NEW PATTERNS OF
MACRO-ECONOMIC GOVERNANCE

by

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Part I

1 This part has been mainly prepared by Hans Singer
1. THE KEYNESIAN VISION

Never Again

When Keynes set to work in 1940/41, at the time of a desperate fight for survival of democracy, to draft the documents which would become basic inputs to the Bretton Woods Conference held in 1944, his objectives can best be understood as negative - in the sense of negating the experience of the Great Depression of the 1930s. The overarching principle was: 'Never again!' - never again anything like the 1930s. Then there was heavy unemployment - so the new objective must be full employment as a top priority (and Keynes had shown in 1936 in his famous General Theory of Employment, Interest and Money what the instruments of a full employment strategy should be). In the 1930s there had been a breakdown of internationally agreed trade and investment rules - so the new objective was to prevent beggar-my-neighbour policies and manage the world economy according to agreed rules. The 1930s had seen first futile attempts to maintain the gold standard, then its collapse and competitive currency devaluations - so the new objective was to have stable currencies with agreed adjustment procedures. The 1930s had been a period of deflation - so the new objective was expansionary macro-economic policies. The 1930s had seen a collapse in commodity prices - the new objective was to stabilise and maintain commodity prices. The 1930s had been a period of rising protectionism, and narrowly national scrambles to achieve self-sufficiency and balance of payments surpluses - so the new objective was to move towards liberal and agreed rules for expanding world trade and to support countries in balance of payments deficit. Above all, the 1930s had seen the withering away of the League of Nations - so the need was to build a new and stronger United Nations to provide the political and social security indispensable for an expanding world economy.

All these objectives were interrelated in Keynes' coherent vision of a better and sustainable world system. For example, the provision of adequate liquidity and the discouragement of trade surpluses also served the objective of full employment: a country in balance of trade deficit helps to produce the public good of full employment since it creates excess demand for goods from the rest of the world. By the same token, the surplus country is the enemy of the world economy in that its failure to import sufficiently reduces employment in the rest of the world; hence, the importance of proper liquidity in the world system and an appropriate recycling of surpluses.

However, of all these objectives that of full employment was the top priority. An expanding economy with full employment of productive resources, especially human resources, would be the rising tide which would 'lift all boats'. Anticipating some of the following discussion, we
may at this point reflect that the objective of full employment has certainly a more human face and a more direct relation to human security than control of inflation which was to take its place as a top priority in later years. This connection was clearly in the minds of the founders of the United Nations: the US Secretary of State, in his Report to the President on the 1945 San Francisco Conference stated: 'No provisions that can be written into the Charter will enable the Security Council to make the world secure from war if men and women have no security in their homes and their jobs.'

Keynes was deeply influenced by the Beveridge Report which was published in the same year, 1942, as his own 'Memoranda' crystallizing his thinking and basic proposals for Bretton Woods. The Beveridge Report embodied the objective of a social welfare state on a national basis (for the UK), but the principle of social security, with safety nets, protection of vulnerable groups on and income transfers to the poor, was readily transferable to an international dimension. Keynes had collaborated in the preparation of the Beveridge Report and was an enthusiastic supporter.

Thus the key elements of the Keynesian vision were: global macro-economic management by established and agreed institutions with growth, full employment and avoidance of deflation as top priorities; prevention of beggar-my-neighbour policies and encouragement of international co-operation to the common advantage; achievement of greater equality, social security and protection of vulnerable groups, both within countries and internationally across countries.

It is a matter of historical significance that the new post-war international order was established not as a unified process but in two separate steps. The first step was the creation of the Bretton Woods system, with the Bretton Woods Conference of 1944 as its landmark. The second step, a year or so later, was the creation of the United Nations, with the 1945 San Francisco Conference as the landmark. Both the fact that the two systems were created by separate processes, and also the fact that the Bretton Woods system preceded the UN system, are important and created a number of subsequent problems.¹

**The Bretton Woods Tripod**

Taking the Bretton Woods system first, the structure envisioned was that of a tripod resting on three legs. In 1942, still at a critical stage in the war, Keynes had produced three famous memoranda respectively on an International Clearing Union, an International Investment Fund and on International Buffer Stocks for Commodities. These three sets of proposals ultimately crystallised in three institutions: the IMF, the IBRD or World Bank and GATT (replacing the

¹ See the subsequent section on 'The Bretton Woods System and the UN System'
stillborn ITO). However, in this process of institutionalisation the original proposals were heavily watered down and in some respects distorted.

(a) The IMF
The IMF was initially envisaged by Keynes as a world central bank, issuing its own reserve currency, or 'bancors'. (The World Bank was envisaged as an investment fund - hence the statement that the Fund should have been a bank and the Bank should have been a fund.) It was to be a powerful institution with resources equal to one half of world imports - under present circumstances this would have meant a Fund of $2 trillion (2 million million dollars!). The Fund was supposed to put strong adjustment pressures on the surplus countries which threatened the rest of the world with deflation and unemployment and shift general liquidity to the deficit countries which helped to maintain full employment and expansion in the rest of the world. For this purpose Keynes proposed penal action against surplus countries in the form of a tax (negative rate of interest) of 1\% a month on outstanding trade surpluses. One need only list these elements of the original vision to see to what extent reality has diverged from it. Some of these divergences, e.g. the failure to create sufficient liquidity in the form of SDRs or the asymmetrical pressure on deficit countries rather than on surplus countries are now the starting point of reform proposals. Above all, the objective of fixed exchange rates which was at the heart of the original proposals was abandoned in 1971 and we now have a regime of effectively floating exchange rates and widespread currency instability.

In the process of shifting the weight of its pressures to the poorer deficit countries depending on its support, the IMF also became an influence in the direction of monetarist, deflationary and restrictive policies with control of inflation, expansion of exports and debt servicing as primary objectives, rather than the full employment maintenance of import capacity and avoidance of debt burdens in the original vision.

(b) The World Bank
The investment fund - which became the World Bank - was supposed to do the major recycling of capital from capital-surplus countries to poorer capital-deficit countries. This was based on the optimistic assumption that the marginal efficiency of capital in capital-scarce countries must be very high compared with the capital-rich countries; hence there would be a large reservoir of highly profitable projects in what we now call the developing countries and a natural incentive for capital to flow in their direction. It was only a question of identifying and designing these projects and creating the institutional framework for organising the flow by borrowing in the rich countries and lending to the poor. Repayment would be assured by the
high profitability of the projects. This would be sufficient to reduce poverty and implement the international aspect of the Beveridge concept of social security.

The role of the World Bank was to be clearly distinct from that of the IMF. The IMF was a monetary institution with an emphasis on short-term equilibrium, the demand side of the economy, and programme lending; by contrast the World Bank was to be a development institution with emphasis on the long-term, the supply side of the economy, and project lending. While this distinction seemed clear-cut in the initial conception, subsequent developments have eroded it. In the case of the World Bank, the limitation to project lending proved to be difficult to reconcile with its envisioned big role in development. This was partly because of the labour-intensive and time-intensive process of identifying, designing, implementing and monitoring of projects, and partly because it became increasingly clear that the success of projects depended not so much on the quality of the project as on the economic policy environment in which the project had to operate (which was supposed to be the sphere of operations of the IMF). Moreover, contrary to the initial optimistic assumptions, it turned out that in the poorer countries there were not sufficient projects which were profitable at non-concessional rates of interest and generated resources sufficient to service the loans. Hence the World Bank (like the IMF) was driven towards offering concessional facilities and beginning to operate as an aid organisation.

As a result of having to deal with the debt crisis and other harmful external impacts on developing countries during the 'lost decade', the World Bank in its structural adjustment programmes was also moving from long-term lending to medium-term lending, while the Fund with its own structural facilities was moving from short-term lending to medium-term lending. Thus there was an increasing 'grey area' of medium-term policy-based programme lending in which the division of functions between the Bank and the Fund was far from clear.

The debt crisis and its move into structural adjustment lending also meant that the Bank (as well as the Fund) took on the role of debt custodian. The original intention, by contrast, had been that the Bank (and Fund) should be the custodians of an international order in which the debt crisis would not have arisen in the first place.

(c) The ITO/GATT

The third leg of the tripod of the Bretton Woods system was supposed to be the International Trade Organisation. Although this was not negotiated at Bretton Woods but three years later at Havana (1947-48), its establishment was already confidently anticipated at Bretton Woods and the Terms of Agreement of the IMF and World Bank were drafted on this assumption. In Keynes's vision, the ITO was an essential part of the Bretton Woods system. Among its
essential features was included the negotiation of commodity agreements - Keynes for many years had been a strong believer in the need for stabilisation of commodity prices. As negotiated in Havana, the charter of the ITO included chapters on: Purposes and Objectives, Employment and Economic Activity, Economic Development and Reconstruction, Commercial Policy, Restrictive Business Practices, Intergovernmental Commodity Agreements, Institutional Aspects of an ITO, the Settlement of Differences and General Provisions. The far-reaching scope of the ITO - much beyond the scope of the present GATT - will be evident from this list. Apart from commodity agreements, it included employment, restrictive business practices, economic development, and it also provided for a close relationship with the United Nations (which by that time had been established). Among its purposes was also 'to encourage the international flow of capital for productive investment' and improvement of labour standards where the ITO was expected to work closely with the ILO. In commodity agreements, the ITO was to secure 'such prices as are fair to consumer and provide a reasonable return to producers'. It is clear that the ITO, if established, would have been a very powerful organisation, even overshadowing the IMF and World Bank.

In the event, the ITO was never established. It lapsed in 1951 when it became clear to the US administration that the US Congress would not ratify the Charter as negotiated in Havana. Here is a clear gap in the system as envisaged at Bretton Woods. By the time that it was clear that there would be no ITO Keynes was dead. He had left Bretton Woods - like everybody else - in the firm belief that the ITO would be established. It is an open question whether he would have been satisfied with the outcome of Bretton Woods if he had known that there would be no ITO.

Pending the ratification of the ITO, in 1947 a 'Protocol of Provisional Application' was adopted - the present General Agreement on Tariffs and Trade (GATT). This provisional arrangement has now lasted for 46 years - rien ne dure que le provisoir! GATT clearly covers only a part of the functions of the ITO. Moreover it is not an institution like the IMF or World Bank defining and implementing precise norms, but it is in the nature of a negotiating or consulting mechanism engaging in a number of 'rounds' of negotiations aiming at trade liberalisation. There is however a proposal now on the table in the Draft Final Act of the current Uruguay Round to establish a full organisation (a Multilateral Trade Organisation or MTO). This proposal, like the Uruguay Round itself, is however still in the balance at the time of writing. Even if the MTO is successfully established, it would have much narrower functions than the ITO. Moreover, in a significant shift illustrating the difference between 1947 and 1993, the MTO would not be linked with the UN as the ITO was supposed to be but with the Bank and the Fund.
Apart from filling part of the gap created by the non-ratification of the ITO with GATT, in 1964 UNCTAD was established which also took up some of the ideas behind the original ITO Charter, i.e. in its integrated programme for commodities. But UNCTAD remained a forum for discussion and formulation of new ideas. It remained an integral part of the UN and was not a separate institution. The present situation can only be understood against the background of history, with the rest of the ITO agenda - insofar as it did not go to GATT - scattered over the rest of the UN system. The subsequent discussion of restructuring the system will have to concentrate on GATT and the proposed MTO.

(d) The United Nations: Global Governance

The ITO is not the only gap compared with the original vision. Although at the time of Bretton Woods the United Nations did not yet formally exist, it was already on the horizon and it was clearly envisioned as being the locus of global macroeconomic governance. The need for such a locus was inherent in the 'never again' approach to avoid the unemployment and other disasters of the 1930s. The UN was considered the obvious place for global governance because avoidance of the events of the 1930s was seen by everybody concerned at the time as crucial for the maintenance of peace and avoidance of war. The organs for global economic governance were defined the year after Bretton Woods - in 1945 - when the UN Charter was agreed as being the UN General Assembly and the Economic and Social Council (ECOSOC). The UN was also to be equipped with a fund for aid to developing countries - a little later the Marshall Plan served as a precedent.

In the event, this did not materialise for reasons discussed in the section on The Bretton Woods Institutions and the UN. The UN was limited to technical assistance and food aid, while multilateral financial aid was allocated to the World Bank (and to a minor extent the IMF). The function of global governance went partly to the Bretton Woods institutions and partly outside the UN system altogether to the G-5 or G-7 and the OECD. Thus the Bretton Woods system - apart from being incomplete due to the lack of the ITO - also in the event lacked the envisioned essential fourth leg of global governance in the UN. In addition to being incomplete, the system also operated in a way quite unforeseen in the original vision and in some ways heavily distorted away from it. Today we are seeing a need to restructure the system. The original vision is still valid in indicating to us directions which restructuring should take.
Did the Keynesian Vision have a Human Face?

The answer to this question - comparing the Keynesian vision with the present reality - is yes and no. Let us take the 'yes' first.

As emphasised in the preceding part of this paper, the guiding star of the Keynesian vision was: 'Never again!', i.e. by all means avoid the miseries of the Great Depression of the 1930s. These miseries were not only economic but human miseries, in the form of heavy unemployment, social insecurity, starvation wages and a heavy incidence of poverty. Avoiding a repetition of this traumatic experience was therefore conceived as a humanitarian as much as an economic necessity.

The establishment of full employment - abolition of unemployment except for an inevitable minimum - as a dominant objective was in itself a human and social orientation, relating to job security as well as participation and avoidance of social marginalisation. The objective of full employment is certainly more closely directed towards human resource-oriented development than the objective of control of inflation and avoiding balance-of-payments deficits which has presently largely replaced it.

The expansion of productive employment which was the main Keynesian objective is today recognised as one of the three core themes of the World Social Summit, in addition to poverty reduction and enhancement of social integration. Full employment is also closely interrelated with these other two objectives. The unemployed and their families are being integrated into the social fabric. Moreover, as the 25 years of full employment Keynesianism 1946-1971 have demonstrated, full employment makes foreign immigrants welcome as an essential addition to the labour force and prevents the rise of xenophobia and racialism. With full employment, the new immigrants are quickly integrated into the economic and social life. In more recent years, with the abandonment of full employment strategies, we have seen all this happening in reverse.

The link of full employment with poverty reduction is equally clear: the unemployed will normally be among the poorest families and their poverty is alleviated by obtaining employment. There may be a certain reduction in real wage rates for those already in previous employment, but if this occurs it would be amply compensated by increased opportunities for upgrading, promotion and overtime earnings. Moreover, government revenue would be increased by high taxable profits and incomes from employment which would help to support social services and the financing of social safety nets. All in all, although full employment would bring cross-currents of redistribution among as well as between social groups, it is a
positive sum-game. With proper social arrangements the losers could be compensated leaving the rest better off than before. The high rate of investment and pressure on available resources would also stimulate technological innovation and thus contribute to higher future growth rates.

Keynes was also deeply involved with the Beveridge Report of Social Security For All, establishing the framework of a Social Welfare State, which appeared in 1942, the same year as Keynes's three original memoranda for the Bretton Woods triad of IMF/WB/ITO. While the Beveridge Report was not formally part of the Bretton Woods agenda, Keynes was an enthusiastic supporter, having closely collaborated with Beveridge in its formulation. Thus the idea of a social safety net with universal coverage and protection for the most vulnerable groups - the young, the old, the ill and all other groups outside the labour market as well as the chronically unemployed - was fully embraced by Keynes. It is true that this was on a national basis, more directly for the UK. It is also true that Keynes's initial interest in development problems was weak - too weak to embrace the idea of an international welfare state. But he held that the principles of the Beveridge Report were moral principles which should apply even - or perhaps especially - in the reduced economic circumstances of the UK during and immediately after the war.

In his essay: 'The Economics of our Grandchildren' Keynes had approached the idea of an international welfare state indirectly and implicitly, but nonetheless unmistakeably. He argued there that as the richer countries became richer and richer, very little value would be attached to further wealth accumulation; instead, additional resources provided by technical progress would be devoted to charity as well as increased leisure-time spent on cultivating the arts. Although he did not mention this explicitly he would readily have agreed that while the charity he had in mind might begin at home it need not and should not end at home.

It was well-known to Keynes and his circle that the Western concept of unemployment, based on full-time public sector jobs, would not be directly applicable without modification to, for example, rural people in marginal environments or more generally to developing countries with large informal sectors. Indeed, conditions resembling the informal sector of developing countries were recognised to exist even in advanced industrial countries and were covered by the concept of 'hidden unemployment' (developed by Joan Robinson) or 'underemployment'. In the 1970s it became the standard view that the real problem of developing countries was poverty rather than unemployment. This was particularly strongly argued by the ILO Employment Mission to Kenya\(^1\) which established the concepts of the informal sector and of

the 'working poor'. Since then, there has been a synthesis of the specifications of poverty and unemployment respectively as the chief problem, embodied in the policy objective of increasing 'productive employment'. In this qualified form, employment has been re-established as a key objective, with the further proviso that it has to be supplemented by social safety nets for groups not capable of employment. The qualified objective of productive employment makes the human-oriented character of the objective even more explicit by linking it with the objectives of poverty reduction and increase in human welfare.

Having said all this, in support of the thesis that the Keynesian vision of an expanding full employment world economy was essentially human-centred, we now enter into a more doubtful area. In the first place, it is certainly true that Keynes and the Keynesian consensus treated unemployment more as an economic waste and economic folly than as an offence against human-centred development. He used the language of a professional economist, not of a social reformer. The latter role he left to his involvement in the Beveridge Report and to his more peripheral writings. However, since the economic waste and the human waste of unemployment coincide, perhaps not too much need be made of this particular distinction.

More serious is another divergence of the Keynesian vision from our present emphasis on human-centred development. The Keynesian vision of full employment growth was in terms of full-time paid jobs, leaving little room for preferred part-time employment ("disguised unemployment"), flexible employment arrangements, working from home nor indeed was women's work at home or in raising children recognised as productive employment. In all these respects, the Keynesian approach is at odds with current emphasis on flexible labour markets and, in particular, the notion that only paid work has value.

Thirdly, the Keynesian picture of full employment neglected the rural-urban relationship crucial in developing countries. If employment in the urban/formal sector increases, there is intensified migration from the low-income rural areas. If the income gap between rural and urban incomes is high, it becomes rational for rural workers to run the risk of unemployment in the town for the sake of a chance of a well-paid urban job. Thus for every new job created in the urban sector, there may be several new migrants and unemployment may actually increase (Harris-Todaro model). Thus a full employment policy may have to be concentrated on rural employment opportunities and the reduction of the rural-urban income gap.

'productive employment' in the sub-title already foreshadowed the 'synthesis' mentioned in the text.

2 There is a parallel between the qualification of the full employment objective as 'productive employment' and the qualification of the growth objective as 'labour-intensive growth' or an 'appropriate pattern of growth'. In the qualified forms of 'productive employment' and 'labour-intensive growth', the growth and employment objectives clearly come close together.
The main instrument in the Keynesian system for achieving and maintaining full employment was demand management by active macroeconomic government intervention; and the main objective of this active government intervention was the maintenance of a high level of investment, both private and public. This is most clearly expressed in the Harrod-Domar formula which links the Keynesian system with development economics, by defining the conditions for sustained and sustainable full-employment growth. The H-D formula analyses this growth as a function of the rate of investment (or saving) divided by the capital/output ratio. Thus stated, this is a simple tautology - telling us that if the rate of investment is for example 15 per cent and the capital/output ratio is 3:1 (indicating an efficiency of investment of 33.3 per cent), then the rate of growth will be 5 per cent. In this formulation, the approach could appear mechanistic and abstract, since the 'investment' is clearly perceived as physical investment, in terms of 'bricks and mortar'. There is no indication here of the concept of human investment or human capital formation which today is universally accepted as an important element in total investment.

The H-D formula can easily be interpreted - or misinterpreted - as a form of 'capital fundamentalism'. When linked with models like that of Arthur Lewis embodying the concept of surplus labour, it easily leads to the notion that capital is the only scarce factor and sets the limit to development. Even when 'human capital' is added it may lead to a limited view of human capital, limited that is to what promotes the more efficient use of the ultimately decisive factor of physical capital. In education, this could lead to stress on high-level skills needed to operate modern technology, with insufficient concern for the primary and secondary educational infrastructure. Even though this would not have reflected the views of Keynes or H-D, it is undeniable that it influenced development practitioners of 'capital fundamentalism' during the period of the Keynesian consensus.

Capital fundamentalism or investment fundamentalism had implications for income distribution not conducive to a 'human face', once a state of full employment was approached. If the key to growth lies in investment, savings must be increased. This puts a premium on shifting income to richer groups with a higher capacity and propensity to save. (Indeed, the fashionable Kuznets curve indicated that this was a normal process in the earlier stages of development). This view not only run counter to objectives of poverty reduction, it specifically neglected the importance of asset acquisition by poorer people as a means of increasing economic (and human) security.

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However, there are two qualifying factors which make the H-D formula approach appear more human and less mechanistic that it might appear at first sight.

(a) The all-important capital/output ratio in the denominator of the simple H-D equation measures the efficiency or rate of return of investment. It is perfectly compatible with the Keynesian system to argue that the capital/output ratio is partly, mainly, or almost wholly determined by labour productivity which in turn is the result of human investment in health, education, training, etc. It is perhaps a pity that these factors were not specifically identified but instead tucked away in the denominator under such a neutral term as 'capital/output ratio'. But at least a proper interpretation of the H-D formula shows that the human factor has not been eliminated from the picture.

(b) The H-D formula identified per capita growth rather than aggregate growth as the objective; hence the rate of population growth was introduced as a negative factor, deducted from the rate of investment (or saving) divided by the capital/output ratio. The population factor clearly introduces an element of human development. The H-D formula opens up the possibility that the desired objective of higher per capita growth can be achieved by slowing down the rate of population growth. This is particularly relevant for developing countries and forms an integral part of a human-centred view of development. The consensus today is that human investment particularly improved literacy and education for women, can be an important factor in reducing the rate of population growth.

(c) Within the context of Keynesian full-employment macroeconomics, investment (or saving) is achieved, not by cutting consumption - which would reduce human welfare and could reduce human capital formation - but by increasing total resource utilization. Investment and consumption increase together, by way of increases in total income. It is only when the condition of full employment and full resource utilisation is reached that choices between investment or consumption have to be made.

Summing up, we can say that the Keynesian growth system, while it certainly was mechanistic, and did not explicitly mention the human driving forces, yet it is capable of incorporating the present view of human-centred development without forcing us to abandon the system. There are however new elements other than people and population which are missing from the system:

4 The 'residual factor' of increasing total factor productivity (TFP) through technical progress is also not specifically identified in the H-D formula.

6 \[ G = \frac{I(S)}{ICOR} - p \], where ICOR is the Incremental Capital/Output ratio.
Keynesian vision. Social integration may perhaps be considered as at least partially taken into account through full employment. However such elements as the environment, the role of women, and the question of human rights, which now form an integral of our concept of development, were clearly not represented in the Keynesian vision (nor in the neo-liberal counter-vision which displaced the Keynesian consensus in more recent years). Thus we may say that the Keynesian vision is still valid, with the addition of some new issues such as the ones just mentioned.
2 The Bretton Woods Institutions and the UN

It is customary to talk of two different systems: the Bretton Woods system and the UN system. This reflects the facts of life but not the legal situation. Legally there is only one system, the UN system. The Bretton Woods institutions - the International Monetary Fund and the World Bank - are legally part of the UN system. They are specialised agencies of the UN, the same as the United Nations Food and Agriculture Organisation (FAO), the World Health Organisation (WHO), the International Labour Office (ILO) etc. As specialised agencies of the United Nations they are subject to guidance and recommendations by the UN General Assembly, the UN Economic and Social Council (ECOSOC), and subject to the administrative co-ordinating functions of the UN Secretary-General. In fact it was initially envisaged that the specialised agencies of the United Nations should all be together in one place - presumably New York - to facilitate day-to-day control and co-ordination.

However, all this is grey legal theory. The facts of life are very different. The Bretton Woods institutions do not consider themselves to be part of the UN system and the idea of guidance by the General Assembly, ECOSOC, and the UN Secretary-General would provoke hollow laughter at 1818 H Street NW, Washington. The separation of the two systems - in actual fact although not in law - has historical origins. The Bretton Woods institutions were established in 1944 at the Bretton Woods conference, on the basis of three famous memoranda written by Keynes in 1942 on the International Clearing Union (which became the IMF), the International Investment Fund (which became the International Bank for Reconstruction and Development or World Bank), and International Commodity Buffer Stocks (the stillborn International Trade Organisation (ITO). The United Nations was created in a separate process culminating in a conference at San Francisco in 1945 - a year after the Bretton Woods conference. Hence at the time of the Bretton Woods conference the UN did not exist (although its intended establishment had been proclaimed in the Atlantic Charter in 1941 and was thus known to the negotiators at Bretton Woods). This explains the absence of detailed discussions on the relationship between the two systems, as well as the more general references to linkage to the forthcoming UN. A special irony of this historical sequence is that the largely financial and banking institutions of the IMF and World Bank were established at the political capital in Washington DC whereas the UN, an essentially political institution, was established at the financial centre of New York. This geographical anomaly turned out to be a great advantage to the Bretton Woods system and a great disadvantage to the UN system.

The statement that the United Nations rather than the Bretton Woods institutions was envisaged as being the **locus** of global macroeconomic governance conflicts with the conventional wisdom that the Bretton Woods institutions were to be responsible for global
macroeconomic governance. In fact this is something of a chicken-and-egg problem since the chronology of the creation of the two systems - UN and Bretton Woods - is intermixed in a complicated manner. The first step in this chronology is the Atlantic Charter of 14 August 1941 (well before the Bretton Woods conference and even preceding Keynes's original memoranda of 1942). The Atlantic Charter foresaw the creation of a 'wider and permanent system of general security'. Among the objectives of the 'wider and permanent system' listed in the Atlantic Charter was 'to bring about the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labour standards, economic advancement and social security'. This was further underlined in a declaration at Washington by the twenty six states of the anti-Axis coalition on 1 January 1942. A more specific outline was decided at a conference at Dumbarton Oaks in October 1944 - in other words immediately following upon the conclusion of the Bretton Woods Conference in July 1944. Thus the Bretton Woods Conference preceded the Dumbarton Oaks Conference, but only just, and in fact the link was emphasized by the official title of the Bretton Woods Conference, ie 'United Nations Monetary and Financial Conference'. However the Charter of the UN itself was not signed until 26 June 1945 - almost a year after the conclusion of the Bretton Woods Conference at the San Francisco Conference.

The relationship between the World Bank and the UN gave trouble and was in doubt from the very beginning (more so than in the case of the IMF). The agreement between the World Bank and the UN was not completed until November 1947 and the negotiations were rather antagonistic and acrimonious.5 The UN had been pressing for an earlier agreement but the Directors and management of the World Bank requested repeated postponement. It is likely that an earlier agreement would have given greater emphasis to the role of the UN, but the final agreement emphasized the independence of the World Bank and stressed the limits of the relationship with the UN.

The Terms of Agreement of the World Bank include a section on the relationship with other international organisations. With the UN already so clearly on the horizon, this clearly refers to the UN prominently among the 'other international organisations'. The key provision specifies that in making decisions on loans or guarantees relating to matters 'directly within the competence of any international organisation ... the Bank shall give consideration to the views and recommendations of such organisation'. While the requirement to 'give consideration' is rather vague, and in the negotiations of an agreement with the UN the World Bank insisted on its independence and special status different from other specialised agencies, yet the Terms of

5 With some understatement, Mason and Asher in their standard history of The World Bank Since Bretton Woods Washington DC, Brookings Institution (1973) describe the negotiations as 'not particularly cordial' (p55).
Agreement clearly give the various organs of the UN a legitimate right to express views and make recommendations to the World Bank. This provision in the Terms of Agreement of the World Bank is in addition to a general duty to 'cooperate with any general international organisation and with public international organisations having specialised responsibilities in related fields'. The 'general international organisation' referred to in specific distinction from 'international organisations have specialised responsibilities' clearly refers to the UN itself.

The difficulties and delays in reaching an agreement between the World Bank and the UN and the insistence by the directors and negotiators or the World Bank to put a distance between the two systems was an early indication that the major powers put their confidence in the Bretton Woods institutions with their more 'reliable' distribution of voting power. This greater 'confidence' factor rules today as strongly as ever and is now further defended by a 'competence' factor. At the time of the early agreements giving the Bretton Woods system virtual autonomy from the UN, however, the 'competence' factor could hardly have played a role. Any competence differential may well be the result of 'confidence' and the consequent distribution of support and resources between the two systems. It may also be more a question of different approaches and different comparative advantages and disadvantages rather than competence differentials. The other UN specialised agencies have also striven for 'autonomy' although not to the same extent and not with the same support by the industrial countries since the other agencies remain tied to the UN voting system. In their case it is more the developing countries which are behind the drive for 'autonomy', but both tendencies create obstacles in the way of co-ordination and joint action by the whole system. Distribution according to 'confidence' and voting systems seems a poor substitute for distribution according to comparative advantage and complementarities.

There are still remnants of the legal position. For example, the President of the World Bank and the Managing Director of the IMF present a report at one of the two annual meetings of the Economic and Social Council, although this is more in terms of a lecture than of accounting for their activities. It is yet another anomaly that the Secretary-General of the UN is not reciprocally allowed to make a statement at the annual September meetings of the Bank and Fund. (There seems however no reason why the Secretary-General should not break with this convention and forcefully participate in the annual meetings of the Bank and Fund, representing the interests of the global community - he could hardly be denied the floor!)

The main difference between the two systems is the different voting system and method of control. in the Bretton Woods system voting is on the basis of contributions: hence the IMF and World Bank are firmly under the control of the major industrial countries and financial centres. This is also clearly reflected in the different outlooks and approaches of the two
systems and the composition and previous training of their staffs. In the UN system, leaving aside the veto power in the Security Council on potentially military matters, voting is on the basis of one-country-one-vote. At the beginning of the UN, when most Third World countries were still colonies, this did not trouble the major industrial countries unduly. But with decolonization the principle of one-country-one-vote meant a built-in majority for the developing countries - especially when they teemed up with the Soviet bloc. This difference in control proved highly beneficial to the Bretton Woods system (where for a long time the Soviet bloc was absent), and it thus became the chosen vessel of the industrial countries while the UN system was sidelined and marginalised.

Insofar as the one-country-one-vote system and universal membership can be considered more democratic than the one-dollar-one-vote system, the refusal of the industrial countries to give serious support to an institution governed by one-country-one-vote sits uneasily with the promotion of democracy proclaimed by the Western countries. A third voting system, reflecting the size of member countries' population (one-person-one-vote) would give very similar results to the UN system of one-country-one-vote, as far as the ratio between industrial countries and developing countries is concerned - but would give enormous voting power to China and India.

The method of decision-making is also different in the two systems. In the Bretton Woods institutions binding decisions are made by a relatively small body (about twenty) of Executive Directors, representing the major contributors (with a virtual veto power by the US) and groups of minor contributors. In the UN system, non-binding resolutions are decided in much larger bodies (54 in ECOSOC, over 100 in the General Assembly), in practice on the basis of preceding discussions within and then between the three major groups. This group procedure is most directly embodied in the decision-making process of UNCTAD. In the Bretton Woods system, the developing countries feel powerless and at a disadvantage, even though they also have their separate channel of expression in the Development Committee. In the UN system the industrial countries (and to some extent the large countries) feel at a great disadvantage. We have yet failed to find methods of decision-making with which both sides feel comfortable, although qualified majorities and group systems represent promising approaches.

There are also differences in staffing and recruitment. The UN system, including the Specialised Agencies, operates on a country quota basis. This means that nationality considerations may prevail over competence and suitability - an inferior candidate from an 'under-represented country' may get priority over a candidate from a country with an 'overcrowded quota'. Alternatively, if highly competent candidates from countries with skill scarcities are recruited, this represents a harmful brain drain for the country concerned. The
Bretton Woods system has the advantage of less concern with 'country quotas' but the disadvantage of a less diversified and less multicultural staff. This will lead to less representation of different development experiences and greater ideological uniformity of views among the staff which in the long run can be as harmful to effective performance as lack of competence.

The original division of labour between the World Bank in particular and the UN was that the World Bank would concentrate on project financing on a non-concessional basis, while the UN would be the focus of global macroeconomic management (centred on ECOSOC) and of a concessional multilateral aid programme (the Special United Nations Fund for Economic Development, or SUNFED, more accurately described by its original name of UNFED, without the Special!). In the event, this original division of labour has completely disappeared. The World Bank has struck out from the project basis into programme lending and structural adjustment lending, largely in the service of debt collection. At the same time the World Bank, through its IDA window, has also moved into the field of concessional lending (although the bulk of its lending is still non-concessional). In this process, the World Bank has assumed a more controversial role and the results of the structural adjustment and stabilisation policies imposed both by the IMF and the World Bank are mixed and their impact a matter of debate. Furthermore, in this process the quality of the Bank's project lending has declined (by its own evaluation) as emphasis has shifted from agricultural engineers and other skilled project personnel to monetarist/neoclassical macroeconomists, and staff incentives have shifted in the same direction.

The Bretton Woods institutions justify their approach by arguing that the developing countries must face the facts of life and that without the type of adjustment imposed on them their plight would be even worse. This last statement, as a counterfactual argument, is difficult to prove or disprove; as for the 'facts of life' argument, the counterargument would be that the Bretton Woods institutions were not created to impress the facts of life on deficit countries but to change the facts of life. This would imply pressure on the surplus countries rather than the deficit countries. Indeed such pressure on surplus countries - or at least symmetrical pressure on all countries - was part of the original vision for the Bretton Woods institutions. This symmetry still exists on paper in the form of IMF 'surveillance' of all member countries. But this is a very shadowy affair and not taken seriously by the powerful member countries not in need of direct IMF or World Bank assistance.

At the same time, the function of global macroeconomic management, insofar as it has not been taken out of the multilateral system altogether and embodied in the G-5 or G-7, has been moved from the UN to the Bretton Woods system. The concessional aid fund foreseen in the
form of SUNFED or UNFED has also been taken away from the UN and incorporated in the World Bank. The same process has been at work with another fund, the idea of which originated in the UN, i.e. a compensatory fund for unforeseen losses in export earnings. This has been incorporated in the IMF in the form of the Compensatory Financing Facility (CFF), but there is now a consensus that it has become emasculated and distorted away from its original intended purpose, and that it should be better used and with greater concessionality in line with original intentions. There is also broad support for the idea that the CFF should be widened to deal with increases in import prices and changes in terms of trade (not just export earnings) as well as other contingencies (the latter extension has already been made in principle).

The separation between the UN system and the Bretton Woods system is strikingly demonstrated in the way the IMF/World Bank stabilisation/structural adjustment programmes are being negotiated. These negotiations are limited to financial IMF and World Bank specialists from Washington on one side of the table, and representatives of ministries of finance and central banks on the other side of the table (the latter themselves quite likely former staff members of the World Bank and IMF). Many of the deficiencies and doubtful effects of the programmes can be explained as the result of such a narrow financial framework for their negotiations. Decisions which have a major impact on the fate of say agriculture or health of a country are made without representation of the UN agencies responsible for agricultural problems and with field representation in the country, i.e. the FAO, or the WHO is the case of health, and on the other side of the table without representation of the Ministries of agriculture or health. A broadening of the negotiating framework could do much to restore the unity of the UN system. Other potential reforms of the present process of stabilisation and structural adjustment relate to the country-by-country approach with insufficient regard to aggregation effects and to the nature of performance indicators.

A fashionable suggestion for a new division of labour between the two systems - often in the name of 'revitalizing the UN' - is to allocate to the Bretton Woods system the 'hard' core of development, i.e. macropolicy, finance, and trade (GATT being considered as an adjunct of the Bretton Woods system). The UN would deal with 'soft' issues such as poverty reduction, social policy, employment, environment, human resources, vulnerable groups such as women and children, refugees, disaster relief, etc. Leaving aside such questions as what is 'hard' and 'soft' in development, and whether such a division into hard and soft issues makes any sense, this proposed division of labour would only work if the UN, in charge of the 'soft' issues, would receive the same degree of political and financial support as the Bretton Woods system. As already explained, this will not be the case as long as the financially powerful countries, in their dislike of the UN voting control and the UN's different approach, concentrate their
backing on the Bretton Woods system while marginalising the UN system and keeping it on the brink of bankruptcy. The precedent of the environment is not encouraging: although environment would be counted among the issues allocated to the UN (with a UN agency already in existence in the form of UNEP - the UN Environment Programme), when it came to establish the financial backing for the agreements arrived at the Rio Environment Conference, the chairmanship, administration and overall co-ordination of the General Environmental Facility (GEF) (including policy and investment projects) was entrusted to the World Bank and not to the UN system (although the UNDP was made responsible for technical assistance activities and UNEP for the administration of subsidiary funds to help developing countries to comply with the provisions of the Montreal protocol for phasing out ozone-destroying substances).

The GEF also illustrates the attempt to reach compromises between the dollar-a-vote Bretton Woods system and the country-a-vote UN General Assembly and ECOSOC. The developing countries have pressed for control of GEF operations to be moved away from World Bank decision-making procedures and this has in principle been accepted. The latest proposal provide for a "Participant Assembly" with 30 groups or "constituencies", of which at least half would be represented by developing countries. This elaboration of the 'Group' system parallels proposals for the distribution of voting power in a reconstructed and smaller ECOSOC or new Economic Security Council. The principles accepted in all these cases is that decision-making power should be "transparent, balanced and equitable" - but this still leaves room for different interpretations of what institutes "balance" and "equity".

Recent experience illustrates the highly unequal distribution of resources between the two systems. While the recent replenishment of IDA has shifted 13 bill. SDR in new contributions to the window of the World Bank, the GEF (General Environmental Facility) in which is the UNDP and UNEP have at least a share in resources (although administration and investment decisions and implementation are in the hands of the World Bank) has received less than 5% of this over a similar 3-year-period (7% if co-financing is included). For the GEF, this was, of course, an initial plot phase, but even for the next 3-5 year phase the target is only 11% of the IDA contributions (on an annual basis) - and it is by no means certain that this target will be met. By even sharper contrast, the UNDP initiative for sustainable development (Capacity 21) which would be entirely within the UN system has remained virtually inoperative for lack of contributions. No wonder that the Report of the Secretary General to the first sessions of the Commission for Sustainable Development, while listing IDA and even GEF as "positive developments", Capacity 21 appears among the "not encouraging" items (E/CN17/1933/11, paras. 54 and 55).
There have also been significant shifts within the Bretton Woods system itself. The net result has been a shift in influence away from the World Bank and towards the IMF. The IMF, according to its Articles of Agreement, has the purpose 'to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems'. Another of its purposes is 'to facilitate the expansion and balanced growth of 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 role of facilitating 'the expansion and balanced growth of international trade' has been largely taken over by GATT. Moreover, the task of 'promoting international monetary cooperation ... and machinery for consultation and collaboration on international monetary problems' has in fact been taken over by the G-7 and it is notable that during recent troubles of alignment among major currencies the IMF has been very much on the sidelines.

To that extent, as well as in its lack of effective surveillance of powerful member countries, the IMF has lost ground compared with the original expectations. On the other hand, in compensation or otherwise, the IMF has gone into the development business by establishing strict and effective policy surveillance of debtor countries and developing countries generally. It has also moved away from its intended limitation to very short-term and temporary support towards medium-term assistance and a type of conditionality which goes well beyond the single criterion of balance of payments equilibrium. Moreover, this conditionality can hardly be said to be inspired by 'the promotion and maintenance of high levels of employment and real income and the development of productive resources ...'. The IMF in fact through its stabilisation programmes and medium-term facilities impresses a particular type of development policy upon those member countries for which its surveillance is effective.

In doing so, the IMF has inevitably encroached upon the functions of the World Bank. Development was supposed to be World Bank business, not IMF business. The original clear division of responsibilities between the two institutions has become blurred. Moreover, in its relation to the IMF the World Bank has come to assume a subordinate role, playing second fiddle\(^6\) - the Bank cannot provide programme lending of any kind until the country concerned first has an IMF programme in place. A suggestion has been made that a tidy new division of labour would be to restore to the IMF its trade and surveillance functions by merging GATT

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with the IMF, but on the other hand getting the IMF out of the development business and restoring it to the World Bank.\(^7\)

The erosion of the normative and analytical functions of the UN in favour of the Bretton Woods system has also extended to the UN specialised agencies such as the FAO, ILO, WHO, UNESCO, etc. Their financial resources are as precarious as those of the UN itself and they are increasingly compelled to compete for technical assistance resources from bilateral donors, the UNDP, and indeed the World Bank itself. Their intended functions of norm-setting, policy advice and analysis have increasingly been taken over by the IMF and World Bank. The lack of financial resources has a cumulative effect in that it lowers the capacity of the UN and its agencies to do their work competently and this then serves as a further reason (or pretext) to cut their resources further and shift them to the Bretton Woods system. As long as this vicious circle is not broken all talk of 'revitalization' is idle.

There is enough in this 'black-and-white' overall picture of a shift in support and resources away from the UN system and towards the Bretton Woods system to give food for second thoughts and provide a case for a movement back towards better balance. Yet at the same time this picture is oversimplified and could be seriously misleading. Reality is more complex. Neither the Bretton Woods system nor the UN system are homogeneous in the degree of support which they receive. There are elements in the Bretton Woods system which are struggling to attract support, and there are parts of the UN system which are recognised success stories and command a great deal of support. This applies particularly to some of the work of the WHO, to the work of UNICEF, to the operations and co-ordinating functions of the World Food Programme, and to some of the work of the FAO (such as the establishment of early warning systems for impending crop failures in cases of drought etc). Some of the comparative advantages of the UN system are widely recognised, such as their strong field presence, their co-operative relationship with recipient governments in drawing up country programmes and discussing policy changes, and their less dogmatic and more pragmatic approach. The UN system also seems better equipped in any movement from unilaterally imposed quick-fire stabilisation and structural adjustment programmes to mutually binding long-term development contracts; there is a growing consensus in favour of such a shift.\(^8\)

It is perhaps not sufficiently recognised how many major innovations within the Bretton Woods system have grown out of analyses and initiatives developed within the United Nations system. Because of this lack of public perception it may be useful to present a list of the major

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\(^7\) Ibid.

\(^8\) Originally proposed by Thorvald Stoltenberg of Norway at the 25th Anniversary of the OECD Development Centre in 1989.
innovations of this kind. As a quantitative indicator of the importance of the UN as a source of new ideas, at least six Nobel prize winners in economics have worked for the United Nations. Often the role of the UN has been to serve as a scapegoat in the sense that the major industrial countries adopted UN initiatives, but shifted them to the Bretton Woods system as part of their strong preference for acting through the Bretton Woods Institutions rather than the UN. (There is a parallel here with the political arena where the role of the UN has often been to serve as an alibi for not taking unilateral action which might have led to conflict.) In this sense it is true to say that 'the UN's greatest successes are its failures'. This is particularly well illustrated by the first item in our list, the creation of IDA as the soft aid window of the World Bank.

(1) The creation of IDA was the direct result of pressure for a multilateral soft aid mechanism in the UN. Originally proposed by the UN Sub-Commission for Economic Development and a UN Expert Group on 'Measures for Full Employment', this led to long negotiations on the creation of a Special United Nations Fund for Economic Development (SUNFED). It was to avoid the creation of SUNFED within the UN that the industrial countries and the World Bank changed their previous opposition to the idea of multilateral soft aid and agreed to the creation of IDA within the World Bank - as a lesser evil, as it were. As the standard history of the World Bank by Mason and Asher (The World Bank since Bretton Woods) states (pp568-569): 'The International Development Association (IDA), like the Special Fund, owes its existence in large measure to prolonged agitation within the UN for a capital development fund.' Eugene Black, then President of the World Bank, stated that 'IDA was really an idea to offset the urge for SUNFED'.

(2) The International Finance Corporation (IFC), the private borrowers' window in the World Bank, also goes back to a World Bank Report requested by ECOSOC. The ECOSOC resolution in turn picked up a recommendation of the US International Development Advisory Board Partners in Progress: A Report to the President (March 1951). Thus the origin of this initiative in the UN is not quite as clear as in the case of IDA, but it was the UN (ECOSOC) which picked up this recommendation and routed it into the World Bank decision-making process.

(3) The creation within the IMF in 1963 of a compensatory facility for the financing of export shortfalls (CFF) was in response to an initiative by the UN Commission on International Commodity Trade in 1962, but going back to discussions within this UN Commission since 1959. The UN also repeatedly suggested that the CFF should be broadened to compensate not only for shortfalls in export earnings, but also rises in
import prices and deterioration in terms of trade. The former suggestion was indeed accepted by the IMF when OPEC initiated the dramatic increase in oil prices in 1973; an oil-financing facility was then added to the CFF. Furthermore, as a result of suggestions from the FAO and the World Food Council, a further facility was added to the CFF to compensate for crop failures or for sharp increases in world prices of food, especially cereals. Rather than establishing a separate facility for this purpose, the CFF was widened and became the CCFF. Thus the story of the CFF provides at least three different instances where initiatives emanating from the UN led to changes in the Bretton Woods system.

(4) The creation of SDRs by the IMF goes directly back to the recommendations of a high-level group of experts set up by UNCTAD and the UN which, in revival of Keynes's proposals at Bretton Woods, indicated the need for deliberate international liquidity creation and a link between this liquidity, commodity price stabilisation and development finance (the Hart/Kaldor/Tinbergen Report). Although SDRs have not been systematically used in the service of global macroeconomic management, the fact that this facility exists is highly significant and could facilitate future action to strengthen the international liquidity position of developing countries when the resistance of industrial countries to such action is relaxed.

(5) The creation of the General System of Preferences (GSP) goes directly back to continued pressure from the UN, especially UNCTAD, for the rules of a global multilateral trading system to give special consideration to the problems of developing countries. Apart from the GSP which was of great (although diminishing) value to developing countries, the principle of special exemptions from general MFN rules was recognised by the addition to the GATT of a special chapter (part IV) recognising their special and different needs. This was in partial restitution of the provisions of the stillborn ITO.

(6) The UNICEF Report (by Cornia/Jolly/Stewart) on Adjustment with a Human Face had a considerable impact on the approach to structural adjustment lending by the World Bank and stabilisation lending by the IMF. It focused the increasing worries about the danger of harmful social impacts of these programmes and procedures. It is possible to argue that the UNICEF initiative had this impact only because it corresponded also to growing doubts within the World Bank (and perhaps even the IMF) itself. This is possible, but the fact is that it was this UNICEF initiative which gave voice to these doubts and suggested the need for modifications and alternative approaches. The
World Bank programme on Social Dimensions of Adjustment (SDA) can be considered as a direct outcome of the UNICEF initiative.

(7) The concern with environmentally sustainable development coming from the UN system, expressed in the establishment of the UN Environment Programme (UNEP) and above all in the Rio Conference (UNCED - UN Conference on Environment and Development) has certainly played a major role in moving the World Bank in the direction of paying greater attention to the environmental impact of projects as well as structural adjustment programmes and also to give greater emphasis to directly environmental projects. The Rio Conference has also led to the establishment of the General Environmental Facility (GEF) within the World Bank (although with some participation by the UNDP and UNEP).

(8) Finally, the initiation of Human Development Reports by the UNDP has clearly played a role in sharpening consciousness in the World Bank and IMF of the importance of human resource development and human welfare as the objective of economic development. This is indicated in the increasing use of human development indicators among the performance criteria and conditionalities used by the World Bank and IMF in their programme lending and structural adjustment programmes, and in the case of the World Bank also increased pressure to increase the share of projects directed towards health, education, nutrition, sanitation and other areas of human resource development.

Quite apart from this list of UN initiatives influencing the Bretton Woods system, it should be realised that even in terms of resource flows, the UN system is more important in relation to the Bretton Woods institutions than is often realised. It should be remembered that the resource transfers through the UN system are on a grant basis, while transfers of the Bretton Woods institutions are repayable - their net transfers in recent years have in fact been quite small or even negative. It can also be pointed out that in the fields of specific UN responsibilities (including the broad field of human resources and human development) there has been much more actual progress and international convergence than in the fields of GNP growth, balance of payments equilibrium, currency stability, macroeconomic management, etc which are the special responsibility of the Bretton Woods institutions.

Thus, while the role of the Bretton Woods institutions may be currently predominant, the role and even more the potential of the UN system remains a key element in the promotion of human progress and the eradication of poverty. The challenge to the world community is to
use both systems equally well and equally fully, allotting tasks according to their comparative advantages and getting the two systems to work in harmony and mutual supplementation.

What of the future? It is difficult to believe that the original vision of 1944-1945 can be restored, with development policy centred and co-ordinated in the UN with its more democratic voting system. This would only happen if, motivated by the political need for a strong UN in peacekeeping and peacemaking, the idea of revitalising it in the economic and social fields is also taken seriously. Meanwhile, the best that can be hoped for is a return to a reformed and updated version of the Bretton Woods system which for 25 years served to create a 'Golden Age' of full employment. There seems to be an emerging consensus in this direction, a growing pressure for change of the present relationships and present modes of operation, a feeling that the pendulum is swinging back towards the original vision. At the same time, new concepts of human-based development are seen to require new concepts of human-based global governance with new emphasis on the UN system and a re-ordering of relations within the system.
3 Global Governance: An Economic Security Council?

The proposal to create a UN Economic Security Council arises from dissatisfaction with the present institutional arrangements for global development policies within the international system. This dissatisfaction is justified since presently we have no institutional arrangement which would combine the two essential requirements of democracy and effectiveness. Insofar as the present system is centred in the Bretton Woods institutions of the World Bank and IMF, it is clearly not democratic. The developing countries containing the majority of mankind as well as the majority of sovereign member countries have virtually no say either in the decision-making process or in the management of these institutions. They are effectively controlled by the G5 or G7 - so it makes little practical difference whether the G5 or G7 handles development policies directly or through the World Bank/IMF. The decision-making process and the management of these institutions may be effective but only in the sense of carrying out policies and decisions which are non-democratically determined.

On the other hand, the UN institutions - the General Assembly and ECOSOC - are democratic in their distribution of voting power, but they are not effective, partly because of the excessively large numbers of actors involved which makes for unwieldy and time-consuming procedures, and partly because the powerful countries needed to give effect to their decisions do not support institutions in which they are in a minority.

The proposal for an Economic Security Council (ESC) is not the only possible way of resolving the present impasse. Other possible approaches would include the following:

(1) One proposal is for the present Security Council to widen its mandate beyond purely military threats to peace so as to include also threats to peace arising from economic crises, poverty, environmental degradation, migration, refugees, unemployment, etc. This would also fit in with attempts to give peacekeeping a more actively preventive role (as also suggested by the Secretary General of the UN in Agenda for Peace). Since the Security Council is in permanent session, it would be possible for it to consider current economic as well as political crises.

(2) Another approach would be to make development management in the Bretton Woods institutions more democratic by giving a larger say to developing countries and moving away from the idea that financial contributions must give the 'donors' a corresponding right of control. It would also presumably mean a change in the 'culture' of these institutions - in the type of management and staffing. There seem to be no present moves in this direction, however.
Another suggestion which has been made is to accept the fact that global governance presently rests with the G5 or G7, but to create also a group of non-five which would be associated with the G5 in reaching joint decisions. This proposal has been elaborated in considerable detail by WIDER. It could be both democratic and effective but would move decision-making out of the UN system altogether.

To the extent that the ineffectiveness of ECOSOC is seen in its large size (presently 58), the remedy could lie in the size of ECOSOC and also putting ECOSOC into permanent session, instead of only two sessions of a few weeks each year with an overcrowded agenda and a multitude of resolutions. However a reform of ECOSOC in the directions indicated would in practice amount to the creation of a new and quite different organ and present the same or perhaps greater difficulties.

Perhaps even more important than dissatisfaction with the present institutional arrangements and a desire to arrive at a better combination of democracy and efficiency are changes in the real world. These can be perceived as the problems of increased globalisation beyond anything that could have been imagined some fifty years ago when the present international system was created. Previously it was possible to argue that even major economic and social crises and problems need not be dealt with decisively as long as they did not develop into cross-country military conflicts (which they rarely did). Today, however, in a world of increasing globalisation it is simply not possible to ignore localised deprivations since they frequently and unpredictably spill over across frontiers and directly affect other countries. The history of the 1930s should in any case have given a warning signal that problems of deprivation, unemployment, social insecurity, etc invariably develop into protectionism, trade wars, fanning of nationalism, and ultimately war.

Among the non-military and apparently localised problems which today spill over across national frontiers and constitute major global problems from which no country is exempt are of course the problems of environmental degradation which are now recognised as a global concern to be dealt with by the United Nations. The creation of UNEP, the establishment of the Global Environmental Facility in the World Bank with the collaboration of the UNDP and UNEP, and the establishment of the UN Commission for Sustainable Development are all indications that this is now a recognised fact.

9 World Economic Summits: The Role of Representative Groups in the Governance of the World Economy WIDER Study Group Series No 4 published by the World Institute for Development Economics Research of the United Nations University, see especially Appendix A by Stephen Marris 'A Proposal to Create the "Group of the Non-Five"'.

However there are many other problems arising from economic and social degradations, particularly in the developing countries, which are of comparable seriousness and create a comparable need for global action. These would include problems of disease (especially AIDS), drugs, international crime syndicates, terrorism, massive migration of 'economic refugees', political refugees, etc. Unemployment has also returned as a widespread international problem with indications that once again it may lead to protectionism, nationalism, and danger of conflict. The widespread debt crisis in developing countries is another situation which at one point could easily have led to confrontation between debtors and creditors and may do so again. The marginalisation of Africa is a sufficiently serious problem to require global action and contain the seeds of future conflict if allowed to continue.

In addition to this globalisation resulting in an increasing tendency for national problems to spill over into global problems calling for effective treatment at UN level even in the absence of direct military international conflict, there is also an increasing realisation that preventive action is much cheaper than waiting for these problems to develop into military conflicts. The need for, as well as the scope for, preventive diplomacy has been emphasized by the UN Secretary General in *Agenda for Peace*. We know from the operation of early warning systems for crop failures operated by the FAO that early warning can save money as well as lives, provided it leads to early action. An ESC with an effective secretariat could be the natural channel for receiving such early warnings and for preventing the manifold localised deprivations from reaching a scale where they spill over across national boundaries. Such a wide agenda certainly suggests that the ESC should be in continuous session and form special negotiating groups (possibly in the form of ESC sub-committees) to deal with the major problems identified above.

This last point leads us to the question of the more specific composition and working methods of the ESC. In formulating suggestions in this direction the closest existing blueprint is the proposal for a 'World Economic Council' arising put forward by WIDER as a follow-up to their proposal for a Group of the Non-Five.10 As part of this proposal they suggest that the Non-Five group should merge with the G5 (or G7) to form a 'World Economic Council'. The suggestion is for a governing body of 8-11 members; in the case of 11 members three would come from Western Europe, three from Asia and Oceania, three from the Western Hemisphere, one from former USSR and Eastern Europe, and one from Africa and the Middle East. This composition has been arrived at on the basis of a mixture of economic and social indicators, including GDP (on a Purchasing Power Parity basis), external trade and population. In the light of the agenda of the ESC, in which the problems of Africa figure so strongly, and

10 op. cit.
the possibilities of constructive developments in the Middle East arising from recent peace moves might also be an important item, it might be suggested to increase the membership of the ESC to fifteen by giving Africa the same number of seats as Asia and the Western Hemisphere, i.e. three, and by giving the Middle East two seats by itself. This would weaken the position of Western Europe and the US (which would be part of the Western Hemisphere representation). This weakening should not be counter-balanced and made acceptable to Western Europe/US by watering down the mandate of the ESC to general and non-binding discussions and resolutions, but rather by making action dependent on a qualified - say two-thirds - majority in the ESC. Minorities would always be free to put forward alternative recommendations. The list of issues mentioned above makes it clear that in any case positions taken would often cut across a simple North-South divide.

The smaller size (around 10) of the WIDER proposals of around 10 members stems from its origin in balancing the G5 with a Group of Non-Five. However, elsewhere the WIDER study mentions the Committee of Twenty which proved to be an effective negotiating context in the mid-1970s for the development of proposals for the reform of the international monetary system and the Group on Supplementary Financial Measures work within UNCTAD in the mid-sixties to evolve compensatory measures for protecting developing countries against export shortfall.11 The membership of the Committee of Twenty was arrived at by balancing the existing Group of Ten (industrial countries) with nine members of developing countries and a seat for Australia. If the membership were increased from 11 or 15 to 20, it would be possible to give greater representation to size of population (only 10 per cent in the WIDER proposals as against 45 per cent for GDP (on PPP basis) and 45 per cent for share in world trade.

If, instead of balancing the G5 with an equal number of developing countries, the G7 is taken as the starting point and representation from the Second World (Russia and Eastern Europe) is added, we would also arrive at a membership of around 18. Special reserved membership for China and India outside the normal calculation, to give greater weight to population would bring membership up to twenty.

The structure of an ESC would thus be a body of 10-20 members meeting all year round to receive reports and recommendations of smaller negotiating groups on subjects referred to them by the ESC, such as the above-mentioned threats to peace and economic security as debts, Africa, changes in IMF/World Bank structural adjustment requirements, AIDS, migration, refugees. In addition, the ESC would deal with direct economic threats to peace referred to it by the Security Council or by the Secretary-General. It would also deal with

11 op. cit. pp28-29.
Security-Council-related matters, e.g. to devise methods of sanctions which protect vulnerable civilian populations and compensate poorer third parties for losses incurred as a result of the implementation of sanctions. The ESC in turn would put before the Security Council direct threats to peace arising from deterioration of economic conditions in sensitive areas. Another standing subject of the full ESC would be recommendations concerning the improved working and co-operation of UN agencies. The ESC would give special attention to 'interface' problems falling between or cutting across agencies, e.g. links between trade and finance, environment and employment, structural adjustment and labour markets etc. The economic problems of specific regions, e.g. Africa or Palestine, are also typical cross-agency matters.

The smaller negotiating groups dealing with specific problems would have flexible structures and procedures depending on the nature of the problems with which they are concerned. The group dealing with Africa should obviously have stronger African representation and base its secretariat in the ECA; the group dealing with debt and structural adjustment problems would be based in the Bretton Woods institutions, the group dealing with migration and refugees would be based in the HCR, the group with AIDS in the WHO, etc. Each group would be given a definite time limit to report back to the ESC with agreed recommendations and action programmes for all UN agencies (as well as governments). This would enable the ESC itself to schedule its meetings well in advance and give consideration in depth to the selected 'topic of the month', in addition to its continuing functions of dealing with potential economic threats to peace and problems of rehabilitation after military conflicts, in collaboration with the Security Council.

Obviously, in the initial years procedures would evolve in the light of experience. For this reason, the different negotiating groups might well deliberately adopt different procedures. The groups could well co-opt professional experts to participate in their work as well as request advice from consultants. But the ESC itself, like the Security Council, should be composed of diplomats of ambassadorial rank, with economic and social competence and fully representative and in touch with their constituencies.

The recommendations of the ESC should have priority status on the agenda of ECOSOC (assuming that ECOSOC continues as at present) and the General Assembly. The recommendations of the ESC should be given priority over the mass of routinely recurring items now clogging up the proceedings of the General Assembly and ECOSOC. This would enable these organs to have a more concentrated and higher-priority agenda and achieve greater effectiveness. Similarly, the relevant recommendations of the ESC should be placed on the agenda of the annual meetings of the IMF and World Bank, and their relevant
Committees and their Directors, as well as the governing bodies of the UN Specialised Agencies concerned.
4 Structural Reform of World Bank

Structural Adjustment Programmes

In response to the development crisis of the 1980's due to a calamitous combination of declining terms of trade, rising real interest rates, virtual halt of commercial bank lending and reduced growth rates and increased protectionism in industrial countries, the World Bank and IMF executed many adjustment programmes. While there was a technical distinction between IMF "stabilisation" programmes - with presumed emphasis a demand management - and World Bank "structural adjustment" programmes - with presumed emphasis on the supply side -, in practice the two turned out to be difficult to separate and have many common elements and instruments. The principle of 'cross-conditionality' gives formal recognition to this inseparability. The following discussion of 'structural adjustment' programmes should be understood as referring to both Siamese twins of adjustment and stabilisation. The creation of an Expanded Structural Adjustment Facility within the IMF also indicates the erosion of the old boundaries; it indicates that in this new combination the IMF rather than the World Bank has become the leading partners.

Together with the IMF, the World Bank - at least in its Structural Adjustment segment - has become the creditors' instrument of choice for getting the debtor governments to service their debts. This was never part of their intended purpose. The main purpose of the World Bank was - in present language - to reduce poverty in less developed countries. Yet the fact is that despite much growth and improvement of many social indicators, 50 years of lending $250 bill. has not prevented a situation today where income disparities and poverty are greater than ever before. We concentrate, however, first on the new role of the Bank as debt collectors through structural adjustment programmes to show that the approach to structural adjustment is itself in need of structural adjustment. One counterfactual question which is difficult to answer is whether there is any connection between the partial shift from project lending for growth to structural adjustment lending and the deterioration of the Bank's performance in project lending (as documented by the Wapenhans Report). If there is such a trade-off it must be counted as part of the cost of structural adjustment lending.

Alternative Approaches to Adjustment and Stabilization

Much thought has been given to modifying the strict character of orthodox IMF approaches to stabilization and orthodox Bank approaches to adjustment. In the course of this discussion, a large number of proposals have been made and ideas emerged. The Seminar presentation distinguished no less than [24] such proposals. In this summary of the presentation these can only be briefly mentioned and listed.
There should be more dialogue and persuasion rather than imposed conditionality. This is basically non-controversial and thinking in the IMF and World Bank is moving in the same direction.

There must be recognition that at least part of the present difficulties of many developing countries necessitating stabilization and adjustment are due to external reasons over which the developing countries have no control, e.g. weak commodity prices, deteriorating terms of trade, high rates of interest, slower growth in the industrial countries, protectionism, absorption of available funds through the U.S. balance of payments and budget deficits, failure to co-ordinate the use of Japanese and German surpluses, etc. The IMF/World Bank argue that while this may be true yet the need for adjustment is not affected as a fact of life. But those asking for alternative approaches argue that this does not justify special consideration for the debtor countries, also that it calls for more symmetrical adjustment on the part of the industrial countries (especially the surplus countries), and that the Bretton Woods institutions were created not just to help developing countries to adjust to the international facts of life but rather to change them.

Some of the critics have also argued that the IMF and World Bank themselves carry some of the responsibility for the magnitude of the debt crisis, in the sense of inadequate warnings and preventive action during the period 1974-1982, i.e. from the first big rise in oil prices to the full eruption of the debt crisis with Mexico's suspension of payments. During that period OPEC was happy to put its surpluses into the commercial banks of the U.S., U.K., Switzerland, etc., for recycling (instead of supplying cheap oil to developing countries). The commercial banks were only too eager to press loans without conditionality and often without much concern for creditworthiness upon developing countries at favourable rates of interest, many developing countries equally eagerly accepted these funds as an easy remedy for their investment and ultimate repayment, and the major industrial countries were happy to continue this system because it removed any threat to the international financial system and gave them time to adjust to the rise in oil prices and counteract OPEC pressures, etc. In this sense, everyone carried some responsibility for the debt crisis, including the IMF/World Bank themselves for standing too much on the sidelines during that period. In the view of the critics of the orthodox approach to adjustment this widely shared responsibility established a case for also sharing the burden of adjustment today.

In the matter of acceptable and sustainable stabilization/adjustment policies and the impact of given policy instruments, there is still considerable uncertainty and lack of
knowledge. These are matters of great complexity and the impact of the instruments in the orthodox repertoire is by no means clear. The empirical evidence is mixed. In these circumstances there is a case for being less self-confident in prescribing measures such as devaluations, abolition of food subsidies, move towards market prices, fiscal policy, etc. Instead there is a good case for considering alternative approaches, and evaluating their results without ideological prejudice.

(5) Adjustment is a difficult process with serious political and social implications. Hence sufficient time must be given to make the process more gradual and soften the political and social impact. This means that more time should be given to debtor countries and other countries in difficulties than is often allowed for. By contrast, stabilization measures can be enacted almost instantly, but for that very reason they tend to have an immediate shock effect which also carries its own political and social dangers. Any alternative approach should make greater allowance for such shock effects and difficulties.

(6) This last point is closely related to the advocacy of more external finance being made available, as a quid pro quo for accepting the great sacrifices and risks often involved. There is a danger of a vicious circle in that external finance is conditional upon strict adherence to the adjustment programme, while the adjustment programme depends on the maintenance of external finance. There is a risk - which experience has shown to be all too real - that even temporary and perhaps unavoidable lapses from the original adjustment targets may result in a cessation of external support and the collapse of the whole programme.

(7) This last point also leads to the suggestion that in alternative approaches the number of conditions and targets should be more limited, and deviations from the targets should be a matter of discussion rather than automatic suspension of external; support - in other words, fewer and more flexible targets. In particular, the suggestion has been made that the conditionality of stabilization/adjustment programmes should be restricted to actual outcome targets (such as balance of payments deficits, growth rates, food production, etc.) rather than instruments (such as devaluation, budget deficits, credit restrictions, pricing policies, etc.)

(8) New unfavourable changes in external circumstances subsequent to the conclusions of agreements should be taken into account and more readily admitted as reasons for modification of original conditions. Alternatively, there should be compensation facilities. While this has in principle been accepted, for example, in the IMF
Compensatory Financing Facility (CFF) or the EEC's STABEX, there is a present
danger that these compensatory facilities are being eroded and themselves become
subject to stricter conditionality.

(9) There should be more concern with income distribution and the social impact of
stabilization and adjustment programmes. Many programmes have resulted in severe
cuts in real wages. The UNICEF volume on Adjustment with a Human Face has
documented widespread harmful impacts on child nutrition, educational and health
facilities and infant mortality. Reductions in food subsidies, increase in food prices,
and cuts in social expenditure often have had a hard impact on poorer and vulnerable
groups. There is a danger that destruction of human capital may defeat the longer
term objective of adjustment, i.e. to lay the foundations for subsequent sustainable
growth. Many adjustment programmes involve a reduction of "urban bias". While the
shift from urban to rural incomes is per se a move towards greater equality of income
distribution (since rural incomes tend to be lower than urban incomes), there is a risk
that this may be offset by an unfavourable redistribution of incomes within the rural
sector towards the larger and more prosperous farmers who are better able to take
advantage of new price incentives offered, at the expense of small farmers or landless
people. In any case, we do not want to solve the rural poverty problem at the expense
of creating urban poverty - it should be possible for programmes to protect poor and
vulnerable groups, both rural and urban.

(10) There is also concern about the present timing and sequencing of IMF and World
Bank action, and their mutual relation. The IMF stabilization measures, usually
working in a contractionist and deflationary direction, tend to come first and have
immediate effect. The structural adjustment measures and the longer-term structural
adjustment finance which at least in principle are more growth-oriented, take a much
longer time to be effective. This relationship is embodied in cross-conditionality with
the IMF providing a "seal of approval". The basic idea is that stabilization, often
involving devaluation, greater reliance on market prices, reduction of government
deficits, trade liberalization, etc., is needed in order to lay the foundations of
subsequent economic growth. But there is a danger that the contractionist pressures
become cumulative and stand in the way of resumption of economic growth, rather
than "laying the foundations". Another danger is that the sacrifices and pressures of
the transitional stabilization period become politically and socially unsupportable and
prevent countries from reaping the benefits expected from the subsequent adjustment
period. The present paradigm is that of reculer pour mieux sauter, of a temporary
retreat providing the room for manoeuvre needed for a new forward jump. But the
danger is that the paradigm becomes one of stepping back down a slippery slope from which it is difficult to recover or gain ground for a forward jump. The critics want to reverse the sequence between support for longer-term growth-oriented adjustment support and the more immediate need for stabilization to improve the balance of payments. They want a policy of "growing out of debt" instead of "contracting out of debt". In particular, the critics point to the import compression or "import strangulation" presently imposed by the balance of payments crisis upon Latin America and African countries as making it impossible to import the goods needed for new export promotion, or even for efficient import substitution. For example, in the case of agriculture, import strangulation may prevent debtor countries from importing the goods, such as fertilizer, agricultural machinery, transport equipment, etc. needed to enable such stabilization measures as increased prices for agricultural producers to have the intended effect of stimulating production.

(11) Related to this criticism is the suggestion that there should be more emphasis on the "real economy" rather than macro-economic aggregates - more concern with supply, specifically with supply bottlenecks. It is felt that the negotiations concerning stabilization and adjustment are presently too much confined to the financial sphere, taking place between financial experts of the IMF or World Bank on the one hand, and of ministries of finance and central banks of debtor countries on the other hand. It is felt that the conditions of the various sectors of the "real economy" such as agriculture, industry, transport, institutions, etc. are insufficiently built into the negotiations and programmes. This may lead to excessive belief in the efficacy of financial incentives, such as higher prices, a belief which may then be frustrated by such factors as lack of transport to collect crops, lack of storage, difficulties of supplying fertilizers or seeds to farmers, etc. Similarly, changes in exchange rates are supposed to lead to greater exports or efficient import substitution, but this may be frustrated by a scarcity of inputs needed for the expansion of exports and/or efficient import substitutes. In this context, greater emphasis on sectoral rather than overall adjustment lending may be indicated.

(12) To reduce the harshness of the impact of adjustment programmes on poor and vulnerable groups, a number of suggestions have been made to build in compensatory measures into the adjustment process itself, as distinct from providing ex post safety nets such as the IMF Compensatory Financing Facility or STABEX. One current proposal under examination is for the use of good aid as part of adjustment programmes. This could be in the form of programme food aid since food is naturally targeted on poorer and vulnerable groups for whom food is a more important part of
expenditure. But it is more effective to use food aid selectively targeted on poor groups lacking effective purchasing power for food so as to make sure the additional food aid does not interfere with the objective of increasing form of specific projects directed at vulnerable groups endangered by adjustment difficulties, e.g. by way of food-for-work projects, feeding programmes for poorer children, etc. The use of counterpart funds from the sale of programme food aid could provide the local finance for projects included in adjustment programmes. Counterpart funds could also serve to reduce the budget deficit which is usually also one of the objectives of adjustment programmes. The World Bank/WFP project in this area was described.

(13) Some modifications are also suggested in the present country-by-country approach. It is true that adjustment problems and optimal adjustment policies are country specific, and there is a need for careful country specific analysis. On the other hand, the impact of what is recommended to Country A on other countries, also subject to advice on adjustment policies, cannot be disregarded. For instance, if devaluation is recommended to say Kenya in order to increase the export of tea, the impact of this on the tea exports of say Sri Lanka cannot be disregarded. If Sri Lanka at the same time is induced to devalue its currency to bolster its tea exports, the backlash on Kenya will undo at least some of the intended advantages of Kenya's own devaluation; in the end both countries may be worse off, with the tea importing countries as the main beneficiaries. More generally, concern exists about the effect of outward orientation, i.e. promotion of exports, which underlies many adjustment programmes, on export prices and terms of trade. It is also not always clear that devaluation with high prices for export crops, in terms of local currency, always gets through to the producers and if it does whether the resulting increase in exports is not at the expense of food production for domestic use. The orthodox approach emphasizes that import substitution must be efficient (and that it is efficient if viable at "proper" adjusted exchange rates). But the critics would extend this qualification also to export promotion and stipulate that export promotion must also be "efficient" and can be inefficient, especially for developing countries as a whole. The concern is often expressed in the form that the country-by-country approach is open to a "fallacy of composition".

(14) The monitoring of performance in stabilization and adjustment programmes has also become a matter of debate. It is suggested, for example, that more social indicators should be used, such as reduction of infant mortality, school enrolment rates, literacy, provision of employment, reduction of poverty, etc., so that countries doing well in these respects are given credit for their performance. Similarly, suggestions have been
made that performance in all targets taken as a whole so that under-performance in one individual target should not automatically trigger off suspension of promised assistance.

(15) As a general trend, there is increasing recognition of the need for adjustment programmes to be more "growth-oriented". The point emphasized is that sectoral shifts and industrial restructuring are all easier in the context of growth. The same is true of shifts in income distribution, as was recognised in the development strategy of "Redistribution With growth advocated by the World Bank in the "McNamara era" of the early and mid 1970s. The principle that adjustment should be more "growth-oriented" is not controversial; the Bretton Woods institutions themselves are increasingly accepting this point. But there still remains an area of doubt as to what extent stabilization, often involving "austerity", is a pre-condition for growth and hence must come first; as against the view that growth orientation should dominate both stabilization as well as adjustment. In a growth-oriented stabilization approach, the avoidance of import strangulation and maintenance of rates of investment would be more important objectives that they are now compared with a better balance of payments equilibrium or control of inflation.

(16) A particularly important criticism of the orthodox approach is that it is not country-specific enough, in the sense that the programmes reflected too much a "standard" approach, dominated by monetarist or neo-liberal doctrines and ideology. This criticism refers to a general presumption of these programmes that market failures are less important than government failures; that rational allocation of existing resources, broadly identified with allocation on market principles, is a more immediate objective than promotion of growth by increasing resources, or at least the precondition for it; that "getting prices right" is of primary importance and that price incentives are vital and effective; that criticisms of a "standard" approach are denied by the IMF and the World Bank but various analyses have shown that the country programmes in fact bear considerable resemblance to each other in the above and other respects. The critics ask for greater or more balanced emphasis on market failures as well as price incentives; dangers and risks of competitive devaluation of debtor countries; need for more symmetrical adjustment by creditor countries, etc. The case of the critics is that the programmes are both (in the sense of following a country-by-country approach without sufficient consideration given to the "fallacy of composition".)
5 Reform of GATT (MTO)

GATT has been a mixed success. Its contribution to tariff reduction is clear, its effect in the 'grey area' of non-tariff barrier (NTB) less so. Even if the Uruguay Round is successfully completed, there will still be gaps. While in the Uruguay Round GATT is extending from trade in goods into trade in services, trade-related investment measures (TRIMS), and trade-related intellectual property rights (TRIPS), the competence of GATT would still fall short of that of the originally envisioned ITO. In particular, GATT does not deal with commodity prices nor with restrictive business practices, nor with environmental aspects of trade. Another major exclusion is the question of social impacts of trade on income distribution, employment and labour standards, as well as environmental aspects of trade. The latter may be of direct importance, in view of the dangers of 'green protectionism'.

While it is not excluded that after a successful Uruguay Round future new rounds could extend into some or all of these areas, the GATT would then de facto develop into a full-scale trade organisation - a new GATT - but without the binding powers and normative functions of a full institution.

In this connection a recent resolution on the Uruguay Round by the European Parliament may be quoted:

'... the strengthening of an open system of world trade must, of necessity, be achieved by respecting worldwide environmental balances and must be accompanied by the promotion of parallel social development ... that the expansion of free trade does not necessarily serve the needs of the poor of the world or the conservation of the environment and there are cases in which the freedom granted to trade in goods and services may undermine a more fundamental freedom - the freedom which allows peoples and their governments to exercise democratic control and tackle their most important problems effectively.'

The resolution also raised the question of the influence of TNCs on world trade as a neglected area and supported the Canadian proposals for the creation of an MTO, adding 'that it should have a democratic international structure and be empowered to regulate fairly the trade activities of states as well as multinational corporations'.

Apart from the need to make GATT more comprehensive, there is also a recognised need for improved and strengthened dispute settlement procedures and for monitoring compliance. In particular, the GATT has not been able to prevent a wide area of unilateral retaliatory and
discriminatory action by important industrial countries, e.g. Section 301 action by the US and similar EEC regulations. Unilateral determination of such concepts as 'unfair trade', 'unreasonable' volume or prices of exports, 'dumping', and definition of 'offending countries' all sit uneasily with the GATT concept of non-discriminatory rule-based multilateral trading. It is felt that a full institution like the MTO, with powers similar to those of the IMF and World Bank, would be better able to cope with such thorny problems.

Even without the MTO, GATT would need a more effective trade policy review mechanism, including surveillance and country reports similar to those of the IMF and OECD. This review mechanism should also include trade-related environmental issues as well as social and gender issues relating to international trade. This would involve links not only with the IMF and World Bank as presently proposed, but also with the other agencies in the UN system dealing with human and sustainable development. The way in which environmental and social issues (especially labour conditions and social security) come to the fore in trade negotiations is vividly illustrated in the negotiations concerning the North American Free Trade Area (NAFTA).

There is no doubt that GATT in the post-Uruguay world, or any successor organisation like the MTO - would be increasingly involved with the environmental and social aspects of world trade. This raises the danger of conflicting approaches to environmental objectives (World Bank/UNDP/UNEP operating the GEF) and social objectives (ILO, World Summit for Social Development) on the one hand and trade policies (GATT or MTO) on the other hand. This will create new and hitherto unexplored problems of coordination within the UN system.

The proposal for an MTO, based on a Canadian initiative, is detailed in the Draft Final Act (DFA) but is not itself part of the Uruguay Round agenda. The present draft proposes close links with the Bank and Fund but not with the UN itself as was the case in the non-ratified ITO charter. Apart from the UN itself, one would suggest close links with UNCTAD and with the UN Committee for Sustainable Development. Environmental questions are mentioned in the preamble of the MTO proposal detailed in the DFA but not subsequently operationally specified. The suggestion has been made that the MTO should establish a Committee on Trade and Environment and also a Committee on Trade and Social Development.124

The special needs of developing countries were not initially considered in GATT but special provisions were subsequently added (Part IV of GATT). The present unilateral action by

major industrial countries works of course to the disadvantage of developing countries which lack powers of retaliation and are often the specific targets of such unilateral actions. Success in the Uruguay Round would benefit the developing countries, especially in the reform of the Multi-Fibre Agreement (MFA) and for food-exporting countries in the field of agricultural policies of industrial countries. There will, however, be losers as well as winners and compensatory action would be called for, especially for the poorest food-importing countries. This is in fact recognised and provided for in the Draft Final Act of the Uruguay Round.

The weaker countries have a special interest in substituting rule-based instead of power-based policies and settlement of disputes. To the extent that an MTO would have greater powers to assert the observance of rules, this would act to the benefit of developing countries, provide for a more equal distribution of the benefits from trade and improve the social impact. Whether by creation of an MTO, or by the strengthening of the powers of GATT, much still needs to be done to improve the contribution of trade to human development and give sustainability to its impact on growth. There are clear danger signs that the absence of a social dimension in the approach to the world trading system is leading to a backlash against the very idea of free multilateral trade, in the form of a 'New Protectionism', 'managed trade' and regionalism. A better balance between efficiency and social justice will lead to a more sustainable world trading system.
6 Restructuring the UNDP

The UNDP is clearly in decline, as far as its traditional role as the central funder and co-ordinator of technical assistance operations in the UN system is concerned. This traditional role is being eroded in a number of directions. The UNDP has been affected by the general shift of resources and support away from the UN system in the narrower sense to the Bretton Woods system - the World Bank now is more important as a source of technical assistance funding than the UNDP. The resources of the UNDP have been stagnant in the face of increasing needs, increasing populations, and increasing incomes of donors. As a result, the role of the UNDP's share in total transfer of resources to developing countries in purely quantitative terms and on a gross basis has become quite insignificant - 2 per cent or so of the total. The specialised agencies of the UN tend to be less dependent on UNDP resources and rely more on their own resources, bilateral donors, special funds, etc. The proliferation of special purpose funds established with the Specialised Agencies by donors has hurt UNDP's central funding role and directly competed with its fund-raising efforts. The UNDP itself tends to rely more on direct execution by recipient governments, bypassing the specialised agencies.

In the light of this, it is worth emphasizing some of the enduring comparative advantages of the UNDP, especially in comparison with its chief rivals in the Bretton Woods institutions. The UNDP has a considerable field structure and field offices where local staff are increasingly prominent. In the field, the UNDP has unquestionably played a useful role in co-ordinating technical assistance operations and in a number of cases beyond this in co-ordinating general aid through its Roundtables - in parallel with the World Bank Consortia. The UNDP is recognised as being politically neutral in its country allocations, as expressed in the indicative planning figures and operates without conditionality; for this reason it is popular among recipient countries (but perhaps for the same reason unpopular among donors) and enables both them and the UN system to plan ahead on a medium-term basis. Its relationship with the governments of developing countries is much more in the nature of a genuine "development contract"; as a result its programmes and projects are more genuinely "owned" by the governments. Its neutrality between sectors and absence of special ideology or macroeconomic conditionality enables the UNDP to operate in countries regardless of economic structures and policy orientation. Its multisectoral orientation makes it flexible in fitting in with the governments' own priorities. The UNDP voting system and methods of control by its Governing Council are generally recognized as representing a fair compromise between the Bretton Woods system of one-dollar-one-vote and the UN system of one-country-one-vote.
In view of these formidable comparative advantages, the relative decline and lack of support for the UNDP has perhaps less to do with the UNDP itself - even though the Kienbaum Report suggests a number of improvements in its managerial structure - than with the general preference of major donors for the Bretton Woods institutions over the UN system, and specifically with lack of trust in the UN specialised agencies through which UNDP assistance is channelled and which act as the chief technical advisers to the UNDP. Thus to some extent the restructuring of the UNDP is an integral part of the general restructuring of the institutions and instruments of global governance, and in particular a healthier relationship between the Bretton Woods system and the UN system.

However, to some extent the relative decline of the UNDP and failure to use its comparative advantages fully is due to its image as a mere funding organisation, without much colour, vision, or defined position. The UNDP appears as a somewhat 'grey' institution - its very advantage of neutrality, absence of ideology, absence of politics, may have worked to its disadvantage. So increasingly thought is turning towards associating the UNDP more clearly with some leadership in development thought. The one area that comes to mind in this connection - the one exception to the 'grey' image of the UNDP - is the area of human development. In this area the UNDP has in fact played a leading role (together with UNICEF) through the Human Development Reports published since .... Here the tide is moving in the direction of the UNDP. New insights into the nature of development and increasing dissatisfaction with the approaches of the Bretton Woods institutions have combined to make the Human Development Reports into major influences, not only in developing new thinking but also in changing more conventional approaches, including those in the Bretton Woods institutions.. In restructuring and revitalizing the UNDP, it may be natural to build on this success and let the spirit of human development more strongly permeate and influence the whole work of the UNDP. In the past, the Human Development Reports have seemed more like an isolated activity which happens to emanate from the UNDP but does not really influence its other activities. The idea of a more people-centred development by now has become sufficiently accepted as to be virtually uncontroversial - hence perfectly compatible with the UNDP's comparative advantage of 'neutrality'.

Apart from being the flagship of human development, the UNDP could also become the flagship of sustainable development. In this respect, the association of the UNDP (and also UNEP) with the General Environmental Facility (GEF) established after the Rio conference could serve as a starting point. At present this association seems more nominal than real and

the UNDP plays second fiddle to the World Bank in the decision-making process (or even third fiddle to the World Bank and UNEP which has a lead in at least part of the GEF activities). Capacity 21, if properly funded, could become an important "identity" for the UNDP. Similarly, the new Commission for Sustainable Development provides another opportunity for the UNDP to be closely associated with its work on social integration, poverty reduction and productive employment and thus acquire a new purpose and image.

This possible strategy for a new UNDP is also discussed in the Kienbaum Report. But perhaps the Kienbaum Report poses a false dilemma. Leadership in thought and leadership in technical assistance funding and co-ordination need not be alternatives. Leadership in thought in the directions here indicated may help to mobilize for the UNDP the political support, resources, and influence which are needed to make its role in co-ordinating technical assistance operations for the whole UN system more effective and important.

Because of its strong field orientation, the traditional coordinating functions a country level through its Resident Representatives and its good relations with Government is also destined to play a role in coordinating UN action in cases of emergencies (natural and man-made) as well as rehabilitating after major emergencies. Given the increasing importance of such emergency situation and the increasing role of the UN in dealing with such situations, the UNDP could here play a role of key importance for the reputation and future of the UN and the whole UN system. This is particularly so when the area of emergency or conflict is limited to a particular country covered by a UNDP field office and Resident Representative. The UNDP seems less well equipped to play a coordinating role in problems such as refugees or international wars where boundaries are crossed - here the coordinating role would lie clearly with HCR or other relevant bodies, but the role of the UNDP would still be important in adjusting country programmes so that they serve to cope with the effects of the emergencies and with rehabilitation.

The present relations between the UNDP and recipient governments are coming very close to the proposals for a balanced relationship with mutual rights and obligations in the form of a 'Development Contract'. Not surprisingly, therefore, the authors of this proposal have been thinking of the UNDP as the organisation charged with administering and monitoring such development contracts. For this purpose, a UN Commission on Development Contracts has been proposed within the UNDP as well as the annual or bi-annual publication of a Progress

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Report on Development Contracts by the UNDP. It is recognised that if the development contracts involve active assistance in negotiations, mediation, arbitration, etc. a separate secretariat within the UNDP would be required. This involvement, like the Human Development Reports would serve to give the UNDP a heightened profile which in turn could help to attract additional support and resources.

Apart from its grey image as a more 'funding' organisation the UNDP has to contend with some other weaknesses. A fairly recent listing\textsuperscript{17} included patchy agency performances in delivery of projects, slow response time in approval and design of projects, orientation of New York staff to servicing a cumbersome Governing Council rather than the field offices, too much reliance on a rotating group of senior experts instead of flexible recruitment of experts best suited for the specific projects and specific country for shorter periods as required. These are problems of managerial reform rather than part of the restructuring of the UN system, although some of them concern the UNDP's relationship with the Specialised Agencies and the whole question of the role of the UN and the Secretary-General \textit{vis-à-vis} the Specialised Agencies and their governing bodies. Ultimately, this is a matter for the member governments to speak with one voice in the UN and the agencies. The patchy performance of the agencies faces the UNDP with a dilemma. Is its primary duty to the developing countries - which may point towards direct execution - or to the UN system to help the agencies cope with their financial pressures? There might of course, be no conflict between these two duties - but what is the duty of the UNDP when there is a conflict?

\textsuperscript{17} From the UNDP Management Study by Quentin Smith and Robert Pursell (1990).
7 Problems of UN Specialised Agencies

(1) The traditional roles of the Specialised Agencies of setting standards, collecting, analysing and disseminating information, and giving policy advice within their respective fields of competence have been greatly eroded. This parallels the similar erosion of the role of the UN itself.

(2) The erosion is reflected in - and also largely caused by - a shift of financial support from the UN system to the Bretton Woods system. This reflects the political support of the economically powerful countries for the Bretton Woods institutions and the lack of such support for the UN system. The World Bank now spends more on technical assistance than the UNDP, even though technical assistance (together with food aid) was allocated to the UN in the 'Great Compromise' of around 1960 when IDA came to the World Bank instead of the UN.

(3) As a result of lack of financial resources, the Specialised Agencies are now largely dependent on extra-budgetary resources. These are available almost exclusively for technical assistance activities rather than policy-making or analytical functions. FAO, WHO and UNIDO now depend for over 50 per cent of their resources on extra-budgetary funds; ILO and UNESCO are not much below that figure. The main extra-budgetary resources are bilateral donors, the UNDP and in fact the World Bank itself. We thus have the anomalous situation that one part of the broader UN system is dependent on another part - the Bretton Woods system - for its financial resources. This cannot fail to be reflected also in a loss of intellectual independence and initiative on the part of the Specialised Agencies.

(4) The inevitable result has been that the competence of the Specialised Agencies in standard-setting, policy-making and analysis has been greatly weakened. This has set up a vicious circle: lack of resources and political support leads to lack of competence and the lack of competence then forms a reason (or pretext) for shifting resources and support even further - to the Bretton Woods system. The results of this ongoing process are clearly visible. They are particularly clear in the case of UNESCO - where lack of support has taken the extreme form of important countries leaving the Agency altogether - and of UNIDO where the process has perhaps gone furthest. Performance in the Agencies is now largely measured by their ability to attract extra-budgetary funds. Those parts of the Agencies and staffs involved in the traditional functions of standard-setting etc which cannot share in the scramble for technical assistance resources, and staff working in areas not corresponding to funders' priorities, are liable to be in a state of frustration or demoralization. This then is often attributed to 'bad
management'. The quality of management may well be affected by the frustration of staff in yet another vicious circle. (This is not to deny that there are also cases of bad management and low morale due to more avoidable reasons - but these are not limited to the Specialised Agencies part of the wider UN system.)

(5) Reliance on extra-budgetary resources creates a new problem: either the overhead payments agreed with the Agencies are generous, in which case the Agencies become dependent even for their normal activities on securing enough extra-budgetary funding; or else the overhead allocations are insufficient, in which case reliance on extra-budgetary funding exerts a further drain on the resources available for the traditional and normal work of the Agencies. The authors of the Nordic Project assume that the latter is the predominant case. This is, however, not clearly established.

(6) This process threatens to become unsustainable: if technical competence declines this is also bound to show in lack of competent support for operational activities financed from extra-budgetary resources. There are signs that they aim for quantity rather than quality (which absorb more staff and is not rewarded) in the execution of UNDP projects and pad the equipment which requires less staff time to deliver and extend projects unduly instead of transferring as soon as possible to the recipient. In this and other ways, budgetary pressures affect the quality of project work. Competition for projects and the associated overhead funding also discourages cross-sectoral and cooperative projects and approaches. Competition for projects by direct contacts with the Ministries of recipient countries also makes the coordinating work of Planning Ministries more difficult. Such complaints, however, do not by any means to all agencies - or indeed all operations of any agency. But the tendencies here described are perhaps the inevitable consequence of budgetary pressures. All this makes the coordinating and monitoring functions of the UNDP all the more important. The logical result would be that the World Bank as well as the UNDP and bilateral sources are driven to implement their technical activities directly or through channels other than the Specialised Agencies.

(7) The erosion of the Specialised Agencies is most clearly expressed in their exclusion from the negotiations of structural adjustment and stabilisation programmes by which the policies of most developing countries are now largely determined. These negotiations take place between IMF/World Bank officials on one side of the table, and Ministry of Finance/Central Bank representatives on the other side. Even though the decisions may have a deep effect on such sectors as agriculture or health, the FAO or WHO are not represented in the negotiations nor are the Ministries of Agriculture and Health of the developing countries. The unspoken assumption - which may well be true by now - is that the World Bank has itself sufficient
direct competence in matters of agriculture or health which it assumes to be superior to the competence available in the Specialised Agencies. Otherwise it would be difficult to explain the exclusion of the Agencies from this major policy-making process. If there is a serious intention to revitalise the Agencies, this may well be one of the places to start. However, the indispensable precondition would be greater and more reliable direct budgetary support for the Agencies and - perhaps even more important - greater political support.
8 Environment and Sustainable Development

The Need for a 'Global Partnership'

Just as the nature of environmental problems is global so too is the need for the response to be a global one. It must be a 'global partnership', in which all countries work together to resolve problems that affect all of us, and have their roots in activities that take place all over the globe. While the Rio Summit and its aftermath focused attention on multilateral initiatives, we must not lose sight of the need for all countries to implement 'sustainable development' at a national and local level. There is a need to integrate local, national and international initiatives, and to incorporate environmental and development considerations in all activities. The multilateral institutions (the UN, the IBRD, the IMF and regional groupings such as the EC) and national governments must ensure that their policies take full cognisance of environmental concerns. Discussions at the Rio Summit did not ignore this, and indeed stressed the importance of each country producing strategies for national 'sustainable development' strategies. As Under-Secretary-General Nitin Desai told the Commission for Sustainable Development in June 1993, if UNCED's decisions are forgotten at a national level they will lose their force at the international level. (ENV/DEV/193)

The Rio Summit promised much, but it was not without its problems. Many issues are still in contention, and progress since the Summit has been disappointing. Unfortunately, the response so far has been characterised by a North-South divide, where the North's concerns are principally related to the environment, and the Southern countries, not surprisingly, with development. There remains a tension between the two, and it will be a crucial task for the future to fully integrate them, to the benefit of both.

Financial Questions

At the base of disagreements over the implications of the Rio Summit and its legacy there is the question of resources. The costs of implementing Agenda 21 are large, though undoubtedly the cost of inaction would be even greater. According to the Agenda 21 estimates, the cost of implementation to developing countries totals US$561.5bn per annum between 1993 and the year 2000. Of this the international community would need to provide US$141.9bn in concessional funding. It was estimated that around $15bn of that concessional funding was already being provided.

The failure of the Rio Summit to put any figures on the likely cost for industrial countries of implementation was of concern in itself, as the need for industrial countries to adjust their
behaviour is just as crucial for a successful outcome, if not more so, than that of the developing countries. Whether developing countries are in any position to provide the two-thirds of finance that Agenda 21 demands for the implementation of its proposals is open to question, most crucially if the debt crisis, falling terms of trade, and other economic issues that constrain the South's development are not addressed.

The 1992 UNDP Human Development Report calculated that there was a net flow of $50bn from South to North in 1989 due to the debt crisis, and that $60bn worth of potential income is foregone by the South due to unfair trade restrictions and barriers in the Northern countries. The resolution of these problems would do more than an increase in aid to help resolve environmental and developmental problems in the South. The impact of structural adjustment has aggravated many environmental problems as social safety nets have been reduced, forcing people to exploit scarce resources in order to survive.

However, at the Rio Summit industrial countries failed to pledge anything like the resources needed in concessional finance. While commitments were made to increase resource flows to the South, they were not backed up by concrete figures or target dates, beyond vague commitments to reach the long-standing UN target of 0.7% of GNP for ODA. Together industrial countries pledged only around US$2.5-3bn per annum in new resources at the Summit. Since the Summit ODA from many countries has actually fallen. Thus the resources already pledged are clearly inadequate for the task that faces the international community. Such a commitment must be taken seriously by the North, and concrete dates must be set for the achievement of the UN target.

Four areas specifically need to be addressed so that developing countries can devote the necessary resources to achieving 'sustainable development':

(1) Open and competitive markets are needed for trade expansion, as well as supportive trade rules;

(2) The debt crisis is far from resolved. One possible method would be to transform sizeable portions of debts into investments for priority 'sustainable development' objectives (for example clean water supplies, sanitation systems, etc.);

(3) Defence spending and other large-scale projects could be reviewed in light of the need to reorientate priorities towards sustainable development. This could be done as part of a country's formulation of sustainable development strategies aimed at achieving maximum efficiency in the use of both domestic and external resources. The Rio Summit called on all countries to formulate such strategies, and some countries, such as the US have already begun to do so. (The Presidential Council on Sustainable Development was established on 14 June, 1993);
The mobilisation of increased multilateral funding for an expanded environmental financing mechanism.

There is clearly a need to adopt a longer-term view of the development process and to place people at its centre. Longer term commitments to development from both the North and the South could take the form of Development Contracts. There will continue to be a need for multilateral and bilateral assistance, however, to build capacity in the South, to fund technology transfer, national sustainable development strategy plans, and to ensure that the poorest are not marginalised. While improved economic prospects for the South must be the cornerstone of sustainable development, there is no guarantee that such prospects will apply uniformly across the South, and aid will be needed to assist those who do not benefit fully.

Implementing Bodies

The 'global partnership' needed to address the environmental challenges must be constructed. It cannot be left to chance. There is a danger that rather than such a partnership we will see a reversion to the 'donor-recipient' relationship which has come to dominate the multilateral development institutions' activities in the 1980s. The moral arguments for such a partnership are unassailable. The industrial countries have contributed disproportionately to the pollution of the global commons. They cannot now refuse the developing countries the right to use their natural resources as they wish simply because industrial countries have already polluted the commons to near capacity. As a matter of equity it is the developed countries that are looked to for abatements that will make room for growth in the South without precipitating environmental disaster. However it is clear that continued 'environmental vandalism', as Vice-President Al Gore put it, will be detrimental to us all. A global response must take account of these factors and requires complementary actions from all states. This is particularly true in response to the Climate Change Convention. While many countries have agreed to the Convention, the challenge now is to implement it. The US, initially lukewarm about the Convention, has now committed itself to reducing greenhouse gas emissions to 1990 levels by the year 2000.

Unfortunately, the principal existing administrative mechanism for the distribution of these funds (the Global Environmental Facility (GEF)) exhibits the potential for reverting to a 'donor-recipient' relationship. While the GEF is formally a partnership between the World Bank, the United Nations Development Programme (UNDP) and the United Nations Environment Programme (UNEP), it is dominated by the World Bank, which administers the fund, provides the secretariat and implements investment projects.
The World Bank, dominated as it is by the G7, is not the appropriate forum for such a Facility. The World Bank's lack of democracy and transparency make it ill-suited as the administrator of the principal global sustainable development fund. The crisis is a global one and requires a global response, where all countries feel they have a say in policy formulation and implementation. The dominance of the GEF by the World Bank makes this unlikely. Many Southern countries have expressed the fear that environmental criteria will become just another form of conditionality imposed by the North. Nor does the World Bank's environmental record suggest that it is the most appropriate body for drawing up a strategy for the Facility, as it is required to do by the GEF. It has continued to treat environmental concerns as externalities, and has failed to integrate them fully into its analysis of projects (though this is perhaps a reflection of a wider slowness to adopt, or even formulate mechanisms for 'full costs accounting', which present formidable difficulties. This is in itself an area that requires further work). In addition, the Facility is short of funds.

The present GEF is only a pilot scheme, due to end in mid-1994. Negotiations on its restructuring are expected to be completed by December 1993. This provides an ideal opportunity to restructure the GEF as a true partnership between the UNEP, the UNDP and the World Bank, perhaps with its own secretariat that can draw on the expertise of the three agencies in the design, implementation and evaluation of projects. Ideally, this would be located in the UN, under the authority of the Commission on Sustainable Development, and ultimately under democratic control by member states on the basis of one-member-one-vote, and not the weighted voting system that exists in the Bretton Woods financial institutions. This would enhance both the prospects of a global partnership and the co-ordination of the multilateral actions, and the authority of the Commission on Sustainable Development.

The present arrangement, with the principal financial mechanism existing outside the UN and the Commission, weakens its authority and the cohesiveness of the multilateral environmental institutions.

This new body should be constituted with a more democratic decision-making mechanism, perhaps along the lines of the Montreal Protocol Fund, balancing representation of developing and industrial countries on its Executive Committee. In addition, it will need to be financed by new mechanisms which give it a continuous, or at least predictable and independent, flow of resources. Possibilities would include taxes on environmentally harmful activities in member states; consumption taxes on unsustainable products (such as CO2); 'feebates' (fees levied on resource consumption over a basic need level, rebated to countries below that level) - all these having the two-fold effect of helping to curb such behaviour and of raising revenue for
environmentally beneficial activities; earth stamps; debt swaps or conversion; taxes on arms sales; on energy sources; on global currency markets; etc.

Cofinancing should not be counted as part of GEF contributions as it will inherently introduce elements of the donor-recipient relationship into the body and will also allow richer countries to pick and choose those projects that are of most interest to them. It should only be welcome where it is clearly additional to GEF contributions and other aid. Finally, some resources should be made available for South-South projects and co-operation.

While the establishment of the GEF in 1990, and the Rio Summit, its declarations and the Commission for Sustainable Development have produced a number of new multilateral bodies dealing with the environment, existing development and environmental agencies (UNDP, World Bank, IMF and related financial institutions, the UNEP and the other UN specialised agencies) have a vital role in promoting Agenda 21 and the Biodiversity and Climate Change Conventions. The task is too great for one agency. Indeed, it is vital that the new emphasis on the environment and development is integrated into all the activities of these agencies, and of member states of the UN.

In recent years the World Bank has introduced reforms aimed at strengthening its awareness of environmental criteria. It has greatly expanded its environmental staff and has a number of different departments for reviewing the environmental impacts of projects. However, many of these reforms have been criticised for being poorly executed, and the Bank has overridden its own environmental guidelines in a number of cases. The Bank has announced a new set of reforms, specifically to improve a declining project success rate, but which have implications for sustainable development. These include an ombudsman, an independent review group which will monitor projects, and greater transparency in its operations.

However, it is clear that for the World Bank to tackle sustainable development successfully it must institute changes that go beyond formal institutional changes and include the culture of the organisation. Project completion and monitoring must become more important than loan approval. The Bank must adopt a longer-term view of development, and environmental concerns must be more thoroughly integrated into project analysis. Participation of local governments, NGOs and local communities must become more integral to the processes of project design, implementation and evaluation. All this is recognised by the World Bank itself (in the Wapenhans Report on Effective Implementation: Key to Development Impact), and some changes have been made in this direction. However, the Bank remains highly centralised and this is a hindrance to its efforts.
Among the UN specialised agencies there is a lack of resources and capacity. Both have combined in a vicious circle which has led to demoralisation in many UN agencies as staff have moved elsewhere, frustrated by a lack of resources, and those left have to cope with institutional restraints. However, the UN is the appropriate body to coordinate the global response to the environmental crisis, and this requires both financial and political support from its member states. It is vital that the CSD is not reduced merely to a figurehead of the system by a lack of resources and the location of the major environmental funds essentially outside the UN system.

The UNDP needs to be strengthened so that it can fulfil its role of providing technical cooperation and capacity building, crucial to environment-friendly development. UNEP has seen growing financial support, but the UNDP has not benefited accordingly from the increased international concern with the environment. Its Capacity 21 fund, launched during the Rio Summit with the aim of raising $100m to aid developing countries to formulate strategies for sustainable development, received only $6m in pledges. This is symptomatic of the UNDP's declining role in the provision of technical assistance. Although it was designated as the principal multilateral body for the provision and co-ordination of technical assistance, UN member states have channelled their money through other bodies. As a result, the UNDP's core fund represents only around 2% of the total funds available for technical assistance. Since then the fund has stalled and some countries have frozen payments, and contributions to the UNDP's regular budget have fallen. The UNDP must formulate its strategy for capacity building and the UN member states must put greater weight behind the process. On the UN's part there must be greater co-ordination between the specialised agencies in their response to the challenge of implementing Agenda 21.

UNEP must strengthen its Earthwatch database, and expand its functions so that the data becomes more widely available to governments and international organisations engaged in the design and execution of development projects. The valuable work that UNEP has done in promoting scientific study on particular environmental issues, and its promotion of international environmental law and policy-making, should be continued. The growing importance of environmental law is demonstrated by the establishment of a Chamber of the International Court of Justice specifically to deal with environmental disputes in August 1993.

Where UNEP has been less successful is in its role as a co-ordinator of environmental policy in the UN system. This should be made a priority, and member states, both directly and through the CSD, could upgrade the UNEP's ability to do this by demanding that all technical cooperation projects should receive prior seal of approval by a UNEP-directed central project review body before any disbursements.
Poverty alleviation is crucial to a sustainable development strategy. Structural adjustment packages have paid insufficient attention to poverty in the past, and there is therefore a need to find new development approaches that can combine economic growth with poverty alleviation. The IMF also must integrate poverty reduction into its stabilisation programmes (and both institutions should perhaps move beyond them, to development contracts). (See next section.)

**Development Contracts**

The future role for the UNDP might be as the central organ of a Development Contracts system, the successor to Structural Adjustment Programme. Development Contracts, first proposed by Thorveld Stoltenberg in 1989, have received growing attention. They would provide a mechanism for medium-to-long-term development planning, formulated by developing countries themselves, in consultation with the various donors and multilateral agencies. The developing country and the donors would agree to a development plan and accept certain mutual obligations as a consequence. All parties would agree to follow the policy framework laid down as long as external circumstances did not change too radically from those assumed in the plan, and all other parties met their obligations.

The Development Contract would offer a number of advantages including a co-ordinated and coherent funding base for the development plan, a more co-operative relationship between donors and developing countries, and greater commitment to the plan on the part of the developing country as they had formulated it themselves. The contractual nature of the relationship would mean that obligations rested on all parties - while developing countries would be required to undertake reforms, so too would developed countries be required to reform their trade policies to allow developing countries access to their markets, to assist in the alleviation of the debt crisis, improve the quality and level of assistance, and accept reciprocal obligations concerning the environment. The Development Contract could be linked to the National Sustainable Development Strategy Plans that countries were asked to formulate by Agenda 21, and would thus provide a mechanism for drawing up sustainable development plans that would encompass both development and environmental considerations.

There is also room in the Development Contract mechanism for dealing with issues of governance and democracy. Criteria relating to transparent administration, democratic institutions and public accountability could be included in the Contract. Monitoring of such criteria would be problematic, but use could perhaps be made of human rights organisations, constitutional experts, or the UNDP's proposed Political Freedom Index (PFI)).
Clearly there would need to be a forum for negotiation between the various actors, and a monitoring and arbitration system to deal with any failures to fulfil obligations. The UN ECOSOC would provide a possible forum, and the body to which reports on misdemeanours could be submitted for consideration. The UNDP would serve in a supporting role as the forum in which detailed country negotiations would take place, and as the monitoring organisation, submitting reports to ECOSOC on an annual/biannual basis. The publication of a Progress Report on Development Contracts might serve as an additional vehicle for monitoring and compliance. The UNDP would need to be expanded to take on this role, particularly by increasing its expertise on environmental matters, and might set up machinery for mediation, appeal and arbitration in cases of breach of contract.

Such a contractual arrangement already exists in a more limited state in the form of the World Bank's Aid Groups, which bring together donors with a long-term interest in supporting a particular developing country. The Aid Groups have facilitated the development of continuing policy dialogue between donors and developing countries, encouraging early recourse to the World Bank and IMF in times of economic difficulty. Similarly, the UNDP already organises Round Tables for 25 of the poorest countries to assist them in the presentation of their aid requirements to the donor community and the mobilisation of assistance. At similar Consultative Group meetings, which the World Bank organises for another 30 developing countries with relatively large capital assistance programs, the Bank looks to the UNDP to report on technical co-operation requirements for these countries. Thus there is already a cooperative relationship between the UNDP and the World Bank in such activities, laying the basis for an expanded mechanism, the Development Contract, that would encompass the wider social and environmental concerns.

Governments have a vital role in implementing Agenda 21 at a national level. It is regrettable that there is not compulsory reporting to the Commission on Sustainable Development about each countries' efforts at 'sustainable development' as it makes the task of monitoring global efforts difficult. However, for many countries to be able to complete such reports there must be financial resources and capacity building assistance in place. Governments need to review the totality of their policies (trade, transport, energy, production, etc.) in the light of environment concerns.

NGOs played an important role in the Rio Summit, and Agenda 21 called on governments and multilateral agencies to establish working relationships with competent NGOs. Their involvement has continued in the CSD, NGOs having attended and contributed to the early meetings of the Commission. Their continued role in monitoring, researching and evaluating
the behaviour of businesses, governments and the IFIs is a valuable addition. They also can fulfil a more pro-active role of proposing projects, and assisting in their design, implementation and evaluation. This increased involvement needs to be strengthened. For development to be sustainable people must feel committed to the process. Drawing on the knowledge of local communities will also help to formulate projects that have increased chances of success.

Commission on Sustainable Development

The Commission on Sustainable Development (CSD) was established following the Rio Summit as the forum in which environmental and development problems could be discussed and resolved at a global level. It was charged with monitoring the progress and problems that emerge in implementing Agenda 21, and to make proposals to the General Assembly of the UN. It is expected to enhance international cooperation and rationalise the inter-governmental decision-making process for integrating environmental and development issues.

As the main body charged with monitoring the implementation of the proposals of the Rio Summit, the Commission will play a key role in future developments. Its principal role is to coordinate the completion of environmental assessments by member states in order to assess efforts to respond to environmental concerns. By monitoring the activities of states those that fail to implement Agenda 21 will be identified and encouraged to do so. The CSD’s powers are however, limited. It has no powers to demand reports from governments, which remain voluntary. Indeed, the procedure that was adopted makes the completion of such reports, their format, level of detail and scope entirely voluntary. This threatens to make the process inherently weak. There is a legitimate concern on the part of poorer countries about the costs of such an exercise, but it is crucial that states research and define sustainable development strategies. The CSD should act to create de facto standards of reporting so as to ensure that the information received is easy to process and is comparable in nature wherever possible.

The relationships between the CSD and the financial institutions and UN departments, and particularly the GEF, have yet to be clearly laid out. Hopefully the process of restructuring the GEF after the pilot phase will facilitate such a process. The CSD should play a lead role in ensuring that agreements on financial resource transfers from North to South are implemented and it should also give specific and concrete guidance to the international financial institutions on resource provisions.
Technology Transfer

The question of technology transfer is a crucial factor in formulating sustainable development strategies. Developing countries in particular need access to new and efficient technologies to enable them to develop with as little detrimental impact on the environment as possible. As important, they need the capacity in terms of economic, managerial and technical skills to make use of these technologies, and to be able to choose between them. Again finance is a key to this process - finance to enable developing countries to gain both such capacity, and clean and efficient technology. Some of this technology is not covered by patents or lies in the public domain. International organisations should promote the transfer of such technology. Where this is not the case there is perhaps a role for international organisations to buy the rights or patents of such technology at market rates, and then distribute them to developing countries on non-commercial terms. In other cases companies could be encouraged to grant licenses, TNCs should be encouraged to adopt new practices and promote greater direct technology exchanges between parent and affiliate companies, etc.

This clearly has considerable implications for the GATT and any regulatory system for trade and Transnational Corporations (TNCs). Patents for important technologies (for example medical drugs) often represent the product of heavy investment in Research and Development by TNCs, and are likely to be extremely expensive, if they are for sale at all. Furthermore, a major preoccupation for many states in the current GATT talks concerns intellectual property rights, and is the source of some dispute. Agenda 21 stipulated that they must be protected in any technology transfer. Conflicts between the interests of the North and South were evident in the Biological Diversity Convention as Southern countries demanded that they receive some benefit from developments based on biological entities found in their countries. These issues are far from resolved.

Capacity building is as, if not more important than technology transfer. Without proper capacity in terms of human and institutional resources such technology is unlikely to be used at anything like its potential. And with such capacity countries can improve the efficiency of their use of present technologies. There must be emphasis on the transfer of managerial and engineering techniques required to learn incrementally and continuously - in short on human resources. The UNDP, as the most important provider of technical co-operation should obviously be expected to play an important role in this process.

In general, business and governments and international organisations need to find better ways of working together to improve and conserve the environment, while at the same time
ensuring that development priorities are met. This will relate closely with the facilitating and regulatory framework that countries impose on business.

**New Indicators of 'Sustainable Development'**

Associated with the reporting procedure is the need to find new indicators of development that include environmental data. As pointed out elsewhere, the disparities between the UNDP's Human Development Index and national GNP measures provide at least circumstantial evidence that efficient use of scant resources can engender good standards of living as much as the wasteful use of abundant resources. The use of national indicators ('real-cost accounting' at a national level) that would account for waste as well as production would give policymakers and politicians a much greater appreciation of the environmental costs of actions. A similar process must be incorporated into project appraisal of donors and into the accounting practices of governments and businesses.

**The Biological Diversity and Climate Change Conventions**

The Climate Convention and the Biological Diversity Conventions both have laudable aims. However, many scientists believe the actions proposed to achieve their ends are insufficient. The Climate Change Convention was primarily a symbol of the world's recognition of the problem and the need for action. Those developed countries who signed the Convention committed themselves to reduce greenhouse gas emissions to 1990 levels by the year 2,000. Developing countries made not such commitment, arguing that development must inherently involve the increased production of such gases. However, development, with the aid of new technology and increased efficiency, need not be as 'dirty' as it was in the past. For this goal to be realised the questions of capacity building and resource transfers from North to South must be addressed. At the Rio Summit the questions of resource transfers was left unresolved. The Biological Diversity Convention was dodged by differing interests in relation to property rights and competing demands on forests and other sources of genetic material. There has been progress since the Rio Summit (the US has signed the Climate Change Convention) but it has been slow. The Climate Change Convention must be ratified by the parliaments of those states that signed before it becomes international law. There must be renewed political commitment to the Climate Change and Biodiversity Conventions and to the guidelines for the management of forests. The UN, and particularly the CSD and UNEP, has an important role to play in catalysing such a renewed commitment, along with the strong and vocal environmental NGO movement.
Two trends in the international economy have become increasingly apparent in the last few decades - the increasing globalisation of production and the importance of transnational corporations (TNCs) as motors of both economic growth and the process of internationalisation.

Transnational corporations occupy a pivotal role in international production and trade. Their activities have an extensive impact on the environment. TNCs control 70% of the world's trade, and 90% of all technology and product patents worldwide are held by transnationals. An estimated 40% of world trade is conducted in the form of intra-firm trade. A UNCTC/TCMD study on climate change estimated that more than 50% of global greenhouse gas emissions were in the province of TNCs.

Transnational corporations thus have great power, which, if harnessed to the process of sustainable development, could prove of great benefit. There is an growing consensus that governments and TNCs should work together in mutually advantageous ways to promote national and international economic welfare. It is no longer a question of simply regulating transnational corporations, but rather of structuring cooperative national approaches that facilitate rather than inhibit international transactions, and economic and social development.

However, while governments and TNCs exhibit a more constructive relationship, there is still a need to regulate the activities of transnational corporations. As transnationals have become more globalised, they have to some extent escaped the power of national authorities to regulate their behaviour. It has, for example, become increasingly difficult to pinpoint where legal responsibilities lie and where tax should be paid. In addition, the speed and ease with which TNCs are able to restructure their assets, relocate production, the oligoplistic strategies they pursue and the perceived lack of social awareness or environmental sensitivity that some large international firms display are all causes for concern. The issues of transfer pricing, technology transfer and tax avoidance are still of relevance. Moreover, individual states, particularly in the developing world, continue to find themselves in a weak bargaining position with TNCs, particularly in the face of fierce competition between states for scarce capital.

TNCs, while enjoying such power, are not democratically accountable, their actions are not transparent, and there is no guarantee that their actions will benefit social and environment-friendly development. Of particular concern is the growing marginalisation of the majority of developing countries in terms of the flows of FDI, at the very time that flows of such
investment are rising faster than world trade and output. Between 1980/84 and 1985/9 the developing countries share of FDI fell from 25% to 18%. Ten developing countries received three-quarters of the total. Efforts must be made to increase the flows of FDI to developing countries as a whole.

A multilateral framework is clearly necessary. It must balance the need to promote FDI, particularly to the least developed countries with the necessity of regulatory frameworks to ensure that host countries benefit from FDI, and that it conforms with sustainable development plans.

**The UN Code of Conduct on Transnationals/Anti-Monopoly Authority**

A valuable starting point is the UN Code of Conduct for Transnational Corporations. This document has taken nearly 20 years to negotiate. It should be completed as a matter of urgency. Voluntary in nature, it would provide a framework by which the behaviour of both corporations and governments could be judged, and it would also provide other benefits. In particular it would help to make host country-TNC relations more transparent. the completion of the Code will require renewed political commitment from the UN member states. The conditions for such a development are better than they have been as globalisation has blurred the distinction between home and host countries. Many industrial countries now face problems once largely limited to developing countries.

Many of the issues that the UN's Code deals with are presently under discussion as part of the GATT talks (National Treatment, Restrictive Business Practices, the Transfer of Technology, etc.). This is inevitable, as any discussion of international trade must quickly recognise the importance of TNCs. In addition, the inclusion of the trade in services in the Uruguay Round has further promoted discussion of issues relating to TNCs. However, the mandate of an institution which would deal with these issues would have to be more comprehensive than that of existing institutions. Moreover many of these issues are close to resolution in the UN Code, and it would be best to continue to negotiate the UN Code, perhaps linking it to the GATT talks.

For the Code to be effective a monitoring agency (perhaps located in the UN) would be necessary to evaluate the adherence of both governments and TNCs to the Code. The publication of the identities of offending countries and TNCs would provide some form of incentive to both parties to observe the Code.
A small number of transnational corporations dominate the production, distribution and sale of a large number of goods. This is particularly true for many of the goods that developing countries produce. For example, five TNCs have 77% of the world cereal market, while 4 companies have 87% of the tobacco market. While individual states have legislation restricting monopoly behaviour, there is no mechanism for preventing such behaviour at an international level. There is thus a need to bring international policies in line with national legislation, perhaps in the form of a Global Anti-Monopoly and Restrictive Practices Policy or authority which would be charged with monitoring TNCs, and encouraging international co-operation in competition policy, disclosure of corporate information, and common accounting principles.

There is also a need to consider TNCs behaviour in the context of sustainable development, and the environment. TNCs played a prominent role in the UN Conference on the Environment and Development, and prior to the Conference the international business community and individual corporations adopted a variety of environmental codes of conduct. While such developments are encouraging, there is a role for the UN organisations in setting standards of behaviour which TNCs should emulate. At the Conference a series of recommendations for industry were adopted - that they should adhere to codes of conduct; adopt a cradle-to-grave approach to their products; provide information on environmentally sound management and energy conservation; and should implement general standards of environmental responsibility to their foreign operations fully consistent with those used in their home countries. In addition, there is the need to develop methods of real-cost accounting. UNEP's Cleaner Production Programme proposed development of international guidelines on information disclosure by exporters on the potential environmental impacts of their products is a useful step forward. The UN Centre on Transnational Corporations/Transnational Corporations and Management Division (UNCTC/TCMD) and the Commission on Sustainable Development (CSD) have roles to play in defining environmentally sustainable activities and monitoring current activity.

Harmonisation of National Incentive Policies and Regulatory Frameworks

Developing countries are in a weak bargaining position with TNCs. Lacking alternative sources of capital they have been forced to bid against each other for scarce FDI. This has sometimes resulted in successful countries gaining investment at the cost of any benefit to their own economies.

A positive role for the multilateral institutions would be to harmonise national incentive policies and regulatory frameworks for FDI. The completion of the UN Code of Conduct on
Transnational Corporations and a global Anti-Monopoly Authority would aid this process, establishing a framework within which FDI regimes could operate. Building on this, a multilateral body or a UN agency (the UNCTC/TCMD or UNCTAD) could collect data on national FDI regimes as a first step to harmonising them. Governments could undertake to inform the agency of their policies, laws, regulations and administrative guidelines bearing on TNCs. This would provide a comprehensive overview of prevailing policy regimes, thus making FDI regimes more transparent, and encouraging the comparison and review of national policies.

It might then be possible to negotiate fiscal incentives down under the auspices of the UN. Increasing numbers of countries liberalised their economies in the 1980s. As a result liberalisation is no longer a sufficient incentive to TNCs to invest. Countries have responded by offering a variety of fiscal incentives. However, the widespread nature of such incentives has reduced their effectiveness, and perhaps represent little more than a cost to the host country. Certainly the extent of incentives' influence on the location of FDI is far from clear.
Building Capacity

A major constraint on developing countries attracting FDI and of ensuring that they can make the best use of it is a lack of physical and human resources. The benefits of FDI to a host country are significantly determined by the terms of specific agreements. Many LDCs do not possess strong negotiating skills to secure the best possible terms, and there is a role for the UN agencies, under the co-ordination of the UNDP, to provide technical assistance and training to address this problem. In addition, national governments often need assistance in economic management and training, and in appropriate macro-economic and organisational policies for dealing with TNCs. Such assistance has been provided in the past by the UNCTC/TCMD and clearly needs to continue.

Assistance will continue to be needed in many countries to improve infrastructure and assist in the provision of education, in order to improve poor local market and supply problems.

Many of these problems cannot however, be solved without the resolution of other long-term problems, not least falling primary commodity prices and debt. TNCs are part of this process - they are the buyers of much of developing countries' production of primary commodities, and the multinational banks hold much of the debt of developing countries. Without the resolution of these problems strong markets, improved infrastructure and human resources will be extremely hard to produce.

Encouraging Investment

For the majority of developing countries discussion of framework for FDI is largely academic. As outlined above, while FDI flows are increasing faster than world trade or output, developing countries are becoming increasingly marginalised. A concerted effort on the part of the international financial institutions and the UN agencies is necessary to help redirect investment towards developing countries and particularly the least developed countries. There are a range of measures that could be taken alongside assistance for infrastructure and human resource development and capacity building. Administrative reform may be necessary and technical assistance can be provided. Where non-commercial economic risks deter potential investors there is a role for trade credit guarantee schemes (for example the Multilateral Investment Guarantee (MIGA) scheme), and where large infrastructure capital investments are necessary the development banks can co-finance projects with private bank consortia (e.g. the EC Investment Partners Programme).
The UNCTC should be allowed to promote investment through the convening of workshops between governments and TNCs, through assisting governments to assess their FDI needs and co-financing feasibility studies. Once FDI requirements are identified the UNCTC (or another body) could play a pro-active role in attempting to attract investment.
There is a growing consensus on the need for greater democracy and 'good governance' as part of the development process. The elimination of corruption is a vital part of building accountable and efficient public services. To this end the establishment of Transparency International in May 1993 was an encouraging development.

A new NGO, established in Germany, the organisation aims to counter corruption in global business transactions. The principal tool at its disposal is its Standards of Conduct, a document that demands that all parties to international business transactions respect the law in both letter and spirit, that no parties to contracts will offer or accept bribes, and that full accounting procedures are followed. Governments are asked to take appropriate actions to combat corruption and promote transparency and accountability.

As the organisation acknowledges, corruption takes place between parties, and businesses as well as governments are targeted. It is hoped that governments agreeing to the Standards of Conduct will restrict international competitive bidding on government contracts to those corporations that have themselves signed the Standards, thus encouraging corporations to endorse the Standards of Conduct.
This part has been mainly prepared by Stephany Griffith-Jones
I INTRODUCTION

At a time of increasing globalisation of international private flows, there is a clear need for a corresponding growth of international public regulation of such flows. At a time of severe liquidity constraints in many of the poorest developing countries, there is a clear need for renewed issues of SDR's, and/or enhanced use of other mechanisms to provide low-conditionality or no-conditionality liquidity. At a time of dramatic slowing down of growth in the world economy - accompanied by stagnation in the industrial countries, there is a clear need for macro-economic co-ordination, especially of the largest economies, to improve their economic performance, and that of the world economy.

There is therefore a clear need for vastly improved and increased global financial and macro-economic governance. As Paul Streeten¹ and Mahbub ul Haq² pointed out recently, such tasks could be best carried out by a World Central Bank. However, as John Williamson³ wrote, there are very serious technical problems about the creation of a World Central Bank in a context of massive capital mobility.

An intermediate strategy is suggested here. It is suggested that a World Central Bank is maintained as a long-term objective, and that technical discussions on its' nature (in the current context) be maintained. Simultaneously, however, it is suggested that the most urgent needs for global financial and macro-economic governance are met - via measures that are more technically and politically feasible. Indeed, the implementation of such measures would not only be valuable for improved performance of the world economy and a more favourable context for poorer countries' development; they would also improve the prospects for further and future steps for enhanced global financial governance, hopefully leading eventually to a World Central Bank. This is best illustrated by the issue relating to the creation of world liquidity. A central feature of a World Central Bank would be for such an institution to exert control over international liquidity. A key role in such a task would be played by the SDR. However, it is somewhat utopian to discuss how the SDR should be brought into the heart of the international monetary system, while the SDR has not been issued for over 10 years (in

¹ P. Streeten "Global Governance for Human Development" Occasional Paper no 4, Human Development Report Office

² M. ul Haq "Bretton Woods Institutions: the Vision and the Reality" Paper prepared for North-South Round Table Sept 1-3, Bretton Woods, Hampshire

spite of urgent liquidity needs in some countries), and the SDR represents only about 3% of world reserves. Therefore, an essential step for improved future global financial governance is that in the short-term the issue of SDR's is renewed, and in the medium-term that its role is enhanced.

This paper will consist of four sections, additional to this Introduction. Section II will briefly outline the existing needs, and evaluate the extent to which existing institutions (and particularly the IMF) meet these needs. Section III will deal with short-term measures to improve global financial management. These would include a) renewed issue of SDR's, b) broadening of the compensatory financing facility of the IMF. A third area which we will not discuss here - but which is of key importance - is to significantly increase the emerging trend of greater emphasis by the Fund on less stringent and more growth oriented conditionality. Section IV will deal with medium-term measures that would lay the basis for global finance governance. These would include a) substantially improving global macro-economic co-ordination - and giving the IMF as a representative of the global interest, a far larger role in the process and b) increasing substantially regulation and supervision of global private flows, possibly via the creation of a Global Board of Regulators. Finally section V will deal briefly with the long-term challenge of creating a World Central Bank.

Before concluding this Introduction, it is important to stress that global financial and macro-economic governance should be seen as an "International Public Good".

Thus, global macro-economic policy co-ordination should be viewed as the process by which governments pursue commonly agreed or collective objectives and defend the international economic system from economic and political shocks. Individual governments acting alone - and pursuing their own national objectives - would not necessarily be able to achieve commonly shared objectives (the reference of "international public good" in this context is to failures or gaps resulting from the sum of actions of individual governments). The "international public good" of developing and enforcing rules for assuring a stable and growing world economy was after World War II performed by the US; as the US lost relative importance and no other power replaced it, the task should be carried out by a collective of governments. New mechanisms of co-ordination need to be devised, and above all new institutional arrangements created. Viewed from this perspective, international policy co-ordination, like international public health, is an "international public good" which if not deliberately, actively and properly pursued, will imply an explicit cost. In this sense, international co-ordination of economic policy is an activity which would benefit all but which without conscious co-ordination will not be supplied at all - or will be supplied incompletely - by governments acting on their own.
On the other hand, global regulation of international private flows should also be seen as an "international public good" as it would contribute to avoid costly market failures, especially those causing systemic risk, which would result from the actions of individual private market actors acting on their own, and without considering the aggregate impact of their individual actions. The latter concern can only be represented by a global public institution.

II DOES THE IMF CURRENTLY MEET THE NEEDS OF INTERNATIONAL FINANCIAL GOVERNANCE?

In any discussion on the current role of the IMF it seems relevant to recall the Fund's objectives, as expressed in its own Articles of Agreement. The objectives are:

(i) To promote international monetary co-operation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of 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.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade;

(v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with an opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity;

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.
A senior Fund official 4 admirably summarized the Fund's objectives and raison d'etre in one sentence:

"The IMF was founded to avert world-wide economic depressions".

The Fund's activities have, in a very large proportion, been concentrated on influencing policy-making in those economies drawing on its' resources. Particularly since the late seventies, those drawing on the Fund's resources have been exclusively developing countries. The picture contrasts sharply with that for earlier periods. In 1968-72, for example, 11 industrial countries, including all the G-7 countries, except Japan, drew on the Fund. Drawings by developing countries, though numerous, were also relatively small. Indeed, in 1970, of the total outstanding credit of the Fund - SDR 3.2 billion - SDR 2.4 billion, that is 75% of the total - were outstanding to industrial countries. 5

The IMF is often criticized for what it does and how it does it; even though such criticisms are important, it seems far more crucial to concentrate on remedying "its sins of omission", that on what it should do, but has not been able or willing to do until now.

The Fund has focussed too little attention to its' global responsibilities and to influencing policy making in industrial economies. By acting in this way, the IMF's sphere of influence in the world economy has been constrained. Furthermore, the IMF focused its energy and work in the last ten years excessively on adjustment in individual developing countries to a deteriorating international environment; too little weight was placed by the IMF on efforts to improve this international environment.

It would seem to be in the interests both of the developing economies and the world economy, that the IMF's work and influence is spread in a more balanced way; this would imply that both global issues and industrial country issues should be given far more weight in the IMF's work and issues of specific management of developing economies (and particularly very small ones) given far less weight. Indeed it could be argued that a broad criteria for the distribution of work and attempted influence by the IMF on policy-making in individual countries should be to make it roughly proportional to those countries' weight (e.g. measured by its share in the world GDP or trade) in the world economy. Furthermore, special attention should be given to the IMF's work to its global role.


At a time when world economic interdependence increased significantly, the need for global economic management became far greater. However, the way in which international financial arrangements evolved during the 1970's and the first half of the eighties served to marginalize the systemic role of the Fund. The generalized adoption of flexible exchange rates and the increased importance of private flows to fund balance of payments deficits (for industrial countries and creditworthy developing ones), as well as the resulting perceived reduced need for SDR creation and the failure to introduce a substitution account reduced the global role of the IMF significantly.

In particular, the role of the IMF was greatly reduced by the breakdown of the fixed exchange rate system in the early 1970's, the limited use of the SDR mechanism to create or absorb liquidity and the very limited ability of the IMF to influence industrial countries' monetary and fiscal policy. The exchange rate regime that emerged in the 1970's was rightly called a "non-system", because of its' clear lack of collectively agreed rules about exchange rates, about modalities for creating and absorbing liquidity, about the adjustment process and about the precise nature of co-ordination of economic policies. For example, with the Second Amendment to the IMF's Articles of Agreement (in 1976), the need for Fund approval of changes in par values was replaced by the far weaker requirement that the Fund "exercise firm surveillance" over its' members' exchange rate policies. The IMF's power and influence was further limited by a system in which conditional assistance to industrial countries was far less likely to be called upon, and has de facto never been used since the late seventies. More generally, the introduction of generalized floating weakened the links for cooperation and multilateral surveillance which had been designed for - and explicitly revolved round - the Bretton Woods system of fixed exchange rate. Generalized floating not only removed the rules of the game which had enforced a degree of policy cooperation, but also removed the occasion, and seemed incorrectly to reduce the need for explicit multinational policy discussion. There was some slight - mainly temporary - shift towards increasing the Fund's role in global macro-economic policy during the mid 1980's, when the IMF played some (though clearly very limited) role in exercises designed to encourage macro-economic policy co-ordination amongst industrial countries. These efforts of co-ordination were focussed mainly on the promotion of exchange rate stability amongst the major industrial countries. They reflected a disillusion with laissez-faire in macro-economic policies. In 1982, President Mitterand had launched the idea of "multilateral surveillance" of the economic policy of the major industrial countries. In 1985, there was an attempt to correct the dollar exchange rate through the G-5 Plaza Agreement; in 1986, at the Tokyo Summit, the Group was widened to seven (the G-7), and an indicators exercise was started. Then, at the Louvre, "reference ranges" for exchange rates seemed to be adopted by the G-7 finance ministers. Furthermore, the discussion of a system of co-ordination of developed countries' policies seemed to move beyond focussing exclusively on exchange rate issues to the broader issue of macro-economic
management. In these exercises, the IMF played a fairly limited, supporting role; whatever limited policy co-ordination took place was, however, mainly decided by the G-7 Finance Ministers, though the IMF Managing Director also tended to participate in some of the meetings. It is unfortunate that the IMF's role in the mid 1980's - as well as now - is restricted mainly to a briefing on the IMF's World Economic Outlook, with the Fund's Managing Director in routine attendance only during the background factual discussions. Indeed it has been reported that these G-7 meetings very often determined the essence of discussions on IMF policies formally adopted immediately after by the IMF Interim Committee. The process of policy co-ordination may have contributed somewhat, however, to the improvement - in that period - of the performance of industrial countries.

However, after the Louvre meeting, the tentative moves toward macro-economic policy co-ordination declined significantly. As Williamson points out, the subsequent performance of the world economy - notably the depth and length of the world and industrial country recession of the early 1990's - seems to show that the decision to virtually abandon policy co-ordination by the G-7 was an incorrect one.

Even a brief critical evaluation of the IMF would be incomplete without referring to the Fund's role in stabilization of developing countries, which - as pointed out above - is the focus of Fund activity since the late 1970's. Criticism of Fund conditionality can be referred either to the theoretical basis on which Fund-supported programmes are designed and to the impact they have on countries' economic performance.

Criticism of the theoretical basis of Fund conditionality includes a number of elements. The IMF sets out its lending programmes by analyzing LDCs' needs through application of its "financial programming" model. Although it is not completely accurate to characterize the IMF approach as narrowly monetarist, the analytical core of all Fund programmes is still domestic credit control. This is true even of the less short-term and more supply-side, Extended Fund Facility (EFF) and Enhanced Structural Adjustment Facility (ESAF) programmes.


Moreover, the IMF model can be criticised for the way it focuses on aggregate demand and domestic credit as the source of balance of payments difficulties. Often, of course, difficulties result from other factors, such as adverse terms of trade or other external developments. It is doubtful whether developing countries are in a position to effectively control net domestic assets as much as the IMF's financial programming model requires.

A recent critique of the Fund model is that it is not dynamic and cannot cope with time lags, uncertainty and the formation of expectations. Edwards9 has suggested that - therefore - the Fund has not kept abreast of best practice in the design of macro-economic policies, especially those - like for example the theory of speculative attacks and devaluation crises - which incorporate the effects of private sector reactions to government policies, and which maximize the credibility of these policies.

The Fund has been criticized by the neo-structuralist school, which identifies a large number of variables whose behaviour often differs from that assumed by the Fund. The neo-structuralist school identify the possible stagflationary consequences of Fund programmes: in particular they argue that devaluation will have a recessionary as well as cost inflationary impact and that credit controls will be cost inflationary as well as demand deflationary. They blame the Fund for taking too uniform a view of macro-economic processes.

Not all criticism of the Fund's programming is equally valid, or confirmed by empirical evidence. Arguments against the Fund's invariable advocacy of devaluation of exchange rates illustrate this. Evidence to support the argument that devaluations have a direct contractionary effect is hard to come by (see Killick, op. cit.). There have been cases where sharp devaluations have led to reduced inflationary rates. There are, however, evident dangers for primary product exporting countries that deployment of devaluation in large numbers of them could bring about a series of competitive devaluations, the aggregate effect of which could be increases in output linked to reductions in world prices.

Furthermore, the globalization of financial markets and the increased innovation in the financial sector have lessened the feasibility of achieving the desired control over money supply within the confines of a national economy (which the IMF stresses), as banks have successfully resisted the desires of the monetary authorities when these seemed contrary to the banks' own interests.10


However, the practicability of the monetary approach adopted by the IMF is even less suited for poor developing countries, where the Fund has a high proportion of its programmes. Indeed, as the IMF staff itself admits.11 "In a country with a relatively undeveloped, sharply segmented, financial market, the economy is likely to respond much less flexibly to changes in monetary policy."

To counter the argument about the inefficiency of its monetary policies the IMF has asserted that it pursues an essentially fiscal approach to balance of payments. However, the IMF's own Director of its Fiscal Affairs Department disputes the usefulness of focusing on the size of the budget deficit at the expense of the "quality and durability" of the specific fiscal measures used by the government to remain within the programme's budget ceiling. Unfortunately, political obstacles, directives on conditionality and timing considerations have prevented their being taken into account in Fund programmes.

As regards the impact of Fund programmes on countries' economic performance, the recent literature12 seems to show that adoption of a Fund programme has few, if any, statistically significant effects. There is some evidence, though it is not conclusive, that Fund programmes lead to some short-run declines of output, and some beneficial impact on the balance of payments; surprisingly, there is little association between IMF programmes and inflation. There is, however, a clear link between IMF programmes and a substantial and sustained fall in investment rates, which is very likely to reduce growth of output and employment in the medium-term.

In this respect it would be desirable to incorporate growth, investment - and poverty alleviation - into the IMF's model as a target, as for example the Group of 24, representing developing countries, has suggested. This poses methodological problems, which could however be overcome. The main problem is that by putting growth as a target, the dependent variable is the amount of external finance necessary to support such a growth oriented stabilization and adjustment programme. This requires longer programmes and increased levels of Fund finance, or finance from other sources. The case for a more growth oriented IMF model (and conditionality) is therefore intimately linked to the need for a larger IMF, and preferably one whose size is semi-automatically increased (see discussion below). Indeed without greater availability of Fund finance, for countries that have limited or no access to international private markets, the phrase "adjustment with growth" in conditions of Balance of Payments crisis will remain an empty slogan.


12 See, Killick, op. cit. and Bird, op. cit.
III SHORT-TERM MEASURES

As was concluded in the previous section, one of the crucial elements that prevent IMF programmes effectively supporting stabilization with growth is the lack of foreign exchange resources which countries facing serious balance of payments can access internationally. This is particularly true for low-income countries and for countries in transition to the market, where costs of stabilization at the expense of growth are particularly high.

To help overcome these funding constraints, two mechanisms could be deployed easily, from a technical point of view. They are a renewed issue of SDR's and a widening as well as a liberalization of the conditionality of the Fund's Compensatory and Contingency Financing Facility (CCFF).

A) An SDR issue

As pointed out above, renewed issue of SDR's would not just help meet urgent needs of many countries (the short-term objective), but would also provide the possible basis for an enhanced role of the SDR. in the medium-term, which is essential if the IMF were to become a World Central Bank in the full meaning of the world, that is, would influence or control international liquidity creation. Indeed, nationally one of the key functions of a Central Bank is to control directly and influence indirectly the creation of national liquidity.

The short-term case for an SDR issue has been powerfully made by the IMF management, and especially by the Fund's Managing Director, Michael Camdessus.13

The Fund's management is also encouraging options whereby SDR's once issued, would be redistributed on a voluntary basis. This is based on the fact that the role for the SDR has changed since its original creation in 1969.

The management of the IMF is supporting a new allocation SDRs on the grounds that there is a long-term global need for a supplement to existing international reserves. The assessment of such a need is based on projections that the global demand for reserves will expand by several hundred billion SDRs during the sixth basic allocation period (1992-96), as well as the fact that, at end 1992, a large proportion of the membership had low levels of international

reserves relative to commonly applied standards of reserve needs (Table 1). In particular, 20 percent of the developing countries, and nearly 40 percent of the countries in transition, held non-gold international reserves equivalent to less than eight weeks of imports. Furthermore, from end 1990 to end 1992, 99 percent of the total growth in non-gold international reserves for developing countries was accounted for by 16 countries that have experienced recent surges in capital inflows and 75 percent of the reserve growth was accounted for by only seven of these countries. An SDR allocation would facilitate developing countries and countries in transition to reach more adequate international reserve levels without additional recourse to expensive borrowing or the compression of domestic demand and net imports, which is inimical to their growth and transformation efforts. It would, thereby also reduce the risk of setbacks in these efforts, which could have adverse spillover effects on the world economy.

The management of the IMF clearly and correctly argues that an SDR allocation that met only a moderate proportion of the growth in the global demand for reserves would have virtually no effect on global inflation. It would also be compatible with the objective, contained in the IMF's Articles of Agreement, of making the SDR the principle reserve asset of the international monetary system and stem its decline as a share of total world reserves (Table 2). Furthermore, it would help correct the imbalance in the distribution of SDRs with respect to the 38 members (including the states of the former Soviet Union) that did not participate in previous SDR allocations.

The IMF management proposal of an allocation of SDR 36 billion seems reasonable to attain the modest objective of beginning to reverse the declining relative importance of the SDR in members' international reserves. The proposal is based on raising the present share of SDRs in world international reserves to the average of the last two decades, or 5.3 percent (Table 3).

As pointed out above, some developing countries (especially the poorest ones) have an important need\(^\text{14}\); furthermore many of the economies in transition face similar needs.

Therefore, in the early nineties the unsatisfied demand for international liquidity by a large proportion of developing countries and countries in transition is very high, as is the cost to those countries' economies and peoples of the fact that this demand was not met by international creation of liquidity via the IMF.

\(^{14}\) For a recent discussion of these needs, see G. Bird "Economic assistance to low-income countries: Should the link be resurrected?" Working Paper Series 93/5 Dept. of Eco. Surrey University, August 1993
### Table 1. Distribution of Countries by Ratio of Non-gold International Reserves to Imports of Goods and Services, 1992

<table>
<thead>
<tr>
<th>Ratio of International Reserves to Average</th>
<th>All Countries</th>
<th>Industrial Countries</th>
<th>Developing Countries</th>
<th>Countries in Transition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of Countries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than 4 weeks</td>
<td>34</td>
<td>3</td>
<td>24</td>
<td>7</td>
</tr>
<tr>
<td>4 to 8 weeks</td>
<td>27</td>
<td>6</td>
<td>17</td>
<td>4</td>
</tr>
<tr>
<td>8 to 12 weeks</td>
<td>32</td>
<td>6</td>
<td>23</td>
<td>3</td>
</tr>
<tr>
<td>12 to 16 weeks</td>
<td>20</td>
<td>4</td>
<td>15</td>
<td>1</td>
</tr>
<tr>
<td>16 to 20 weeks</td>
<td>15</td>
<td>2</td>
<td>12</td>
<td>1</td>
</tr>
<tr>
<td>20 weeks or more</td>
<td>32</td>
<td>1</td>
<td>29</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>160</td>
<td>22</td>
<td>120</td>
<td>18</td>
</tr>
<tr>
<td><strong>Percent of Countries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than 4 weeks</td>
<td>21.3</td>
<td>13.6</td>
<td>20.0</td>
<td>38.9</td>
</tr>
<tr>
<td>4 to 8 weeks</td>
<td>16.9</td>
<td>27.3</td>
<td>14.2</td>
<td>22.2</td>
</tr>
<tr>
<td>8 to 12 weeks</td>
<td>20.0</td>
<td>27.3</td>
<td>19.2</td>
<td>16.7</td>
</tr>
<tr>
<td>12 to 16 weeks</td>
<td>12.5</td>
<td>18.2</td>
<td>12.5</td>
<td>5.6</td>
</tr>
<tr>
<td>16 to 20 weeks</td>
<td>9.4</td>
<td>9.1</td>
<td>10.0</td>
<td>5.6</td>
</tr>
<tr>
<td>20 weeks or more</td>
<td>20.0</td>
<td>4.6</td>
<td>24.2</td>
<td>11.1</td>
</tr>
</tbody>
</table>

**Sources:** IMF, *World Economic Outlook* and *International Financial Statistics*.

1/ End-of-year reserves as ratios of imports of goods and services during the year. Imports include interest payments on debt where data are available. Imports for states of the former Soviet Union (FSU) exclude intra-FSU trade. Country groups are consistent with those used in the World Economic Outlook.

2/ Includes Bulgaria, former Czechoslovakia, Hungary, Poland, Romania, former Yugoslavia, and twelve states of the former Soviet Union. Albania, Mongolia, Georgia, Tajikistan, and Turkmenistan are not included in the table.
Table 2. Holdings of SDRs in Relation to Non-Gold International Reserves, 1971-92 1/

(End of year data, in percent)

<table>
<thead>
<tr>
<th>Year</th>
<th>All Countries</th>
<th>Industrial Countries</th>
<th>Major Oil Exporting Countries</th>
<th>Non-Oil Developing Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971-80 (Average)</td>
<td>4.8</td>
<td>6.6</td>
<td>1.2</td>
<td>3.4</td>
</tr>
<tr>
<td>1981</td>
<td>4.9</td>
<td>6.4</td>
<td>2.6</td>
<td>3.3</td>
</tr>
<tr>
<td>1982</td>
<td>5.3</td>
<td>7.6</td>
<td>3.2</td>
<td>1.9</td>
</tr>
<tr>
<td>1983</td>
<td>3.9</td>
<td>5.6</td>
<td>2.4</td>
<td>1.4</td>
</tr>
<tr>
<td>1984</td>
<td>4.0</td>
<td>5.9</td>
<td>2.5</td>
<td>1.1</td>
</tr>
<tr>
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<td>6.5</td>
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<td>1.8</td>
<td>2.7</td>
<td>1.7</td>
<td>0.6</td>
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</tbody>
</table>

Sources: IMF, World Economic Outlook and International Financial Statistics.

1/ Data for the former Soviet Union are included in calculations for all countries and for non-oil developing countries for 1981-92.

2/ Most of the decline from end-1991 to end-1992 in country holdings of SDRs reflects a temporary increase in the IMF's holdings following payments associated with the recent quota increase.
Table 3. Illustrative Calculations of SDR Allocations

<table>
<thead>
<tr>
<th>Actual Share of SDRs in Total Non-gold International Reserves</th>
<th>Estimate of New SDR Allocation Needed to Achieve Ratio in First Column</th>
</tr>
</thead>
<tbody>
<tr>
<td>(In percent)</td>
<td>(In billions of SDRs)</td>
</tr>
<tr>
<td>1. End-1971</td>
<td>7.3</td>
</tr>
<tr>
<td>2. End-1981</td>
<td>6.5</td>
</tr>
<tr>
<td>3. End-1991</td>
<td>3.2</td>
</tr>
<tr>
<td>4. Average 1971-91</td>
<td>5.3</td>
</tr>
</tbody>
</table>

1/ Includes SDR holdings by the IMF.

At the same time, as large numbers of developing countries have large unsatisfied demand for reserves, industrial countries were facing a completely different phenomena. This latter change has resulted mainly as a result of rapid growth and integration of international capital markets.

Practically for all industrial countries, the supply of international reserves has become extremely elastic; the total stock of their reserves is basically "demand determined". Industrial governments - by having access to international capital markets - can borrow as much as they wish (provided they maintain their credit-worthiness, which almost by definition of being industrial countries they tend to) from private financial institutions. As a result, industrial countries' needs for officially created reserves seem to have largely disappeared (at least while international capital markets continue to provide them with this unconstrained supply of reserves).

It is interesting to note that by financing external deficits or reserve accumulation through the issue of their own liabilities, all industrial countries can partake in some measure of the benefits previously accruing to a reserve currency country. Thus, the relevant distinction in this context is no longer between reserve currency countries and the rest of the world (as it was during the gold standard years of the Bretton Woods era) but between "creditworthy countries" and those that are not.
An important and to some extent new asymmetry has thus emerged between industrial and many developing countries, as well as many countries in transition as regards reserve needs; (these are defined as the difference between the demand for reserves and the supply that can be endogenously determined). As the supply of reserves for a number of countries (the creditworthy industrial ones) became endogenous, their level of reserves is determined by their demand, via the private international market. While these markets continue to function satisfactorily for them, their reserve needs are negligible, even though the SDR does have certain advantages as an owned (rather than a borrowed) reserve asset.

On the other hand, many countries have substantial demand for reserves not met by supplies of international private credit, and therefore have reserve requirements that need to be met from external sources. If such needs are not satisfied, (as has occurred clearly since 1981, period in which there was no SDR allocation) the countries are obliged to follow deflationary policies so as to generate the payments surplus to maintain or build up reserves; such deflationary policies are not only harmful to those economies, but to all those countries that trade with them, and thus to the world economy. Thus, not issuing SDR's to satisfy the reserve needs of those countries implies a violation of the Fund's objective "to avoid economic stagnation and deflation".

Indeed, a possible mechanism to allocate SDRs linked to the reserve needs of developing countries15 would be to allocate them initially in proportion to IMF quotas; the industrial countries' surplus to their reserve requirements, could be reallocated by them to the developing countries in the form of overdraft facilities. Access to the SDRs on the overdraft facility by LDC governments would be permanent and unconditional, but they would not imply a transfer of property. In such a scheme, these SDRs would basically be used to increase reserve holdings, rather than be spent. Indeed, their use could be limited by some rule of repayment or reconstitution within a given period.

Such a proposal should satisfy industrial governments because it would clearly preserve the role of the SDR as a purely monetary asset, (as industrial governments have resisted strongly the use of SDRs as a tool for permanent resource transfer) and would provide developing countries with additional reserves, which would allow them to pursue adjustment consistent with growth rather than deflationary adjustment. Since the liquidity created would have limits on its availability through time (via rules of reconstitution), it would encourage rapid and effective adjustment.

15 For the original proposal, see A. Sengupta "The Allocation of Special Drawing Rights Linked to the Reserve Needs of Countries" in UNCTAD International Monetary and Financial Issues for Developing Countries United Nations, New York 1987 E87 II D3
B) **Expansion and Liberalization of the CCFF**

To reduce the impact of adverse shocks on commodity producing countries due to fluctuations in commodity prices, a compensatory financing facility (CFF) was created in the IMF in 1963. In 1988, the coverage of this facility was extended to a Compensatory and Contingency Financing Facility (CCFF) to deal with balance of payments problems caused by other shocks (e.g. increase in debt-service payments resulting from an increase in world interest rates).

The CCFF has serious limitations, several of them inherited from its predecessor.

Firstly, total access to the CCFF is limited to a certain percentage of the country's quota. As a result, countries cannot get full financial compensation for their shortfall of exports; indeed, often they get very partial compensation for such shortfalls.\(^{16}\) To overcome this limitation, the best method for improving the CCFF would be to eliminate the quota limit altogether. If this is not feasible, a second best solution would be to significantly raise the limit for the CCFF, thus diminishing its restrictiveness.

Secondly, under current arrangements countries have to repay their CCFF purchases in a relatively brief period. An important improvement would be to adjust CCFF repayments in line with ability to repay. This would help overcome the fact that countries may be affected by negative external circumstances for a long period, as recent experience has shown; as a result countries often have to start repaying contingency financing at a time when that contingency is not yet overcome. This could be overcome by greater flexibility in the repayments schedule of the CCFF.\(^{17}\)

Given the international community's concern about negative net flows from the IMF to LDC's, such a proposal for greater flexibility in the repayments schedule may be more acceptable than in the past. To preserve symmetry, slower repayment if the external contingency/ies continue, should be accompanied by accelerated repayment if the external contingency finishes and there is no balance of payments need.

Thirdly, and perhaps most importantly, the creation of the CCFF continued a previous very unfortunate trend (particularly since 1983) to make compensatory financing more closely


\(^{17}\) For a more detailed discussion, see S. Griffith-Jones, *op. cit*
linked to upper credit tranche conditionality. The case for all - or at least most - compensatory financing to remain with low or no conditionality remains as strong as in 1963, when the CFF was created. Indeed, the low conditionality compensatory facility was created as a substitute for commodity agreements that would have regulated commodity prices internationally. Because such compensatory finance should provide temporary assistance, due to changes completely outside the government's control, its increased linkage to conditionality is particularly inappropriate. Furthermore, as Kenen has pointed out recently, by making access to the CFF strictly conditional, similar to access for ordinary drawings on the Fund, "the IMF made the facility virtually redundant and broke an implicit contract with the developing countries, which had given up the quest for commodity agreements in exchange for establishment of the CFF". This situation could be reversed if the CCFF was made unconditional. If this was not acceptable to the Fund, at least the level of conditionality should be lowered to that existing in the early 1980's.

An increased and low-conditional compensatory facility, due to the counter-cyclical nature of such IMF lending, would make a useful contribution to dampen fluctuations in the world economy. Indeed, as R. Cooper rightly pointed out, helping to stabilize the world economy would - by analogy with domestic central banking - be a key feature of an enhanced IMF that would provide the basis for a future World Central Bank. More generally, measures to make IMF activities more pro-cyclical would be valuable in that they would contribute to stabilize the world economy and compensate for the often pro-cyclical character of private lending, especially to developing countries.

IV MEDIUM-TERM MEASURES

In defining the institutional and policy measures that should be taken to promote financial and macro-economic governance in the medium-term, it is useful to keep in mind what will be the

18 For an early analysis of these trends and their negative impact, see S. Dell (1985) "The Fifth Credit Tranche" World Development, February

19 I thank Hans Singer for this point.

20 P. Kenen "Reforming the international monetary system: an agenda for the developing countries", paper prepared for FONDAD Conference on the International Monetary System, June 1993, Holland

key purposes of a World Central Bank. Drawing on parallels with national central banks one can assume that a World Central Bank would: a) contribute, via its influence on factors such as world liquidity, world interest rates, exchange rates of main countries, to the promotion of growth with low inflation in the world economy. It may be worthwhile to highlight in this context that, at a national level, the role of central banks in stabilizing economic activity - as opposed to their other roles - came fairly late in their evolution. A full achievement of the objective of a World Central Bank stabilizing the world economy would therefore also be expected to come late in the evolution of a World Central Bank. b) regulate and supervise globally commercial banks, as well as global capital markets. In the case of national central banks, there are either responsible for prudential supervision directly or - if not directly responsible for this aspect - have a strong presence in the supervisory process. Under current institutional arrangements, if the IMF was to become an embryonic World Central Bank, it could either exercise global prudential supervision directly or - as may be more effective - have a strong presence in the global supervisory process, for which initial institutional basis could be in the Bank for International Settlements. We will return to these important institutional aspects below.

A) The role of the IMF in global macro-economic governance

A very important medium-term objective for an enhanced IMF would be for it to play a central role in global macro-economic governance, to assume as high a level of global output consistent with low levels of inflation, and an acceptable distribution of current account deficits and surpluses.

The objectives of quality enhancing and consistent macro-economic policy co-ordination were clearly set out in Williamson and Miller as: "the primary objective of international macro-economic policy co-ordination is the achievement of as high a level and rate of growth of output in the participating countries, and indeed the world as a whole, as is possible on a sustained basis. Policy co-ordination should help each country to achieve their objectives by presenting rules that are both helpful to itself and to ensure that when its major partners follow similar rules the result is a set of mutually consistent policies".


A body of literature supports the rationale for policy co-ordination in an inter-dependent world, by pointing out is benefits. Co-ordination can be viewed as the logical extension of an optimizing process by which national governments pursue their policy objectives: from this point of view, policy co-ordination serves to internalize the effects of economic interdependence that no single government can capture on its own. In attempting to measure potential gains from co-ordination, Holtham and Hughes-Hallett\textsuperscript{24} have reported welfare gains for industrial economies, from policy co-ordination, measured in income equivalent units, as large as 6 or 7 per cent of the GNP, under certain assumption. Such estimates should give a firm encouragement for industrial countries to pursue the path of co-ordination more rapidly. Furthermore, additional benefits would be obtained by developing countries; indeed, a study by Sachs and McKibbin\textsuperscript{25} has reported that developing countries would have been the principle beneficiaries of coordination among industrial economies, even if industrial countries only took account of their collective self interest in deciding their policy actions.

A very important step in developing a blueprint for international co-ordination seems to be the framework designed by Williamson and Miller, op. cit. Building on their earlier work on exchange rate target zones\textsuperscript{26} and on the work of Nobel Prize Winner James Meade\textsuperscript{27} and others, on treating the growth of countries' nominal income as an intermediate target, Williamson and Miller designed a set of rules for the conduct of monetary and fiscal policy in the major industrial countries that would stabilize both real exchange rates and nominal demand growth. A summary of the Williamson-Miller Blueprint can be found in Table 4.

Though there are some important critiques of the Williamson-Miller framework and some broader areas of disagreement, the Williamson-Miller blueprint does seem to crystallize an initial emerging consensus on which international policy co-ordination could be built. It is interesting that an authoritative study evaluating different blueprints\textsuperscript{28} concluded, using the simulations of the National Institute Global Econometric Model over the 1975-86 period, that


\textsuperscript{27} J. Meade (1984) " New Keynesian Bretton Woods". Three Banks Review, June

gains associated with the proposal advocated by Williamson and Miller were larger and more substantial than those of an alternative scheme;29 the latter, alternative, scheme uses interest rates to stabilize national income, while fiscal policy is assigned to controlling the current account. This is in contrast with the Williamson-Miller scheme, where monetary policy is designed in part to avoid real exchange rate disequilibrium while fiscal policy stabilizes domestic demand.

From the point of view of developing countries, the Williamson-Miller blueprint, also has an important direct advantage in that it targets the average level of world (real) short-term interest rates, a crucial variable for LDC's, as excessively high levels of interest rates in the 1980's have been a major cause for lower LDC performance. Furthermore, particularly by attempting to influence world real short-term interest rates, the process would be performing globally one of the key functions of a modern national central bank, which is to influence or determine national interest rates.

29 Boughton, J., "Eclectic Approaches to Policy Coordination" in B. Eichengreen et al. (eds), Blueprints for the Exchange Rate System, CUP, forthcoming.
Table 4: The Williamson-Miller Target-zone Proposal

The Blueprint

The participating countries [the Group of Seven] agree that they will conduct their macroeconomic policies with a view to pursuing the following two intermediate targets.

(1) A rate of growth of domestic demand in each country calculated according to a formula designed to promote the fastest growth of output consistent with gradual reduction of inflation to an acceptable level and agreed adjustment of the current account of the balance of payments.

(2) A real effective exchange that will not deviate by more than [10] per cent from an internationally agreed estimate of the 'fundamental equilibrium exchange rate', the rate estimated to be consistent with simultaneous internal and external balance in the medium term.

To that end, the participants agree that they will modify their monetary and fiscal policies according to the following principles:

(A) The average level of world (real) short-term interest rates should be revised up (down) if aggregate growth of national income is threatening to exceed (fall short of) the sum of the target growth of nominal demand for the participating countries.

(B) Differences in short-term interest rates among countries should be revised when necessary to supplement intervention in the exchange markets to prevent the deviation of currencies from their target ranges.

(C) National fiscal policies should be revised with a view to achieving national target rates of growth of domestic demand.

The rules (A) to (C) should be constrained by the medium-term objective of maintaining the real interest rate in its historically normal range and of avoiding an increasing or excessive ratio of public debt to GNP.

Source: Williamson and Miller (1987), p 2; brackets and italics in original.
For the process to genuinely be a global exercise, as well as for it to provide one of the pillars for an embryonic world central bank, the IMF should play a key role in this coordination, as well as exercising surveillance particularly over the major countries. Furthermore, experience has shown that for global actions to be successful on a sustained basis, there is a need for supranational institutions to play a key role, as institutionalized cooperation can allow decisions and actions to be taken at a multi-country level, even when the parties fail to agree. The central role for the IMF in such a process would contribute to make sure that the interest of the non G-7 countries were clearly represented in this process. Furthermore, the interests and positions of developing countries and countries in transition, (the non-G7) should also be directly represented in the process of macro-economic coordination, partly because according to recent IMF estimates, the non G-7 economies account for over half of world output.30

An important issue is what sanctions can be used, stronger than existing ones, by the IMF on major industrial countries, which follow unsustainable policies. One possible sanction is to make all IMF advice on sound macro-economic policies public, particularly where the performance of major industrial countries has a major global impact. A second, more radical sanction would be for the IMF to declare that major countries with inappropriate policies are conducting unsustainable policies. The Bank for International Settlement (BIS) could then link the capital weighting (and thus the level of reserves) which banks have to hold against loans to those countries, to the IMF's evaluation. This would imply a more sophisticated system of rating than current BIS rules, where national debts of OECD countries and Saudi Arabia carry zero risk weight, while international debts of all other countries carry 100 per cent risk weight. By being able to apply sanctions, which would affect industrial countries' ability to raise funds from private banks, the IMF would have an important lever on industrial countries' policies; its' role as an embryonic world central bank would be strengthened.

To summarize, the need for a strong IMF to provide the framework for policy coordination arises partly from the need of non G-7 countries interests to be considered (though other measures would also help ensure that), but equally strongly from the need of the G-7 countries themselves to pursue more pervasive and more permanent coordination.

Recent trends (briefly outlined above) are not very encouraging for a significant enhancement of the process of macro-economic global coordination, leading to global governance. However, there are three elements that give cause for optimism. Firstly, the new US Administration has expressed clear interest in enhancing macro-economic coordination. Secondly, the record seems to show clearly that when policy coordination has occurred,

30 For a discussion of how the non G-7 could be integrated, see J. Williamson, "In the Modalities of Macro-Economic Policy Coordination", op. cit.
economic performance improves. Thirdly, simulation exercises confirm this result, by showing that with coordination countries perform better than without.

Finally, it should be stressed again that a strengthening and a widening of the process of macro-economic coordination, including an enhanced role for the IMF in it, would provide a very important step towards macro-economic global governance and towards allowing the IMF to perform some of the key functions which its founders wished it to carry out and to move it in the direction of an embryonic world central bank. Though the IMF would not directly be influencing world liquidity (as it does not at present have the instruments to do so), it could via the process of coordination influence world interest rates, and via this instrument indirectly influence individual countries and world aggregate monetary policy.

B The challenge of global supervision and regulation of private flows

Particularly during the last decade, the size and structure of global financial markets has undergone profound changes. The dominant initial force explaining these changes is deregulation, which considerably enhanced the role of free market forces in determining choices open to economic agents. Many restrictions which previously limited competition (e.g. by restricting lines of business, geographical operation, quantitative constraints on credit volumes and interest rate restrictions, controls on foreign exchange transactions and international capital flows) have either been removed or undermined. As a result, financial markets have become increasingly globalized and integrated, the size and influence of financial markets has increased markedly in all countries - as reflected for example in a massive increase in the turnover of all the major securities markets - and functional boundaries, particularly between banking and securities, have been rapidly eroded. These changes have favoured the creation of complex conglomerate structures (often across national borders), which combine traditional banking services with various types of securities and - more recently - the provision of insurance. Finally, there has been a greater institutionalization of savings, which has provided a base for the expansion and internationalization of securities markets.31

Important policy issues, especially in the regulatory field arise as a result of these trends. Indeed, there is a growing consensus that global financial deregulation and liberalization, though having many positive effects, such as allowing both original suppliers and final users of funds to obtain better terms, also resulted in greater risks for the global financial system, for investors and for borrowers and recipients, at individual and national levels. Though it may

seen paradoxical, it seems likely that the more free enterprise oriented the global system becomes, the greater the role for global supervision will be.

Thus the changes brought about by deregulation and the freeing of market forces in the financial sector are creating new urgent regulatory needs (such as capital adequacy requirements), particularly at a global level. These new regulatory challenges have been only partly met, and urgent tasks (nationally, and, above all, globally) still need to be accomplished. These relate both to complex conceptual economic issues (such as defining appropriate measures of capital adequacy for different sectors in the financial industry) and to institutional issues, which imply developing or creating appropriate institutions especially globally, and giving them sufficient power to carry out their regulatory task properly, but not excessive power, so as to avoid them stifling economically desirable flows. Developing the global regulatory role and the global regulatory institutions would also provide an important pillar for global financial governance and for establishing an embryonic world central bank. Indeed, the supervisory and regulatory function at a national level is an important element in national central banks.

The new needs for regulation pose difficult policy challenges, as it is important to safeguard the benefits of deregulation, while minimising its current and future potential costs. Those costs relate to greater financial instability and fragility, reflected in the form of very large fluctuations in asset prices and/or distress among financial institutions.

The greater internationalization and integration of the financial industry meant that shocks are more easily transmitted across borders, as well as from one market to another. This was illustrated by the global nature of the stock market crashes of 1987. Thus, as a result of the changes in the structure and workings of the financial system, the nature and transmission of systemic risk changes significantly and possibly increased. Systemic risk also became more globalized. Systemic risk can be defined as the danger that disturbances in financial markets will generalize across the financial system, so as to disrupt provision of payments services and allocation of capital.

Amongst the sources of potential for systemic risks, especially at a global level, three can be highlighted: a) increased exposure of institutions to market risks, that is risks of losses stemming from movements in market prices, including interest rates, exchange rates and equity values. As positions are increasingly taken over a large number of markets, problems in one market can be quickly transmitted to others. The 1987 stock market crash illustrated how different operating arrangements in different markets for highly substitutable instruments can have destabilizing effects because they result in differing price reaction speeds and uncoordinated stoppages. b) Large variations between different national regulations of financial firms (especially securities), as well as fundamentally different approaches to
regulation amongst banking and securities' regulators and c) regulatory gaps, particularly at a
global level, (e.g. in international regulation of securities), seem at present to be also an
important source of systemic risk. Indeed, as the Federal Reserve Bank of New York pointed
out32, "there is a growing tendency to build financial links along regulatory fault lines, where
responsibility for supervisory oversight is weak, divided or clouded." Indeed, it is differences
in the perceptions of securities' regulators that have impeded an attempted global agreement
on capital requirements of securities firms (which would have done for securities what the
Basle accord has done for banking) and, as a result of that, it has not been possible as yet to
reach agreement for a joint global framework on capital adequacy for banks and securities
houses.

Overall, though regulation and supervision of banks and financial markets have made quite a
lot of progress at the national level, progress has been far slower at the international level, and
even more at the global level. This is in sharp contrast with private banking and capital
markets which have become extremely globalized. Also, supervision and regulation globally is
patchy as regards certain aspects and very uneven. Thus, as can be seen in Table 5, while
securities and financial conglomerates outside the EEC will not have to adhere to any
international guidelines (though there are national regulations for securities), banks inside the
EEC will have to meet three different sets of rules for measuring market risks and for capital
requirements to cover those risks (the BIS ones, the EC Directives and possibly some national
ones).

Furthermore, in the future, an enhancement of global supervision and regulation of private
flows could potentially also help support the task of global macro-economic governance, for
example by contributing to reduce both exchange rate instability and misalignments.

32 E. Frydl, "The challenges of financial change", Federal Reserve Bank of New York,
Table 5: Regulatory Frameworks of Financial Institutions

<table>
<thead>
<tr>
<th></th>
<th>International</th>
<th>EC(3)</th>
<th>USA</th>
<th>UK</th>
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<td>x(1)</td>
<td>xx</td>
<td>x</td>
<td>xxx</td>
</tr>
<tr>
<td>Securities</td>
<td>-</td>
<td>x</td>
<td>x</td>
<td>xx</td>
</tr>
<tr>
<td>Financial Conglomerates</td>
<td>-(2)</td>
<td>x</td>
<td>x{4}</td>
<td>x</td>
</tr>
</tbody>
</table>

(1) Includes both the 1988 Accord and the regulation of securities activities of banks, the latter proposed in 1993 and to be implemented by 1997 at the earliest.

(2) There is a IOSCO proposal for principles on which to regulate financial conglomerates, but no formal regulatory agreement.

(3) EC directives to be enacted by 1996.

(4) Till recently, U.S. regulation of non-bank securities' houses, within major financial groups, was practically non-existent.

Source: Table prepared by the author, on the basis of interview material, and BIS documents.

It would seem, that unless special efforts are made to overcome this asymmetry, it is likely to remain for quite a number of years. This relates not only to the conceptual differences between regulators mentioned above (which originate largely in the diversity between different financial institutions and their differences amongst individual countries), but also due to institutional differences, for example between BIS and IOSCO (the International Organization of Securities Commissions). The BIS is a long established G-10 institution, which carries a lot of weight, as its' members, the G-10 central banks are regulators and lenders of last resort of their own banking systems. Its' work on international harmonization of supervisory standards has gone on for around 20 years. Therefore, it seems to find it easier to reach agreements than IOSCO, which is a far newer institutions; though created in 1974 mainly by Latin American institutions, it became international in only 1987. Its' work on harmonization of international regulations is thus far more recent than that of the BIS. It represents bodies from 51 countries, which in itself makes it more difficult to reach agreement than in a G-10 institution, though it has the virtue of being more global.

Furthermore, the bodies whose activities it coordinates, (the securities commissions) themselves tend to be fairly young, and do not have special lender of last resort powers domestically. For these reasons, it may continue to be more difficult to reach agreements on common regulations, though understandable, these regulatory asymmetries pose serious additional risks to the financial system.
To achieve close and coordinated supervision and regulation of financial institutions globally a number of important tasks need to be accomplished. In the near future, the issue of appropriate and coordinated supervision of securities needs to be dealt with far quicker than in recent years; this would require probably that securities regulators develop their equivalent of the Basle Concordat for banking supervisors. More generally, a serious effort needs to be made to extend regulatory coverage to financial institutions, that are now effectively unregulated, such as financial conglomerates. Though banking supervision is more advanced, both nationally and at a G-10 level, this supervision needs to be globalized, so it will cover all countries rather than merely the G-10. Finally, the criteria for regulation between each financial industry's regulators (e.g. banking and securities), once agreed globally, need to be coordinated across financial sectors.

To meet these important and complete challenges, which the need for greater global financial governance pose, important legal and - above all - institutional requirements have to be met.

Firstly, there seems to be an increasing need to achieve greater global integration of contract law, so contracts can be challenged internationally, and regulators can carry out liquidation proceedings that are internationally equitable. This task is difficult as it requires the promotion of international treaties. Global bodies, like the United Nations, could play a key role in studying, promoting and implementing global integration of contract law.

Even more importantly, the increased need for globalized and integrated regulation of private flows seems to require the creation of new institutional capacity. At a first level, this would require a substantial strengthening of IOSCO and a far close integration of all countries into the BIS Basle Accord. At a second level would be the creation of a new body, of a Global Board of Regulators, with national central banks and other regulatory representatives. This Global Board of Regulators could be formed around the BIS, which already coordinates banking regulation for the G-10 countries, and has valuable experience in this field. Alternatively it could be formed as part of - or very closely linked to - the IMF, as the Fund has a more global membership than the BIS, and as its' other activities - particularly if its' role in global macro-economic coordination is enhanced significantly as suggested above - would complement that of global regulator; furthermore, if this second option was adopted, the IMF would really start acquiring the attributes of an embryonic world central bank; a third option would be for the Global Board of Regulators to be independent, but to work very closely with both the IMF and the BIS. As pointed out above, in some countries regulation of banks is carried out by an independent body, though liaising clearly with the central bank, while in other countries this regulatory function is carried out by the central bank.

The choice of institutional arrangement should be pragmatic. However, it would be advisable that whatever arrangements are adopted, these give the Global Board of Regulators sufficient
authority and universality; as regards the latter, the key point is that whatever the number of
countries directly represented in the decision making body, the rules should be globally
enforced.33

The establishment of a Global Board of Regulators would be very important for several
reasons. Firstly, such a body could set mutually acceptable minimum capital requirements for
all major financial institutions, and do so globally, establish uniform trading, reporting and
disclosure standards and monitor the performance of markets and financial institutions.
Secondly, such a Board would increasingly achieve a truly global perspective on regulation,
integrating both different national and functional perspectives; at present such global
perspectives are difficult to achieve as regulators respond to their constituencies and to their
specialized conceptual frameworks (both at a national and at a functional level). Thirdly, such
a Board would provide an important and very necessary pillar for global financial governance,
and a key input into a potential future central bank.

V LONG-TERM MEASURES FOR CREATING A WORLD CENTRAL BANK

The measures outlined above - if fully implemented - would imply very crucial steps towards
improving world financial and macro-economic governance very significantly. They would
also transform the IMF (possibly linked with other institutions) in several key aspects into an
embryonic world central bank.

To further develop the role of the IMF into a proper world central bank implies very major
challenges.

First, it would require a larger IMF, and one that is not so dependent on political factors for
determining its' size. As is well known, IMF quotas already in the late 40's were far smaller
(as percentage of world imports) than had originally been proposed by Keynes. They further
decreased from about 16 per cent in the later 1940's, to 12 per cent in the 1960's, to only around
5 per cent in the 1980's. Furthermore, the negotiation for an increase of IMF quotas is always
a long and difficult process.

To prevent a continued erosion of the size of the Fund, and also to increase the IMF's
autonomy in relation to the major industrial countries necessary for the Fund to be able to
effectively influence their policies, it would be desirable that the size of IMF quotas be
dependent on appropriate, technically defined and consistent criteria, which could be designed

33 I thank Robert Griffith-Jones for this point.
to receive aid provided for in this and the bill to be considered in connection

This new bill would cover a wider range of services and would provide for a more comprehensive system of education.

The main objective of this bill is to improve the quality of education in the country and to ensure that all children have access to educational opportunities.

In addition, the bill would also establish a new funding mechanism to support schools and ensure that they are well-equipped to provide quality education.

The bill would be funded through a combination of tax revenues and grants from the national government.

Furthermore, the bill would also establish a new system of evaluation to ensure that schools are held accountable for their performance.

Overall, this new bill represents a significant step forward in improving the education system in our country and ensuring that all children have the opportunity to succeed.

If passed, this bill would have a transformative impact on the lives of our children and ensure that they have the tools they need to succeed in life.

I urge all members of this parliament to support this bill and ensure that it becomes law as soon as possible.
by the Fund staff, and applied automatically or semi-automatically. The size of the Fund's quotas would need to relate to the role which the IMF will be required to play in financing current account deficits; therefore variables to be considered would be the size of those deficits and the availability of non-Fund finance.

If such criteria could not be agreed on, the level of Fund quotas could be fixed in terms of "real" SDR's, rather than in nominal values, so that inflation in the countries whose currencies compose the SDR basket would lead automatically to an increase in the size of nominal quotas.

The most difficult challenge, however, for the IMF to become a world central bank in the current international financial context, is for it to exert a clear influence on world liquidity. This would require in the very long term an internationally agreed instrument of liquidity, internationally issued and internationally managed, via the SDR.

A first step for this very long-term aim is the renewed issue of SDR's discussed above. A second step is to widen the use of the SDR significantly. This would require implementing some important proposals already made some time ago. Kenen has proposed measures to encourage far greater private use of the SDR, via a new clearing house to which central banks would transfer SDR's in exchange for deposits of national currencies by their commercial banks with each central bank. As a result, commercial banks and other private financial institutions would have access to SDR's, and begin to deal with them. Once private use of SDR's spread, central banks could intervene in foreign exchange markets through SDR's; demand for SDR's as reserves would rise as a result. Furthermore, if commercial banks began to trade extensively in SDR denominated claims, this would imply the birth of fractional reserve-based deposit banking on a world scale; as Cooper, op. cit., points out, IMF issuance of new SDR's could as a result influence bank credit and economic activity directly. The seeds of a global monetary policy would have been planted. This mechanism would be particularly valuable in the current context, as private financial flows play such a major role in financing industrial countries' current account deficits.

Another important proposal was made by Polak, which would avoid the intermediary use of national currencies in IMF operations, by consolidating the Fund's general account, available for normal lending, and the SDR account, which deals with creation of SDR's; both would be based on the SDR. This would have the advantage that the IMF would no longer depend on

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34 See P. Kenen, "The Use of the SDR to Supplement or Substitute for Other Means of Finance" in G. von Furstenberg (ed.), International Money and Credit, IMF 1983; see, also, J.J. Polak, Thoughts on an International Monetary Fund Based Fully on SDR's, Pamphlet 28, IMF. 1979.
contributions of national currencies to support increases in quotas, but could just issue SDR's to meet calls on it by borrowers. As a result, it would imply an important move nearer to a world central bank, even though the Fund's ability to create SDR's in this way would still be limited by the quota of member countries.

The key issue would, however, be whether private liquidity, which is essentially demand determined in the present system could and should be regulated. Regulations established for prudential purposes, such as the BIS capital adequacy rules for banks could possibly be used as a mechanism to control or influence such liquidity as Massad35 suggests; furthermore, Massad suggests that minimum reserve requirements could be established, and that both these measures could help regulate better the total supply of liquidity. These proposals need to be carefully studied, to determine whether the benefits of greater control of world liquidity would compensate for the possible costs of reduced flexibility (particularly for industrial countries and creditworthy developing ones), as well as any loss of allocative efficiency that could result. The feasibility and desirability of such measures would also depend on the direction in which the international monetary system evolves, and on the extent to which the type of measures outlined before are taken. In this sense, it may be premature to define too precisely how an embryonic world central bank would run if it has not yet started to walk!

Should the path towards making the SDR the main (and then the only) currency be eventually adopted, the mechanism to reduce - and then eliminate - the role of national reserve currencies has already been amply discussed in the early 1970's, by the Committee of Twenty (C-20). This would imply using a "substitution account" in the IMF, which was then conceived as a mechanism to exchange SDR's for dollars at a fixed rate; as SDR's would be created during the operation, against dollars absorbed by the substitution account, there would be no net increment in liquidity as a consequence of the operations of the account. As Massad, op. cit., rightly points out, if used in the future, given the evolution of the international monetary system, such a substitution account would have to be open not just for dollars, but also for the currencies of other industrial countries, which are now also used as reserves. Furthermore, during the transition to an SDR based world monetary system, special attention would need to be given to banks and other financial institutions operating in international markets.

Though it is an important and desirable objective to transform the SDR into the main (or only) instrument of international liquidity, and thus allow the IMF to transform itself fully into a world central bank, this objective is both technically and politically difficult to achieve under current circumstances. The best reform strategy therefore seems to be to contribute to create

35 C. Massad "A New International Monetary System for the Future", paper presented to the North-South Roundtable, on September 1-3 at Bretton Woods.
the pre-conditions for this long-term aim to become more feasible, by taking steps to significantly enhance global financial and macro-economic governance (and in particular, to increase the role of the Fund in a far stronger process of macro-economic coordination for the major economies, to supervise and regulate globally banking and other private flows, and to enhance the role of the SDR, by renewed issues and other mechanisms).