fund needs additional resources and a reinforced mandate in order to handle future crises on the scale of Mexico. It needs to exercise surveillance over member countries policies more effectively, and more universally, than hitherto in particular, over industrial countries policies which have international impacts. Many participants agreed with Dr. Mohammed that in the long term there was a case for transforming the IMF into a world central bank that can *create* liquidity. Meanwhile, Special Drawing Rights, which can help to meet the short-term liquidity needs of developing countries that are adapting and may have viable economies, have become marginalized as a reserve asset; their role should be reaffirmed and expanded through new allocations.

Second, on the subject of the governance of the IFIs, there was a surprising degree of convergence that **more effective political-level direction is essential**. The transformation of the ministerial-level Interim Committee and Development Committee, from being advisory bodies to the IMF and World Bank, into organs that make policy decisions, was widely endorsed. The Regional Development Banks (RDBs) need to be formally integrated into the Development Committee, where they are at present still observers. However, the current voting power, quotas and shareholdings in the Bretton Woods institutions need to be updated. They no longer reflect relative economic strength, particularly that of the developing countries, which are consequently underrepresented. The adoption of a purchasing power parity (PPP) rather than a market-based estimate of GNP as an index of relative economic strength on which to base future quotas and shareholdings, commanded considerable support moving to a PPP-based system would raise the relative voting power of many developing countries to more appropriate levels.

The idea of creating a new UN Economic and Social Security Council met with less agreement. The world nonetheless lacks a forum in which key economic and social issues can be discussed and decisions taken that will make a real difference. While the Bretton Woods committees could make policy decisions on financial and development issues, they are not competent to deal with trade issues, which the World Trade Organization (WTO) should cover. This could enable the present Security Council to take on more vigorously problems such as refugees and economic emergencies. It was agreed that institutional reform needs to take place *throughout* the international organizations in the UN as well as in the Bretton Woods organizations.

While participants acknowledged the World Bank s strengths as an institution that can mobilize resources and make a profit, as well as being a centre of excellence on development research and analysis, these strengths have too often led to an overbearing, sometimes arrogant, attitude. Some participants drew attention to the lopsided relationship between the World Bank and the Regional Development Banks and suggested a greater degree of competition between them would be healthy for all concerned. The RDBs have some advantages over the World Bank since they are owned by regional members and are generally closer to the development problems and the peoples of their regions. There is a stronger case than previously for a decentralization of research from the World Bank and some transfer of decision-making initiatives to the RDBs. This could require further capacity-building in the RDBs since the latter lack the staff and lending resources of the World Bank.

Third, on financing for long-term development, participants agreed that **increasingly scarce ODA and other official flows will require managing these resources more carefully than ever and ensuring that they give priority to the world s poorest people, to collective goals of the world community and to good performers among recipients**. The importance of marketing ODA to the donor countries, by demonstrating that assistance is carefully targeted, monitored and can demonstrate results in reducing poverty, was noted. There was some debate on the efficacy of structural adjustment programs, but a degree of consensus emerged that such programs need to be judged as a total package, including their social impact. Moreover, every SAP needs to be compared with alternative packages of macroeconomic policies, in determining the most successful route to longer-term stability and growth, without which poverty reduction is quite unlikely. Responsible domestic fiscal policies in recipient countries were recognized as a particularly important requirement by some Third World participants, who felt that external assistance should not become a substitute for domestic savings and efforts to mobilize internal resources. At the same time, participants underlined the point that such policies could only realistically be pursued if the IFIs made sure that local governments had (and sincerely felt they had) ownership of the policy-making process.

Furthermore, given the sombre outlook on official financing, other expedients now deserve more prominence than ever. For example, several participants underlined the importance of more sweeping debt relief, particularly for the poorest and most debt-distressed African countries. In this context, the relieving of official debt owed to bilateral creditors, going considerably beyond the recently adopted Naples terms, needs urgent consideration; so does relief on multilateral debt itself. Current discussions to this end in the Executive Boards of both the IMF and the World Bank were to be encouraged.

In addition, several participants suggested that the decline of official development financing prompts the need to search for new and additional sources of financing for international public goods. These include charges on international currency and capital transactions, and for the use of the global commons on and under the high seas, in the air and in space, and on the electronic transmission spectrum, including cyberspace. Such charges would not only raise needed revenues; some would also serve to reduce speculative transactions and to restrain the overuse of common-property resources.

On a more general plane, it was suggested that proposals for reform are more likely to gain universal acceptance if all participants see mutual gains. Reform must be, and must be seen to be, a win-win proposition for the G-7 countries, the other OECD countries, and the rest of the world. It was especially important to link reform proposals which would benefit developing countries with benefits to the G-7 and OECD countries. For example, the direct link between more successful development efforts and increased industrial-country exports and employment needs to be reiterated; so does the link between development and environmental sustainability.

Finally, many participants stressed that the *process* of reform was critical. There are currently many proposals on the table which deserve careful and thorough study before the most appropriate among them can be implemented. Study, international discussion and design, and implementation will take time. But the process needs to be unpackaged to be kept manageable, and fitted to a constraining timetable in order to bring about closure and results. Some speakers endorsed a proposal by the G-24 (group of developing countries) to create a ministerial committee of 20 to oversee the process, and to be an improvement on the C-20 in the 1970s, which combined rich and poor countries but never managed to bring its proposals for reform to a conclusion. It was suggested that, if started soon, a comprehensive process of reform of the international organizations could be brought to fruition before the turn of the century.

The Halifax Summit and Beyond

It is instructive, if a bit sobering, to compare the outcome of the seminar with that of the Halifax G-7 Summit which followed it by a month. The purpose in making such a comparison is not to decry the Halifax Summit in particular or the G-7 Summit process in general. Indeed, it should be mentioned here that some participants emphasized that excessive expectations from the Summit were not warranted and were not even desirable. These participants argued that, if major decisions were going to be taken concerning the governance of the global economy, it would be better to deliberate on them in a more representative and universal gathering than the G-7 Summit.

Nonetheless, it is safe to assume that most participants would have wished at least some outcomes more consistent with those of the Ottawa seminar. In general, the Halifax Summit declaration expressed considerable caution as to either the necessity or even the possibility of drastic changes to the current set of institutions overseeing the international economy or the underlying policies governing the behaviour of public and private agents. The G-7 acknowledged the instability and excesses in the exchange markets, but they put the onus on appropriate macroeconomic policies *at the national level* unlike the Ottawa seminar, which saw international initiatives as imperative. The Summit dismissed administrative measures, such as selective taxes or controls on capital transactions, as both ineffective and too costly. It generally regarded investment and capital flows (in contrast with the Ottawa seminar) as *reinforcing* stability.2 It in fact advocated changing current rules under the IMF to include a staged liberalization of capital account transactions3 in other words, making countries even more open to destabilization through speculative capital flows than they already are.

The Summit put its emphasis on early warning and surveillance (via the timely publication of key and standardized economic and financial data) which the IMF would oversee. When it came to new financial mechanisms to deal with instability, however, the G-7 chose not to accelerate the current review of IMF quotas. Instead, it opted for systematizing an Emergency Financing Procedure (to enable the Fund to mount operations similar to that used in the Mexican peso crisis) on an as-needed basis and doubling the funding available under the General Arrangements to Borrow (GAB) through the G-10 and perhaps other wealthier countries.

The decision to enhance the GAB reflected a preference by the G- 7 for mechanisms outside the ambit of the Bretton Woods (or more universal) institutions and much closer to the industrial countries. This was also apparent in the discussion on financial market supervision and regulation. The G-7 chose to ask the Bank for International Settlements (which came under some criticism at the Ottawa seminar for its lack of transparency and universality) and the International Organization of Securities Commissions to study these increasingly vital issues.

On Special Drawing Rights, the Halifax Summit supported a one-time allocation for the newest members (particularly republics of the former Soviet Union and Eastern Europe), an approach which would provide additional SDRs to some of the poorest countries. But the measure was clearly a minimalist one. Much will depend on an ongoing study on the future role of the SDR. Given the opposition to SDR allocations from some G-7 members, a termination of the SDR would seem more likely at this point than a dramatic enhancement of its role. Anointing the SDR as the basis of world liquidity, and issuing them on a discretionary basis by the IMF acting as a global central bank (as suggested by Dr. Mohammed), appears to be, at this point, dreaming in technicolour .

The Halifax Summit also discussed long-term issues of sustainable development. On these issues there was some resonance with the Ottawa seminar. In particular, the G-7 suggested that increasingly scarce concessional resources should be allocated to countries needing them most and using them most effectively;4 countries with access to capital markets (such as China and India) should be graduated from receiving concessional assistance. The Summit also emphasized the centrality of poverty reduction in the assistance strategies of the Multilateral Development Banks, and suggested that eligibility for assistance be geared to developing country recipients commitment to poverty reduction.

In other respects, however, the G-7 s faith in private capital markets to meet a wide spectrum of development needs, and in effect to displace official aid or assistance (for example, in physical infrastructure), went against some sentiments expressed in Ottawa. An exception was made for public goods such as those produced in the social sectors, where official finance was seen to have a continuing role.

The Halifax Summit provided no impetus at all to resolving outstanding developing-country debt problems, despite the fact that the U.K. delegation had gone to Halifax with proposals (supported by Canada) to initiate relief from multilateral debt. Instead, the G-7 took satisfaction in existing debt-relief initiatives and deferred the thorny question of multilateral debt to the IMF and World Bank.

Finally, on process issues and institutional governance, on which the Ottawa seminar had plenty of useful suggestions, Halifax did suggest that the Interim and Development Committees be reformed, and urged consideration of two options. The first would result in a unified committee to focus on global financial and development policy issues, and the second would shake up the moribund

Development Committee to make it more like the Interim Committee.

The first of these options suggests the possibility of institutional reform writ large. However, the G-7 simply does not appear collectively to be able to agree on changes beyond the incremental. Moreover, while there was plenty of lip-service given to the growing role and importance of developing countries in the world economy, this has not translated into formally accepting a larger voice for these countries in the world's key decision-making councils (as strongly recommended at the Ottawa seminar). The problem with this stance is that it will inevitably erode the legitimacy of institutions such as the IMF and the World Bank, further marginalizing them as important public agents in the industrial and rapidly industrializing economies.

Increasing recourse to mechanisms and agencies outside the IMF and World Bank, (such as the G-10 and the BIS) as suggested at the Halifax Summit, are further cause for worry. However, it is important to note a subtle shift in G-7 pronouncements about itself. There is a new, outward-looking mood which was reflected in the decision to seek new recruits outside the G-10 "rich man's club" in the current plan to double the GAB. It is open to question whether a "G- 20" consisting mostly of OECD countries and a few newly industrialized economies should supplant what the G-7 and G-10 presently do, rather than making the IMF and World Bank more representative and participatory. On the other hand, the expansion of such a group eventually to include countries such as China, India, Indonesia and Brazil would nonetheless alter the nature of international economic discourse.

Thus, the chances are good that debate on the nature and structure of the international economy will continue into the next century, and that the number and the origin of the proponents in the debate will change significantly. One can only hope that the debate will proceed under circumstances of relative order rather than crisis and breakdown.

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Endnotes

1 This section draws on a longer Briefing prepared after the seminar, A Win-Win Proposition for the IFIs: Gathering Advice for Halifax and Beyond, *Briefing Paper,* 38. (Ottawa: The North-South Institute and IDRC, 1995).

2 Government of Canada, Halifax Summit: Review of International Financial Institutions. Background Document, 1995, p. 3.

3 *Ibid*., p. 10.

4 *Ibid*., p. 11.

Part 1

Overview

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The Eclipse of the G-7

Gerald K. Helleiner

This is an important event. It is important, above all, because of its timing   the particular conjuncture of the G-7 Summit conference, with its review of the international financial institutions prominent on the agenda, and the currently exploding perception around the world that the existing multilateral economic institutions, valuable as they may have been, may be incapable of addressing effectively the principal global economic and social problems of the next decade, let alone the next century.

Needless to say, no one expects miracles from the Halifax meeting. Change takes time. We should not waste time here bemoaning the immediate political constraints, whether it be the current U.S. Congress, the present views of the Bundesbank or political uncertainties in Japan. Our concerns relate to longer-term needs and processes and change.

The 50th anniversary celebrations of the Bretton Woods institutions and the United Nations, and the inauguration in January 1995 of the World Trade Organization (WTO), have generated a degree of concentrated public and professional attention to global economic governance that has not been seen in more than 20 years, perhaps not even in 50. We are fortunate that at the last G-7 Summit in Naples the decision was taken to maintain some of the momentum of this intensified discussion, which at that time had not yet even peaked, into the Halifax Summit meeting.

The key question now is what will transpire in the period after the Halifax Summit: what, if anything, can that meeting do to assist a continuing process of orderly and participatory consideration of necessary changes at the intergovernmental level? Can this particular Summit meeting, timed to respond to 50th anniversary considerations, serve to lever longer-run change in the appropriate direction? Do we not, in fact, already agree on what that direction is? At a technical level, there seems to be more agreement than there is in the political arena.

After all the conferences we have attended on the subject, it may be a little tiresome to review the major changes that have taken place in the global economy over the past several decades; but some context for our discussion is necessary. Let me make three observations. Two are familiar to the citizens and politicians of the G-7 countries and one is generally not.

For better or for worse, we now have a global economy.

Most familiar is the relatively recent and incredible increase in international economic interdependence and globalization of economic activity, most remarkably through financial markets. In many respects, for better or for worse, we now have a global economy. Secondly, for those with any interest in international economic affairs, it is well known   although the details may not be   that the central intergovernmental institutions in the global economy have become the International Monetary Fund, the multilateral development banks (of which the World Bank is the best known), and, for the better informed, the meetings of G-7 finance ministers and the Bank for International Settlements. Most recognize, at least at an intuitive level, that effective macroeconomic and financial management at the global level is far more important to overall output, employment, and income, that is, the *real* economy, than marginal changes in the trade regime. Exchange rate changes and misalignments can and do easily swamp trade policies in the short to medium run; and surges in private capital markets and financial crises can disrupt the global economy far more quickly and to far greater effect than most trade phenomena. It is therefore critically important to get the central macro- and financial institutions for the newly globalized economy broadly right.

Much less well known within the G-7 is my third contextual observation: the rapidly growing importance of non-G-7 members in the world economy, and therefore the growing importance of these economies to G-7 welfare   or what a recent World Bank study *(Global Economic Prospects)* calls reverse linkages. I am speaking of much more than population trends; many do know about them, and quite a lot of G-7 citizens fear them. I am speaking of economic strength and economic potential. In purchasing power parity terms, developing countries already account for fully 44 percent of world output. According to the World Bank, by the year 2010 they will account for 56 percent of global consumption and 57 percent of global capital formation. How many know that during the 1991 recession in the industrial world three-quarters of the increase in world exports, which buffered their problems, went to developing country markets? How many G-7 businessmen know that developing-country offers of increased market access in the Uruguay Round were together worth more to the United States than those of either the European Union or Japan, or that they were worth more than those of the United States to both Japan and the European Union? Developing countries as a group are generally projected to grow at roughly double the rate of the industrial world during the coming decade. The developing countries (and other non-G-7 members) are economically as well as demographically important, and they are very rapidly increasing their importance in the global economy.

There is another side to developing country participation in the global economy, which may be even more important to G-7 citizens and politicians, and on which, I have said, they are underinformed. As has most recently been shown in Mexico, the developing countries economic performance while, on average, impressive is also subject to much greater volatility. Their closer integration with and increasing importance to the world economy poses increased risks both to them and to the world economy. Some of the most significant shocks to the world economic system over the past two and a half decades have originated in developing countries, whether it was oil prices, debt crises, or financial shocks. Moreover, as Michel Camdessus, the Managing Director of the IMF, has recently emphasized, there are bound to be many more Mexican-style financial shocks. This is not to ignore the non-economic disasters of climate, civil disturbance and war. Apart from the fact that the G-7 countries represent a small and declining proportion of the world s population, then, their own economic and political security now rests significantly and increasingly upon events in the rest of the world.

From these facts flows an inescapable conclusion: the G-7 can no longer expect to serve as a self-appointed executive committee (and not a very effective one at that) for the governance of the global economy. The world will have to find its way toward more politically and economically representative, and thereby both more effective and more legitimate, means of economic governance. The process through which such new arrangements are put together must itself be representative, and thus be both legitimate and effective. A review process that begins and ends within the G-7 will be neither. From the standpoint of non-G-7 members, success at the Halifax Summit, insofar as the review of international financial institutions are concerned, will reside in the *initiation* of a participatory and therefore legitimate and effective review process. Success will be achieved if there is at Halifax a strong political push toward such a review process. It is as simple as that.

The G-7 can no longer expect to serve as a self-appointed executive committee for the governance of the global economy.

The developing countries (G-24) communiqué in Madrid was forthright and clear about these issues. Expressing dissatisfaction with the announced G-7 review of the international financial institutions, it called instead for a participatory intergovernmental review which would carry greater legitimacy, a greater sense of overall ownership and thus greater effectiveness. Their implicit warning was heard by the Managing Director of the IMF. It was evidently not heard or, if heard, not heeded by G-7 finance ministers, some of whom seemed surprised at subsequent developing country actions (over SDRs) in the Interim Committee. The warning was re-issued in the G-24 communiqué at the ministerial meetings in Washington in April 1995:

Any evaluation of the functioning of the international monetary system should be made with the participation of the developing countries, along the lines of the Committee of Twenty of the early 1970s, in order to ensure its effectiveness and legitimacy.

The willingness of some non-G-7 members, acting together, to hold out on matters of great concern to them all, against the preferences of the G-7 members, appears to have stiffened in Madrid and thereafter. Even under the existing governance systems, non-G-7 members have the power to block some changes which may seem to be in the general interest if they do not provide sufficient accommodation of their own particular needs. The G-7 may expect more such strike action .

Other speakers at this meeting, most of whom are from developing countries, will present their views as to the technical substance of many of the most important reform questions. Many of these views have been presented before. They will undoubtedly be put forward again. They must not only be heard within the G-7 but they must also be assigned greater weight than in the past. Review processes and, ultimately, governance structures must be designed to achieve that purpose, greater representation of others interests, no less than of those that often receive greater prominence in the rather inbred G-7 discussion.

I do not believe there will be much disagreement here about either the basic nature or the general direction of the required changes in the international institutional machinery. In the newly globalized market economy of the 1990s and the 21st century, there is need for the provision of certain public goods which markets cannot by themselves deliver. These include macroeconomic management for the purposes of overall stabilization and the containment of crises, as well as the provision of development finance that yields high social return but that markets do not provide.

The IMF and the World Bank were created to respond to the problems created by such market failures. The fundamental purposes for which the Bretton Woods institutions were created as responses to market failures are still valid. While far from perfect, the IMF and the World Bank have functioned to address these purposes. As has repeatedly been stated during the past year, if they did not exist, they would have to be created . The world now has plenty of evidence that governments, no less than markets, can fail. At the level of the global economy, however, most now perceive major risks from global *under*governance. In particular, as the papers for our meeting attest, improved governance would seem a prerequisite for the attainment of such basic goals as maintenance of stability and growth in the global economy, and accelerated development in the lowest-income countries.

On the latter goal, last year the Development Committee of the IMF and World Bank created a task force to analyze the mandates and functioning of the world s multilateral development banks. It has been slow to get moving; but its creation was at least a start. Because of its origins in the multilateral institutions, it began with considerably greater legitimacy than the G-7 review. Previous such task forces, however, have been akin to what In Canada are called Royal Commissions. They have no power and usually little effect. Many therefore regard the creation of this task force as a diversion from the real business of serious review, reconsideration and reform. There has as yet been no serious political momentum behind any of the activities initiated by its moribund parent, the Development Committee. In its present form and in the absence of any further associated commitments, few expect much from this task force either. Its work might, however, be rolled into a more serious undertaking initiated from the Summit.

On IMF and global macroeconomic management issues, there has not so far been even that much of a multilateral response to the emerging problems. In this sphere I think it accurate to say that there has emerged something of a technical consensus on the need to strengthen considerably the IMF and to create a more powerful version of its present Interim Committee, perhaps the long-postponed Permanent Council, discussed in the C-20 in the 1970s. Some would prefer it as an Economic Security Council, reflecting their perception of the need for democratization in the IMF. There is, in any case, widespread intellectual recognition of the need for more effective macro management at the global level, more stable sources of international liquidity, improved and more symmetrical surveillance, faster crisis response mechanisms, and a larger multilateral lender of last resort. The principal problems with their achievement seem to rest with national-level politics and the perceived political risks of reduced sovereignty. Here the politics of the G-7 are at present decisive. Political constraints within the G-3 still seem to block the way to more effective global macroeconomic management.

In this sphere, therefore, lies perhaps the greatest potential for the Halifax Summit: the potential for at least beginning to break this particular political log-jam: through some such negotiation device as the Committee of Twenty of the early 1970s (formally known as the Ad Hoc Committee of the Board of Governors on Reform of the International Monetary System and Related Issues), in which the issues can be carefully and deliberately addressed and where other major participants may not only make their voices heard but also exercise a mediating influence among the more powerful. In the current context, the mandate for such a committee could usefully be expanded to incorporate the Multilateral Development Banks and elated issues. Some specifics as to how such participation might be engineered may be found in a G-24 technical paper, Global Financial System Reform and the C-20 Process (April 1995), by Azizali Mohammed, who is with us today.

Again, the necessary directions for change in the international financial institutions and in arrangements for global economic governance more generally now seem fairly clear. Neither the details nor the processes through which the details will be negotiated are as yet anywhere near agreement. I am sure that this meeting will provide plenty of suggestions as to both the technical details and the 1egotiation processes. I pray that it is not already too late for some of them to be incorporated into the preparations for the Summit. In particular, again, I pray that the Summit initiates a process rather than concludes it.

To sum up and to repeat, the spheres in which a participatory review process could receive political impetus from the Halifax Summit are essentially three:

- Global macroeconomic management and the role of the IMF therein. (In this meeting we will hear details concerning the problem of volatile private capital flows, and the potential roles of SDRs and expanded quotas);
- The provision of development finance for the poorest countries. (We will hear details concerning multilateral and bilateral debt, the future of IDA, and the long-overdue initiation of automatic mechanisms for the mobilizing of global finance, more appropriate conditions and true local ownership); and
- More effective decision-making structures within the Bretton Woods institutions and beyond. (We will hear views on the future of the Interim and Development Committees, voting arrangements, and links with the WTO and the UN).

By providing such detailed inputs and strong support for the effort, I hope that this meeting may assist the political leaders at the G-7 Summit not to reach conclusions on these issues but to begin an effective and participatory review of them.

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Global Economic Governance: Some Thoughts on our Present Discontents

I.G. Patel[1]

I hope that we will tackle our agenda in the broader sense of development and global governance rather than merely international financial institutions. Otherwise we would leave out such important institutions as the World Trade Organization with the whole trade problem and even the United Nations which has a very important role, although in financing it might be marginal. In terms of moral leadership, even on economic matters, the United Nations has a very significant role.

I think the problems of governance are at the heart of the discontent that many developing countries feel about where the institutions are going; and the nature of development, what makes it possible, is also something, that is not yet a totally settled question. Some people have suggested that this is not a good or propitious time for reform. I don t agree. If we wait for a good time, I think it will never come. By the time anybody decides to do anything, something may well happen around the world that really makes it more than timely. Things have happened before we expected them, like civil crisis and the oil crisis, you name it. We have narrowly escaped in such crises; we should not be so sure that we will escape next time.

There are, I think, two main reasons why we should consider reform. One is that the institutions that we have developed either have certain defects or that there is an amount of dissatisfaction with the way they are functioning. The other and equally important reason is that new problems and new opportunities have arisen and we are not sure the existing institutions address these new problems and take advantage of the new opportunities. When the developed

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1 This is an edited version of the oral presentation Dr. Patel gave at the start of the seminar, and in it he makes references to points in papers he had already read but which were presented later in the day.

countries talk of defects or discontent, they focus on efficiency and effectiveness: are the institutions too large or maybe too small, do they perform the job well? We have no quarrel with that. I think the developing countries certainly want the institutions to be effective but our concerns are more with the equity aspects and with the governance aspects. Any institution, if it is to be effective and relevant, has to have not only the formal participation of all countries, but also, in some form, equal and democratic participation. The way it functions has to be just or equitable. That is not the case today. I don t have to document it; Mr. Buira in his paper has documented it very adequately for the Fund, and we know the situation in the Bank is no different. We know that the United Nations, for all purposes as far as economic problems are concerned, is by and large sidelined. What can be done about it? Can anything be done about it? This is one of the major questions we should ask ourselves.

The problems of governance are at the heart of the discontent that many developing countries feel about where the institutions are going.

The second important question is that of financing. Today, the financing of international institutions the World Bank, the Fund, the UN, the World Food Programme is not only inadequate but uncertain and even wayward. If you don t know what s going to happen tomorrow, that cannot be any basis for an efficient, relevant functioning of an institution. We must again ask ourselves, can we do anything about it?

These two questions, governance and financing, to me are prime questions. In the context of governance, there are three or four suggestions which have come up in the many discussions we have had. Frances Stewart has mentioned in her paper the idea of an Economic and Social Security Council; it is an attempt to say that something beyond the G-7 must be created within the economic framework of the functions of the United Nations. It should be a representative body, not a large body, maybe 20 to 25 people. Our Commission on Global Governance has made the same recommendation, in slightly different terms. That is one idea we seriously need to consider.

There are other ideas in regard to the voting power in the International Monetary Fund and the World Bank. At present they are based on national income figures which everybody recognizes are not a correct or true representation of what the national income of different countries is in real terms. The Fund itself publishes data on national income figures that are corrected for purchasing power parity differences; and even if that equitable step is taken to revamp the quota on the basis of purchasing power parity, you will get a significant improvement in the voting power and decision-making powers of the developing countries. Anybody can give examples to show what the difference would be.

These two questions, governance and financing, are prime questions.

A third aspect of governance is the process of making changes. We spend a lot of time saying this must be done and then that must be done . At the end of the day, we have to ask ourselves what can be set in motion, so that as much as can possibly be agreed to by consensus between all the countries that matter in the world does take place. It is important that we set a precise timetable, for all the countries of the world, from all economic strata, to begin a serious process. We have suggestions regarding that in our report of the Commission on Global Governance. For instance, let us have this year and 1996 devoted to purely intellectual consideration of all the suggestions that have come up, but that have not been fully worked out. Let us discuss all these ideas the financing, the governance and other specific ideas and see what can come out as a consensus of at least alternatives and options. Then 1997 can be devoted to discussions among governments to arrive at an agenda for negotiations. In 1998 we should have a world conference that will seriously address all those questions on the agenda in an integrated way not just environment, not just security, not just peace, not just humanitarian assistance, human rights, development, poverty, social conditions but everything on the line. Then, by the year 2000, we should implement the decisions of the conference through appropriate changes in national policies and national legislation or in the international structure.

Unless we come out with some specific timeframe, we will just talk for the remaining two or three years of the century and perhaps marginally something will happen. We don t necessarily want radical change but we want whatever change is possible in all related areas because all the issues of peace, security, environment and poverty are interrelated; we should not let go of this opportunity, whether it s hung on the 50th anniversary of the United Nations or not.

On financing, there are two or three ideas which ought to be seriously considered. One is the idea of charges I don t speak about taxes but even people who do not like taxes, who are conservative in their economic thinking, will accept that you ought to pay for what you get, you ought to pay for what you abuse and what you use. There are so many things around the world which every country uses and abuses but for which there is no payment. Examples may vary in different people s minds but they would include the use of ocean lanes, the way we occupy the geostationary space, the way we occupy the frequencies. For every country it s grab as you can, there is no payment for it . We use the ocean lanes, we despoil the seas, we fish in international waters and no charges are levied. It s all for free for those who have the means to exploit it. This is an idea that seriously needs canvassing. I myself would not balk at taxes also, where the taxes can be linked to something worthwhile and useful, for example to combatting health problems through taxes on tobacco. The Tobin Tax is a matter for discussion, and also a tax on multinational corporations because they operate all over the world. These are serious ideas which need to be considered.

What about the new problems, what about the new opportunities? One quite clearly is exchange rate instability. Capital movements being freed, and becoming so large. It s a problem in the sense that nobody likes the kind of fluctuations that do not have much to do with underlying physical realities. They are more in the nature of speculation. Can anything be done about it? I am not convinced that just setting up a new exchange system is feasible; but I cannot accept that the international community has to throw up its hands and say, Nothing can be done by the International Monetary Fund to check speculative movements and to defeat them when you are convinced that a particular exchange rate is the right one. Azizali Mohammed has a suggestion in his paper about an international central bank I don t like the term central bank , but something like that needs serious discussion. A way may be found by a different route: it may be through the general agreement to borrow being indefinitely enlarged. The Managing Director of the Fund is talking about it the time has come to discuss these ideas seriously. I suggest that, if we can put into playa scheme, whatever it is, or a facility within the IMF to curb speculative pressures where the Fund and the member country are convinced that the exchange rate is right, then I think it will also lead the way to some surveillance of the richer countries. It is, after all, the currencies of the richer countries that need to be stabilized more often than the currencies of the poorer countries. They will be the ones that will require large sums. Even the sums required for Mexico would pale in significance if we have to support the American dollar or the British pound. Through that door, some measure of surveillance can get onto the agenda of the IMF as far as the rich countries are concerned and, one hopes, better policies can be implemented everywhere, because without them ultimately exchange rate instability will be there.

Then there is the recommendation that there should be a new international agency for the surveillance of the financial institutions. Either the Fund does it the Fund has at least the intellectual ability to do it or else we have to create some other institution. We can t say it will be done by the central banks of the United States, Japan and aided by the Bank for International Settlements for that is certainly not truly internationally.

The other new factor that we all mention is the multinational corporations. They have now grown in strength all over the world. We all welcome them and they are, in a truly integrating way, present all over the world. We talk about their rights but nobody talks of the obligations of the multinational corporations. Surely the time has come to say there has to be a code of conduct for multinational corporations. We should have a system of international registration of multinational corporations in the same way as we have a system of national registration of companies. Some body the World Bank, the World Trade Organization should register the bodies and say Yes, these are the bodies which do practice a certain code . That code may include a pledge of no restrictions on exports from the countries in which they operate; it may include some standards about corruption; it may include some suggestions about their willingness to submit to arbitration.

Nobody objects now to saying that there is so much private money available that it should be made use of as best we can. I think most people would agree that the World Bank, for example, should not only finance governments but should directly finance the private sector in developing countries. If it requires that the Bank has to forego a government guarantee in some cases, they should accept that. I think there is no difficulty in saying that one should cooperate with the financial institutions in the richer countries, with the World Bank and Regional Development Banks, to produce some joint effort.

However, that doesn t mean that the World Bank, or the IMF for that matter, has to play second fiddle to the private sector. They can compete with the private sector: there is no reason that, if the private sector is unwilling to go, the Bank or the IMF should not invest. Even where the private sector is willing to go, in order to put them on their best behaviour, sometimes the Bank or the IMF should also be going there to compete with them and to say No, you cannot be taken for a ride. We are there if you don t get money on the right terms from the private sector. That ought to happen even in countries which are able to mobilize private capital. We have got to change our attitude to these institutions that we have created and make clear that they are not there to play second fiddle or to be only the lender of last resort. They are there certainly to supplement, not to override, but they are also there to establish standards of good behaviour.

The private sector is always talked about in terms of financial institutions; but what about the international civil society and what about the voluntary organizations? They are an important part of the private sector in terms of motivating their governments, and in terms of knowing the grassroots situation. How do you bring them into play to a greater extent in order to promote real development? There are problems with NGOs, as I m one of the first to say. Many of them are only single-subject organizations and they are so fanatical about their single agenda, that they don t see problems in the round. None of them is particularly accountable and, again, the same inequality of power lies there: there are so many voluntary organizations in the richer countries that they have a much bigger voice, whereas those in the poorer countries have little or no voice. Again, we have a problem here. We also have an opportunity, but how to make them accountable and useful, how to use them properly as a channel for money, is still the question.

I will touch on only one other question, which is debt, and I won t go into it in any great length. I would only say this that, apart from what to do about debt to the World Bank or the IMF, there is an issue of charges by the Fund and nobody raises this issue very often. One of the reasons why we had so many problems in the 1980s in Latin America and in Africa, if not elsewhere, was the fact that many countries had to go to the Fund, because of the oil shock among other reasons, and the interest rates were hiked up to more or less the level of market rates. There was a philosophy started by Ronald Reagan that these institutions should not charge concessional rates, they should charge market-related rates and the creditor country should get a market-related return. I think that is a totally unacceptable proposition, that an institution created as a basis for international cooperation should have its interest rates go up and down along with market rates of interest. What is the purpose of a Special Drawing Right if you offer a market-related interest? You will not solve the problems of the poor, debt-ridden countries. Certainly the Fund s facilities which are concessional should be maintained. But its normal charges also need a review and there should be a reaffirmation of the cooperative nature of the Fund.

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Discussion

In this first discussion period there were two brief comments, from Frances Stewart and Cristián Ossa, and two statements from officials speaking from a special standpoint.

Frances Stewart made clear her agreement with Patel and Helleiner that it was crucially important to focus on the *process* of reviewing the functioning of the global financial system. The ideas about reform had been circulating for some time, but there had been too little focus on how to carry through review and reform. She thought one might learn from the experience of trade negotiations; they might be lengthy, but they were successful, and she wondered whether a Halifax Round could not be launched, analogous to the Uruguay Round but focused on the international monetary system and the global financial system, and including deadlines for the completion of negotiations.

Cristián Ossa pointed out the paradox between the strengthening of democratic institutions in large parts of Africa and Latin America (and some Asian countries) and the contrary trend at the global level, where multilateral institutions and the G-7 ruled without democratization.

The Deputy Minister in Canada s Ministry of Foreign Affairs, **Gordon Smith**, who was also a sherpa at the Halifax Summit, addressed the matter of *process.* He said that a good outcome of the Summit would be the start of a process that did not involve just talking about issues but led to decisions being taken. The G-7 had no illusions it could speak for, or reflect the views of, other countries, but it hoped to indicate some sensible directions. He added that there was broad agreement among the G-7 to focus on the functioning of the international monetary system the Mexican peso crisis, the collapse of the Barings Bank and the difficulties in the yen-dollar relationship had pushed this matter to the fore. But, to answer a question from I. G. Patel, he thought the focus would broaden to questions of global governance, best expressed as the capacity of the international system to deal with the challenges ahead, including the relationship of the environment to development and the links between financial systems and political and security issues. The sherpas, he said, had paid particular attention to the future of development assistance at a time of decreasing funds, a time of increasing capital flows, of countries graduating from being aid recipients and others in Africa making little progress at all.

For his part, **Shailendra Anjaria**, the Director of External Relations for the International Monetary Fund, turned attention to the communiqué released the week before (April 26) after the Interim Committee of the IMF Board of Governors met in Washington. Referring to the Mexican crisis, the committee had noted that early contagion effects had been contained, thanks to the prompt international response and strong adjustment efforts by affected countries and had pointed out that collaborative efforts had been launched, in particular, with Argentina and Brazil.

He said the Mexican experience had shown the Fund one had to be as concerned about prevention as about cure. Preventive measures would involve more continuous policy dialogue with member countries and candid recommendations about risky policies they may be following. The Interim Committee had asked the IMF Executive Directors to establish standards for the kind of information that would be made public and should help the markets perform more efficiently. It also argued that the Fund should focus its surveillance more on those member countries where economic disturbances or policies could have broader implications for other countries .

Under the heading of cure , there were different considerations for the short term, of the next 18 months during which the Fund s liquidity is adequate to deal with a Mexican-type crisis, and the longer term. By the end of 1996 its liquidity would decrease, and there would be need to expand; work was soon to start on launching a proposal to double the Fund quotas. Since the Fund had moved away from an immediate general allocation of SDRs, it was time (the communiqué said) for a broad review, which would involve outside experts, of the role and functions of the SDRs. He finally pointed out that the Committee s discussion on how to help members to cope with sudden market disturbances had included both the idea of a special allocation of SDRs and of setting up some sort of debt-work-out arrangement that would establish a legal basis for a country facing a liquidity crisis to deal with a broad range of creditors in a systematic way. These are very big ideas, said Mr. Anjaria, and they would be carried forward in the next few months.

Part 2

Governance and Mandates of the IFIs

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Transforming the IMF into a World Central Bank

Azizali F. Mohammed

The decision of the Naples Economic Summit of the G-7 countries to re-examine the roles of the international financial institutions furnishes an opportunity to consider how to redesign the International Monetary Fund to enable it to meet the challenges of operating into the next century. The growth of worldwide private capital markets and their ability to quickly mobilize very large resources for purposes of speculating against one or more currencies represents one of these challenges. The founding fathers did not envisage the use of IMF resources for dealing with capital account disturbances; instead, members were expected to apply controls on capital movements. In today s conditions of deregulated financial sectors and sophisticated private financial institutions, and the vastly greater importance of capital flows in the world economy, the application of such controls is considered anachronistic by the IMF s Managing Director.[1]

For the IMF to be able to help its members deal effectively with large-scale attacks on their currencies, the primary issue is whether the Fund could be empowered to provide resources well beyond any traditional limits related to member quotas. Such limits set at no more than 300 percent of a member s quota have proved to be quite insufficient in relation to the enormous flows that private markets are able to rapidly mobilize, as the September 1992 and August 1993 episodes within the European Monetary System (EMS), and the January 1995 Mexican crisis, have amply demonstrated. Even a country with a currency not widely traded on international markets, such as that of Mexico, has experienced outflows that required support equivalent to about 20 times its Fund quota.

The amounts that might be called for if speculation affects a number of currencies simultaneously, especially where these currencies are extensively held by non-residents, suggests the need to re-think the manner in which the Fund can mobilize funds, if the institution is to playa meaningful role in counteracting sudden outflows and in order to provide the respite needed for members to put their economies back on track with the help of measures that are not destructive of national and international prosperity .

An international agency like the IMF, might provide the elements of a solution.

A basic condition for any pre-emptive solution is to keep market participants guessing as to the limits up to which a member government or its central bank can draw on the Fund. While this condition applied within the EMS, in that members were obligated to extend unlimited support to each other, the failure to maintain exchange parities despite this open-ended commitment indicates that market participants were aware that sterilized official intervention operates within the constraints of domestic bond and other financial markets. Conversely, non-sterilized intervention creates monetary disturbances and generates financial market instabilities that cannot be sustained by partner countries for any length of time. Hence a second condition for success must be an ability to operate in a manner that insulates, or at least reduces, the impact on domestic financial markets from some of the destabilizing consequences of large-scale exchange market intervention.

An international agency like the IMF, if allowed to create liquidity through the ad hoc issuance of its own reserve asset that is freely convertible into national currencies, *and which private institutions are authorized to hold,* might provide the elements of a solution. The membership of the IMF is now global and may thus be said to constitute a closed system. National central banks have been able to deal with liquidity crises within their own domestic markets through their power to expand both sides of the balance sheet; they create liquidity by crediting the deposits of their member-banks (thereby injecting reserves into their banking system) while acquiring assets in the form of claims on the same member-banks.

An IMF similarly empowered to create international reserves2 would be able to provide any member, or group of members whose currencies are under pressure, with its reserve asset, the Special Drawing Rights, to be used for intervention operations. A country experiencing a speculative attack would have a credit in SDR which could be used to purchase its currency being offered by market participants who would obtain in exchange what was, in effect, a foreign exchange package in which the currency under attack (assuming it was one of the major currencies constituting the SDR basket) would have a fractional weight only. Settlement of these operations would take place on the books of the IMF, and monetary authorities in other countries would not face the same monetary management conflicts they now encounter when having to lend under swap or similar arrangements to support the currency under attack.

For the scheme to work, however, the IMF would not apply ex-ante quota limits on the amount of its provision of SDR to the member or members experiencing speculative attack, and the SDR would be available to private holders instead of being confined within the official circuit as at present.

A *sine qua non* for such a facility to be acceptable to the international community is that the country that was being subjected to speculation against its currency should have been pursuing, or was prepared to adopt, prudent and consistent financial policies, so that a judgment could be quickly rendered that a change in its exchange rate was not indicated by the fundamentals. A major country running a highly expansionary policy, relative to that followed by its trading and financial partners, would be inviting speculative attack and providing it with unlimited access to IMF reserve assets would invite moral hazard objections. The necessity to satisfy the IMF as to the consistency of the country s exchange rate with its macroeconomic policies would give a clear purpose to the Fund s surveillance exercise: a country would have access to this type of facility if its policies were judged by the Fund to warrant support.

It might be that a favourable Fund judgment made at the last Article IV consultation with the country might suffice; on the other hand, it could be argued that a speculative attack would most likely have been precipitated by a change of circumstances which could not be foreseen at the time of the consultations, especially if several months had elapsed since that consultation was concluded. A fresh decision would be required and the Fund might find it difficult to reach a quick judgment to provide rapid and extensive support under the crisis conditions that would almost certainly exist at the time.

The last Mexican transaction suggests that a reasonable speeding up of Fund procedures, together with timely attention from the country s negotiators, could have produced a Board document for decision within an elapsed time of not more than two weeks. If this was nevertheless regarded as much too long, a two-tier operation could be contemplated under which monetary authorities, say of the participants in the General Arrangements to Borrow, would provide speedy financing, with the Fund expected to enter at the next stage, if the initial support operation did not prove to be quickly self-reversing.

Needless to say, these arrangements would not be possible under the current Articles of the IMF, in particular the authorization for private holders of SDR. But an amendment that would enable the IMF to serve as a true central bank of central banks would be a worthy subject for exploration to prepare the institution for its next 50 years. It is perhaps one of history s ironies that the idea of a bancor-based[3] institution proposed by Keynes in the negotiations for the establishment of the Fund might have come closer to meeting the needs of the international community 50 years later!

Endnotes

1 *The Way Forward for the International Monetary System: 50 Years After Bretton Woods* (Address delivered at the Fundación Ramon Areces, Madrid, May 9, 1994).

2 It does so every time it lends to members: a domestic currency subscription paid in by a member whose currency is used for funding the transaction is transformed into an SDR-denominated claim on the Fund.

3 Bancor refers to J.M. Keynes proposal for an international reserve asset issued by the IMF that could be used as money for international transactions by member countries, much like the SDR has later become.

The Governance of the International Monetary Fund

Ariel Buira[2]

The international monetary cooperation efforts that culminated in the Bretton Woods Economic Conference with the establishment of the two major postwar economic institutions, the International Monetary Fund and the World Bank, laid the groundwork for the economic order that was to prevail throughout most of the world during the last 50 years.

The 50th anniversary of these institutions provides a good opportunity to take stock of what the past has given us and to look forward to our challenges for the future. To that end, I will discuss the governance of the IMF, which plays a fundamental role in the present international economic system.

Decision Making and Weighted Voting

The Bretton Woods institutions are international organizations whose member countries do not have equal voting power. The acceptance of weighted voting by members is a departure from the traditional practice of international organizations.

In the case of the IMF, the vote of the member countries has two components: each member country has 250 basic votes simply by virtue of its membership; a symbolic recognition of the principle of legal equality of states; and each has one additional vote for every SDR 100,000 of its quota. As the number of basic votes per member has not been changed, their relative importance has declined with the successive quota increases. Thus, their ratio to total votes fell from the original 12.4 percent to less than 3 percent, despite the entry of 135 new member countries. The same situation prevails in the Articles of Agreement of the World Bank, since its charter stipulates that each member country of that institution has 250 votes plus one

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2 The views expressed in this paper are those of the author alone and not those of any institution.

additional vote for each share (US$100,000) of the Bank held by that country. Though the developing countries have repeatedly raised the question of the need to increase the number of basic votes assigned to each member in order to maintain better balance in decision making, this has not happened.

Currently, in the IMF, the United States has 17.81 percent of the vote, Germany and Japan 5.55 percent each, France and the United Kingdom 4.99 percent each, the G-7 countries a combined total of 44.9 percent, and the G-10 plus Switzerland account for 51.2 percent of the total voting power. The situation is not very different in the case of the World Bank. The voting power is currently distributed as follows: the United States 17.14 percent of the vote, Japan 6.47 percent, Germany 5.0 percent, France and the United Kingdom 4.79 percent each, the G-7 countries a combined total of 44.4 percent, and the G-10 plus Switzerland 50.8 percent.

Developing countries have repeatedly raised the question of the need to increase the number of basic votes assigned to each member.

Although Fund decisions are generally taken by simple majority, the Articles of Agreement stipulate that some decisions require a qualified majority of the votes cast, i.e., a particular proportion of these votes. Whereas at the Bretton Woods conference it was thought that qualified majorities would be required in only two cases (one being quota adjustments), the original Articles of Agreement already established qualified majorities for decision making in nine areas. With the First Amendment to the Articles of Agreement, the number of decisions subject to a qualified majority rose to 18, and with the Second Amendment to 53.1 The obvious explanation for the increase in the number of decisions requiring a qualified majority is the desire to protect some particular interest that could be affected by such decisions. Hence, decisions subject to a qualified majority can only be taken with the consent of the members with a high proportion of total voting rights. In the case of the World Bank, a similar situation prevails. While most decisions require either a simple majority of the votes cast or a simple majority of the total possible votes. There are a number of decisions, including increases in the Bank s capital, use of the special reserve and the suspension of a member, that require a qualified majority.

Despite the fact that the concentration of voting power in the hands of the major industrial countries ensures that they have a determining influence on IMF policies, some of them have sought veto power either for themselves or for a few countries with similar interests. As a result, decisions on 18 subjects require a majority of 85 percent of the vote, thereby giving one member country   the United States   the power of veto, while some 21 other subjects must be decided by a 70 percent majority, and so may be vetoed by the five countries with the most voting power.[2]

Among the issues that the IMF Executive Board can resolve by qualified majority are decisions on: quota size, rates of charge, exchange rate arrangements, special drawing rights, policies on access to Fund resources, payments to the Fund, gold, the use of reserves and the management of IMF investment accounts, publication of reports, remuneration of creditor positions and the temporary suspension of Fund operations. In other words, all decisions related to the size of the IMF, the use of its resources, SDRs, gold, and the international monetary system are subject to the will of one or a few countries.

Some noteworthy areas where special majorities have been used to block decisions that already had an absolute majority of Board votes are: increases in the size of the Fund (i.e., quota increases); SDR allocations; sales of the Fund s vast gold holdings,[3] and policies on access to Fund resources. There are also 13 areas in which decisions by the Board of Governors require an 85 percent majority of the vote, involving powers that cannot be delegated to the Executive Board.

The developing countries have argued that because voting is weighted   a situation that favours the industrial countries   there should be no need for special majorities. However, the countries that for various reasons have been in favour of such majorities have not been prepared to do away with them. In practice, the special majority requirement often has the effect of inhibiting the discussion of issues that are clearly difficult to resolve.

Determination of Quotas in 1943

Since member countries quotas are the main factor determining their voting rights, the process for setting such quotas should be examined.

It has often been said that in the Bretton Woods conference the quotas of the United States, the United Kingdom, the Soviet Union, and China were politically determined.

Raymond Mikesell, selected by the U.S. Government to estimate the first quotas, has written of the directions he was given by Harry Dexter White, the main U.S. negotiator of the Bretton Woods agreements:

In mid-April 1943 . . . , White called me to his office and asked that I prepare a formula for the . . . quotas that would be based on the members gold and dollar holdings, national incomes, and foreign trade. He gave no instructions on the weights to be used, but I was to give the United States a quota of approximately $2.9 billion; the United Kingdom (including its colonies), about half the US quota; the Soviet Union an amount just under that of the United Kingdom; and China somewhat less. White s, major concern was that our military allies (President Roosevelt s Big Four) should have the largest quotas, with a ranking on which the President and the Secretary of State had agreed.

As was typical, White wanted something on his desk in a couple of days it took me four, including a weekend. A modern computer would have saved several days of work on my state-of-the-art calculator and might have produced a more credible result.

Had there been reasonably good official national-income estimates for the major countries in 1943, it might not have been possible for me to approximate White s conditions. Only the United States and Britain had official figures, although several countries had unofficial estimates. There were published figures on gold and dollar holdings (except for the Soviet Union) and on foreign trade, but no formula could meet White s conditions without giving great weight to national income. My sources for the national incomes of the thirty-four countries I covered were estimates of average consumption found in country studies, estimates of wage rates and family expenditures, and extrapolations from budget and tax data. Countries at a similar stage of development were assumed to have the same per capita income. My national-income estimate for China was $12 billion, less than a fifth of the U.S. national income in 1940, and my estimate for the Soviet Union was $32 billion. I confess to having exercised a certain amount of freedom in making these estimates in order to achieve the predetermined quotas. I went through dozens of trials, using different weights and combinations of trade data before reaching a formula that satisfied most of White s objectives. I then found that I could get even closer if I increased the quotas by the ratio of average exports [. . .] to national income [. . .]. Not all the estimates were for a common date, but I tried to adjust the data to 1940. The final formula for determining quotas was 2 percent of national income, 5 percent of gold and dollar holdings, 10 percent of average imports, 10 percent of the maximum variation in exports, and these three percentages increased by the percentage ratio of average exports to national income.

[Subsequently, in the conference] when asked to explain the basis for the quota estimates, I had anticipated this request and gave a rambling twenty-minute seminar on the factors taken into account in calculating the quotas, but I did not reveal the formula. I tried to make the process appear as scientific as possible, but the delegates were intelligent enough to know that the process was more political than scientific. (Mikesell, 1994).

Mikesell goes on to say that the use of a single Fund quota to serve three purposes was both illogical and unnecessary, and this was frequently pointed out during the conference. There could well have been one quota based on, say, foreign trade and export variability to govern drawing rights, a second quota based on reserves and balance-of-payments history to govern contributions to the Fund, and a third quota based on economic and political importance to determine voting rights. *(Ibid.,* 1994).

Equity and Rationality Needed

It is clear that the formula used to determine the quotas was contrived so as to reach a result predetermined by one country. The lack of economic rationality and the arbitrary nature of the criteria that were applied are glaring and detract from the legitimacy of Fund decisions.

The Fund should be more representative of the interests of all its member countries. The lack of equity and rationality in the criteria for the determination of quotas causes controversy and mistrust among the countries, just as it did 50 years ago. At that time, White and his staff used an arbitrary procedure to arrive at the quotas that were recommended and then tried to conceal the calculations from most of the delegates. However, they insisted that the proposed quotas had been determined by a scientific process.

It should be noted that currently, with some adjustments in the weighting and definition of the main variables, the Fund continues to use the original formula for determining member countries quotas. This formula is now combined with four others which give different weights to the same variables, and a certain element of discretion in used in selecting the formula to be applied in each case, opting, at times, for the average of the results of various calculations.

Thus, it is not surprising that quotas are far from representative of the sizes of economies or their importance in the world economy. This can be illustrated by the fact that Brazil, Spain, and Mexico, whose GOP and populations are certainly higher than countries like Belgium, the Netherlands, and Switzerland, have smaller quotas and fewer voting rights. Consequently, their share in decision making is not commensurate with the importance of their economies.

Under the Ninth General Review of Quotas, 60 percent of the quota increase was distributed in proportion to members shares in the total of quotas calculated according to the formulas. The other 40 percent was distributed in a discretionary manner to bring members quotas more in line with their relative economic positions . . .. 4 Similarly, the quotas of the main industrial countries were adjusted based not on the formula but on political criteria. This method brought Japan s and Germany s quotas on par, in second place, despite the fact that the Japanese economy is twice the size of the German economy. The third largest quotas were given to France and the United Kingdom despite the fact that the Italian economy is substantially larger than the U.K. economy.

The success of the postwar economic system, which allowed international trade to grow more than production, is obvious. It is also clear that, with the passage of time and the ensuing changes, some aspects of the system have become dysfunctional. From a technical standpoint, it is evident that the growth of the international economy would be facilitated by some reforms in the current international monetary order. However, these reforms encounter serious political resistance from the existing power structure.

International institutions must reconcile countries political objectives with the interests of the international community. In other words, national policies must be made compatible with international aspirations.

The fact that political decisions are taken by a very small group of industrial country members of the G-7 means that such decisions are usually made in meetings of these countries outside the Fund; and that, in this process, the views and interests of the other members over 170 countries, most of them developing are not given the same consideration.

This concentration of power also makes it difficult to correct the fundamental asymmetry in the adjustment process between the deficit and surplus countries. While the Fund can bring considerable pressure to bear on the economic policies of the developing countries that seek its financial assistance, it does not have the same sway with the surplus and reserve currency countries to induce them to take measures to reduce their external imbalances.[5] Consequently, the burden of adjustment falls on the deficit countries.

The current power structure, which places a single country in a dominant position, detracts from the objectivity of Fund decisions and recommendations. As a result, technically questionable country programs[6] have sometimes been approved in order to support governments allied with the interests of the dominant country or countries, thereby placing the resources of the international community at risk. These cases have a demoralizing effect on the technical staff, who recognize that there are special cases based on non-economic considerations.

Furthermore, this dominance may impose a degree of self-censorship on Fund staff. This would make it difficult, if not impossible, to examine and analyze objectively initiatives or proposals that might be contrary to the interests of the major countries.

Reducing Their Exposure

Turning to another matter, it would seem that the countries with the largest quotas, which are creditor countries of the Fund, have opted to reduce their relative contributions and their exposure to Fund borrowing, thereby reducing the size of the Fund relative to world trade7 (See Table 1). It may also be noted that in recent years countries that resort to the Fund have generally had access to a smaller proportion of their quotas than before, even though the relative size of quotas has declined. These and other factors have weakened the Fund s role as an agency of international monetary cooperation.8

As the size of the Fund and access to its resources have been reduced, a new doctrine has emerged whereby the Fund, rather than provide financing, is expected to act as a catalyst for other resources through its seal of approval for country programs. It should be noted that the Articles of Agreement make no mention of the Fund s, catalytic role , nor is the Fund described as a credit-rating agency

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Table 1
Ratio of IMF Quotas to Merchandise Trade (in billions of dollars)

	Total IMF Quota (A)	Total Trade (B)	(A)/(B) %
1950	8.0	116.1	6.9
1955	8.8	174.1	5.0
1959	14.6	209.9	7.0
1965	20.9	355.8	5.9
1970	28.8	600.1	4.8
1976	39.0	1,873.1	2.1
1978	59.6	2,478.8	2.4
1983	89.2	3,464.8	2.6
1990	90.1	6,775.2	1.3
1993	144.6	7,537.1	1.9

Sources: IMF, *International Financial Statistics;* Financial Organization and Operations of the IMF, Treasurer s Department.

that would enable countries to access international credit markets. This was not the role its founders had in mind when they spoke of promoting international monetary cooperation.[9]

The power structure of the Bretton Woods Institutions has determined the way they have evolved over time and the role they play in ways that often depart from their Articles of Agreement.

Final Considerations

The world has changed considerably in the 50 years since the Bretton Woods conference. Under the international economic order established at that time, the world economy underwent a period of some 30 years of rapid economic growth, almost unparalleled in economic history. Since then, par values have been abandoned, the oil crises occurred, and international capital markets developed rapidly in the 1970s. The growth of these markets, which allowed developed countries not to resort again to Fund financing, was to have a considerable impact on the evolution of the international monetary system.

Since the 1970s, the Fund s operations have been conducted exclusively with the developing countries and, more recently, with the economies in transition. In the last five years, operations have concentrated on the low-income developing countries and the republics of the former Soviet Union. This situation helped broaden the divide between Fund members; on the one hand is a small group of creditor industrial countries with a majority vote, and on the other are a large number of debtor developing countries with a minority vote.

In my opinion, it is not coincidental that the size of the Fund has shrunk in proportion to world trade over the last 20 years, that countries access to Fund resources in proportion to quotas has been reduced, that conditionality, even for the compensatory financing facility,[10] has been gradually toughened, and that SDR allocations have been suspended since 1981. These are manifestations of the growing gap between debtor and creditor countries, which has changed the industrial countries view of the Fund from that of being the centre of the international monetary system to that of a specialized agency assisting the developing countries.

Though there is no doubt that a stable exchange system would benefit the world economy, the unwillingness of the industrial countries to subordinate their domestic policies to the interests of the international community implies that this objective cannot be achieved at this time. Consequently, the Fund no longer plays an important role in the international exchange system.

In addition, with the swift evolution of international capital markets and the suspension of SDR allocations, the international community now has no better control of the level and distribution of international liquidity than it did 20 years ago. Furthermore, because of the relative decline in the resources of international financial institutions, those countries that do not have access to the financial markets find themselves in a very difficult position.

The reform of the international monetary system requires the revision of the quota and the decision-making structure as the means to reconcile national objectives with the interests of the world economy. Such a reform would require that all countries be given a share in the financial structure of the Bretton Woods institutions, based on the size of their economies, so as to legitimize their policy decisions. This is necessary not only for the countries to participate and be jointly responsible for the institutions policies, but also for the better functioning of the world economy.

The current international economic order arose from an unprecedented cooperative effort. In recent decades, it has been deteriorating as the major countries no longer feel the need to maintain the same level of international cooperation to promote their interests. As an exceptional measure, the Fund has expanded access to its resources for a number of countries in the face of problems that, like the Mexican crisis, could have systemic repercussions.

With the end of the Cold War around which the G-7 policies coalesced and the trend toward the formation of regional blocs in Europe, North America and (to a lesser extent) Asia, the trade and monetary tensions already apparent among the members of this group may be expected to increase. This could give the IMF a new opportunity to become once more the predominant centre for analysis and discussion of the problems faced by the international economy.

Endnotes

1 Forty of which are Executive Board decisions and 13 Board of Governors decisions.

2 Other subjects require an absolute majority.

3 At the end of 1993, the Fund s 103.4 million ounces of gold were valued at $4.972 billion, based on a price of SDR 35 ($48.08) per ounce. If these holdings were sold at $350 per ounce, their value would rise to $36.2 billion and increase resources by close to $31 billion.

4 Financial Organization and Operations of the IMF. Pamphlet Series No. 45.

5 In fact, the scarce currency clause included in the Articles of Agreement (Article VII), allowing member countries to discriminate against large surplus countries, has never been invoked by the Fund.

6 See the article in *The Financial Times* of March 21, 1987. David Finch, former Director of the Exchange and Trade Relations Department responsible for ensuring the coherence of adjustment programs and equal treatment of member countries, resigned under political pressure to relax Fund conditionality for Egypt and Zaire.

7 It should be recalled that Keynes proposed that the initial quotas might be equal to 75 percent of average annual prewar world trade. Because world trade in 1937 and 1938 (exports plus imports) averaged about $50 billion, three-fourths would have been $38 billion. See Mikesell, 1994, p. 14. Furthermore, the growing importance of the capital account, as a result of more integrated international financial markets, further reduced the importance of the quotas in relation to the countries total external transactions.

8 According to Article I(v) of the Articles of Agreement, the Fund must make its resources available to the member countries providing them with the opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

9 Furthermore, by placing limits on access, the purpose is also to avoid overexposure of the Fund to one or a few countries, for prudential reasons. However, it should be pointed out that when there are payments arrears, the overdue amounts are distributed equally among users of the Fund s resources and its creditor countries, despite the fact that the latter group represents over 75 percent of the quotas. This means that the countries which account for 75 percent of the capital absorb only 50 percent of the losses, while countries with balance-of-payments problems, which have had to have recourse to Fund credit, bear the burden of the other 50 percent.

10 See Bretton Woods Commission Report.

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Mikesell, Raymond F. (1994). The Bretton Woods Debates: A Memoir, Essays in International Finance No. 192. Princeton: Princeton University, International Finance Section, pp. 21-23; 35-36.

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Global Financial Institutions for the Next Century

Frances Stewart

The IMF and the World Bank emerged 50 years ago as a result of the deliberations at Bretton Woods. Those who attended that conference thinkers, civil servants and political leaders showed unusual imagination and boldness in designing a new monetary system intended to prevent a recurrence of the devastating economic and subsequently political developments that followed the First World War. Bretton Woods was in a sense the antithesis of Versailles; the punitive treatment of the losers at Versailles was matched, but in mirror image, by the generosity of spirit of Bretton Woods together with the Marshall and Dodge Plans.1 The intentions of those at Bretton Woods were realized: the postwar system did not see a return to the economic recession and mass unemployment of the 1930s; international restrictions were greatly reduced and trade and output expanded at an unprecedented rate.

Bretton Woods was the antithesis of Versailles.

Today, however, the Bretton Woods institutions are badly in need of reform, for three rather different reasons: first, in some important respects the International Financial Institutions (IFIs) have moved away from the intentions of the founders; second, the world today is radically different from what it was in 1945, so that the institutions designed for that era do not meet the needs of the 21st century; and third, the governance structures of the institutions, never really satisfactory, seem particularly ill-suited to both today s political realities and democratic aspirations. In this paper, I argue that without substantial reform, the IFIs risk becoming at best irrelevant and at worst, dysfunctional.

The World in 1945 and Bretton Woods

The world economy of 1945 was a war economy: one of almost completely controlled trade; of non-convertible currencies, with Europe devastated by war, which lacked hard currency to buy goods from the one economy which had spare capacity (the United States). The memory of recession and unemployment of the 1930s was still vivid as was the process by which the economic problems following the First World War had led to horrendous political consequences. At the same time, the laissez-faire and monetarist economic philosophy prevalent between the wars had been displaced in official thinking by the much more interventionist views of Keynes. Those who participated at Bretton Woods had not only a very strong motive to avoid the post-First World War events, they also had a new system of thought and well-worked out mechanisms to help them do so.2

Today the Bretton Woods institutions are badly in need of reform.

Two fundamental objectives of the Bretton Woods system emerge clearly from the Articles of Agreement of the International Monetary Fund: to promote high levels of employment and real income; and to enhance world trade, by reducing restrictions on trade, currency convertibility etc., as indicated in the first of the Fund s Articles of Agreement:

to facilitate the expansion of balanced growth in international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

The employment and output objective, perhaps, most clearly reflects Keynes influence; the emphasis on trade liberalization that of Harry Dexter White and the American contingent. Both were believed to be connected and necessary to lay the foundations for growing prosperity in the postwar world.

The IFIs were established to help carry out these functions: the IMF to oversee currency matters and to contribute to reduced currency and trade restrictions; and the World Bank to provide funds and technical advice to promote reconstruction in Europe and development elsewhere. The governance of the two institutions reflected the economic and political power of 1945 with the United States as the major economic power in the driving seat and a significant position for Europe. The Third World, then almost nonexistent as an independent political entity, was ignored.

The initial design of the two institutions was not strictly appropriate to achieve either of the two fundamental objectives. Once reconstruction had been achieved, support for high employment and output required coordination of economic policies among governments representing countries with economic weight in the world and some ability to inject additional finance into the system at the international level when required. Yet, Keynes bancor , which would have achieved the latter, was rejected and the IMF was given only mild coordinating powers. As far as trade was concerned, it was the Marshall Plan and later GATT and the European Economic Community (now the European Union) rather than the IFIs that were principally responsible for the reductions of restrictions on trade, exchange and capital movements.

Developments in the World Economic System Since 1945

As might have been expected, the world economy has changed radically since 1945 partly due to the Bretton Woods system itself; partly to successive trade .rounds, to political changes, and to technological transformation. Important changes, relevant to the role of the IFIs, include:

- the emergence of Third World countries as independent states;
- the establishment of foreign exchange convertibility; and greatly reduced restrictions on trade and capital movements, first among developed countries and more recently among developing countries;
- following reduced regulation, a massive expansion of both trade and international capital movements. World economic growth was 2.75 percent per year from 1950-90, while international trade grew more than twice as fast. Private international capital movements have expanded throughout the period, with a

particular boost in the 1970s through the recycling of oil-finance and in the 1980s with deregulation;

- the role of multinational companies in world trade and investment greatly increased. By the early 1980s, trade within and between the 350 largest TNCs amounted to an estimated 40 percent of global trade. (C. Oman, 1993). Global sales of foreign affiliates in host countries are estimated to have grown by 15 percent per year, (1985-90), much faster than the growth in domestic output; (UN, 1992)
- following successful reconstruction in Europe and Japan and sustained development in many Third World countries, economic power has spread much more widely, greatly diminishing the hegemonic position of the United States;
- the end of the Cold War and the emergence of transition as a major economic and political challenge has radically changed both political and economic maps; and
- the Keynesian economic philosophy that dominated at Bretton Woods was displaced, notably from the late 1970s, by a return to belief in the market model and monetarism as the predominant philosophy in industrialized countries and the IFIs, a change which was reinforced by the collapse of communism.

New Objectives

As noted above, the major objectives that informed Bretton Woods were high levels of employment and the establishment of a prosperous world economy based on the promotion of free movement of goods, services and capital. In the event, in the first 20 years after the system was initiated, the developed countries achieved full employment and their major economic problem then appeared to be inflation rather than unemployment. Subsequently, when unemployment re-emerged in the industrial countries and underemployment emerged as a growing problem in developing countries, the IFIs seem to have lost sight of the employment objective, placing excessive emphasis on inflation control, sometimes at the expense of employment and output. This was partly due to the emerging dominance of the renewed monetarist philosophy.

Since 1945, other important objectives for the world economic system have gained prominence, partly as a by-product of the changes that occurred and partly in response to fresh political pressures. These include:

- Development of Third World countries (and now promotion of successful transition). The World Bank took on this objective as its major remit at an early stage.
- Elimination of poverty. At first, it was believed this would be the automatic outcome of development, but as the failure of the trickle down theory became apparent, basic needs was accepted as an objective by the World Bank, soon to be displaced, however, by adjustment. In the 1990s, poverty reduction has again emerged as an important world objective.
- Problems of the unregulated market system for the environment, at many levels (ranging from soil erosion in particular villages to the world greenhouse effect), have given growing weight to environmental considerations and the objective of sustainable development.
- Finally, because the employment objective so clearly enunciated at Bretton Woods was neglected, it has become necessary to reintroduce high levels of employment as an objective, both in developed and developing countries.3

Implications of the Changes in the World Economy and New Objectives for the IFIs

In principle, government-supported international institutions should provide the collective action that is necessary to promote world welfare, that neither governments acting on their own, nor the market would provide. This sort of collective action is needed because there are externalities arising from certain types of action of governments (and companies, or individuals operating through the market). Because of free rider problems and deficiencies in information, only collective action will bring about the desired results.

The changes in the world economy and the new objectives just noted have strong implications for the type of collective action that is needed and also the effectiveness of the existing IFIs in promoting it.

On the one hand, it might be (and indeed has been4) argued that there is no longer a role for the IFIs for the following reasons:

- they have been marginalized in capital movements, accounting for only a small fraction of the total capital that crosses frontiers (and indeed in the 1980s, when most needed they actually received resources rather than paying them out). Countries, other than the very poor and those lacking in creditworthiness, now have access to private capital markets and don t need the World Bank;
- when there are major problems with international capital e.g., in both the Mexico crises (1982 and 1995) the IFIs were in effect bypassed, and brought in only to endorse prior decisions. Much the same is true of lending to some of the countries in transition, especially Russia. In the 1980s, the Brady solution to the debt crisis was provided by the U.S. Secretary for the Treasury and not by the IFIs;
- they are unable to deal with the problems of the poorest countries. After more than a decade of adjustment , African per capita incomes are still falling, budgets and trade balances are still in deficit, debt has escalated, and the tragedy of ethnic strife has grown;
- aid fatigue in the developed countries is likely to lessen soft transfers to poor countries, who cannot afford IBRD-type lending and have very limited access to private capital markets, further reducing the role of the World Bank. Moreover, aid is not a solution to most of their problems: commodity prices and debt are of greater importance and the IFIs have shown themselves incapable of dealing with either;
- the dismantling of trade and currency restrictions which was so important a part of the original remit of the IFIs has been successful, while the World Trade Organization (WTO) will take on further initiatives on trade, leaving a limited role for the IFIs;
- full employment is still an important objective but one that has long been forgotten by the IFIs; and
-

coordination between the major economic powers, if it occurs at all, takes place via meetings of the G-7, not through the IFIs.

In their present form and governance, the IFIs seem incapable of dealing with the new objectives and problems of the world economy. Environmental issues are dealt with at special meetings and conventions; the strictly pro-market budget-balance philosophy debars the IFIs from dealing effectively with employment or poverty.

Yet, the new problems are global problems, needing global solutions. Ironically, they are largely problems of excessive rather than deficient markets hence part of the difficulties for the IFIs in dealing with these problems, given their strong belief in the market. For example, it has become clear that the unregulated capital market can lead to dangerous fluctuations in capital movements, playing havoc with economic management and development, as in Mexico.5 Some international regulation, and perhaps taxation, is needed. Similarly, some world regulation is needed to prevent exploitation and tax avoidance by TNCs. Competition in promoting supplies between poor countries, (currently encouraged by the IFIs), leads to falling commodity prices (also of labour-intensive manufactures), sometimes so sharply that the result is immizerizing growth.6 Unregulated trade competition can also lead countries to compete by eliminating labour standards, encouraging child labour, avoiding environmental regulations, etc.

Global institutions are needed not only to promote the new objectives but also to react to the excesses resulting from the market reforms.

The functions Global Financial Institutions (GFIs7 should have as the century ends derive from current global objectives and the problems that have emerged from an unregulated global market. Each function arises from the special needs for collective action at a global level, and relates to issues that cannot be dealt with satisfactorily at a national level.

The discussion above suggests the following as the main functions of global financial institutions designed to meet the need for global collective action:

- Coordination of macroeconomic policy among the main economic powers, so as to secure a steady expansion of world output and promotion of employment;
-

Renewed use of the SDR as a source of additional liquidity, to be used to supplement world reserves and world demand when deemed necessary to avoid deflation; and to support the finance of adjustments in poor developing countries and countries in transition;

- Supervision and regulation of capital markets, including administration of a Tobin tax on capital transactions;
- Supervision and regulation of multinational companies, including developing and administering anti-trust legislation at a global level, development and administration of codes of conduct and of taxation of multinational companies;
- Development of global environmental standards; mechanisms of enforcement and monitoring.
- Development and monitoring of a World Social Charter, covering basic social rights, including access to basic goods and services and the elimination of poverty; financial flows would be used to support the achievement of the rights embodied in the World Social Charter and social conditionality would be used as a lever to secure appropriate domestic action;
- Development of appropriate environmental and labour standards, with the standards varying with the level of income of the country; and
- Monitoring trends in commodity prices and devising policies, including producer taxes coordinated across countries, to help reduce excess supplies and downward movement in prices.8

The list of functions to be performed by the GFIs is a preliminary one and it would be added to (and subtracted from) as the institutions develop and new needs emerge.

GFIs with these functions would be playing the role that public institutions ought to play viz., compensating for externalities and market imperfections that occur at a world level and helping meet world economic objectives. But it is unrealistic to expect that the present IFIs could readily be transformed into the proposed GFIs, without first reforming their governance.

Reform in Governance of the International Economic Institutions

The first requirement for any reform is a radical change in governance. The reformed mandate proposed above is unlikely to work without a parallel change in governance. There are two major problems with the IFIs present governance the level of decision maker involved and the composition and voting structure of their Boards of Governors. The level is too low, and hence when governments wish to take serious decisions they convene ministerial meetings. The voting structure of the Boards is too heavily weighted toward the industrial powers and fails to give sufficient weight to others (developing countries, countries in transition) who are seriously affected by their actions, and would be even more so with the proposed reforms in mandates to be considered below. While the IFIs are formally part of the United Nations system, they operate independently and are not regarded as genuinely world institutions, but rather as instruments of the major industrial countries.

Reformed governance

I would propose to allocate power over the IFIs to a newly formed Economic and Social Security Council (ESSC) at the United Nations, parallel to the Security Council, but with responsibility for economic and social matters. Like the present Security Council, the ESSC would be composed of some permanent members and also representative countries from the rest of the world. The permanent members would include the major economic powers in the world (the United States, Japan, Europe, China); revolving membership would include representatives of all other parts of the world. Majorities of three-quarters would be needed for decision making, the composition of the Council being such that no single category of country could secure a three-quarters majority. Hence, the ESSC would (like the Security Council) be much more comprehensive than the G-7, but its representation would allow for greater weight to be given to more powerful countries, to reflect the realities of power and decision making in the world.

The ESSC would make the most important decisions concerning world collective action on economic and social matters, including defining the objectives of the GFIs, and providing them with overall guidance, and deciding when institutional reform was needed. The ESSC could call for changes by national governments (although these would not be binding). The CFIs would continue to have their own boards, but these would be responsible to the ESSC as the major world economic decision-making body. The ESSC would meet regularly to oversee world economic development, review progress and identify changes in national and international policies; emergency meetings would be convened during a world economic crisis. The ESSC would attempt to devise solutions to critical problems or request the CFIs to do so.

This structure of governance would enhance participation in world economic decision making and place the CFIs firmly within the United Nations, under the direction of a political body, the ESSC.

The following matrix indicates the role of the ESSC and how the proposed functions might be allocated as between the existing IFIs. The functions extend beyond finance, strictly speaking (as do the actions of the existing IFIs). For some functions (e.g., the environment) there might be a case for developing a new institution rather than allocating the function to an existing one. But for present purposes, it is assumed that the functions would be performed by one or other of the three existing institutions.

A new economic philosophy

The proposed allocation of functions would not be workable if the IFIs retained their present rigid market-oriented and anti-Keynesian philosophy. Modern economics provides a rich menu of reasons why this simple market philosophy is incorrect justification for public action and alternative ways of thinking about economic development more generally. These alternatives are supported by a large amount of empirical work showing how real markets, institutions and economies operate. The new institutions will not succeed unless they are open to alternative approaches and ways of thinking. Strong political direction will be necessary to bring about such a change in thought, as well as appointing open-minded people at the highest levels in these institutions. A change in recruitment procedures and, perhaps, in location might also be helpful. The institutions need to be much more open to dialogue with others with different views; and, in country work, to views of governments and citizens.

Functions of the Proposed Global Financial Institutions

Function	ESSC	Reformed IMF	Reformed World Bank	Reformed WTO	Present system
Supervise capital movements	Overall policy making	+ supervise tax			BIS / IMF poorly, ad hoc
Global environmental regulations	Overall policy making		+ regulations devised	+ regulations monitored	ad hoc
Social objectives	Overall policy making- devise social charter	+ adapt policies	+ social conditionality		UNICEF / UNDP / ECOSOC with limited effects
Domestic environmental and labour standards	Overall policies — guidelines			+ use of trade as a weapon	No one for the environment ILO re labour issues
Commodity policies	Overall policies	+ support financing and administration	+ support policies with diversified projects		UNCTAD once; no one now
Macropolicy coordination	+ main venue	+ analytic support			ad hoc, G-7
SDRs and demand	Overall policies				IMF — but too limited

Conclusions

The IFIs are becoming marginalized in world economic decision making and capital flows. Their half-century anniversary approaching and also the millennium provide a good opportunity to rethink their mandates. Three options are possible: to close them down as being no longer relevant to the present world; to let them continue to react to events, which may be useful to the achievement of policy objectives of industrialized countries, but makes little contribution to global problems, and may indeed make some problems worse, by reducing public action and giving an excessive role to the market; or to undertake radical reform to enable the institutions to respond to present global economic and social issues. The last seems clearly preferable, but also most difficult to achieve, since no powerful countries are sufficiently alarmed to want major reforms. The unregulated movement of international capital and goods or global environmental damage will have seriously to threaten interests in the powerful countries before major institutional change becomes likely. In the meantime, piecemeal reform, in response to particular crises, is the most likely course, with a continued gradual erosion of the importance of the IFIs. Neither a 50th birthday nor the ushering in of a new century are likely to be enough, in themselves, to induce radical reform. But the global problems which provide the justification for reform are real and growing. Without reform the dysfunctionality of the current system is likely to become increasingly apparent.

Endnotes

1 It was probably no accident that Keynes played an important role in both conferences, but while his ideas were not adopted at Versailles leading to his devastatingly critical (and perceptive) essay The Economic Consequences of the Peace he was determined things would be different after the Second World War and at Bretton Woods his ideas were more closely followed.

2 J. M. Keynes, Proposals for an International Currency Union , 8/9/1941; 18/11 /1941; 15/12/41; Plans for an International Currency (or Clearing) Union , paras. 61 to 134 of the Treasury Memorandum on External Monetary and Economic problems, 31/3/1942; White Paper on the International Monetary Fund, April 7, 1943; Joint statement by experts on the establishment of the International Monetary Fund, 22/4/1944. These are all published in D. Moggridge (ed.), The Collected Writings of John Maynard Keynes, XXV. Cambridge: Cambridge University Press, 1980.

3 It is significant that the World Bank s 1995 World Development Report is going to be devoted to employment, while the ILO published its first World Employment Report in 1995.

4 For example, by Alan Walters, Do we need the IMF and the World Bank? London: Institute of Economic Affairs, 1994.

5 It is worth noting that this danger was foreseen by Keynes and the initial remit for the IMF did not include relaxation of capital controls.

6 For example, Ghana s large increase in cocoa exports (in volume) was more than offset by declining world prices in the 1980s, so foreign exchange earnings from cocoa fell.

7 I use the term Global Financial Institution, or GFIs, to indicate that these would be radically different from existing IFIs, though they might evolve from them.

8 This was intended to be the function of the abortive International Trade Organisation which emerged from Bretton Woods. It should be emphasized that the ITO functions of the proposed GFI are quite different from those allocated to the WTO at present.

References

C. Oman. (1993). Quoted in D. Ghai, Structural adjustment, global integration and social democracy in D. Prendergast and F. Stewart (eds.), *Market Forces and World Development.* London: Macmillan.

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Francisco Sagasti

The topic of this meeting, on the governance of international financial institutions, requires at least some agreement on what good governance would be. To offer one view: good governance of international organizations would have to be efficient in the sense of solving the problems it addresses in a cost-effective and timely manner. To be effective means maintaining the stability of the system but also being flexible enough to accommodate changes. Finally, good governance would have to be legitimate in the sense of representing the various views of all the constituencies in international organizations, and legitimate also in terms of accountability. This is one of the areas in which most international financial institutions fail miserably.

I would like to focus on an area that I know a bit about: development finance and some questions of governance.

The Paris Club

In the first place, I am surprised that none of the papers, especially in a meeting just before the Halifax Summit, touched on the role of one of the most important non-institutions that we have that has a tremendous influence on developing countries: I refer to the Paris Club. There are no articles of agreement of the Paris Club, only a series of codified practices. It works in peculiar ways and has a very interesting impact in terms of cross-conditionality. First of all, as I say, it is a non-institution. It is extremely rigid I don t know any other non-institution that is as rigid as the Paris Club. It doesn t deal with countries on a case-by-case basis. It only reschedules official debt over a very short term three years. It requires an IMF agreement and, in addition, it sets terms in very rigid ways according to income levels. We have heard of the Toronto and the Naples terms and, once it has settled those terms, they apply to all countries in that income category. Of course, they set minimum conditions and countries can be more generous within the framework of the Paris Club but this is very rare. Not only that, but the way in which it is organized is that all the creditors gang up on each country. If you ve been to a Paris Club meeting, you see 15 people sitting in front of two or three people from a developing country and then, the next day, you have another country. Of course, developing countries don t talk to each other; it s the creditor countries that talk to each other and agree on terms.

The G-7 is another non-institution and it defines what the Paris Club is going to do. Therefore, if we want to do something on Halifax, one thing would be to mention that there needs to be changes in Paris Club proceedings. By the way, this is one of the institutions where political conditionality works in a very clear way. Recently, for example, the United States blocked a concessional agreement to Nicaragua and not because the IMF thought that the Nicaraguan economy was in bad shape. It was simple political conditionality with names attached to it: Senator Jesse Jones wanted to bring pressure on the Nicaraguan government to return to some former Somozistas properties that were seized a few years ago and this was used as an excuse for the State Department and the Treasury not to do anything with Nicaragua.

One of the things that I learned from looking closely at these negotiations is that, if you really want to get a good deal at the Paris Club, make sure that, when the IMF mission comes to your country and begins to review your data, you get two or three good people challenging every single figure, because those are the figures that are going to be used in Paris Club negotiations to decide on the terms that your country is going to have.

The practical point here is that if we really wish to have a lasting impact on development finance, let s look at the Paris Club and at official bilateral creditors which now account for something like 40 percent of developing country debt.

Changes to the World Bank

My second point has to do with the World Bank. I do not know whether James Wolfensohn is going to be invited as an observer at the Halifax Summit but it would be a good idea if he were there I know he has friends among the leaders of the G-7, and he s going to take over [the World Bank presidency] on June 1. This is a timely occasion to propose some significant reforms of the World Bank. It has become a large conglomerate with many different products, managed in the way that inefficient conglomerates were managed in the 1970s and 1980s. It needs to be more product-focused, and to be closer to its clients. I have made a quick list of five of its constituencies and products, but I remember when I worked at the Bank we were able to identify many more. You have the role of catalyst for private finance, especially for the NICs high- or middle-income countries. You have the role of providing long-term finance at lower than or near market rates, for middle-income countries. Because of the difference between authorized and paid-in capital, the World Bank has been a most efficient way of raising capital for developing countries in the sense that it delivers more bang for the buck. By paying in a small amount, you re really able to raise a huge amount in the capital market. Of course it s based on guarantees by the industrialized nations, but I don t see any reason why, with some minor modifications, this system could not continue working in order to serve the needs of the rapidly dwindling number of countries that still need long-term financing near market rate.

The third area is concessional finance and here the role of aid coordination is a very important one for the World Bank. It s a different product. Then we have policy dialogue and policy advice, and research. Now the clients and the consumers of these various products are very different. What would be required, in my view, would be to break down the World Bank into four or five sub-units, have a kind. of conglomerate board, and then have the equivalent executive boards for each of the various products and clients and involve more people in each of those areas.

Anyway, this will have major organizational and personnel changes. It will move a long way toward making the World Bank more accountable. It would change radically its relations with the regional development banks. When I was doing some strategic planning for the World Bank and we raised the issue of relations between the regional banks and the Bank, we were really hammered by all the regional vice-presidents and several members of the President s Council that existed at that time. They simply didn t want to discuss that issue, but I think it s high time now to discuss it; and the contributions that the North-South Institute has made on the subject [with its series of volumes on the Regional Development Banks] are extremely important to reach a more sensible definition. In a nutshell, my view is that the World Bank has to take more of a functional cut rather than a regional cut, and one of the first implications would be to abolish regional vice-presidents in the World Bank and to settle on a different type of organizational structure.

One final thought on governance. I think that we should go further than simply broadening the G-7 to the G-15, as Gerry Helleiner said or as Frances Stewart implies in her paper. We should think of including private corporations and the international civil society, including academics, advocacy groups and workers organizations, in the governance of international financial institutions. I do not believe that the time is appropriate to remain locked in the circle of governments. I think it would be possible to expand and to include representatives of international banks and of multinational corporations. Whatever we do, if (for example) we break up the World Bank in the way I have suggested, and if there is one area in charge of providing the catalyst for private finance, it is obvious that you should get some of the private banks involved in governance, in this particular sub-area as a function of the Bank.

Catherine Gwin

I agree with much of what I find in many of the papers and some of what I ve also heard. I especially agree with the overarching point that there is a need for a retooling of the institutions of global economic governance, a retooling that addresses both the issues of governance and mandate, and indeed, I would also add, the instrumentalities of IFIs and other multilateral institutions as Francisco Sagasti has begun to suggest.

Let me comment first on the issue of governance. This is a matter that clearly cannot be left off the table any longer. Though it is often posed in terms of voting shares and in terms of the United Nations versus the Bretton Woods institutions, my own view is that the key issues are broader and different than that. Specifically, while I agree with Ariel Buira that voting shares within the IMF (and I would guess he would say the World Bank as well, if he had also done the numbers there) need revision, I think that really the key governance issue is that too much of the management of the global economy goes on outside of the ambit of the global economic institutions in a fashion that s too ad hoc and too intermittent. Therefore, the key reform, it seems to me, is to bring more of the global governance into the central institutions: in the area of money and finance, that means the IMF. The reasons for this have already been stated and I don t need to belabour them.

The G-7 process is not producing the kind of macro-coordination and the good national economic behaviour that this peer process was supposed to achieve. And, as Gerry Helleiner eloquently said, other countries are both more dependent than ever before on a well functioning system, and are more important to that outcome. Therefore, the situation points to the need for more continuous, and more inclusive, international monetary and financial management. For this, I see the need for a broadly representative, high-level ministerial mechanism of a permanent and ongoing nature. This is needed to provide both the rapid responses to international financial emergencies and the early warning and articulation of new and unresolved issues. And that leads to the conclusion, which has been put in another paper, that the right response is probably the conversion of the Interim Committee [of the IMF] into the permanent ministerial council that it was always intended to be.

In addition to that, there are two other governance issues that haven t been mentioned yet. In the case of both the World Bank and the IMF there needs to be a significant upgrading of the quality of the appointments to the executive board and there needs to be a greater transparency in the institutions in a very systematic sense. Both of these changes are needed, on the one hand, to ensure greater responsiveness and greater accountability by management and, on the other hand, to bolster the independence of management from special shareholder interest and domination.

Similar points could be made about the World Bank, on voting shares, on the board, on transparency. There s also the question of whether it would be possible and beneficial to reform and strengthen the Development Committee of the Bank. Here I m less certain about what needs to be done than I am with the Interim Committee, but I think important consideration must be given to what is needed to give the shareholders a more continuous and greater sense of ownership over the institution. Perhaps this would be accomplished by having the management of the Bank take the Development Committee more seriously and use it in a more constructive way to achieve that kind of interaction and ownership with capitals. But even that step leaves unaddressed the question of how do we get the ongoing review and monitoring of multilateral development assistance that encompasses the full set of multilateral development institutions.

On the IMF, I think I agree with I. G. Patel that, while in the long run the IMF should become a true global central bank, there s no possibility of taking a quantum leap in that direction in the foreseeable future because a true global central bank presupposes a high level of political integration. Nonetheless and you can call it incrementalism or movement in the right direction nonetheless, the short- and medium-term reforms really should lead toward that outcome rather than away from it. In this regard, if recent events have had negative effects, they ve also had at least one positive effect, which is to remake the case for a more central role for the IMF and for making it more likely that steps will be taken to improve the IMF s surveillance role. What is important is that those steps be matched by others that will increase the Fund s capacity to respond quickly and flexibly to difficulties.

There are several steps that are needed to increase the Fund s capacity, and they have already been mentioned around this table, including increasing the size [of its resources], revisiting the issue of SDRs, revising the General Agreement to Borrow, and providing a permanent source of concessional balance-of-payments financing for poor countries. My worry is that the Halifax Summit will take too minimalist an approach to matching an increased surveillance role with an increased capacity on the part of the Fund to assist when there are difficulties. Those two steps need to be matched very carefully.

There s been mention of the long-term issue of regulating the practices of financial institutions. I have to ask: if it s not a function of the Fund, whose function is it? Regulation doesn t just involve ministries of finance; it also involves central banks, and the question of the [relationship between the] Bank for International Settlements and the Fund is one that has to be raised.

Beyond the issue of the IMF, there is the question not only of the future role of the World Bank but, more generally, of the future of international development finance and cooperation. In the context of a world in which some countries are lagging farther and farther behind while others have less and less need of official development finance except to facilitate some incomplete development tasks, there are three points worth emphasizing. First of all is the need to concentrate increasingly scarce concessional development assistance where it s most needed and will be used well, recognizing that low per capita income is no longer an adequate proxy for the lack of creditworthiness and therefore not a satisfactory determination of IDA eligibility in the future; China is the case in point.

At the same time, despite the view that maybe we can foresee the end of the need for the World Bank, we need to recognize that the Bank proper the IBRD and other MDBs still continue to have a role as knowledge-based institutions and financial intermediaries. Although I would accelerate graduation of some countries out of the Fund, I would not in any way hasten the same process in the IBRD. Rather, along the lines of several of the commentators, it seems to me that the Bank should be encouraged to offer a fuller range of services that complement the markets, address market failures and, as Frances Stewart has said, address government failures as well. I think there s much further scope for the Bank in the future.

There are two areas in particular where this will require that the Bank not only do more but do things differently, requiring new instrumentalities. One is in the area of public sector development, which is already under considerable discussion in the Bank. The other is in the area of human resource development where I think that, the more the Bank and the other MOBs get into this area, the more they re going to need quite new instrumentalities, new modes of operation, which the major member governments are going to have to encourage. The suggestion here to think in terms of functions rather than regions may be a very intelligent one.

Let me add one final point that really hasn t come up yet today. While it s important to retool and strengthen the role of the international financial institutions, it s also important to retool and strengthen the United Nations. Indeed a commitment to reform, restructure and revitalize the United Nation assistance programs is perhaps as important for the Summit as taking a decision to get serious about reform and review of the IFIs. It would be a mistake to leave the United Nations out of this discussion and out of the development of a process by which we can begin to look seriously at the UN. The increasing number of emergencies and resultant refugees and displaced persons, are putting severe strains on the UN s limited financial and institutional capacities; yet there are functions of both a normative and an operational nature which the UN is uniquely mandated to perform, in the areas of human rights, humanitarian assistance, immediate human need, peacebuilding, and norm setting for sustainable human development. A serious reform effort is needed, it seems to me, to concentrate the UN on those activities and to overhaul the poorly coordinated, administratively lax central funds and programs of the UN system.

Since we have been mentioning process and the points that have been made on that are absolutely key it seems to me that this issue needs a process of follow-up as well. I don t believe everything should be wrapped up into a single process. Probably what we need is a set of processes that move along on several different issues. As far as I know, this aspect has gone not very far, if far at all, within the preparatory discussions for the Halifax Summit.

Discussion

Eight of the seminar participants joined in a broadening debate during this discussion period, and then the three presenters of papers responded to a number of points. As far as possible, this section deals with the discussion by themes, lifting points from various speakers, sometimes out of the order in which they spoke.

A key question was posed by **Roy Culpeper**, of the North-South Institute, who pointed out that people in power resist change unless they see something in it for themselves. If reformers expected the current power structure and the role played by the G-7 to change, it had to be a win-win situation; so the question had to be, what s in it for the G-7?

Several speakers acknowledged it was a key question; but only **Ariel Buira** attempted a response. He said: The answer may be that you get the world economy working better, and you get higher employment and higher growth for all. Now, this is not easy to prove, but it is the sort of argument one should try to make.

John Murray, chief of the International Department of the Bank of Canada, took up and challenged several points from the papers. On the idea that IFI reform might follow the pattern of trade negotiations, he said the GATT process had the clear and simple objective of trade liberalization, which practically everyone endorsed; in contrast, it would be difficult to achieve a consensus on what the IFIs should be doing, and how ambitious one might be in reforming them. He gave three examples. First, on the need for a more comprehensive form of exchange rate stabilization, he suggested that a major cause of instability comes from countries trying to defend indefensible exchange rates and then restoring equilibrium rates painfully and belatedly. Second, on policy coordination, he accepted there were benefits to meeting regularly, sharing information and anticipating externalities; but he argued that national governments knew what they should do in terms of price stability and fiscal prudence and adopting the appropriate policies that did not hurt other countries. Finally, on the idea of the IMF becoming a lender of last resort, he suggested there was bitter domestic experience with loans not tied to any conditions or backed by collateral and he would worry about enthusiastic attempts to apply things that we cannot even do very well domestically on the broader global scale, whether it s managing currencies, generating employment or coordinating fiscal and monetary policies.

Not surprisingly, he drew counter arguments. On macroeconomic coordination **Professor John Loxley** said: We can t simply draw parallels from the national level. Most people would accept that there are national government problems resulting from international disorder. He went on to say the group should address the need at least to slow down international speculation and to have some position on the Tobin tax or something like that. **Ariel Buira** also countered on the need for policy coordination. Murray had said everybody will do what s best for themselves, so leave them alone. But what if they don t? We have seen fiscal deficits persist, and they impinge on the level of world savings. Obviously, high interest rates impose a cost on others. They were material in unchaining the debt crisis in 1982, while interest rate movements in the United States were a significant factor in determining capital movements in 1993- 94. As to leaving exchange rates alone so that they adjust flexibly, he said exchange rate volatility and misalignments produced uncertainty that hindered trade and investment flows and gave rise to protectionism.

Johannes Linn, Vice-President at the World Bank for Financial Policy and Resource Mobilization, pursued three issues of governance. He doubted whether any overarching control body (in effect, a UN agency) for the whole range of financial and economic development would be either effective or politically acceptable. But significant changes could still be made: for example, the Development Committee could serve a much enhanced role for the World Bank and the IMF if it wants to continue looking across the two institutions . Second, on the issue of democratic governance of financial institutions, as the man in charge of fundraising for the Bank, he warned about the trade-off between being democratic and being relevant: the financial contributors were also concerned about their influence. On the other hand, Bank management regarded the borrowing members as an important part of the policy-making process and consulted intensively with them; so the current set-up, he said, does allow borrowing members to express views and effect changes.

The third issue Linn addressed was the suggestion by Francisco Sagasti that the Bank move toward being a functional Organization, split into sub-units. He called it an interesting idea , but hoped it would not mean the Bank losing its country focus, which had allowed the great improvement of being able to involve NGOs and other partners in programs. The country strategy is increasingly at the core of our work.

Ruth Jacoby, a Swedish official who became Executive Director at the World Bank for the Nordic-Baltic Office in 1994, said she liked Patel s timetable for getting the process of reform started and legislation enacted before the turn of the century. She added her belief that the institutions were continuously changing step by step, and the question was more the pace of change: We ve been talking about incrementalism or radical change. I don t think radical steps are particularly realistic, but it is important to increase the pace of the incremental change. In a later response, **Frances Stewart** firmly disagreed about incrementalism and argued for an Economic and Social Security Council at the United Nations. First, the present institutions might be able to deal with problems on a country-by-country basis, but they were in no position to deal with global problems such as the environment: the World Bank s environmental facility lent money to individual countries, but the basic environmental problem is a global problem, and we need a global institution. Second, the present institutions were too financial and (she added) the problems of the world are to do with social and economic and human and employment problems; and therefore we need a more comprehensive look at them .

On governance, **Jacoby** said that voting rights at the World Bank were indeed important, but in the daily life of an executive director, accountability was the most important matter; so that what the Bank management said in substance, and what was said in the capitals of shareholders, were really important. Governments do have an influence on the World Bank if they make use of it.

Finally, she agreed with Francisco Sagasti that the Paris Club, where I spent four years of my life , should be given more attention. It is a physical case of a ganging up of creditors against this poor debtor country, who sits at the end of the table and has no chance of consulting anybody. She thought the conditionality was straightforward: what counted was what the IMF said. However, the rules applied were fairly flexible, when the Naples terms are put on top of the Trinidad terms. **Emmanuel Tumusiime-Mutebile** agreed there was flexibility in the case-by-case consideration of various countries need for relief; but, he added, it was subject to a big sacred cow the so-called cut-off date cannot be changed .

Besides countering points made by John Murray, **John Loxley** posed questions on the Buira and Mohammed papers. He asked Frances Stewart whether the idea (out of Buira s paper) of increasing the basic allocation of votes within the IMF would meet her concern for strengthening control over the IFIs somewhat along the UN lines she had suggested (which was a full-blown Economic and Social Security Council) while leaving part of the voting rights to be determined by a revised form of GDP calculations. The reply she gave to Ruth Jacoby (summarized above) applied equally to this question.

He also suggested to Dr. Mohammed that there was a peculiar dissonance in arguing that the international community should move to an IMF based on SDRs (a view inspired by Keynes) while adding two conditions he would not have supported; namely, conditionality and capital account liberalization. Loxley went on: We need to differentiate between questions of SDRs to compensate for lack of world liquidity in the trend sense, and issues of SDRs to meet short-term crises. In response, **Dr. Mohammed** said that an unconditional SDR today is an oxymoron : conditionality, he said, was essentially a system of checking the consistency of the existing exchange-rate policy with the requirements of the country s overall situation. Keynes, he added, would have advocated a capital account regime, and this requires a great deal of attention to the speed, the scope, and the sequencing of any capital account liberalization. He himself was simply trying to see how the problem of speculative capital flows might be dealt with through SDRs.

Keith Bezanson, President of the International Development Research Centre, spoke about unemployment and the mass marginalization of populations, no longer on a country basis, but within countries. He felt there was no political consensus on the specifics of institutional reform, whether it dealt with voting shares or liquidity instruments. But a political and an intellectual hook could be found in agreeing to try to deal with the underlying factors causing the angst and political trembling in governments. If the

Halifax Summit agreed on a hook such as unemployment, then one could move back to the level of institutional reform. He also thought that Sagasti s suggestion about reforming the World Bank by breaking up the conglomerate was worth the two-year study period of intellectual leadership to which I.G. Patel had referred.

Jim Carruthers, a director-general in the Multilateral Programmes branch of the Canadian International Development Agency, an institution which has moved to an approach of development-by-results, wondered how the opening up of decision-making in the IFIs would affect the results achieved by them. He suggested that the Bretton Woods institutions (dominated by the OECD countries) were much more efficient than the regional development banks, where one of the major problems was that recipient countries maintained a majority shareholding. The presumed linkage between democratization of these institutions and improved effectiveness needed to be questioned: We may in the end find that the operation was a success but the patient died.

(The three presenters of papers were given time to reply, and their responses have been recorded in the body of this discussion.)

Part 3

Long-term Development and Financing in Low-income Countries

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Financing Long-term Development in sub-Saharan Africa

Nguyuru H.I. Lipumba[3]

After a decade of structural adjustment programs, sub-Sahara African countries have not established an institutional and policy framework for sustainable economic growth that will reduce poverty. Moderate economic recovery has taken place, particularly in countries that experienced total collapse in the early 1980s such as Ghana, Tanzania and Uganda. Yet, even for successful reformers, the per capita growth rate is too low hardly exceeding 2 percent per year (World Bank 1994, IMF 1994). Local support of reforms is fragile and few countries have sustained IMF /World Bank-supported structural adjustment reforms over a long period. There is more enthusiasm and support of the success of the structural adjustment policies within the International Monetary Fund and the World Bank than among government officials and researchers in Africa.

This paper discusses, first, the limitations of structural adjustment programs in promoting broadbased, poverty-reducing economic growth and structural transformation. It then outlines the main building blocks of long-term development strategy in Africa and the role of international financial institutions in providing net resources inflow for two purposes: to assist in the building of a physical and social infrastructure and in the removal of the debt overhang problem that is necessary for promoting domestic and foreign investment.

Structural Adjustment Policies and Long-term Economic Development

Structural adjustment programs in the early 1980s were designed to compensate for the limitations of the short-term IMF stabilization programs that were aimed at reducing demand. But they did not

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3 Professor Lipumba was unable to attend the seminar. His paper was most ably summarized by Professor John Loxley of the University of Manitoba.

explicitly link adjustment policies to long-term development objectives of building an effective institutional capacity. This capacity would or should include an efficient civil service to design and implement development policies, investing in human resources, and improving physical infrastructure to promote poverty eradicating economic growth. The fact that the Bank used only 25 percent of its loans to finance structural adjustment lending while the remaining 75 percent went into traditional development projects does not imply that African countries had coordinated development programs to link market-oriented reforms and supportive investment in social and physical infrastructure and so create the conditions for self-sustained and broadbased economic growth.

The design and implementation of structural adjustment programs have generally ignored appropriate sequencing of reforms. For example, in countries where governments were reluctant to devalue, such as those in the CFA franc zone, the IMF and World Bank supported liberalization of imports even before adequate adjustment of the exchange rate and the removal of policies and administrative restrictions that discourage exports. Interest rates have been significantly increased before commercializing parastatal enterprises the main borrowers from banks and before introducing effective measures to reduce fiscal deficits. Commercial banking has been opened up before strengthening the supervisory capacity of central banks and establishing the conditions for improved performance by state-owned commercial banks. In many ways, then, the lack of appropriate sequencing of reforms has contributed to a poor economic performance.

Again, import liberalization with overvalued exchange rates have increased balance-of-payments deficits, promoted deindustrialization and discouraged exports. High interest rates have not improved efficiency in the utilization of credit but have led instead to the accumulation of bad debts, further weakening commercial banks. Opening up of commercial banking sectors without adequate supervisory capacity have exposed financial sectors to weak banks and con men who have made profits only when interest rates on government securities are very high, but have not significantly increased lending to the private sector. Liberalizing interest rates before establishing a realistic framework for reducing budget deficits has worsened government finances by increasing debt service charges without increasing savings rates or efficiency in investment allocation.

Structural adjustment programs have not strengthened the institutional capabilities of African governments to design and implement development policies that are locally owned and understood. The lack of success in implementing economic reforms in general, and structural adjustment programs in particular, is partly explained by this lack of domestic ownership. The popular opinion among government officials, African intellectuals and the masses is that adjustment policies have been imposed by the World Bank and the IMF. The IMF drafts its own letter of intent that is signed by the African Minister of Finance stipulating financial and budgetary policies that a government intends to implement. The policy framework paper is drafted by the World Bank and the IMF and is usually not widely discussed within African government circles. In drafting letters of intent and policy framework papers, the World Bank and IMF staff are usually more interested in statements that are likely to be accepted by their boards and management rather than ones that reflect African economic and institutional realities.

It is no wonder that policies and programs tend to be similar from one country to another. A program that resembles the Economic Recovery Program in Ghana, a country that is considered to have been a successful reformer, is more likely to be accepted by the IMF and the World Bank management. Local policy makers may not be aware of the whole World Bank policy agenda when they start implementing reforms. They may not even fully appreciate the implications of accepting a study sponsored by the World Bank, that it usually becomes the preamble of policy reform that a country will later be required to implement. Local participation in studies that are supposed to be a joint effort between the government and the World Bank is usually minimal and cosmetic. The terms of reference and final reports are written by Bank staff or Bank-appointed consultants. In the end the policy package imposed on African governments tends to lack local advocates who can articulate its relevance to African conditions.

The lack of domestic ownership is not only the result of inadequate technical and administrative capability, and an inappropriate structure of incentives within African governments, but is also a product of policy conditions being placed on the provision of external finance. The IMF and the World Bank are perceived as offering a policy package on a take-it-or-leave-it basis. Countries do not have options. If they do not reach an agreement with the IMF and the World Bank, the government will neither receive external financing nor manage to negotiate debt rescheduling. Policies are accepted under duress but effective implementation does not take place. The aggressive and paternalistic attitude of the IMF and World Bank staff who claim to know the appropriate policy package discourages serious negotiations with admittedly ill-prepared African policy makers.

Externally imposed policy conditionality erodes not only ownership but also discipline and any sense of seriousness in policy formulation and implementation. Unrealistic targets are accepted by governments that have neither the capability nor willingness to carry out the programs. Most IMF programs have been aborted because of their failure to meet performance tests. Attempts to meet tough IMF conditionalities have led some countries to propose unrealistic budgets and to accumulate budget payment arrears that are not captured in timely fashion in the monetary aggregates of central banks. Instead of negotiating policies, the IMF mission spends more time trying to establish the actual levels of budget deficits and other macroeconomic variables.

The style of policy formulation and dialogue between the Bank and member countries is also problematic. The World Bank offices in member countries are quite small, without power to make decisions. Most work is done by the numerous Bank missions and consultants without adequate coordination. In many cases member countries are usually not well prepared to receive these missions and their long reports are barely read and digested. The sometimes rapid turnover of Bank staff working on a particular country undermines communication bridges that have been established between the Bank and member countries. Strengthening and empowering local World Bank offices in African countries is a reform that is long overdue. Indeed, the Bank could save on its operating expenses by drastically reducing short-term missions and letting the local office work with the government and make use of local consultants.

Long-term Development Strategy

The World Bank structural adjustment policies of the 1980s tended to have a simplistic free market orientation based on the belief that the state was causing inefficiencies in the allocation of resources because of excessive interventions in the market. Yet the truth is that African countries are suffering from ineffective governments rather than excessive government intervention. Improving public administration should have been a priority area among the institutional reforms undertaken.

Eradicating poverty in Africa is a long-term goal that requires immediate action.

The main objective of economic reforms and adjustment policies must be to establish conditions for sustainable economic growth in order to eradicate poverty. Attaining a sustainable balance-of-payments deficit, low inflation, and a competitive exchange rate are important goals if, and only if, they contribute to economic growth and an improvement in the living standards of the majority of Africans who are in poverty. Eradicating poverty in Africa is a long-term goal that requires immediate action. For African countries, it is inappropriate to design policies that focus on stabilization in the short run, adjustment in the medium term and growth and poverty alleviation in the longer term after attaining macroeconomic stability and adjusting relative prices. Stabilization and adjustment policies have to be designed in such a way that poverty-reducing growth is initiated at the same time.

There is a broad, though not universal, consensus among students of African economic development that a poverty-eradicating strategy must be based on increasing the productivity of smallholder agricultural producers and the promotion of small- to medium-sized manufacturing enterprises that are labour-intensive (Helleiner, 1992, 1994). Economic growth and structural transformation of the economy depend on increasing labour productivity. Broadbased human resource development or investment in human capital is both an objective of development policy and an instrument for achieving sustainable growth. Investment in human capital includes universal provision of basic primary education, promotion of technical training in post-primary school education, and primary health care, particularly the use of preventive medicine and family planning. An increase in employment opportunities and a demand for labour is, however, necessary for investment in human capital to lead to sustainable growth.

A Strategy for Agricultural Development

It is generally agreed that the overall impact of government policies has led to the neglect of agriculture and direct and indirect taxation of African farmers. Even Côte d Ivoire, which promoted agricultural development and recorded commendable rates of growth of output in the first two decades of its independence, taxed its agricultural sector at 30 percent or more. Overvalued exchange rates and excessive protection of import-substitution industries have been the main instrument in taxing agriculture (Schiff and Valdes, 1992).

The World Bank has rightly criticized the high levels of direct and indirect taxation of the agricultural sector. To get the African agricultural sector moving, however, price incentives alone are not adequate. We need improvement in the rural infrastructure and effective research and extension. In the past two decades both land and labour productivity have tended to decline while the continent s population is increasing at an average rate of 3 percent which will double its numbers within 23 years. African countries will be condemned to permanent poverty if they do not address the problem of how to increase agricultural productivity greatly (Delgado, 1994).

African agriculture is dominated by smallholder farmers cultivating less than one hectare. Most of the urban elite, including private sector business persons, tend to believe that efficient agriculture is large-scale agriculture that can gain from economies of scale and use modern farm machinery. But smallholder farmers are generally efficient producers, given the nature of agricultural production and decision making and the scarcity of resources in African countries. A broadbased agricultural development strategy requires equitable distribution of land. In order to promote a strategy that addresses the task of eradicating poverty, it is absolutely important to prevent concentration of land ownership and the emergence or submergence of landless peasants (Cornia 1994).

A rapid growth of agricultural incomes will stimulate demand for manufactured goods and services. The growth of non-agricultural, small-scale enterprises in rural areas, including the work of blacksmiths, tailors, carpenters, masons and repair shops, depends on the dynamism of the agricultural sector. As well, increasing specialization and commercialization of smallholder production will stimulate intraregional trade. So, broadbased agricultural development can initiate rapid growth in other sectors.

The main problem facing a development strategy based on agriculture is that world market prices of agricultural commodities, particularly tropical beverages, have followed a sharp and long-term downward trend. Liberalizing trade policies and depreciating the real exchange rate are unlikely to maintain positive price incentives. If all African countries try to increase their existing exports and attempt to capture their peak market shares, and if Asian countries continue to increase similar exports at current growth rates, export prices are bound to continue decreasing. International commodity agreements are not supported by the World Bank and other aid agencies. The collapse of world market prices for tropical beverages has not led to a reduction of consumer prices but to an increase in the profits of food-processing multinationals. International commodity arrangements, which can guarantee some reasonable minimum producer prices and so manage world supplies in an orderly way, can be useful in promoting agricultural transformation in those African countries that are committed to supporting agriculture-based development strategies. Industrialized countries are, however, unlikely to support this approach and primary producer countries may have to organize their own supply management arrangements (Maizels, 1994).

Diversification of agricultural exports should be a priority in any agriculture-based development strategies. Each country needs to put in place supporting policies and institutions that are necessary for a rapid increase in new exports of fruits and vegetables, oilseeds and nuts, fish products, flowers and exotic tropical plants based on smallholder producers.

Measures taken by the United States, Japan, and especially the European Union, that distort agricultural trade are obviously not conducive to the promotion of agricultural exports. However, the outcome of the Uruguay Round is expected to result in more liberalized agricultural trade. In the short run, African countries that are net importers of food are likely to pay more and African exports will lose the preferential treatment they receive in the European Union. The potential increase in food prices in the world market is another wake-up call for African countries to promote domestic food production rapidly. Put positively, the integration of domestic markets, regional specialization and intra-African trade provide opportunities for rural areas to make food production a leading activity to promote growth.

Industrialization Strategy and Trade Policy

Rapid growth and structural transformation necessarily involves industrialization. Agricultural transformation that is not entirely dependent on foreign markets for exports requires the growth of an effective demand for food. The creation of non-agricultural employment increases the demand for food and the availability of low-priced food reduces the cost of labour and increases its demand. An improvement in agricultural productivity and an increase in non-agricultural employment are therefore interrelated.

Industrialization to substitute for imports led to a fast growth of value added in the manufacturing industry during the 1960s and 1970s. In the 1980s, these growth rates sharply declined in most African countries. African industrialization strategy has not succeeded in increasing manufactured exports and industrial employment. The increase in the demand for intermediate imports without increasing manufactured exports contributed to the balance-of- payments crisis. Most industries have tended to be capital-intensive, established as turnkey projects by foreign firms with a low transfer of technological skills to local managers and technicians. Past industrialization programs have tended to concentrate on expanding manufacturing capacity without building an institutional setup and local capabilities to effectively use the capacity created (Lall, 1992).

The World Bank structural adjustment programs do not have any industrialization strategy other than trade liberalization. Liberalization is justified on the grounds that excessive protection and price controls have contributed to the establishment of inefficient industrial structure. Industrialization is, however, a process of learning by doing. The main problem facing the African industrialization process is a lack of local technological skills to plan and implement industrial investment and to select appropriate technologies. Adapting imported technology to local conditions has proved to be difficult and the maintenance of equipment tends to depend on expensive expatriates. Large white elephant industrial enterprises have been established, particularly by state enterprises using borrowed funds and foreign consultants. In many cases, the World Bank has been directly responsible for selecting and implementing industrial projects that ended up being expensive white elephants. African countries have been left with debts and without an effective production capacity.

Industrialization strategy has discriminated against medium-and small-scale industries, because they lacked access to credit and foreign exchange. Government licensing requirements and other controls have generally prevented a steady growth of these small-and medium-scale enterprises although they tend to be labour-intensive and use appropriate technologies.

An appropriate industrialization strategy should focus on the linkage between agriculture and industry and promote small- and medium-scale industries that playa leading role in meeting local demands. Investment in infrastructures that link rural areas to townships, and electrification that increasingly includes rural areas, provide an enabling environment for the development of smaller industries. The removal of industrial licensing hurdles and costly labour laws that pretend to protect workers and end up penalizing employment generation should be part of a reform program. Institutional innovation, including access to information on appropriate technology and credit to acquire equipment and raw materials, is necessary for a widespread promotion of small- and medium-scale enterprises. These enterprises are likely to be better managed by local entrepreneurs than the large turnkey industrial projects. Over time, successful small business industrialists may expand into sizeable enterprises.

Some manufacturing activities such as chemical industries (e.g., fertilizer factories and oil refineries) and vehicle assembly. are characterized by large economies of scale. A number of African countries have established, at high cost, some small-scale enterprises in these subsectors. The sooner the mistakes are recognized and such enterprises are closed, the better for the industrialization effort. Genuine regional integration, rather than the numerous summits and ministerial meetings and lofty declarations without action to remove intra-African trade restrictions, is necessary for promoting industries with significant economies of scale. Even with successful regional integration, African markets are still relatively small. Sustainable industrialization must become internationally competitive within a relatively short period. Internationally competitive import substitution and the potential for successful exporting should guide the selection of investment projects. Private investors should clearly realize that they cannot depend on long-term protection to earn profits from their investment.

To have a positive impact on resource allocation and a high degree of supply elasticity in manufactured output from trade liberalization requires managers of industrial enterprises who have the technical and organizational capability to respond to a new set of relative prices of products and factors of production. Where technological and organizational competence is lacking, trade liberalization that abruptly removes protection will only cause a fall in manufactured output. For manufacturing firms that have the potential of being competitive, it may be important to improve technological and managerial competence before implementing trade liberalization. Deliberate programs to train and acquire technical and managerial skills must be part of the industrial development strategy (Pack, 1993).

Sustainable industrialization and promotion of manufactured exports require competitive exchange rates. The dependence of the manufacturing industry on imported capital goods and intermediate inputs have made managers of industrial enterprises producing for the domestic market in both state and private sectors prefer an overvalued exchange rate. It is self-defeating in the long run for the profitability of manufacturing enterprise to depend on what amounts to the taxation of domestic users. The growth of the manufacturing industry will be constrained by foreign exchange shortages and the manufacturing sector will be characterized by low capacity utilization. The worst policy for the development of the industrial sector is an across-the-board liberalization of imports by removing quantitative restrictions while retaining an extremely overvalued exchange rate. A long-term industrialization strategy requires maintaining a slightly undervalued exchange rate to provide overall protection to domestic production activities.

It is tempting to accept Amsden (1989) and Wade (1990) in their interpretations of the successful industrialization strategy of Korea and Taiwan, and recommend that African countries should adopt policies of selective protection but, as Lall has argued, the preconditions for the efficient deployment of selective intervention are demanding. It requires a strong and competent government which is driven by economic objectives. This [ideal] government should be able to analyze technological information and select only activities which, given resources, skills and technological capability can become efficient in a reasonable time (Lall, 1992). In practice, real existing African governments do not have the capability of implementing an industrialization strategy by getting the prices wrong.

The Private Sector

Most African governments now accept that the private sector is at centre stage in the promotion of economic development. Sustainable eradication of poverty requires a policy and institutional set-up that provides opportunities to individuals and households to improve their wellbeing by working hard and diligently. Microeconomic reforms that remove legal and bureaucratic constraints and popularize the setting up of formal and informal enterprises can go a long way in promoting private investment, even when financial institutions to provide credit are not yet in place.

African governments should avoid reforms that promote a rent-seeking private sector. An overvalued exchange rate, administrative allocation of import support to the private sector, schemes for converting external commercial debt and tax breaks for promoting private investment are among policies that tend to generate rent seekers. It can be argued that providing rents to certain enterprises increases their ability to invest and possibly increase exports to external markets. At present African governments do not have the instruments to direct enterprise, to use rents and other government favours to promote exports. A competitive level playing field is more appropriate for promoting local private enterprises than providing rents to a few enterprises.

In general, African governments that have not been able to provide adequate physical and social infrastructure should avoid running commercial enterprises in manufacturing, road transport, trading, etc. The logical implication of this argument is that African countries should privatize public enterprises. In countries where the majority of public enterprises have losses and require additional injections of capital to become productive, a quick exit by the government from these enterprises is the appropriate policy option. The primary objective of privatizing lossmaking under capitalized public enterprise should be to get the best price for the enterprise when all other costs, including the debt of the enterprises and severance pay, have been taken into account. It will generally be a mistake to limit the sale of these enterprises to local investors or to use them to promote a policy of indigenization. The last thing the government needs is continued involvement in their financial problems.

Competitive profit-making public enterprises should in general be retained by the government and used to promote indigenous entrepreneurs, particularly those indigenous managers who have a track record of providing effective business leadership. They can have performance contracts that allow them to acquire shares of the enterprise depending on the profits they make. It is difficult but not impossible for governments to allow potentially profitable public enterprises to be autonomous and operate commercially in competitive markets.

The modern formal private sectors of most African countries are dominated by non-indigenous business Indians in East and Southern Africa and Lebanese in West Africa. Political demands for indigenization of domestic business have been used to limit the activities of non-indigenous businessmen. In most cases it has not led to the development of genuine indigenous entrepreneurs. Genuine indigenous entrepreneurs cannot flourish by discriminating against non-indigenous nationals. Moreover such policies will tend to encourage ethnic cleavages. Governments will not be seen as discriminating in favour of Africans but rather promoting the interests of certain ethnic groups, which can be a cause of political instability. A policy environment that allows easy entry into every business activity will provide more opportunities to African entrepreneurs. In countries with extensive controls, non-indigenous business people purchase favours from officials who prefer large bribes from the politically unconnected, non-indigenous businessmen to small bribes from politically articulate fellow Africans.

Indigenous African businesses are largely in farming, distribution, commerce and informal sector. Participation of African entrepreneurs in formal manufacturing is limited. The potential of African entrepreneurs in manufacturing should not be dismissed. In other developing countries most of the leading industrialists started their businesses in commerce and the distribution of imported goods. They started manufacturing enterprises only after accumulating enough capital and experience.

Lack of a developed financial sector that mobilizes and channels savings to productive investment hinders rapid development of the private sector. The need for improvement in the financial system, particularly the availability of credit at reasonable cost, constrains the development of the private sector. At initial stages of developing enterprises, entrepreneurs usually depend on their own savings or borrowing within the informal sector. Formal credit channels become important for later growth and consolidation when the firm is well established and can provide collateral. Lack of a developed financial infrastructure should not be used as an excuse for not promoting the private sector by removing policy induced constraints on establishing enterprises.

Financing African Investment Requirements

To initiate a process of self-sustained growth to reduce poverty, Africa requires investment in physical and social infrastructure. Sub-Saharan Africa has the worst physical and social infrastructure of any region. It is characterized by poor communication and transport systems, weak agricultural research and extension networks, limited telecommunication development and unreliable power and water supplies. Investment by the private sector, including foreign investment, is unlikely to flourish in countries with poor infrastructure, even when the exchange rate is appropriate and relative prices are undistorted. Domestic savings, even when increased, will be inadequate to finance the required investment. There is no escaping the need for external financing of any realistic infrastructure investment program. Given the perceived political and economic instability in African countries, private financing of long-term investment projects will simply not be available; hence the need of public source of external funding.

The resource constraints of African countries is worsened by excessive and unpayable debt burdens. At least 26 sub-Saharan African countries have a debt:export ratio in excess of 200 percent a benchmark measure for unsustainable debt burden. Some countries, including Guinea-Bissau, Mozambique, Sao Tome and Principe, Somalia, Sudan, Tanzania and Uganda have a debt:export ratio in excess of 1,000 percent. These countries are not capable of repaying the existing debt.

Past debt-rescheduling clearly failed to reduce the debt burden of African countries.

Since 1986, at least 30 sub-Saharan African countries have signed one or more multilateral debt-relief agreements, with GECD creditor countries. Despite, and in many cases as a result of, these agreements the debt burden of African countries has increased. Hardly any of the increase in debt, with the exception of the World Bank IDA financing, increased resource inflows to Africa. For sub-Saharan Africa as a region, net debt inflows have become negative since 1991. Debt rescheduling conferences have capitalized punitive interest charges on debt payment arrears, which is the main cause of the persistent increase in the debt stock. Sub-Saharan African countries have paid $94 billion in debt service between 1987 and 1993, which is $10 billion more than the total stock of debt in 1980. The total stock of debt has, meanwhile, more than doubled from $84 billion in 1980 to an estimated $200 billion by the end of 1993 (World Bank, 1994). The recorded net inflow of resources to African countries is largely the result of bilateral grants and not from an increase in the debt stock.

The past debt-rescheduling conferences have clearly failed to reduce the debt burden of African countries. Any realistic projection of growth of output, exports and tax revenue of severely indebted African countries show that most countries will not be able to service their debts.

The severe debt burdens have adverse impacts on the successful implementation of reforms to promote economic growth and reduce abject poverty. Debt-payment arrears have disrupted normal channels of trade credit, and as a result, African countries pay 30 to 40 percent more for their imports. Private sector investment, both domestic and foreign, is discouraged by the potentially high taxes to finance present and future debt-servicing obligations. The debt overhang promotes capital flight and reduces the demand for domestic financial assets, discouraging both domestic financial savings and investment.

Most African countries have incurred a large fiscal deficit that was partly due to the enormous debt-servicing obligations. The fiscal burden of servicing the external debt has skyrocketed as a result of massive devaluation. If the severely indebted countries are required to service fully the current debt obligations, domestic macroeconomic stability cannot be attained. Drastic reduction of the debt burden of African countries is a necessary, though by no means sufficient, condition for restoring macroeconomic stability and initiating a process of sustainable growth.

For simplicity, African creditors can be divided into three groups: official bilateral, official multilateral and private creditors. It is estimated that official creditors accounted for three-quarters of the long-term debt stock by the end of 1993. Multilateral creditors accounted for slightly less than 30 percent, while bilateral creditors accounted for slightly more than 45 percent. Unlike Latin American debt, at least 46 percent of the sub-Saharan African debt can be resolved by the public policies of creditor governments. The GECD governments can also indirectly reduce the debt burden imposed on Africa by the multilateral institutions, particularly the World Bank.

Creditor governments within the GECD can take immediate policy action collectively to cancel all outstanding bilateral debt to all sub-Saharan African countries, or at least to the severely indebted low-and medium-income countries. There is no additional cost to creditor governments to cancel this debt which has, in any case, been continuously rescheduled or is in arrears. Most European governments support debt cancellation if the United States and Japan would support the policy. The current rescheduling exercise which may seemingly provide temporary cash flow relief perpetuates the debt overhang problem (Helleiner, 1994; Martin, 1991).

Some severely indebted low-income countries inexplicably contracted loans from the World Bank IBRD on hard terms. The burden of servicing IBRD loans is increasing and is a major problem to countries with severe balance-of-payment problems, particularly given the fact that most projects financed by these loans did not lead to an increase in output. The multilateral institutions are favoured creditors and their debt cannot be rescheduled. In many cases the servicing of this debt by severely indebted African countries is a financial gimmick where African governments borrow or receive a grant from bilateral donors to service the IBRD debt so that they can have access to IDA resources. Non-concessional multilateral debt of severely indebted low-income countries should be written of(possibly using IDA reflows and World Bank profits. In any case, IBRD exposure to severely indebted low-income African countries is not too large to affect adversely the IBRD s rating in financial markets. If the financial markets have accepted the current gimmick of debt servicing, they are unlikely to react adversely to a well thought out plan to eliminate IBRD exposure to poor countries.

During each year of the past decade, the IMF has not provided positive resource inflows to sub-Saharan African countries. The balance-of-payment deficits of African countries are not short-term problems that can be resolved by stabilization programs whose main focus is adherence to quarterly credit ceilings. The IMF does not offer medium- and long-term development finance. Low-income developing countries should largely be dealing with IDA. Exchange rates, monetary and fiscal policies should all be designed within a framework of establishing conditions and institutional setup for sustainable growth in the medium and long term. In the interim, the IMF should at least commit itself to a zero net resource inflow to Africa through a more generous use of the Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF) financing. The IMF could increase resources available to developing countries through the ESAF soft window by selling part of its large gold stock.

African countries must realize that aid fatigue in donor countries is here to stay. Countries that were in the past most generous in assisting poor countries face major fiscal problems with unprecedented high rates of unemployment that persist even when their economies recover. Aid flows in real terms is likely to continue decreasing. Countries that are perceived to be serious in tackling poverty problems by promoting broad-based growth are more likely to attract assistance. Effective utilization of aid in countries implementing policies that promote broad-based development require moving away from tied aid projects to program aid that offers flexibility to the recipient country to carry out an appropriate investment program. African countries must have the courage to reject projects that do not contribute to supporting a broad-based development process.

The OECD countries can assist Africa by providing adequate funding for IDA and untying their decreasing bilateral assistance from supporting domestic commercial interests and consultants to financing development programs. An underfinancing of IDA will severely limit access to external financing by most African countries who do not have access to private capital markets. There is likely to be a trade-off between providing resources to IDA and bilateral assistance that is increasingly being provided in the form of grants. Bilateral aid tends to be tied in the sourcing of imports and biased toward commercial interests of donor countries. IDA funds are more fungible and can be used to finance development programs rather than specific projects.

The World Bank should also transfer a large share of its profits to write off unpayable debt and increase the resources available under IDA. Reducing its huge administrative expenses can contribute to increasing its profits and its contribution to the IDA facility. Given the possibility of channeling IBRD profits into IDA, there is no pressing rationale for completely separating IDA from other lending activities of the World Bank. The share of IDA resources allocated to countries that are IDA-eligible but have access to private capital markets such as China, India and Indonesia should be decreased in favour of countries that are unlikely to have access to world capital markets, mainly in sub-Saharan Africa.

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Multilateral Cooperation for Development: Views on the Eve of the Halifax Summit

Cristián Ossa and Barry Herman[4]

While reshaping international financial institutions to a changing world has been a continuous task as shown by the evolution of the Bretton Woods institutions in the past 50 years a major rethinking of their role is today an important part of the international political agenda. The issue is broader, however, than just these institutions as the very aims and modus operandi of international financial cooperation for development is also under discussion.

Multilateralism is not a given

The Heads of State or Government of the Group of Seven (G-7) will meet in June 1995 in Halifax to discuss, *inter alia,* the framework of institutions required to meet the economic challenges of the 21st century.1 When the decision to consider reshaping the multilateral system was taken at the 1994 summit meeting, the agreement on the Uruguay Round was fresh in the minds of policy makers. The new World Trade Organization was to be established in January 1995 and it would have to be integrated into the existing architecture of international organizations. Yet some major difficulties in international cooperation were also erupting into political consciousness around the same time.

At the United Nations, the President of the 49th session of the General Assembly, Ambassador Samuel Insanally of Guyana, organized international hearings on development in June 1994, at which perhaps the most attention focused on proposals to reform the multilateral system, including the United Nations itself. Most striking here was the depth of critical assessments of the multilateral system.

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4 The views expressed are those of the authors alone and do not necessarily reflect the views of the United Nations.

This reflected, in part, the way the 50th anniversary of the Bretton Woods institutions was being celebrated by some and questioned by others.2 The World Bank became especially sensitive to public and governmental criticism of ineffective lending and financial waste, not to mention environmental and social damage allegedly linked to World Bank projects. The Bank responded with a new mission statement in which it formally recommitted itself to more efficiently fighting poverty and promoting development (World Bank, 1994).

The question of whose Fund is this? had been raised anew.

In subsequent months, important political developments occurred which challenged some premises of multilateral cooperation. First was the open challenge to the group of developed countries by the representatives of the developing countries in the International Monetary Fund, acting through the Group of 24. The voting structure of the Fund does not often provide opportunities to the developing countries to affect materially IMF policy decisions, but the dispute over a moderate and general allocation of special drawing rights versus a more limited and selective allocation provided one such occasion. The developing countries were only able to engage in a blocking action, but surely the question of whose Fund is this? had been raised anew and in a pointed way.

Another important political development in the past 12 months was the Congressional elections in the United States which changed the political landscape in that country, at least over the two-year life of the current Congress. The tough-love view of social and economic policy thus moved from the fringe to centre stage in political discourse if not yet in actual policy in the United States.3 International cooperation for development has to have become one of the most vulnerable categories of U.S. Government expenditure. As funding of the multilateral institutions has generally followed the principle of equitable burden sharing among donors, negotiations for replenishment of concessional funds or for capital increases of non-concessional lending institutions will become even more difficult than they have been.

Finally, the financial, economic and political crisis in Mexico that broke in December 1994 resulted in the virtual abandonment of IMF decision-making practices and lending guidelines in order to accommodate a strategy for solving the problem that was led by the United States. While urgent measures were warranted to address an emergency with near-global repercussions, international consultation and concerting of views were strikingly limited. To the degree that the major economies concert their policies in general, it usually takes place in a less-than multilateral forum, namely, the G-7, or even more selectively, the G-3. The recent Mexico crisis was handled virtually by the Group of One.

Toward Greater Multilateralism in Monetary and Financial Affairs

One major requirement of the Halifax meeting should be to reaffirm the commitment of participating governments to multilateralism in international monetary and financial matters. The argument for a restricted-membership summit on economic and financial issues was: hat government leaders of key countries could trade concessions across the widest swath of issues and thereby reach agreements of global significance that might not be reached in less limited fora (Bergsten, 1992). Whatever the case in the past, it is not so obvious that the Heads of State or government of these particular countries are alone the most appropriate grouping today for broad international economic decisions.

By the same token, the finance ministers of the G-7 have largely acted, albeit without continuity, as the executive committee of the international monetary and financial system. This, too, should be re-examined. The world already has a superior, if still imperfect, forum for multilateral cooperation on international monetary and financial matters, the IMF Interim Committee. It was created as a temporary structure in 1974 as part of the reform of the international monetary system after the collapse of the Bretton Woods structure, largely because the developing and developed countries in the Committee of 20 could not agree on the proposed Permanent Council. the difficult issue was power sharing and the developing countries, it has been said, preferred to take their chances in the informal processes and decision-by-consensus in the Interim Committee, whose decisions were in any case only advisory , rather than have to accept an explicit minority voice in the Council (Dell, 1991). What the developing countries got instead was decision making by the G-7 ministers.

The most desirable approach to replacing international monetary and financial management by the G-7 ministers would be to return to the unfinished business of the Committee of 20, i.e., setting up a permanent structure. A less ambitious approach would be to reform the Interim Committee itself. Criteria for membership in a new IMF Committee, as well as its size and voting procedures, should be updated, and the relationship of the Committee to the Executive Board of IMF and the Board of Governors should be rethought. However, the core of the proposal here is to convert the present Interim Committee into a truly multilateral mechanism for international monetary affairs that would have the capacity and procedures for a rapid-response to international financial emergencies.

The enhanced Committee could operate in a parallel way to the Security Council of the United Nations, which is so organized as to be able to function continuously, with the Secretary-General empowered to bring to the attention of the Council any matter which in his opinion may threaten the maintenance of international peace and security (Articles 28 and 99 of the Charter of the United Nations). Also, in the same manner that Heads of State or government met in the Security Council in 1992, the enhanced Committee could meet from time to time at the highest level to discuss international monetary and financial cooperation.

A first reaction to this proposal might well be that several governments would not want to open up such issues to international negotiation at this time. But there are good reasons that this is precisely the time to rethink IMF operations. In the wake of the Mexican crisis in particular, there is renewed interest in the process of multilateral oversight and coordination of international monetary and financial matters. The international rules of the game assume particular importance for the many developing countries that have liberalized their international trade and capital flows and adopted more market-friendly policies.

Indeed, virtually all countries have become increasingly concerned about and certainly affected by the large-scale international financial movements of recent years. Policy makers and business managers have to confront the unusual gyrations in exchange rates that significantly change the valuation of assets in different currencies, as well as the prices of exports and imports. The once powerful U.S. dollar has not been an exception. On the contrary, after its unprecedented changes in value in the 1980s, many analysts have been at a loss to explain the pounding of the dollar exchange rate over the past year, thereby fostering additional uncertainty.

If financial disturbances or crises can be defined as large and sudden changes in exchange rates, then in the past three years we have witnessed several important examples in western Europe, as well as in the Russian Federation, Mexico and the CFA franc zone in Africa. The still evolving situation in Mexico is certainly an extreme case in point. Owing to the crisis in investor confidence, the resulting evaporation of net capital inflows and the attendant fall in output, the people of Mexico may experience a reduction in aggregate real expenditure of as much as 10 percent of GDP in 1995.

The funds that have been leaving Mexico so rapidly in the past several months to a large extent arrived between 1992 and 1994, highlighting a particular aspect of the new internationalism of portfolio investors. As the stock of potential hot money in a recipient country builds up over the years, the vulnerability to major disruption in the exchange market also builds, since holders of the entire stock may seek to abandon the country at one time.

The exchange rate instability in several countries besides Mexico also reflects large inflows and outflows of funds, which underlines how ample the supply of international finance has become that developing countries can obtain. All countries that wish to tap into this pool of finance must be concerned about what it takes to maintain international confidence in their underlying economic situation as well as in their policy team. And even though most of the funds will flow to middle-income and higher-income countries, certain low-income countries have already seen significant inflows of portfolio and direct investment and more could follow.[4] In this context, the key issue has become how to avoid a sudden disruption of flows and its consequences.

The difficulties that Mexico s crisis has caused for itself and for other countries that were negatively reassessed by the market in the light of the Mexican developments seem to represent a major market failure . It arose from asymmetric information about country risks and the herd instinct of investors, which is the way they have been coping with the uncertainty. The run on uninvolved countries was also the consequence of investors needing to raise cash quickly to cover losses in other markets. All told, this experience calls out for enhanced international oversight, not least in terms of prudential regulation of securities investment, but also in the realm of confidence-enhancing multilateral surveillance.

By the same token, if a strengthened Interim Committee is to calm anxious investors in a crisis situation, the IMF needs to be able to dispose of adequate resources. Although it is not clear that individual efforts on the scale of the Mexican rescue package should be repeated, in that case even the extraordinary contribution by the IMF was a rather modest share of the total funding mobilized. Expeditiously completing the Tenth General Review of Quotas with a recommendation for a large increase would be an important contribution to addressing this problem. If it were impossible to agree on a sufficient quota increase, substantial improvements could be made to the criteria for use, the number of contributing countries and the amount of resources potentially at the disposal of the swap facility created under the IMP s General Arrangement to Borrow.

Weakening Confidence in Official Cooperation for Development

In contrast to the official financial role in balance-of-payments stabilization and adjustment, it is increasingly apparent that traditional budgetary allocations by governments of industrialized countries for official development assistance (ODA) is on the wane. The political debates over ODA in Europe or North America tend to include proposals for substantial reductions in assistance and complete elimination of some programs.

Proponents of ODA everywhere seem on the defensive and vulnerable to questions regarding the length of time a country is supposed to require official development assistance: perhaps more than 25 years; surely not 100 years. After almost half a century of chequered aid history, donors have little reason for self-confidence, other than that their role as donors requires it.

The point is not that people in aid-giving countries have become hard-hearted. Humanitarian aid and disaster relief still seem to be supported, at least as long as people feel the needy actually receive the assistance. Aid that flows as part of political agreements, as in the cases of Egypt, Israel and the Palestinian territories, would also continue. Rather, it appears that political support has evaporated for aid to developing countries under the postwar model of assistance, which might be characterized by three motivations: a sense of post-colonial responsibility (and perhaps guilt) over many developing countries; a competition driven by the Cold War for political influence in those countries; and a belief that ODA could make a significant contribution to economic development.

It appears that political support has evaporated for aid to developing countries.

The latter proposition has always been contentious. Already in the 1960s the radical right argued that well-meaning, albeit naive, aid programs stifled local initiative in recipient countries and the radical left argued that aid was a tool for neo-imperialist dominance over the recipient country.5 In between, arguments for and against aid were made at the macroeconomic level, leading to inconclusive econometric exercises about whether or not aid reduced domestic savings and thus long-term investment. Arguments were also made at the microeconomic level, on the pros and cons of individual projects, how they were designed and what they actually achieved.

From the beginning, aid for development encompassed technical assistance, including some form of economic planning, as well as finance. The usual presumption was that the donor knew something that the recipient did not. The donor would impart knowledge in a manner that the donor would generally choose, control and audit. The hubris of development assistance was a fundamental feature of cooperation.

Today, donors can be as demanding as ever that recipients adopt their approaches which, naturally, are not the same as they were 25 years ago. Demands today cover a wide array of areas: economic, political (e.g., democratization), gender-related, environmental, social, basic human rights. Yet, embracing the new consensus is not consistently underwritten with increased international financial assistance.

Donors ask, nevertheless, how more effective approaches can be designed which while embodying international financial cooperation are locally owned in appearance as well as in fact. But with all the goodwill in the world, they cannot be designed in another country, no matter how excellent its policy advisers and how strong the sympathy for the recipient country. And to the degree that the modus operandi of aid is to use financial incentives to entice recipient governments to adopt an economic policy desired by a donor, it seems a hopeless exercise. The experience of the past 25 years cannot be more telling in this respect.

The point is that the model whereby the North assists the South to develop through ODA programs and projects including those of multilateral institutions is weak, both politically and intellectually. Certainly, it is striking that the donor-based, non-governmental organizations that work in aid-receiving countries are a major source of the criticism of the policies that donor governments promote, especially through the multilateral institutions.

Instead, a new model might be articulated, one in which financial assistance is provided by governments as part of agreed international programs to advance concrete collective goals, whether they be the eradication of a disease from the planet (AIDS is a case in point) or combatting environmental warming or ozone depletion in the atmosphere.6 ODA might also finance technical assistance that is more in the nature of sharing experiences than in the sense of teaching advanced-country expertise to lagging nations. Sharing experiences, whether on policies to tame speculative financial flows or processes that foster the flow of information about international trade opportunities, can even be politically popular. In all such cases, the model of ODA is as a joint effort of countries that come to the table as equals to tackle a commonly perceived problem. If only some are in a position to bring money, all bring something.

Multilateral Finance for the 21st Century

If this view is correct, then multilateral cooperation for development will come to look quite different as the 21st century progresses. Activities closer in approach to the Global Environmental Facility (GEF) might burgeon while more traditional multilateral development assistance would shrink, although not necessarily disappear, especially as concerns the concessional lending programs.

On their regular operations, the multilateral development banks could increasingly take on the role of competitors for the business of borrowing governments. The banks typically offer a package that includes project design and appraisal services, usually some policy-based conditionality and finance. Many developing country governments are already able to unbundle the package and make informed choices among official and private suppliers of the various parts. Sometimes, what the official institutions offer is the best arrangement and sometimes not.

In all likelihood, the banks would adapt and survive in a competitive environment and provide a major public service as a financial intermediary. But in the same way that the European investment Bank does not dominate economic policy discussions in the European Union, it is likely that the development banks would become less and less dominant advocates of the true path to development policy.

Financing International Cooperation

Whatever the model, budgetary allocations are still required to raise aid resources. However, some have advocated automatic financing through international taxation (e.g., a Tobin tax on foreign exchange transactions or an international air passenger tax). The attraction of these schemes is that funds would be provided on an assured basis, avoiding the periodic negotiated replenishment of multilateral concessional funds and annual national appropriations, and that resources would grow *pari passu* with the tax base. But it seems unrealistic to expect that governments would give up the power to tap any good source of tax revenue for national uses, particularly at a time when taxes are so much in the mind of voters everywhere.

This is not to say that all sources of international revenue would necessarily be withheld from multilateral use. Some potential sources are beyond the control of individual governments and can only be collected and thus allocated by a multilateral body. Royalties on mining the seabed in international waters are a case in point. Another case arises from the recent agreement to place under the auspices of the Food and Agriculture Organization of the United Nations all the germplasm collections of the international agricultural research centres. These gene banks could generate royalties that might well be applied to funding agricultural research and technical assistance.7

Neither of these sources, nor others that might be conceived, are likely to generate all the resources needed for particular international programs; budgetary allocations by governments would still be required. There is nothing wrong with that. The essence of democracy includes public decision making over public expenditures. The challenge that has to be accepted is to build a popular constituency for international cooperation under the new model.

Endnotes

1 Economic declaration of the Group of Seven, Naples, July 9 1994, as reprinted in IMF Survey, July 25, 1994, pp. 242-243.

2 See Proceedings of a conference sponsored by the Group of 24 on the occasion of the fiftieth anniversary of the Bretton Woods Conference. The Fifty years is enough campaign showed the sharp dissatisfaction in the community of voluntary, non-governmental organizations, which are important partners in development.

3 To a certain extent, this is not exclusively a United States phenomenon. Similar, although not as marked, signals were also starting to appear in other industrialized countries.

4 The World Bank estimated that portfolio equity flows to low-income countries in 1994 totalled $11 billion, out of $39.5 billion to developing countries as a whole (World Debt Tables, 1994-95, p. 98). Much of the flow was to China and India, but the Ghanaian government also marketed over 25 per cent of its stake in Ashanti Goldfields and a fourth Vietnam fund was launched (mainly investing in joint ventures, as there is no local stock market).

5 Lord Peter Bauer in England can be identified with the former position and Paul Sweezy and Harry Magdoff of the United States with the latter.

6 Given the economic predicament of Africa, the increased uprooting of large groups of people, and the recognition by the international community of the need to reverse the situation through special efforts, this could also be considered a collective goal . For example, an international programme to foster a green revolution in Africa could be agreed upon.

7 For additional details, see United Nations, *World Economic and Social Survey*, 1995, forthcoming.

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Emmanuel Tumusiime-Mutebile

There is a lot I agree with in Professor Lipumba s paper, especially the parts about poverty reduction, about the seriousness of the external debt burden and about aid flows. The only point I disagree with about aid flows is his recommendation that we should be moving away from project aid to program aid. I find it difficult to accept that because of the clear and present danger of that disease. Program aid tends to be directed toward budget support which means it is spent largely on non-tradeables and therefore, once you have reached a stable macroeconomic situation with open market exchange rates, an increase in program aid is likelier to lead to a destruction of the export sector whereas project aid is largely import-intensive and therefore self-sterilizing. Certainly this has been the experience of Uganda in the last few years.

Other than that, I think his discussion of the external debt burden and aid flows and poverty reduction is a useful contribution. I am distinctly uncomfortable, however, with what he has to say about SAPs. I agree entirely with his description of the long-term strategy for poverty reduction and economic development, but I think that the basic challenge is one of raising domestic savings rates and this does not feature at all in his paper, except indirectly through reducing poverty and thereby increasing savings. I think this is a challenge because external financing should not be a substitute for domestic savings. I think external financing should supplement, and not supplant domestic savings, and I think this is where what are called structural adjustment programs come into their own.

With or without the international financial institutions and their conditionality, Africa cannot escape hard budget constraints. The need for making ends meet is absolutely inescapable, and therefore good sensible macroeconomic policies are essential. If Africans cannot come up with sensible macroeconomic policies, then they should be forgotten; as simple as that. Let them sink! I think that there is no justification for taxpayers money in Canada to be spent on countries that are not doing anything to help themselves.

Therefore, macroeconomic stabilization is an absolutely essential precondition for development and I therefore think that the debate about conditionality and ownership in the first part of Professor Lipumba s paper is unfortunate because it tends to give the impression that, if the IMF and World Bank were to sink into the sea, everything would be all right. In fact, whether they are there or not, our countries cannot escape from the need to pursue effective macroeconomic policies.

As an aside, I want in particular to emphasize the role of the exchange rate in the adjustment process and in reducing budget deficits, especially where governments are net sellers of foreign exchange, as in most sub-Saharan countries. In such a situation, devaluation will raise domestic counterpart resources and therefore help to reduce budget deficits. I would also emphasize the need to de-politicize the changes in the official exchange rates. If there s any single action in Uganda that has been central to the stabilization effort, apart from the commitment of the government, it is the de-politicization of the exchange rate. This happened after 1989, when parliament had voted against any further changes in the exchange rate and President Museveni organized a meeting at which experts were marshalled to argue with parliamentarians and, at the end of that seminar, everybody adopted a resolution to legalize the parallel market.

At that time not even the IMF thought it was a good idea. But that was central, because once the parallel markets had been legalized, the changes in the official exchange rate were no longer important. So, the importance of fiscal prudence cannot be over-emphasized, and not just because fiscal prudence will stop the monetization of the deficit, but more importantly because, given the underdeveloped financial monetary system, fiscal action will be required to defend macroeconomic stability in the face of massive inflows following the restoration of external confidence in the economy.

Over the last few years in Uganda we have had complete exchange rate stability and inflation below 6 percent on annual average. This has created huge private transfers, and has recently been compounded by the coffee boom. And in a situation where the central bank has no instruments for stabilization, the government has to step in and cut back budgetary expenditure to create fiscal savings that are required to stabilize foreign exchange inflows. Therefore, once you have stabilized the economy, fiscal prudence is even more important, given the underdeveloped financial system.

I also want to emphasize the role which macroeconomic stability will play in mobilizing domestic savings, both for investment in general, but also to reduce the structural budget deficit, which most of our countries have, with revenue running persistently below expenditure. There follows the importance, having stabilized, of structural adjustment. The discussion about structural adjustment, which tends to regard it as not helping poverty reduction, is unfortunate in that it does not see that there cannot be sustainable poverty reduction unless there is durable economic growth that is broadly based. Structural adjustment is needed precisely because it shifts incentives to the production of tradeables and therefore stimulates the supply side of the economy.

In Uganda s case again, although Lipumba says that there is little evidence for success, there is no doubt that diversification of the agricultural sector has been brought about by the dramatic exchange rate adjustments and associated liberalization in both the domestic and external sector. Just a few years ago, in 1990, exports of coffee still constituted 90 percent of exports and that s when, following the collapse of world prices, the government decided to liberalize the coffee sector and intensify the exchange-rate adjustments. Because of the increase in producer prices that resulted, supply of nontraditional exports rose sharply, and at the beginning of the coffee boom last year, coffee was only 65 percent of exports and the rest was now in new exports of flowers, pyrethrum, vanilla, maize and fish, all of which were based on smallholder production, which cannot but helping reduce poverty.

Lastly, I want to emphasize how much I agree with Lipumba that poverty reduction cannot be sustained unless attention is paid to agriculture, particularly to remove the bias against agriculture that is inherent in most of our post-independence policies. The improvement of agricultural productivity will not only raise rural incomes, but more importantly will reduce the price of food as well as increasing demand for non-agricultural products, including industry. It is not the industrialization through import substitution that will reduce poverty or even dependence on imports; it is the advance in agricultural productivity as well as an increase in off-farm employment in rural areas that will underpin effective demand for industrialization.

I.G. Patel

I was happy that our friend from Uganda reminded all of us that nine-tenths of what happens in the poorer countries will depend on what they themselves do, rather than what we do through aid or anything else. I feel that sometimes the criticism of structural adjustment goes a little too far: as if, were not for that, somehow we would have found an answer to the problem of poverty. We have been trying for all these years and we haven t yet found a satisfactory answer; and the problems of sequencing are real but they re not that easy to solve. Take a simple example: unless you solve the budgetary problem, don t liberalize imports, otherwise you ll get into trouble. But when will we solve the budget problem totally? Shall we therefore never liberalize? One can argue that an extreme budget deficit should be tackled first, before you do something else, but I don t think one can wait to finish one job and then go on to the other.

I was painfully surprised when I heard someone say yesterday that Canadian non-governmental organizations believe that their support to Canadian aid or the Canadian support for multilateral organizations has been greatly compromised by Canada s support for structural adjustment. I hope it is not all that correct. It would be an example of a one-agenda kind of argument.

The real problem we have is that there are not only low-income countries but even by their standards there are extremely poor people. There is not an easy answer because, if you really want to make a difference to them, then you ve got to improve the productivity of the very poorest people in a sustainable way. That is: lot easy because they have nothing: they have no land, they have no particular inherited traditions or technology, and they have not much education. So how can they possibly achieve higher productivity? If they had a piece of land you could do something, but the majority in many of these countries are in debt or indentured. You need to take more difficult action, not market oriented, but through credit, through some training, through cooperative ventures that are some kind of informal sector support. These ventures are not easy, in a situation where you have population pressures that keep swelling the ranks of the very poor who become more vulnerable (because they are poor) to any disease and to any bad crop.

It s an extremely difficult problem and I think it has to be addressed in a direct manner, even if it comes to some extent through subsidization, what even Milton Friedman would call negative income transfers, done directly or indirectly. It is a problem that requires separate distributional action, and cannot just be left to market forces, and that has never been easy.

Given that, what can the financing institutions do to help? We know all about aid fatigue. The suggestion was made this morning that, if we can bring in sustainable development it might help to increase support for development; and I have elsewhere floated an idea to change the name of IDA and enlarge its functions into a new IDEA an International Development and Environmental Association but I don t think the two ideas are related. I don t think there is mileage in saying development and the prevention of environmental degradation in the poorer countries go side by side. I don t want environmental concerns to be confined to global environmental concerns. There are real environmental degradation problems in the poor countries which make the problem of poverty elimination much more difficult. Soils are becoming depleted, waters are getting polluted, the lack of sanitation and health facilities ruin the viability of many poor families. I think there may be some sense in not separating the two, but saying we have one idea IDEA as an agency that will do the trick.

There were other ideas of linking aid to more specific activities that concern the poor. There is much to be said for that. I don t particularly agree with [Emmanuel Tumusiime-Mutebile] when he makes the distinction between program aid and project aid. Aid has never made that much difference to what happens overall but, if you really want poverty eradication to be assisted by foreign aid, then I ll think that you ll have to accept that much of the concessional aid should go for specifically poor-related programs, maybe employment generation, maybe malnutrition being tackled through schools. Essentially, aid will be of a program-oriented nature, rather than a project-oriented nature. I m not in favour of saying that, unless you put 20 percent of your budget into social sectors, we won t give you money. That s useless. You will never implement it in your favorite countries, you will only make an excuse of it when you want to cut aid to a particular country. That's invariably the experience in anything you name in conditionality. But certainly there is legitimacy in saying that your aid should be directed to those activities which can at least be seen as benefiting the poorer strata of society.

Catherine Gwin suggested that low income should not be the only criterion for concessional aid and she mentioned China, but I suppose, five to 10 years on, India will also be mentioned. If we are keen on saying that voting power should change in accordance with the purchasing power parity calculations, then I think the per capita calculations will also need to be based on an adjustment for purchasing power parity. That will certainly make some difference in which countries qualify for IDA aid. Let the chips fall where they may, but I think that is legitimate, honest and equitable, and it should be done.

Something can be done, later if not today, by way of a bargain with certain countries. I mentioned India, but there are several — Pakistan, Sri Lanka — that may be in the same position. A bargain may be struck with them to say, "OK, we will write off your debts on the Paris Club provided you are willing to say we will not be eligible any more for government-to-government concessional aid." I'm not saying multilateral institutions because I don't think that can work, but at least governments will write off all your past debts. Maybe voluntary organizations and agencies that work at the people level will continue, but not based on annual negotiations and all that.

Multilateral associations could take the lead in saying that countries which may have many poor but also some technical competence might be required to set aside a part of the concessional aid counterpart funds for technical assistance to other developing countries. A large part of the needs of the very poor countries is going to be technical rather than financial in nature, a need to share experiences, opportunities for education and things of this sort. I don't see why this South-South cooperation can't be given a positive boost. Let's assume, for the sake of argument, that India's share in IDA should continue for whatever reason, but it can still be argued that India might contribute 2 percent extra on the interest charges (in rupees) and set it aside for technical assistance to sub-Saharan Africa.

There is a lot of experience in India today, which did not exist even 15 to 20 years ago, about what Indian and other voluntary organizations can do in terms of making a difference to the lives of ordinary people. I would hope that would be very much borne in mind.

John Lewis

I ll make a couple of points on long-term development. In the first place I don t mean this to be entirely facetious we tend to enshrine Keynes too much and bury Keynesianism too soon. There is a tendency to think that anything the great man said in his later years was the absolute truth, and I don t quite go along with that. On the other hand, I do not agree that Keynesianism as a practicing doctrine is all shot. There s a lot of it running around in the World Bank. There s a sort of pragmatic amalgam of monetarism and Keynesianism, and one reason for this impression is the extraordinary policy error, the sort of gargantuan error that was made [by the Reagan Administration] in 1981-82, which was so grossly to misalign fiscal policy as to inhibit what can be done with fiscal policy ever since. That has tended to cast a blight, but in fact it s very good to talk about employment again. There are central banks which certainly have been totally focused on inflation, but the Federal Reserve system in the United States, at least, has begun to show signs of recognizing dual objectives rather than the single one [of inflation], and I think this whole set of issues is back in play; and I hope it is in developing countries.

Secondly, on Africa we ve had a nice balance of presentations. I hear them as much more complementary than conflicting, and I cannot add wisdom to them. I do think it s worth noting that sub-Saharan Africa is not an unrelieved black hole. There s a good deal of life in particular national economies in Africa, there s a lot of variance; and it s well to keep that in mind and be encouraged by the good stories as well as focus on the bad.

I have said in another context that the structural adjustment thrust on the part of the World Bank in Africa has seemed farther out of its element than anywhere else. It was like a two-dimensional answer to a three-dimensional issue: it indeed tried to get prices and policies right, but there were issues of institutional capacity that were not addressed very effectively and even left unaddressed for a while. However, one thing I will say about the World Bank is that it is learning a lot of lessons and is repairing many of the oversimplifications that it was making 10 years ago.

It has seemed to me that the 50th year anniversary had a very unfortunate timing but there's no way the event can be avoided, and it's bound to come up in places like the G-7. My only cautionary, or conservative, note would be to recognize the need for a defensive strategy. If you ask a lot of bold questions about big reforms, you may get some very bad answers and they may be irreversible, or at least not quickly reversible answers. I would say lower your sights in terms of the scale of reforms that you're looking for. I say this about the Bank, essentially; I don't know nearly as much about the Fund.

I find Dr. Mohammed's paper impressive and interesting. It would be nice in a simpler world to have a recarved division of labour between the two institutions but there are reasons why that's not going to be feasible in the near future. In the case of the Bank, my premise is pretty much what I've heard today: we do really need an international public sector. We don't need to privatize everything. Markets are absolutely essential but they have to be bounded and disciplined and governed. At the same time, nation-state governments are not enough: they leave real gaps, they have narrow purposes. So the name of the game is to get these inadequate entities to do the better thing, if not the right thing.

You have in the World Bank something that is a big surprise in terms of what people thought back in 1944, and it is on the whole a pleasant surprise to have an institution with these characteristics.

One characteristic is that it seeks some degree of autonomy. It actually has people who have a mind of their own and there is a degree of willingness to cope with the problems at hand in an enlightened fashion. This of course has been true in the history of the Bank: Robert McNamara was always reaching for more autonomy. And the motivation as far as I can tell from reading a lot of documentation, is development-driven. These are people who are really concerned to promote development. They don't have a lot of bilateral diplomatic distractions close at hand. Next, the quality of personnel that has been assembled over a period of time has been, on the whole, very high, almost unparalleled. Again, it's a homogeneous work force. It has been considerably de-nationalized, you actually can't tell where a Bank person is from very clearly. They have achieved a degree of interchangeability as working and thinking parts. Finally, all of this is possible because it's a wonderful money-raising machine. The world stumbled onto a way to raise a lot of resources with an amount of leverage and, in the process, has run a program that makes good profits. And so you have a kind of ease of resource availability that has nurtured these other characteristics and also has supported a very lively almost, you might say, extravagant research program that has really been a public good, on a considerable scale.

Now, these characteristics and this asset have some unpopular and distasteful aspects. There s a tendency for it to produce a kind of arrogance and it s been over-centralized and there are other flaws. On the other hand, it has been learning a great deal in recent years. The Bank has been scared stiff in the last five years or so and has become somewhat more humble. It has seen there are things to do that can greatly improve the effect of its operations: it can decentralize more, and I would guess that s going to be one element in the future. It has seen that the kind of conditioning it was doing really became counterproductive when it was all hooked together, a whole set of policy targets under one loan, which therefore defeated the enforceability of anyone of them, really. So, I think it s seen now that structural adjustment is giving way to development again, but in a different mode than development was done previously.

There is an asset here that is not trivial which is important to see not frittered away by a lot of reformism that isn t going anywhere. What s been said about process is just fine. I would join Senator Allan MacEachen in arguing for incrementalism, and particularly as to governance, which is the sensitive part. You need to move money, that s another of my premises, through this mechanism [of the Bank]. I like I.G. Patel s notion of yardstick competition for non-concessional loans. But most of all, you need to get more concessional money than is now in sight, and here two points that have come up in today s discussion that are small steps, but may be of the order of what they should be thinking about in Halifax. One is this purchasing power parity shift. It s outrageous that this hasn t occurred some years ago, really, but if that were done it would make a significant difference in the way that people keep their goals and targets. And the other is the good old IDA. This really is the most constructive mode of transfer that s available to the low-income countries and it ought to be at the top rather than at the bottom of priority lists.

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Mohammad Sadli

This seminar is very important for the work I am involved in Indonesia. President Suharto is currently in the chair of the Non-Aligned Movement (NAM) and is responsible for the execution of the resolutions of the 1992 Jakarta Summit, including among others, the debt problem of the least developed countries. I am a member of a team of former economic ministers assisting President Suharto in this responsibility.

In March 1994 the chair of the NAM convened a conference in Jakarta which was attended by more than 20 finance, economic or planning ministers from the least developed and heavily indebted countries. The invited countries were mostly from sub-Saharan Africa, although we had also Cambodia, Myanmar and Bhutan. The ministers heard and agreed with the conclusions of the report of a group of experts, chaired by Gamani Corea, who have worked on this debt problem for more than a year. Among their findings, substantial debt relief was recommended, and no group of creditors should be exempted. This means that the Bretton Woods institutions should be included, and here lies the problem. Everybody agrees on the gravity of the debt problem but not on the solutions.

It should be recognized that until now, on a cash basis, low-income and heavily indebted countries are still provided with positive aid flows. Debt owed by 41 of such countries to the international financial institutions (IFIs) is also not the highest, on average about 25 percent of their total debt. This figure stands at more than 50 percent for official bilateral debt, but the creditor countries have extended increasingly substantial debt reduction and have made new aid available, so that such flows help offset debt-service payments to the multilateral institutions.

One can question the sustainability of such recycling. In a period of aid fatigue and budgetary constraints in the traditional creditor countries, sooner or later this recycling of new aid to the IFIs will draw the attention of governments and the public. The communiqué of the Development Committee of the World Bank/IMF, dated April 27, 1995, expressed concern about the prospect of a fall in total official development assistance, but stops there.

Finance ministers and their staffs of the G-7 countries have been willing to go along with the argument that the rules of the IMF and the World Bank should not be tampered with. The World Bank s triple-A credit rating in the financial markets should be firmly upheld and cancellation of bad debts will send the wrong signals to these markets. When I have visited World Bank headquarters in Washington, top officials have tried to impress me with the argument that, if the World Bank borrowings in the financial markets do not carry the most favoured rate of interest because its ratings have been tarnished, the consequent increase in lending rates to countries that have been performing well like Indonesia might go up a notch. This will cost the country hundreds of millions of dollars of extra debt servicing of the new credits (Indonesia gets more than a billion dollars of new loans a year). That is the moral hazard of which all developing countries should be aware.

Even if this rating argument does not sound too convincing its validity should be tested against what happened in the aftermath of the Latin American debt crisis the fact that finance ministers of the G-7 and other GECD countries are buying this argument in a way forecloses the case. A small grumble from finance officials of Indonesia, however, is that at one time the country had to accept an 11 percent per year rate of interest on an IBRD loan, and that did not feel very preferential. Borrowing rates in the financial markets are not the only determinants of World Bank lending rates to developing member countries. High overhead and other costs are also playing a role.

Although the IMF does not borrow from the capital market, the rules for repayments are considered sacrosanct even though in a number of cases these have caused outward net transfers from those heavily indebted and least developed countries. I have noticed in my conversations with foreign affairs and aid agency officials occasional signs of unease with the general proposition of the recycling to the IFIs, but no word of concrete or better alternatives. No part of officialdom wants to rock the boat.

In a way, it can be argued that the present status quo is optimal and also in the interest of the recipient countries, because under the circumstances it may maximize the total gross aid flows. In other words, as long as finance ministers buy the arguments of the IFIs, they have to continue making available gross flows to those countries to produce net aid inflows. To say that with multilateral debt reduction the net aid flows will increase contains a ceteris paribus condition which in practice may be questionable. Let us imagine that the IFIs consent to debt reduction or cancellation. To keep up the present net flows, the bilaterals do not need to pump the same amount of money as now. In an environment of aid fatigue and budgetary restraints new bilateral flows might go down. Especially if the IMF comes to the conclusion that, for the time being, until the recipient countries show better fiscal and development performance, the current net flows are enough to support the structural adjustment programs and to keep those countries lean and hungry .

But for selected countries which the international community really wants to help over the development hump, a reduction of IFI debt should be considered.

Another argument, related to moral hazard, is that debt cancellation, for instance for sub-Saharan countries, is unfair to other developing countries, such as Indonesia, which has gone through much effort and pain to make sure that increased output and exports will make debt-service payments feasible and bearable. If the principle is accepted that the debts of the sub-Saharan countries can be written off, why should Indonesia, with a debt stock of three-quarters of its national income and 30 percent annual debt-service payments, not have the same right? This is of course apart from whether a country like Indonesia would desperately want such relief, knowing that it jeopardized the flow of new commercial credits needed by its burgeoning private sector. This comparison with Indonesia, however, underlines the fact that such a policy should not be a general rule and should be applied as some kind of last-resort solution or with special consideration for very specific cases, that is, considered as a good investment in the future of a country. In 1970 the Japanese prime minister managed to change a law in his country solely to help Indonesia in an exiting program . Twenty-five years later I think it has been a good investment.

The World Bank also seems to think that, once it accepts and executes debt stock reduction, for the very poor countries in sub-Saharan Africa, there is no guarantee that sooner or later lower-middle-income countries, in other parts of the world, will not line up. Such a move (the Bank thinks) may erode the basis of discipline in the multilateral lending institutions. On the other hand, the resolution of the debt problem of Latin America, based on write-offs, is regarded as benefiting all parties. May I quote here a line of a recent commentary by Rudiger Dornbusch: By the late 1980s, Brady debt deals were in place that accepted as a fact that Latin America could not service its debts. And literally within days, more money poured in than had just been written off. Easy money around the world was one reason for the plentiful supply to Latin America. Economic reform was the other. Of course I do realize that Africa should not be compared to Latin America, but for single countries, such as Nigeria, Kenya, Ghana and Côte d Ivoire, it may be applicable.

Bad debts with private and government banks are now also plaguing a number of developing countries. In the end, the solution consists in write-offs and consolidation, with government help and often at some sacrifice to taxpayers. Hence, the burden of bad debts is not solely put on the shoulders of the debtors. The banks have also to bear some guilt for having pushed credit down the throats of their clients in boom years. There was a period in the history of the World Bank when success was measured by the amount of project lending to developing member countries. Why should poor countries always have to pay for the development follies of the IFIs?

When I made the rounds of the capital cities of the G-7 countries and talked to aid officials and to officials in foreign affairs and occasionally in the ministry of finance, the following typical reactions can be related. Practically everybody recognizes that gravity of the debt problem and there is no dearth of sympathy for the plight of the African nations. One hears frequently that Africa is a sinking continent, marginalized and forgotten. Such a sentiment was again reflected in some observations at the annual World Economic Forum in Davos. Nevertheless the same prominent Forum invited celebrities from Africa.

Japan insists that its ODA-related debt stock in sub-Saharan Africa is not yet very large but finance officials warn that, once Japan writes off a debt because of the recipient country s inability to repay, new flows will not be forthcoming. Japan thinks like a banker. On the other hand, Japan is willing to shoulder additional international obligations with respect to Africa. Witness the holding of a large, ministerial-level conference in October 1993 in Tokyo, the so-called Tokyo International Conference on African Development (TICAD), although the host ministers at the time stressed that the conference was not a pledging event.

European donor countries pride themselves that their aid to Africa is continuing, although privately some aid administrators confess that they still do not see much hope of the continent recovering. A senior finance ministry official from a major G-7 country confided to me that debt forgiveness is an inexpensive means of aid and therefore politically popular, but there are formidable administrative and legal obstacles when it comes to implementation. It requires the political support of national leaders, and the decision of the G-7 economic summit in Naples was helpful. Africa can still count on a huge reservoir of goodwill in the world but donors are waiting for hard evidence that the recipients of their support will put their own house in order and help themselves first.

The trouble is that most of these least developed and heavily indebted countries, especially in sub-Saharan Africa, still have not come out of the development trap. The typical growth rate of the economy is less than 3 percent per year while the population growth rate is around the same percentage figure. Hence, they are at best stagnant economies at low levels of income and low stages of development. At the moment that is the general picture in sub-Saharan Africa, but there are exceptions and one should focus on those countries that emanate rays of hope rather than be mesmerized by dismal statistics of burdens and performances for all countries together. Apart from Botswana and Zimbabwe, there is an honour list of a small number of performing countries, such as Ghana and Uganda. It is a pity that this list is still short. Outside Ghana and Uganda, one is not very certain but would like to include Kenya, Zambia, Tanzania, Côte d Ivoire and Senegal, while very poor countries such as Ethiopia and Mozambique are making great efforts to overcome the damage of long periods of civil war and deserve recognition, sympathy and support. Even for Uganda and Ghana, one should not forget that they also suffered a decade or two of difficult and turbulent periods of nation building.

As somebody coming from Indonesia, I would also like to note that my country suffered the same ordeal in the first two decades of independence since 1945. We suffered from everything: political instability during experiments with west European parliamentary systems; occasional coup attempts; rebellion from militant religious groups; outright civil war; threats of communist take-over; economic neglect and decline of industrial production because of wholesale nationalization; and finally, runaway inflation. In the late 1960s, nobody could know how long or whether the new military-backed government of General Suharto would survive. Now, more happily, the country is thrown into the basket of Asian miracles.

The Non-Aligned Movement supports proposals, already aired in other circles, that can augment the aid flows to the poor countries to their concessionality, such as proceeds from the sale of IMF gold, new SDR allocations and utilization of the World Bank s accumulated profits. Some of these proposals were repeated at the last Bank and Fund meeting in Madrid, but there is still resistance from G-7 countries for some of them. As long as the bilateral donors are still willing to continue present aid flows, perhaps marginally augmenting them, other solutions have to wait in the wings. That is why the more important thing is to amplify the motivations to continue helping the economic and social development of sub-Saharan Africa and to increase the number of success stories , that is the Ghanas and the Ugandas, and perhaps helping a few candidates with exceptional measures to get over the development hump.

Apart from more categories of debt applicable for reduction and rescheduling, the Non-Aligned Movement also argues for an exiting program for deserving countries. Indonesia received such treatment in 1970, but it was stated as an exceptional case. If exiting still should be like that, at least state the conditions in more transparent terms. If one of the conditions is good performance under the structural adjustment program, then such performing countries could look forward to graduating out of the short leash of having to go to the Paris Club every year, occupying the precious time of ministers and their staff.

In conclusion, permit me to quote what a representative minister from the Southeast Asian group remarked in the recent IMF Interim Committee meeting in Washington. He said: For the low-income and heavily indebted countries, a comprehensive and lasting solution to the debt burden of the poorer debtor countries is essential to the restoration of economic growth. We therefore support the proposal to include multilateral debt in debt alleviation and debt rescheduling, including the recent initiative to make ESAF (the Enhanced Structural Adjustment Facility) a self-financing facility to deal with the protected nature of the debt and external payments problem of the poorest debtor countries. This would send a strong signal to the international community that the Fund is taking a balanced stance in the light of recent developments where a few large loans now account for a significant share of the use of Fund resources.

Finally, let me not forget to mention the recent activities to help African countries gain more insight and self-confidence in their restructuring and reforming policies, that is, to look at and share experiences with the East and Southeast Asian countries It started with the World Bank publication on the Asian Miracle. It was taken up at the Tokyo conference in 1993 and followed up at a technical level by the Asia-Africa Forum in Bandung, Indonesia, in December 1994, under the auspices of the Japanese government, the United Nations and UNDP, and hosted by the Indonesian government. More follow-ups at specific operational levels are planned. The Economic Development Institute of the World Bank and the finance ministry of the Japanese government also have similar programs. At the NGO level there are other activities of a similar nature, like those sponsored by the International Center of Economic Growth, the Global Coalition for Africa, the African Economic Research Consortium (AERC), the African Capacity Building Foundation, and the East and Southern African Initiative on Debt and Reserve Management (ESAIDARM). Two European-based NGOs (Fondan and Eurodad) have mounted an active research advocacy movement of debt relief. My group in Jakarta is interacting with all of them.

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Discussion

There was an hour-long discussion period after the two papers and the four respondents, and some participants took advantage of having the floor (or the microphone) to comment on topics covered earlier in the day. So the record cannot be limited entirely to the subject of the session. The best summary may be drawn from the remarks of the chair, **Professor Gerald Helleiner,** at the end of the session. He said he had sensed consensus on five points:

- There was a deep concern with the *apparent decline in resources* available for long-term development.
- There was a need for new ways of thinking at the policy level about how to use the now limited resources. In *setting priorities,* however, there were differing suggestions about either concentrating on the best performers, directing the resources on a functional basis, focusing on humanitarian objectives or alternatively on growth.
- The long-standing argument about *the role of debt relief* had been affected by this decline in gross flows of aid, and as a result discussions about the Paris Club procedures and the inadequacy of the Naples terms needed to be thought through afresh.
- Again, the decline in traditional aid budgets was forcing consideration of new *money machines,* whether these be user charges for the global commons or innovative forms of global taxes. However long it took to have them in place, these proposals should be put on the agenda of policy makers at once.
- Finally, the ultimate responsibility for performance had to rest with the *recipient countries* themselves, in terms of macroeconomic stability, their own savings rates and their domestic policies generally. The sources of external finance, therefore, needed to recognize their role as encouraging a longer-term approach oriented to capacity building, with less focus on immediate targets of macroeconomic performance. (In

these words, Helleiner covered the frequent references to structural adjustment programs.)

Setting Priorities with Less Funds

Now, to turn back to the comments of individuals:

Johannes Linn, of the World Bank, said he believed the papers and responses showed there was broad agreement on the appropriate strategy to pursue in Africa under very difficult circumstances to reach the goal of sustainable development growth and poverty reduction . The agreed strategy combined macroeconomic stability with investments in infrastructure and human resource development, and he thought they had moved beyond the argument over the merits of structural adjustment to a debate on how to implement these reforms. He also claimed that southern NGOs and the Bank were finding common ground about the replenishment and future role of IDA, including its help over multilateral debt, which he said was a potential problem in a few countries not a large number.

The Executive Director for Canada at the World Bank, **Leonard Good**, took up Linn s claim that the debate on structural adjustment was past history now and argued that, to the extent that people still have problems with the cookie cutter economic model that the Fund and the Bank use , one should address this problem, which extended from structural adjustment along to investment projects. He hoped there could be changes that permitted loans to be more effective, and he commended I.G. Patel s suggestion that NGOs could be used as both a means for better delivery of loans and a way of achieving ownership in the recipient country. He also thought Mr. Patel s suggestion of a two to three-year process for planning and making changes to the IFIs a critically important idea for the way ahead.

It was **Catherine Gwin** who introduced the point about setting priorities for concessional funds. We simply cannot be satisfied with letting the air go out of the current ODA balloon. There are an increasing number of countries and an increasing number of problems. Tough choices have to be made.

She went on to caution against the analogy, suggested by Frances Stewart, of the Uruguay Round for a world conference on all the issues of global governance. Trade negotiations were different in several respects. They operated on the bicycle theory that, if you didn t keep moving on liberalization, you would fall over. Second, the Uruguay Round was sector ally specific, focusing on the single subject of trade; and that led governments to be engaged in every sense. Finally, all groups had a sense of what they wanted to get out of trade negotiations, and formed themselves into coalitions of special interests (like the Cairns group on agriculture) rather than automatic blocs. She thought it would be more effective to break down the issues of global governance into various parts, rather than wrap them all up in a single process. **Frances Stewart** responded to this by saying there were equally constituencies for international monetary reform as there was for trade, constituencies to do something about commodities or the instability caused by capital movements. If we put the issue together, we could have some sort of trade-off, and perhaps some movement.

Structural Adjustment A Mixed Record

Structural adjustment came to center stage with the intervention of **Steven Langdon**, a former New Democratic Party MP and economist who had recently carried out a consultancy project in Ghana. He said officials and academics in African countries had harsher comments on structural adjustment than anything heard from northern NGOs or at this seminar. In particular, the failure of the experiment could be judged from so-called success stories like Ghana, whose 2 percent per capita growth in six out of nine years was meager by the standards of East Asia. He pointed to the stagnant agricultural sector, the imbalances between regions and the rising rate of infant mortality in Ghana, all indices of increased poverty that had matched the period of structural adjustment. (The chair, **Gerald Helleiner**, later commented that he would take these comments as the reply that Dr. Lipumba might have made, had he got his visa in time and been able to be present.)

Francisco Sagasti observed that the definition of development surviving from the 1940s, that developing countries could achieve within a generation the standard of living of industrialized countries through a process of social engineering, is no longer workable. We had to accept that not all problems have short- and medium-term solutions. We had better keep a long-term perspective, or we may end up doing more harm by trying to solve things quickly. As an example, he cited the efforts in his own country, Peru, by President Alan Garcia in 1985-86 to find an alternative to structural adjustment: It bankrupted us. It really wrecked the country completely. It destroyed institutions. This experience had made him more conservative, leading him to ask where have alternatives worked, before dismissing structural adjustment.

Frances Stewart said she had tried to avoid talking about structural adjustment for one day, but the subject was a compelling one! She had surveyed 23 different studies looking at the effects of structural adjustment programs, and the outcome appeared to be that they had some positive effect on balance-of-payments, very little effect on growth or on inflation, a negative effect on investment and probably a negative effect on education. So, on balance, they had not had all that much effect, and not all that positive effect, but not all that much to get excited about, either.

Even later in the discussion **Professor John Loxley** reverted to the debate on structural adjustment, arguing that the seminar should be promoting at the very minimum the local design of structural adjustment programs. The World Bank had not backed away from placing a whole pile of requirements on countries. In order to reduce the Bank s disproportionate influence over development thinking , they ought to be promoting not only more local input into the design of programs, but also be strengthening the regional development banks, especially the African Development Bank, and building up the capacity of their staff to join in this debate. The regional banks could provide a diversity of viewpoints; they were closer to the action; and one hopes they could be made more accountable.

From this base Langdon argued that the drive for institutional change was too urgent to be simply set in the context of a G-7 summit meeting. He thought the UN Security Council should hold several sessions each year on economic and social issues, which would give more overall world-based legitimacy to initiatives than the G-7 could offer. He further supported Francisco Sagasti s idea of breaking the World Bank down into functional units, and thought the IDA itself could in the process be restructured with more participation from developing countries.

New Money-machines

Keith Bezanson, IDRC President, combined the worrisome issue of adequate funding for the international public sector with new mechanisms for the orderly mediation of the global market. Even if the burden-sharing formula in IDA were altered, he said, it would mean little because all donors were in retreat. It was urgent to put proposals for alternative funding mechanisms on the table, whether they are called payments or taxation. The World Bank had worked almost miraculously as a money machine, and a new money machine was now needed. He thought it unfortunate that the Tobin tax was used as a proxy for various other proposals, because he did not consider the Tobin tax workable, and a range of other schemes should engage intellectual attention while political space existed for them. John Loxley disagreed, saying there was a strong argument for the validity of a Tobin kind of tax in improving the management of the industrialized economies; and he would link it to aid. As for existing mechanisms, he would also push for increasing the automatic stabilizers in the IMF the compensatory and contingency financing facilities and look again at their degree of concessionality. He also pointed out that part of the reason for the World Bank s success as a money-making machine was because governments had given it first priority in terms of loan repayments.

Other participants spoke about sources of automatic finance. Steven Langdon suggested it was worth exploring a number of sources, including very small taxes on international capital movements, on international air travel and on international use of the Internet which is a public good that is used freely . Francisco Sagasti thought that a new sort of money machine was particularly important as a source for concessional assistance, and insisted that part of its proceeds should go to debt relief beyond Naples terms. If you cannot provide additional concessional resources, at least lessen the burden of servicing the old loans. He believed the present time was a plastic moment when almost anything can happen and one should use this opportunity to put some of even the most crazy ideas on the table. **Cristián Ossa** poured some doubt on the importance of increased debt reduction. Significant debt reduction for many African countries since the late 1980s had not increased the net flow of resources, as the Japanese approach had shown. It might bring benefits in improving the balance sheet of African countries and thus encouraging the flow of private funds. On the whole, he preferred the approach of assisting low-income countries with grants instead of soft loans.

Late in the day, there was renewed debate about the effect of aid. Frances Stewart said that, while some people were romantic about aid, realistically it was difficult to find studies showing aid as having very positive effects, so I don t think we should be too upset about this aid stagnation . Instead, one should think about what to do with much less aid. She would put much more into an emergency fund, to deal swiftly with various human-made and natural disasters for rescue and reconstruction. (A sad side effect of the Uruguay Round had been the elimination of food surpluses, vital in such emergencies.) The rest she would keep for innovative programs not otherwise adequately financed, such as the Grameen Bank or UNICEF s immunization campaign, and for debt relief and not mind too much about the regular cycle of aid.

Caroline Pestieau of IDRC put an opposing view. She said that aid now going into servicing debt or into humanitarian assistance was not particularly useful in promoting development and she was tempted to say there was too much humanitarian and emergency aid. The people at Halifax should realize that there was actually very little long-term development financing around; whether they were prepared to do anything to guarantee regular financing was another matter. She also raised the question whether the loan portfolio of the World Bank would change dramatically, since many former borrowing countries now raised money in the private sector. Was it going to compete in the private sector, or see its role as supplying loans to those who cannot raise them elsewhere?

Cristián Ossa added the observation that, while OOA was virtually stagnant if not in decline, for the new operations of the United Nations in peacemaking, peacebuilding and peacekeeping the related resources for humanitarian and economic interventions had increased tremendously and indeed were now about three times the regular budget of the United Nations. He said: When the need is there, the international community is really eager to help. Finally, **Mohammed Sadli** spoke about the prospects for increased financing from Japan. Indonesia was indifferent whether Japan continued to provide most of its assistance multilaterally or bilaterally. Japan contributed about $1.3 billion a year bilaterally to Indonesia, a notch below the World Bank, but it helped Indonesia escape the dominance of the World Bank.

Five Principles and Public Opinion

Tim Draimin, of the Canadian Council for International Co-operation, returning to the issue of governance, drew from the day s discussion a set of five principles. These were: that governance should be participatory, both between North and South and also drawing in the civil society that is represented by private enterprise and the voluntary sector. Three further principles were of transparency (often mentioned during discussion), accountability, and a cluster of attributes linking reciprocity, equity and symmetry. Lastly, there was the principle that governance of these institutions should maintain a focus on people, in particular poor people.

On accountability, he pointed to the importance of better monitoring of the system. Since the institutions did not monitor themselves well, he saw a role for academics and voluntary organizations, perhaps in organizing an annual meeting ahead of the G-7 summit and in building some kind of Internet conference that would provide research and monitoring on a year-round basis. Much of the day s discussion had focused on the mechanics of the system, and less on its impact on people; he thought it was the responsibility of a group like the present one to make links between events such as the peso crisis and what it meant for people around the world. This was necessary in order to build up informed public opinion that might help bring about change and create pressure to make the political will more positive .

In short comments on Draimin s remarks, **Jean-François Tardif**, of the non-governmental organization Results Canada, stressed the importance of marketing to the taxpayers of the North the worth of development funding. His organization had found the best way to do this was by a series of simple steps, measuring the verifiable results of development by such social indicators as literacy rates and baby deaths. He also thought that earmarking specific amounts of development funds for various basic human needs such as primary health care, and then demonstrating results, would help in this marketing to taxpayers.

Johannes Linn warned that there were real costs of managing (especially at the country level) little pots of money for certain types of projects . However, he agreed that it had public relations value, and the Bank was, he said, trying to be more proactive through a lively outreach to its constituents and stakeholders in the North. On that positive note the final discussion session closed.

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