

Development in an interdependent world: old issues, new directions?

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Why does development matter? It matters because we aspire to a more equal world, in which the possibilities of living well are available to all, and not just to a minority of the world's population. That aspiration requires the convergence of living standards across the globe. Convergence in turn requires the economic development of countries with low standards of living and, in view of the threat of climate change caused by carbon emissions, paths of convergence that are consistent with a low-carbon future for our planet. Although economic integration with the rest of the world, through increasing trade and capital flows, is a well-established method of raising living standards, historically it has been most effective when attempted by a few nations at any one time. When used en masse, this method will not necessarily result in a form of interdependence that is benign and consistent with desirable paths of convergence.

Economic integration by trade and capital movement imposes two types of constraint on national strategies of economic development. The first kind may be described as fundamental or underlying. They arise spontaneously from the working of self-interest, Adam Smith's 'willingness to truck and barter' and the market institutions which the pursuit these two motives bring into being. They are the disciplines imposed by market forces, such as the fact that a trade deficit is a typical accompaniment to development investment and has to be financed in one way or another and that countries can borrow abroad only when creditors are confident of being repaid.<sup>1</sup> An understanding of these underlying constraints derives from international economics. Strategies of economic development in less developed countries aimed at quickening the existing rate of economic growth often find themselves running up against these fundamental or underlying international economic constraints.

The second type of constraint is one that national governments impose upon themselves, by voluntarily limiting their national sovereignty. Joining with other governments in agreeing to obey certain rules in relation to trade and capital flows has the objective of gaining benefits (often referred to as

international public goods) that are not to be had when market forces operate unimpeded. For example, international trade rules can be agreed to limit the discriminatory or exploitative trade behavior of economically powerful nations. Or, financial resources can be pooled and made available to be drawn down by those nations that are in balance of payment difficulties. This second type of constraint is accepted, then, in order to ease the impact of the first type of constraint. Ex ante, the expectation is that limiting national sovereignty by accepting some self-imposed constraints will increase total national welfare. The idea begins to exert an influence in the 1930s, when global laissez-faire was degrading the international economy.<sup>ii</sup> It comes to fruition after the horrors and disruptions of the Second World War inspire a new attempt to design a rational system of international economic co-operation.

### **1 Post-war efforts to manage global interdependence: the evolving logic of collective action**

The immediate aftermath of the Second World War is often regarded as the high tide of idealism in international economic co-operation. Certainly, two substantial sections of a new international institutional architecture that were planned during the war (the IMF and the World Bank) were quickly put in place. The reason for this was not so much the atmosphere of high idealism as the special circumstances of the international scene at that time. The number of independent countries formally involved in coming to agreement was small by today's standards, at around forty. Moreover, most of them, exhausted by war, were quite willing to delegate the work of designing new international architecture to an inner group of two—the USA and the UK. The idealism of this inner group, such as it was, was diluted by a strong dose of economic and financial calculation. The United States, the largest financial contributor to the new international financial institutions, insisted on retaining effective control of them. Both Harry Dexter White and US Treasury Secretary Henry Morgenthau were “determined that the United Nations was never going to tell the World Bank or the International Monetary Fund what to do.”<sup>iii</sup> The British firmly supported the Americans in this stance, and in 1947 the Anglo-American position was entrenched in letters of agreement which the IMF and the World Bank exchanged with the UN.

Some other countries disagreed, and were willing to see the IMF and the Bank subordinated to some form of control by the new United Nations Organisation.<sup>iv</sup> This issue did not loom large, however, until the great transformation of the international landscape in the 1960s, when many former European colonies became independent, joined the international community and asserted that the Bretton Woods institutions should be part of a system of world government operated through the United Nations. This claim, although already overridden in 1947, continued to compete with the established fact that they operated as independent executive agencies, whose actions could be influenced only through their own contribution-weighted systems of governance. After the developing countries formed their own bloc (the Group of 77) for the purpose of international negotiation, the conflict became entrenched, and it animated two decades of subsequent struggle over the shape of the international economic architecture.

The third major section of the planned post-war international architecture, relating to trade rather than finance, was never completed. The agreement to set up an International Trade Organisation, negotiated in Havana in 1947-8, was never ratified by the United States. Only the interim General Agreement on Tariffs and Trade (GATT) stood in its place. This was concerned exclusively with the modalities for negotiating reductions in industrial tariffs on a non-discriminatory basis and with safeguards against trade that damaged industrial employment. Industrial tariff reduction was a matter of considerable interest to the advanced countries, but had little appeal for the newly independent developing countries that were joining the international community. Their concerns were quite different, deriving from their ambitions for economic development and the economic strategies that they were trying to pursue.

Premised on the existence of surplus rural labour, these strategies called for accelerating investment in an industrial sector run on capitalist lines, and the reinvestment of this sector's profits in its own further expansion. In their simplest form, these development strategies implied an economy closed to trade. In practical terms, however, since most developing economies were to some extent open to trade, they implied the use of tariffs sufficiently high to afford protection to the new "infant industries" that their governments were creating. An international trade organisation devoted to tariff reduction plus employment safeguards therefore seemed not merely an irrelevance, but a threat to their development ambitions. In the face of competition from the products of advanced countries, and safeguards against their own exports, the expansion of these new industries would be limited and so would the profits needed for further investment.

The Group of 77 countries therefore advocated new trade arrangements that acknowledged the special financial problems that arose in the course of economic development, namely an increasing deficit on their foreign trade account that needed to be financed by some international public mechanism. They regarded the facilities of the new institutions of the International Monetary Fund (IMF) and the International Bank of Reconstruction and Development (IBRD or World Bank) as quite inadequate for the purpose. The IMF provided short-term balance of payments support, whereas the need was a continuing and long-term one for development finance. The Bank provided project loans on a small scale, whereas the need was much greater than could be met through lending for projects.

There was little sympathy in the advanced countries for developing countries' fears about trade liberalisation, or the long-term financing demands to which their development strategies gave rise. North America and Europe were discovering, to their considerable surprise, the power of trade expansion to promote their own economic growth. Their trade expansion was being engineered by two quite distinct methods. One was undertaking successive rounds of GATT negotiation to liberalise tariffs. The other was the formation of the European Economic Community in 1956. This regional customs union had a special exemption from the basic GATT rules of MFN treatment and non-

discrimination. The EEC was the modern pioneer of deep regional economic integration, becoming the single unified market of the European Union by 1989. The statistics of increased EU trade and capital flows as a share of GDP in 1960-94 indicate that integration took place on an intra-EU rather than a global basis.<sup>v</sup> However, both the EEC/EU and the GATT/WTO experiences confirmed the view that tariff reduction and the sharper competition that it brought to national industries resulted in generalised gains in efficiency, as resources released from industries unable to compete were re-absorbed by others with better prospects. The underlying condition for this successful outcome from trade liberalisation was that of rapid mobility of factors of production between alternative uses.

Nevertheless, developing countries remained unconvinced of the benefits to be derived from trade liberalisation. In part, this was because the economic case that could be made for it at that time was quite weak. It was generally agreed that the static efficiency gains from liberalisation would be only between 3 and 5 percent of GDP, and would be a once only effect; while it was counter-argued that the dynamic gains from retaining trade protection could be much larger. In part it was because before rates of *effective* protection were calculated in the late 1960s, developing countries were not fully aware of just how protective their tariff structures were. In part it was because extensive but invisible protection created powerful vested interests in developing countries generating political pressure to maintain the economic status quo.

The theory of the second best also provided a warning against piecemeal liberalisation. There is no guarantee that removing one market distortion while others stay in place will increase national welfare, and removing all distortions at once was too radical to contemplate. Once again, it was only in the late 1960s that second best theory was developed further, to demonstrate that tariffs were a low-ranking policy option to deal with the development problems of labour-surplus economies in the process of industrialisation.

Thus in the 1950s the inadequacies of the GATT to deal with the trade-related problems of development became a major cause of international contention. The advanced countries reacted defensively, trying to maintain the basic structure of GATT, but conceding minor modifications of GATT and of the IMF from time to time. In 1955, for example, developing countries were granted special treatment in GATT, allowing them to protect particular industries and to plead balance of payments reasons for adding to quantitative restrictions on trade, contrary to normal GATT rules. In 1963, the IMF set up a Compensatory Finance Facility for countries affected by sudden sharp shortfalls in their export revenues. The defensive posture was undermined in the 1960s by EEC actions. In 1963 the EEC granted tariff preferences to its ex-colonial territories in the Yaounde Agreement. It also set up its own STABEX scheme to offset fluctuating commodity prices for its overseas associated territories.

<sup>vi</sup> These actions breached the unity of the advanced countries' defence of the basic GATT principles of non-discrimination and reciprocity in trade liberalisation.

The EEC also supported plans for a new complementary trade organisation to deal with the linked set of trade, development and finance problems. The new body, the UN Conference on Trade and Development, convened in 1964, advocated a generalised system of non-reciprocal, non-discriminatory preferences for developing countries, and this was agreed at UNCTAD II in 1968. The implementation proved to be very different from the principle, however—a multiplicity of partial, uncoordinated and unpredictable preference regimes<sup>vii</sup>.

As these defections from the post-war multilateral trade regime strengthened, the chances of reaching multilateral agreement on revised regime diminished. The possibility for multilateral co-operation depends in an important way on the numbers of players in the group seeking agreement and the heterogeneity of their characteristics and interests. De-colonisation had increased both the number of players and the dispersion of the characteristics and interests of members of the international community. So it was hardly surprising that rich and poor countries then tussled for two decades about the appropriate forms of global economic governance, without coming to any resolution. In the 1970s, this tussle took the form of a struggle for a New International Economic Order. The main issue was the formation of additional International Commodity Agreements and their financing. In the face of new commodity producers' organisations such as OPEC, the advanced countries closed ranks, while the solidarity of the developing countries, though evident in form, ultimately lacked substance. The Common Fund, the main institutional innovation, was by any account puny.

The incentive problem that prolonged these fruitless struggles had already been revealed in the 1950s, when many developing countries campaigned in the UN for a new soft loan fund that was independent of the World Bank. They wanted not only to set up a soft loan agency for developing countries; they wanted to create a new financial executive agency under UN control. In the first aim they succeeded, but in the latter aim they failed. Significantly, the failure occurred not because the campaigners could not muster the votes in the UN General Assembly to out-vote their opponents—after 1958 they were able to do so. The reason was that the campaign's supporters recognised the need to compromise with the countries that would have to shoulder a disproportionate share of the costs by subscribing the necessary funds. It is a fact of international life that aid donors prefer to operate through international agencies where they have the ultimate control. They have no incentive to commit their funds to organisations in which they cannot control financial disbursement. Even those who deplore this situation recognise that it is a fact.<sup>viii</sup>

The compromise that emerged from the soft loans controversy was that soft loans for poor countries would be made available, but only through an institution (the World Bank) that the developed countries controlled. It might therefore have served as a model for future co-operation between the UN and the Bretton Woods institutions. In this compromise model, new policy proposals could be presented and

negotiated in the UN, and when agreed in principle, implemented through executive agencies where voting is contribution-weighted.

When the trade, development and finance issues flared up again in the 1960s and 1970s, the developing countries again sought the establishment of a new institution (the Common Fund) that would be governed by majorities in the UN General Assembly, but funded by the industrialized countries. That was not in the spirit of the soft loan compromise.<sup>ix</sup> Unsurprisingly, the earlier experience was repeated. Despite the developing countries' greater voting power, the G 77 had to compromise with the advanced countries: once again the mere weight of numbers did not bring ultimate success. Finally, when the Brandt Report recommended setting up a World Development Fund with broadly based control, the advanced countries at the 1981 Cancún summit successfully maintained what they termed the "integrity" of the IMF and the World Bank.

The paradox that numerical superiority does not automatically bring about the changes to the international system that developing countries desire was spelt out in 1973:

"The developing world pressed for [UNCTAD] to be set up within the UN system, believing or hoping that their numerical preponderance organized in a bloc system would enable them to exert a powerful influence on the policies of the developed world. Yet in questions of trade and development sheer weight of numbers cannot force the rich countries to share what they have already secured or make them change a system that benefits them only too well."<sup>x</sup>

Ignoring this lesson of experience rendered the North-South dialogue "little more than a laborious twenty-five-year-long exploration of an intellectual and diplomatic blind alley."<sup>xi</sup>

Moreover, while the NIEO struggle continued, the oil price rises engineered by OPEC and the subsequent re-cycling of OPEC petro-dollars through Western banks to many developing countries undermined their diplomatic position. The large-scale borrowing of petro-dollars on terms that were unsustainable led them straight into the debt trap of the 1980s. The Mexican debt moratorium of August 1982, less than a year after the Cancun summit, set off a severe debt crisis in developing countries, particularly in Latin America. There followed a veritable counter-revolution in North-South relations, brought on by changes in relative economic positions. While the growth of production in the advanced countries in the 1980s improved slightly on the record of the 1970s, the output growth of the developing countries fell from a brisk 6 per cent on average to virtually nothing. Over the 1980s, the economies of the middle income developing countries and of sub-Saharan Africa actually contracted. This "lost decade of growth" sapped their policy autonomy. If they wanted to receive fast-disbursing development assistance, they found that it now came with policy conditions attached. It was the intellectual exponents of economic neo-liberalism, newly installed in both the IMF and World Bank, who supplied the content of the policy conditions attached to aid.<sup>xii</sup>

For the governments of the advanced countries, rebuilding their banking systems was their paramount consideration. The write-down of bad debt and the re-capitalization of the private sector banks required time, during which indebted developing countries were presented with a series of ad hoc and largely ineffective plans for debt relief. Since the global level of development aid was no longer programmed to rise and new private credit was no longer available, the aggregate balance of payments deficits of developing countries had to be halved very rapidly, reduced from approximately US\$ 70 to 35 billion between 1980 and 1986. Tough policies of macroeconomic stabilization had to be widely adopted. It was not so much that there was no alternative as that no alternatives were on offer from the bankers and governments of industrial countries. Together they urged the debt-distressed countries to adopt “sensible economic policies”, a term that encompassed not just macroeconomic stabilization on a grand scale but also microeconomic measures of thorough market liberalization. In 1988 this position was formalized; in a concordat aimed at improving policy coherence, the IMF and the World Bank agreed that adjustment lending would be available only to countries undergoing an IMF stabilization program.

## **2 The unexpected results of adjustment programs**

The adjustment programs of the 1980s and 1990s combined measures of macroeconomic stabilization (reduction of budget deficits, cuts in domestic credit and devaluation) with measures of liberalization designed to roll back government intervention in the economy. Although no single adjustment program was applied to all borrowing countries, many such programs featured liberalization measures in the trade sector, the financial sector, the private production sectors of agriculture and industry and the public sector, where privatization was urged. The microeconomic policies of neo-liberalism were justified as necessary supports to make currency devaluation effective in reducing balance of trade deficits.

However, the impact on economic growth of the widespread adoption of stabilization and adjustment programs was not what their promoters in the Bretton Woods institutions hoped for and predicted. Their expectation was of a considerable boost to growth in those countries that undertook stabilization and adjustment programs. In the special case of the countries in transition from socialism after the collapse of the Soviet Union, a transformation recession was expected, but it was forecast to be shallow and brief. The outcomes by the end of the 1990s were quite different. In Latin America and the Caribbean the growth of per capita income was less than 2 percent; in sub-Saharan Africa it was slightly negative; while in the transition economies (except those on the edge of the EU) the transformation recession was deep and protracted. During the same period, however, the East Asia and Pacific economies experienced faster than forecast growth of 6 per cent on average, with China leading on 8 percent.<sup>xiii</sup> The pace of economic differentiation within the developing world was in fact much

greater than the advocates of liberalization and globalization expected, despite the eruption of an unexpected financial crisis in East Asia at the end of the 1990s.

These regional differences in growth outcomes pose difficult questions in interpreting the effects of IMF-Bank stabilization and adjustment programs. It would be facile to infer from the fact that the countries that undertook these programs were the slow growers and the fast-growing economies did not undertake them that the processes of stabilization and adjustment themselves were responsible for the subsequent economic differentiation. Firstly, it is wrong to identify economies having stabilization and adjustment programs with stabilizing and adjusting economies. Some countries that entered such programs did so with reservations. As the official jargon put it, they “did not have ownership” of their programs. Lack of ownership meant that stabilization and adjustment was at best partial and at worst non-existent. Secondly, it is wrong to identify non-participation in these programs with the absence of stabilization and adjustment. Countries enter internationally sponsored programs when they have been unwilling or unable to stabilize and adjust on their own to the national economic conjuncture that they face. The Asian high-growth economies of China, India and Vietnam were all stabilizing and liberalizing their economies, but they were doing so pro-actively, at their own pace and in their own sequence, rather than with one that was externally imposed as the condition of international lending. Although there were undoubtedly design flaws in the IMF-Bank programs, on their own such flaws are insufficient to explain the disappointment of neo-liberal hopes and the acceleration of economic differentiation in developing countries.

The subsuming of the GATT into an expanded and strengthened World Trade Organization (1995) was the most substantial addition to the international economic architecture in this period, and indeed in the entire post-war era. That it happened at all was most remarkable, given that the agreement establishing the WTO required the formal agreement of all 76 GATT members. The completion of the single European market and the prospect of its further enlargement following the end of the Cold War in 1989-90 were the effective triggers. The USA saw these portents and concluded that a more rule-bound trade regime would now be in its own national interest. As usual, the developing countries played little part in shaping the new organization. Those that belonged to the GATT were on the margins of the Uruguay Round negotiations, while those that did not were faced with a take-it-or-leave-it choice—join the WTO as you find it or not at all.

Could it be that the developing countries, except those like China and India large enough to negotiate special terms for their entry, were persuaded to don an economic straight jacket that restricted their subsequent growth? This seems unlikely. Although specific WTO rules are onerous and unfair to them given their circumstances (see section 9 below), one must set against this the positive benefits conferred. WTO rules do something to curb the oppressive actions of large countries and permit some types of industrial policy for development. WTO negotiations also now encompass issues of

importance to development prospects—such as liberalizing the trade in agricultural products. Although WTO rules do have inadequacies and unfairness from the perspective of developing countries, their introduction can hardly have produced such large differential growth effects as those observed during the 1990s.

The key question then is why many developing countries were unable to take advantage of the opportunities provided by a more open global economy, fortified by WTO rules, while at the same time a small minority were able to diversify into export-led growth based mainly on manufacturing? Part of any explanation must lie their differing initial conditions. Comparative advantages in trade arise from factor endowments, and factor endowments differ. In comparative terms, Latin America and sub-Saharan Africa are both relatively well endowed with land, while East Asia, although short of land, is relatively well-endowed with skilled labor. Starting from these factor endowments, one would expect Latin America and sub-Saharan Africa to be able to specialize in exports of agricultural products and other primary commodities, and East Asia to be able to specialize in exports of manufactures. Indeed, the ratio of human capital to land turns out to be a good predictor of the share of manufactures in a country's exports for all countries over one million in population for which data is available.<sup>xiv</sup>

Given the initial pattern of factor endowments, however, the available factors have to be drawn into productive uses to meet foreign and domestic demand. Trade liberalization certainly helps in this process, because it does two important things. It sends more appropriate signals about the efficient use of the country's resources, since the effect of protection is to obscure the opportunity to switch the local resources absorbed by the protected good to more profitable uses. It also creates a more appropriate set of price incentives to induce producers to move resources into the more profitable uses. Yet more appropriate signals and more appropriate incentives may not be sufficient by themselves to shift resources from less efficient to more efficient uses. They are permissive; they are not automatic. Many other impediments may deter would-be producers from making the necessary investments.

Poor physical infrastructure is one major impediment. According to a 2009 report by the Infrastructure Consortium for Africa, investment in the water, telecommunications, energy and transport sectors should run at a rate of \$93 billion a year over the next ten years, compared with the current level of \$45 billion, to bring it up to modern standards. Other obstacles are lack of credit and other financial services, an unhelpful business environment (though now improving in some parts of Africa) and uncertainty about government economic policy and/or political stability. All create extra costs and extra risks that cause investors to wait or to invest elsewhere. The potential advantages of a more open trade regime in terms of promoting economic growth may therefore not be realized because of a lack of capacity to absorb foreign capital and technology.

So it is quite plausible to suggest that the same degree of trade liberalization will have different effects on growth in different countries, according to their income level.<sup>xv</sup> Recent empirical research into the link between trade openness and economic growth between 1960 and 2000 identifies the existence of an income threshold at around US\$ 800 per capita in 1960. Countries below this threshold that liberalized trade experienced nil or negative effects on growth. Countries above this threshold found that trade liberalization had growth effects that were positive.<sup>xvi</sup> Admittedly, the statistical measurement of trade liberalization is not straightforward, but these results are robust to various different ways of measuring trade liberalization. The threshold effect was found to apply both to physical capital accumulation and to the growth of total factor productivity. The study did not try to establish the causation underlying the statistical association, so the correlation may merely reflect the operation of omitted variables. Yet, whatever the causes, the existence of a trade openness/growth threshold does help to explain the increasing differentiation of the global economy as neo-liberal policies prevailed in the 1990s.

### **3 The growth and impact of private financial flows**

One impetus behind the design of the Bretton Woods international institutions was the fear of the return of economic depression. Internationally, the new institutions of economic co-operation were designed to sustain high levels of employment within a non-discriminatory and progressively liberalizing system of world trade. The GATT rules were there to ensure that any trade measures taken by countries in balance of payments deficit did not trigger trade-reducing retaliation by other countries, as had happened in the 1930s. The new fixed-but-adjustable exchange rate regime, policed by the IMF, was intended to outlaw one of the worst features of the pre-war economy, competitive devaluation. IMF drawing rights were set up to allow countries in balance of payments deficit the time to make necessary adjustments to their fiscal policy smoothly. (The burden of adjustment fell on deficit countries, not on surplus countries.) These institutions worked well while they lasted, and the quarter century from 1946-71 is often regarded as a golden age of high employment and continuous growth.

During the golden age, the fear of depression evaporated. The UN's attention moved from preserving full employment to promoting economic development, and Arthur Lewis's advice on how to do so assumed that the world was "unlikely to repeat the horrors of the 1930s".<sup>xvii</sup> The golden age, however, contained the seeds of its own decay. As the dollar emerged as the main reserve currency, and as European countries running balance of payments surpluses proved reluctant to revalue their exchange rates, confidence in the dollar's peg to gold ebbed. Various stop gap measures such as US capital controls and the growth of Euro-dollar markets attempted to get around this confidence problem, but by 1973 the Bretton Woods system had terminally collapsed. Despite attempts to design a new international monetary system, what evolved was a non-system of currency free-for-all. Gold was demonetised, exchange rates were allowed to float (or not, according to choice) and major countries

agreed to hold their dollar reserves in the US rather than in the Euro-markets. US capital controls could then be abolished (1974). In fact, but not in name, the world accepted a dollar standard operated unilaterally by the United States. The US authorities were able to sustain this standard because of the adoption after 1980 of the tough anti-inflation policies previously referred to, which underpinned a strong dollar policy even while the US trade deficit widened. It was left to the private financial sector to devise new ways of coping with the much greater volatility of exchange rates and commodity prices.

During the golden age, the supply of private international capital to developing countries had been highly restricted. Only very few of them had good access to private capital markets. The others were perceived as being dependent on earnings from volatile commodity markets and subject to high political risks. In these circumstances, the public international financial institutions could play an important role as financial intermediaries. Because their debt was privileged over other types of debt, they were able to borrow on the capital markets of the developed countries and re-lend to the developing countries. The main problem was the limited scale of this financial inter-mediation, partly due to the World Bank's insistence on using projects as the only channel for its lending. From 1958 onwards, when the European Development Fund was set up, the scale problem was tackled by setting up regional development banks. There followed the Inter-American Development Bank (1959), the African Development Bank (1964), the Asian Development Bank (1966) and finally the European Bank for Reconstruction and Development (1990), aimed at the transition economies. The regional multilateral development banks expanded the volume of private funds available for re-lending to developing countries, but by and large retained the traditional project mode, which was cumbersome, slow and uninformative about the true economic effect of the loans.

The scene changed abruptly in the early 1970s. After the oil price rise, the oil exporters deposited large funds in New York and London, and private banks engaged in the massive re-cycling of these petrodollars to developing countries' governments. However, as previously stated, the process was an unhappy one. The sovereign loans had both a willing lender and a willing borrower, but mutual willingness did not (alas!) guarantee the correct understanding by either party of the terms and conditions of the loans. In this instance, the developing country borrowers' failed to see the significance of the variable interest rates attached to their loans, rates that rose sharply when developed country governments took tough action to bring down their own levels of domestic inflation. At the same time, the developed country private bankers had failed to see that repayment of sovereign debt could be made subject to lengthy moratoria, since sovereign countries could not be bankrupted. Both parties therefore could be convicted of transacting without due care and attention. The result was the sudden drying up of new private bank loans through the 1980s. The World Bank and the IMF were encouraged to act as managers of this debt crisis, and both developed new financial instruments to do so. The Bank retreated from its previous stance of project lending only and started program lending with policy conditions. The Fund established its Structural Adjustment Facility (1985) and its

Extended Structural Adjustment Facility (1988). These initiatives, however, did not avoid the need for debt relief for heavily indebted poor countries at the end of the twentieth century.

A second wave of private sector lending to developing countries gathered strength in the 1990s. Certain Asian countries had succeeded in industrializing in response to world demand for manufactured exports (namely South Korea, Taiwan, Hong Kong and Singapore) and their success encouraged the growth of a 'second tier' of newly industrializing countries in Asia (Malaysia, Thailand and Indonesia). More significant than all of these was the Peoples' Republic of China, whose rapid growth followed an abrupt change of economic strategy in 1978. The trade surpluses of these successful Asian exporters accumulated as dollar reserves, matched to the growing US trade deficit, and were available to be recycled through the US financial system. The portion that went into overseas lending was largely recycled to the dozen or so emerging economies that had succeeded in developing, but the hope of attracting foreign investment led other developing economies to liberalize their regulatory and tax environments. The policy of "graduating" countries from public to private funds dominated the international agenda in the area of finance.

However, the eruption of a new type of financial crisis associated with the volatile, pro-cyclical nature of private capital flows challenged this policy. The outbreak of the financial crisis in Thailand in July 1997 took the IMF unawares, and led to dramatic falls in the exchange rates of Asian countries, losses of income and employment and rises in poverty. There was a knock-on effect in Africa, as the pre-existing recovery of primary commodity prices was reversed. Most analysts attributed the Asian crisis solely to the policy mistakes of the Asian countries, masked by failures of transparency and surveillance, or, with Joseph Stiglitz, to the wrong-headed stabilization policies of the IMF.<sup>xviii</sup> Very few apart from the UNCTAD *Trade and Development Reports* saw it as evidence of a growing systemic risk arising from the growing imbalances in the world economy and the vulnerabilities inherent in global financial recycling mechanisms. The crisis caused the worst global recession (at that time) since 1945. Moreover, the losses that it inflicted on American and European banks prompted them to perverse forms of financial innovation that would, a decade later, prove immensely damaging to themselves and to the world economy.

The technique of credit default swaps developed in the 1990s was now extended from corporate debt to mortgage debt. Unlike for corporate debt, the risk of default on mortgage debt was virtually impossible to calculate with the mathematical risk models that the banks and the credit rating agencies used. In addition, the financial regulators scarcely understood the complex financial products being marketed to investors and had in any case already opted for policies of industry voluntary self-regulation and 'light touch' official regulation. Indeed, even after the Asian crisis US administrations took a series of further measures to liberalize the finance and banking sector. The repeal of the Glass-Steagall Act (1999) gave impetus to bank mergers and the creation of giant multi-purpose banks. Many of them rapidly

expanded mortgage lending to sub-prime borrowers and then immediately sold on the default risk in packets of “collateralized debt obligations” (CDOs) to investors who took the credit agencies’ assessments of the default risk at face value.<sup>xix</sup>

With the hindsight of 2010, it is easy to see that such extreme profit-seeking behavior increased financial fragility, not just in the United States and the UK (which was even more lightly financial regulated), but in all countries whose investors participated in this latest round of global financial integration. Nor is it very difficult to explain how this happened. There was a large investor demand for high return paper, which the private banks obligingly fed with CDOs in various fancy forms. The supply of complex financial products in a regime of light regulation increased the profits of the banking and finance sectors both absolutely and relative to the profits of other business enterprises. This brought bankers greater influence over economic policy, both through inter-change of personnel with governments and through their lobbying and electoral campaign contributions. Politicians, persuaded by orthodox economists of the folly of government intervention, feared to tamper with such an apparently successful sector. Moreover, they believed (wrongly, as it turned out) that CDOs would spread the benefit of home ownership to groups of the poor previously excluded from it. The mutuality of interest of financiers, credit rating agencies and politicians in prolonging a bonanza economy explains why the timing of the crisis was so difficult to predict. Even when worrying signs begin to appear (such as rising mortgage defaults with no interest rate rises or economic slowdown), there was a mutual interest in ignoring them, hoping that the good times would last.<sup>xx</sup> Then investor confidence finally collapsed and euphoria turned into the extreme fears and doubts that powered the financial collapse and consequent economic recession.

In a financially globalized world, this kind of silent collusion has an international aspect. Every international institution fears that *its* public warning of growing global financial fragility will be the negative move that triggers the downward spiral. Each national financial center fears that *its* move to stronger regulation will send its banks and bankers migrating to its rivals. Everyone has a motive to sit silently waiting until the disaster hits.

#### **4 Alternative norms of co-ordination: optimal subsidiarity versus policy coherence**

Since entering into international co-operation is voluntary, one might expect that existing international institutions would not be a source of controversy. Have not countries selected co-operative options precisely because they prefer them to the option of non-co-operation? That question ignores the well-known problems of organising collective action, and takes a static not a dynamic view of the problem of choosing whether or not to co-operate.<sup>xxi</sup> There may be public goods available where co-operation has not been chosen because of the existence of information or incentive problems. This would lead to perceptions of gaps in the international institutional architecture. Or, existing institutions may be

composed of members who did and did not negotiate the detailed rules of the institution (i.e. leaders and followers or founder members and others). This would give rise to complaints about the application of the rules to the circumstances of the followers. Or again, perhaps the features of long established institutions have become gradually out of kilter with current circumstances of leaders and followers alike. In all of these cases, the existing architecture of international co-operation may be a cause of inter-state dissatisfaction or dispute.

Are there useful principles by which one can appraise proposed adjustments to the international economic architecture? One starting point is the analogy between the division of international and national responsibilities and the division of national and provincial or state responsibilities in a democratic federal constitution. In order to accommodate as fully as possible the differing preferences for public goods among the lower level units, powers should be devolved downwards to the lowest level at which any given function is capable of being performed. This is the principle of subsidiarity. Following the analogy, one can argue that international organisations should not be required to perform functions that nation states are capable of performing on their own.

The principle of subsidiarity needs to be supplemented with a principle of net benefit. Even for functions that cannot be performed at national level, international co-operation should be invoked only when the net benefit accruing from it is positive, or the gross benefit accruing is greater than the cost. These two principles combined provide the test of 'optimal subsidiarity'.

Unfortunately, matters are more complicated than this, for two reasons. One is that the tremendous variety in the circumstances of countries in their history, culture, political systems, and standard of living entails not only differences in their preferences for public goods, but also in the effectiveness of their governance institutions and their capacity to perform the functions of government. Functions that can be performed at national level in some countries cannot be performed at that level in others. Diversity affects not just the demand for public goods, but also their supply. Thus, while the application of the optimal subsidiarity principle may yield a clear answer in regional groupings of broadly similar countries (like the European Union), the answer will be much less well defined in relation to the 190-odd countries of the whole world.

The other complicating factor is that, even when the net benefit of a co-operation proposal is positive in global terms, the country-wise incidence of net benefit is likely to vary. The distribution of the net benefit from any scheme of co-operation will not be uniform. Again, because of differences in standard of living, and therefore capacity to pay, some countries will be expected to shoulder a larger share of the total cost of providing the public good. So, other things being equal, their incentive to provide it will be weaker than those to whom it will be provided at low cost or free. The proposed pattern of

burden sharing is as vital to the success of an international co-operation negotiation as is the extent of the benefit conferred by the international public good.

To pose the problem of ‘policy coherence’ is in effect to accept that designing the global economic system on the principle of optimal subsidiarity is not a practical undertaking. The search for policy coherence takes the less ambitious route of acknowledging that what we have is a set of different international institutions, created at different times for different purposes with different mandates, and that individually they pursue policies that are inconsistent when taken as a whole. The task then is to reduce the extent of that inconsistency. There is a vast range over which the problem of policy incoherence might be identified and discussed, but this paper is limited to policy coherence between three institutions - the IMF, World Bank and WTO.

It has already been noted that, as the Fund and Bank modified their facilities after the end of the ‘golden era’, they needed to make a series of concordats to eliminate competing claims and overlapping functions and to define their methods of co-operation. By 1989 they were operating a practice of informal cross-conditionality, whereby Bank adjustment lending was confined to countries undertaking IMF stabilization programs. A further concordat was provoked in 1997-8 by wrangles over who had the right to do what during the Asian crisis. The establishment of the WTO introduced a third dimension to policy coherence. A three-way “Joint Declaration of Coherence”, issued at the ill-fated Seattle Ministerial Meeting of the WTO (1999), emphasized their shared belief that trade liberalization was essential to the promotion of global growth and stability. It supported the use of informal cross-conditionality in lending to ensure that borrowing governments liberalized their trade regimes. In the last twenty years, IMF-Bank-WTO policy coherence has markedly increased, but it has been policy coherence in the service of the neo-liberal policy agenda.

The global financial crisis has now exposed the limitations of neo-liberal policies. While policy coherence is clearly desirable, it is, like consistency, a second-order requirement. What is needed is not policy coherence per se, but policy coherence around an alternative global agenda. Policy coherence must move on from the misplaced hopes and expectations of neo-liberalism to an agenda focussed on the goal of supporting the catch-up growth of less developed countries, while at the same time moving to a low-carbon environment.

How is the new agenda to be established? The UN General Assembly provides a world forum where economic ideas, interests and policy proposals can be presented, discussed and negotiated. Its authority is a moral authority, because it is an organization that stands for peace, for justice, for equality, for development, for human rights—in short, for all those values that people believe will ensure the survival of humanity. Even great powers that say they want to ignore the organization, or over-ride its decisions, find themselves trying to make use of it in different ways.

Once the process of UN discussion and negotiation produces agreements, however, their implementation has to be delegated to executive agencies in which the countries that will foot most of the subsequent bills can place their confidence. In matters of trade, finance and development, that implies bodies with near-universal membership, like the World Bank and the IMF, which have weighted vote systems, or the WTO, which, despite having a one country, one vote system, chooses to seek consensus rather than deciding matters by voting. This ‘walking on two legs’ approach certainly does not imply that the current functioning of the international executive agencies leaves nothing further to be desired. On the contrary, setting aside the utopian prospect of the UN replacing them must inevitably bring into sharper focus the question of their urgent improvement. As Sidney Dell wrote before his death: “there is no international agency that is dealing systematically with global questions of consistency and inconsistency” in matters of economic policy, and the triumvirate of IMF, World Bank and GATT/WTO left to themselves are not up to this task.<sup>xxii</sup>

In 1995, a reformed UN Economic and Social Security Council was proposed for this directive role. A representative body of thirty plus countries, both developed and developing, its decisions were proposed to require a simple majority of both industrial and developing nations, but no single country would be able to exercise a veto on double majority decisions.<sup>xxiii</sup> This idea received only modest support at the time.<sup>xxiv</sup> A major disadvantage was that it would require changes to the charters of all the UN agencies, but behind the legal and diplomatic difficulties were more intractable political ones. The more powerful countries were generally satisfied with things as they were<sup>xxv</sup>, while many developing countries were wary about allowing issues that affect their sovereignty to be decided by a Council on which they did not sit.

## **5 Will the G20 give global economic direction?**

After the financial and economic crisis of 2008, both of these long held attitudes have begun to be modified. The best indication of this is the emergence of the G20, the Group of Finance Ministers and Central Bank Governors from twenty countries, into a higher profile leadership role after 2008. From its first meeting in 1999 until November 2008, the G20 met at finance minister and central bank governor level. Then, the Washington G20 meeting of November 2008 and the London meeting of April 2009 raised its representation to heads of government level. Could the G20 be transformed into a high-powered body for the future direction of global economic policies?

The G20 is a very loosely institutionalised body. It has no formal criteria of membership, and membership has not changed since 1999. Its nineteen country members are in fact all among the largest 24 economies in the world, measured by 2007 GDP at purchasing power parity. Other large European economies that are not themselves members are represented through its twentieth member, the

European Union. Apart from size of GDP, membership seems to be related to regional significance and population size (e.g. Argentina, South Africa and Saudi Arabia and Indonesia).

The G20 also has no permanent secretariat, unlike many international organisations. Responsibility for convening G20 meetings rotates by agreement among the member countries. The convening country provides the temporary secretariat for the meeting that it convenes and the direction of G20 business is in the hands of a 'rolling troika' consisting of the convenors of the previous, current and succeeding meetings.

The Managing Director of the IMF and the President of the World Bank are counted as members of the G20. The remit of the G20 is to provide a forum for discussions to promote international financial stability, but to focus on issues that go beyond the mandates of existing organisations, such as the Bank and the Fund. Can the G20 achieve this? It must be said that the G20 itself failed over the first decade of its existence to address the capability of the IFIs to maintain stability, as financial development outstripped economic growth. Its success in addressing the question now will determine whether the G20 can move from current crisis management to permanent direction. The IMF has priority for reform because its mandate is most clearly directed to ensuring financial stability. Yet the April 2009 G20 summit merely bolstered the resources of the IMF to cope with the crisis. It did not tackle the much thornier issues of currency re-alignment or of reforming its own structure and governance.

Some developing countries, for example Nigeria, have complained about exclusion from the G20. However, increasing their participation would add little to the economic weight of the meeting, and it would take its size over the threshold where consultations turn into speech making. The ten next most economically weighty developing countries are, in descending order, Iran, Thailand, Venezuela, Malaysia, Israel, Colombia, Singapore, Pakistan, the Philippines and Chile. Including these countries would add only 3 percent of world GDP to the G20's existing share of 85 percent. At the same time, the size of the meeting would increase by 50 percent, potentially hobbling it as a decision-making body. Even so, Sub-Saharan Africa and the Caribbean and Pacific countries would still have no representation. There would be little advantage therefore to trying to expand the membership of the G20. Much more relevant is the question of reforming the outdated quotas of the Fund and the Bank, and giving them a stronger and more transparent political driving mechanism.

## **7 What should be done to reform the IMF?**

The 1982 debt crisis was a watershed in the evolution of the IMF. Whereas it had been a co-operative self-help association in which developed countries alternated as creditors and debtors, after 1982 it became an organisation in which the large debit position of the developing countries in aggregate is financed by the persistent creditor position of the developed countries.<sup>xxvi</sup> Since this change occurred,

the IMF has become increasingly dysfunctional. Its resources were allowed to decline as a proportion of world trade, to the point that many economies were simply too big to be able to benefit from the financial support it had available. At the same time, the number of Fund programs in smaller and poorer developing countries has steadily increased. The conditions embodied in these programs have expanded greatly in scope, going well beyond the traditional fields of monetary and fiscal policy and issues related to the exchange system. The Fund began to impose conditions relating to poverty reduction, on which it had little expertise, and even advises on the achievement of the Millennium Development Goals.

As the number of conditions, particularly structural conditions attached to loans, increased during the 1980s and 1990s, the rate of member countries' compliance with Fund supported programs has declined, to below 30 percent in the 1990s.<sup>xxvii</sup> The low rate of program compliance makes it difficult to argue that numerous conditions secure the repayment of loans and ensure the revolving nature of Fund resources. Moreover, as compliance declined, the credibility of Fund programs has been eroded, and their catalytic character in relation to private financial flows has become increasingly doubtful, a fact that again has implications for the size of the IMF resources.<sup>xxviii</sup> These trends pointed to the need for an expansion of the size of IMF resources, but under the existing IMF Charter, expansion requires an 85 per cent majority vote, which means the agreement of the US.

The IMF has been hobbled by a series of inter-linked problems. They are:

- (a) its quota system which still after a series of recent small revisions does not reflect the economic realities of today;
- (b) the resulting veto on major changes exercised by the US;
- (c) the European-US informal agreement on the appointment of the Managing Director and the Deputy Managing Director;
- (d) the restriction of its resources to the point where it can influence only small poor countries;
- (e) the resulting lack of legitimacy of its decisions and
- (f) the fragmentation of its responsibilities for ensuring global financial instability.

Hopes expressed at the time of the Asian crisis for an effective early warning system for financial crises are fanciful and likely to be disappointed. Financial crises are the products of complex non-linear causes. Government policy preferences, investors' expectations and herd behaviour all enter the equation, alongside measurable economic quantities such as the assets and liabilities of the banking system, the balance of payments deficit and the size of the foreign exchange reserves. The IMF has in recent years promulgated new standards and guidelines for disclosure and transparency of financial and economic information. However, given its lack of leverage with the developed economies, this loaded responsibility for countering financial instability on to the capital-receiving countries, saddling them with inappropriate and costly financial standards. In any case, failure of disclosure is not the whole

story. Economic and financial information that is in the public domain should have rung alarm bells, but did not. What is needed is to improve the systems of information evaluation, both by the Fund and the Bank, as well as by the financial markets.

It is time to move beyond the tactics of crisis prevention to a more fundamental diagnosis. The great defect of the current system of floating exchange rates is the large and frequent misalignment of key global currencies. There are no rules of macroeconomic policy, such as apply to trade, that discipline the policies that produce fluctuations and gyrations of global currencies. The solution, which has been advocated for twenty years, is to specify exchange rate targets for key currencies, and find instruments to move them towards the specified targets.

Developed countries have been reluctant to take action, a reluctance that stems from the facts of global inequality. They have large economies with a moderate exposure to international trade and financial facilities to lay off foreign currency risks. By contrast, misalignments of key currencies inflict major instability on the economies of developing countries. The financial systems of developing countries are relatively small, and often fragile. Poor credit evaluation and poor control of banks' foreign currency exposure are typical aspects of fragility. These weaknesses become much more dangerous after they liberalise their capital accounts, as the IMF has persistently advocated. When foreign capital inflows, induced by relative interest rates in combination with foreign investors' expectations of exchange rate movements, are large in relation to the size of the developing country's financial system, substantial damage can be inflicted by their sudden exit. This is the key danger that developing countries face in a more financially integrated world, and it is doubtful if any exchange rate system that they choose—whether free floating, managed floating or hard peg—can guarantee stability as long as the rates of key currencies fluctuate as they do.<sup>xxix</sup> The international community will have to return to this issue; as a first step, the IMF's surveillance of key currency countries needs to be redirected to achieve greater policy coherence between them.

For all its past failings, the IMF is a near-universal institution and could become, if radically reformed, a more effective body for the purposes of multilateral financial co-ordination. To regain its legitimacy in this role, it will need to accelerate the changes in its quota system to reflect current economic realities, shrinking the inflated quotas of the USA and smaller European countries, and depriving the USA of its veto power. Once this is done, the institution could be given a transparent multilateral political directorate. Indeed, with very little change the loosely institutionalised G20 could be formalised as a new Council of the IMF to give it strategic direction. The governance structures of the Executive Board and management need also to be re-shaped to improve their accountability, along the lines proposed by the Committee on IMF Governance Reform in March 2009.<sup>xxx</sup>

These far-reaching governance reforms are necessary, but not sufficient to restore the IMF's legitimacy. The Fund needs additional resources to provide adequate international liquidity on appropriate conditions to support macroeconomic and exchange rate adjustment. At present, developing countries are building up their foreign exchange reserves as an alternative to having to borrow from the IMF, increasing them from 6-8% of GDP in 1995 to 30% by 2004.<sup>xxxix</sup> These reserves cannot be used for investment, but represent a loan to the US Treasury. What is needed now is a method of reserve creation that does not require one country (the USA) to run an increasing current account deficit and surplus countries to hold ever-increasing stocks of US dollars. The issue of new allocations of SDRs is a costless and efficient method to create extra liquidity, and the G20's agreement to its use in April 2009 was a hopeful sign for the future that the Fund can adopt a less restrictive stance on this matter.

Finally, there is the question of the extension of the IMF mandate to include the capital as well as the current account. At present, the sole formal jurisdiction that the IMF has over members' capital accounts is the right to require members to impose capital controls in certain circumstances. In the late 1990s, the Interim Committee of the IMF recommended that the Fund's Articles of Agreement be changed so that the liberalization of international capital movements became a central purpose of the Fund, and its jurisdiction be extended to capital movements.<sup>xxxix</sup> These recommendations were put on hold after the Asian crisis, but are being revived as part of current IMF reform plans. This poses a dilemma. The push for the liberalization of capital accounts is seen by many as the high point of neo-liberal hubris, and is resisted for that reason. (The Fund denies this, claiming that it was aiming at the orderly liberalization of capital movements.) On the other hand, leaving the capital account outside the multilateral framework would make it impossible to deal with the volatile capital movements that are so damaging to developing economies. A more representative political Council for the IMF would help to ease the fears of the skeptics, but this would have to be accompanied by a thorough overhaul of the technical expertise of the Fund staff to improve its ability to detect systemic risk arising from international capital movements.

Financial crises will no doubt continue to occur periodically whatever improvements are made in the multilateral surveillance and prudential regulatory framework. In that event, advance provision for private sector burden sharing in the event of a country bankruptcy would reduce moral hazard and inequity between the private and public sectors. The Fund should continue to press for a scheme that would require debt contracts to include a clause providing in advance for collective action agreements in the event of debt crises. The adoption of such clauses would render future debt crises much more manageable. To the extent that the volume of private flows to developing countries was reduced as a result of their introduction, this loss would be balanced by a reduction of the costs of financial instability.<sup>xxxix</sup>

## 8 What should be done to reform the World Bank?

The World Bank also began to get into political difficulties in the mid-1980s. US environmental NGOs attacked Bank-financed projects in Brazil for encouraging environmental damage. They claimed the Bank's procedures for making environmental impact assessments of its projects were inadequate. The Bank gave in under pressure from the US Congress and Treasury and set up an Environment Department in 1987. Then in 1992, an independent review charged that the Bank had breached its own guidelines with respect to the resettlement of people displaced by the Narmada dams in India. During these controversies, US NGOs demonstrated their ability to harass the Bank by means of well-organised lobbying of the US Congress.<sup>xxxiv</sup> The Bank put in place new measures of accountability, including an independent inspection panel to make public reports on contentious cases. The irony of this was that the NGOs themselves are, for the most part, not publicly accountable; and that the Bank became more accountable to US politicians, rather than to the politicians of its client countries.<sup>xxxv</sup>

Under the presidency of James Wolfensohn became President (1996-2004), the Bank pro-actively reached out to its NGO critics, shaping its policies to reflect their concerns. Wolfensohn pursued this political approach both in his public rhetoric and in a managerial style that placed him at odds with the bureaucratic culture of the institution. The invention of the Comprehensive Development Framework (CDF), a matrix for co-ordinating all the development activities of a country, let the Bank to adopt a central position in the development process. Through the CDF the Bank provides a diverse range of services (loans, technical assistance, advice) to the entire development community, branding itself as a development partner and facilitator, instead of as the home of arrogant bankers. At the same time, Bank lending has been increasingly diversified to support a new development agenda that would find favour with the US NGOs—gender equality, participation, civil society and good governance, in addition to environmental conservation.<sup>xxxvi</sup>

The Bank has long suffered from multiple conflicting objectives—sound banking, promoting development, and neo-liberal policy advocacy are just three of them. In this context, a populist approach of co-opting potential NGO critics of the Bank has its own dangers. Despite the declaration that poverty reduction is the Bank's paramount goal, overall focus on strategic priorities is blurred. The Bank is also failing to exploit fully the functions in which it has a genuine comparative advantage, and, by extending the responsibilities of its staff members into areas where they have relatively little competence, it is confusing and demoralising them. The Bank may well also be alienating the governments of developing countries, on whom it relies as customers for its loans.

The past trends stem from the dominance of the US in the political direction of the Bank. The need of the hour is for a broadening of the political leadership of the Bank to regain legitimacy and strategic focus. It happens that there is an almost perfect symmetry in the composition and status of the

decision-making bodies of the Bank and the IMF. (This is because the Bretton Woods conference ended up adopting the respective IMF quotas to determine the subscriptions for members of the Bank.) It follows that certain reforms of the IMF (advocated above) are inextricably linked with counterpart reforms at the Bank. A realistic quota system at the Fund would have to be matched by an equally realistic subscription and voting system at the Bank. A more transparent political directorate at the Fund would have to be matched at the Bank. A merit-based appointment procedure for the top managers of the Fund would have to be matched by a similar procedure at the Bank. It is virtually inconceivable that one of the Bretton Woods twins could be radically reformed in these ways while the other remains as it is.

One further way bring the Fund and the Bank together around a new agenda of catch-up growth is to revive the proposal of an organic aid-SDR link.<sup>xxxvii</sup> The idea of the link fell into abeyance in the 1980s because of US reluctance to move forward with further creation of SDRs. It was argued for two decades that the development of private capital markets and the accumulation of reserves in emerging market economies provided sufficient liquidity. Financial crises provoked two further distributions of SDRs in 1997 and 2009, but both of these were on a universalistic basis. They were not directed to the funding of multilateral aid agencies, although they remain strapped for cash to pursue internationally agreed development assistance targets. Apart from the provision of necessary additional resources, funding of the World Bank and other multilateral development banks by this route would do much to counteract the current tendency to make them a hostage of NGO fashions and the whims of the US Congress and Treasury Department.

A direct link between SDR creation and aid would be simple to operate. The Bank and other multilateral development agencies would have accounts with the IMF, into which the newly created SDRs would be paid. They would lend in the normal way, and when the loan recipient made purchases with the loan, the exporters from whom they purchased would be paid in SDRs out of the loan agency's IMF account. No doubt the old argument that this would be inflationary would then be heard again, but the scale of SDR creation remains very small relative to the GDP of the developed countries, and their anti-inflation policies are unlikely to be changed because of anything on this scale.<sup>xxxviii</sup>

This new source of funding should be negotiated in return for a number of changes in the Bank's lending practices. The need for the Bank to continue project lending to middle-income developing countries (on IBRD terms) has been doubted, given the increased availability of private capital flows. Between 1970 and 1995, private flows to developing countries increased forty-fold, while IBRD flows increased threefold in nominal terms, so the original post-1945 justification of this type of lending, in terms of the need for inter-mediation in imperfect private capital markets, became much weaker.<sup>xxxix</sup> However, private finance flows are quite concentrated geographically on about a dozen countries and they also tends to flow in pro-cyclically, so that they are there when they are least needed and absent

when they would be most useful. Other justifications are that private flows do not reach the “pockets of poverty” in middle-income countries; and that Bank inter-mediation has desirable risk-reduction benefits. Nevertheless, it would make sense to let the regional development banks complement private flows to the middle-income developing countries, and to focus World Bank loans and grants on low-income developing countries.<sup>x1</sup> Even in this niche, however, the Bank must refine its role further in relation to two striking twenty-first century developments: the move to using grants rather than low-interest loans and the explosive growth of private philanthropy. In middle income countries, the Bank could explore the option of floating bonds in local currencies to help to develop a market in long-term bonds, especially for financing infrastructure.

It has been suggested that the Bank could also play a role in relation to any new climate change agreement that involves financing new low carbon technology transfer to developing countries. The Bank could certainly take on some new responsibilities in this area—whether technical, administrative or fiduciary, but they would need to be carefully selected to avoid creating further conflicting objectives and internal conflicts of interest in the absence of adequate checks and balances.

### **9 Do WTO Rules need further modification to meet development needs?**

The World Trade Organization, which swallowed up the former GATT, went much beyond it in scope and ambition. The overall aim broadened, from non-discrimination and the reduction of trade barriers, to the adoption of policies in support of open markets generally. New agreements cover trade in agricultural goods, sanitary and phyto-sanitary (plant hygiene) standards, textiles and clothing, technical barriers to trade, and trade-related investment measures, trade in services, intellectual property rights, and the removal of various non-tariff barriers. The WTO is much more intrusive on national policies, because it makes rules across this substantial new agenda, rules that over-ride the pre-existing national laws of members. The WTO requires countries to change existing domestic laws that conflict with the obligations of WTO membership, and a new Trade Policy Review Mechanism requires members to give regular public accounts of the state of their compliance with their obligations. The WTO has also strengthened its Dispute Settlement Mechanism (DSM).<sup>xii</sup> These five institutional innovations, taken together, have had two general effects. They made considerable inroads on what were matters of domestic governance before the coming into force of the Uruguay Round agreements, and they further “judicialized” the process of trade co-operation.

It is widely believed that the changes to the world trade system inaugurated by the WTO are desirable in the interests of the developing countries, because they create a stronger umbrella to shelter them from the arbitrary trade practices of large and powerful developed countries. However, this general judgement needs to be qualified, and that the appropriate question for the future is what policies can better support a system of trade rules. The first task is to show that WTO rules are not sufficient to

regulate trade in a world of substantial economic inequality, and the second task is to explain how policies can support the working of a rule-based trade system in the presence of gross inequalities.

### **9a How to improve trade dispute settlement**

A major question for any rule-based system is whether the rules (whatever they are) are enforced fairly. By common consent, the WTO handles trade disputes far better than the GATT did. The WTO dispute settlement process is more automatic, and sets time limits on its procedures. Requests for panels on alleged violations are approved more automatically, as are the panel reports, the appellate body reports and the authorisations of retaliation. Instead of requiring a positive consensus in order to proceed, they now need a negative consensus to fail to proceed.<sup>xliii</sup> These changes allowed about 160 cases to be handled during the first five years of the WTO, roughly three times the previous level. Developing countries have been involved in more of the cases, about 25 per cent of the new total.<sup>xliii</sup> This has been taken as a sign that the DSM is working well, including for the benefit of the developing countries.

Unfortunately, it is still true that, for developing countries, serious deficiencies remain at every stage of the WTO dispute settlement process, from inception through judgement and granting remedy to enforcement. These deficiencies arise from the interaction of the standard features of a legal process—its cost, absorption of time and uncertainty of outcome - with the incompleteness of international legal machinery and the great inequalities of wealth and power that currently exist between nations. Given the substantial cost of bringing a WTO case, in terms of legal and diplomatic person time, poor countries are deterred disproportionately from embarking on a dispute. Only governments can bring cases to the DSM; and poor governments will be disproportionately deterred from doing so by the prospect of antagonising more powerful countries, on which they depend in many matters not connected with trade, such as defence or foreign aid.

By convention, no compensation is paid by the loser for a violation, after a process that can still take over two years to complete, a fact that bears more heavily on poor states than on rich ones. If a country does not take measures to comply with its WTO obligations, there is no centralised sanction. The only sanction is retaliation. Since all economic sanctions are costly to the initiator, the ability of a poor country to sanction a rich one is much less than the reverse.<sup>xliv</sup> Thus even if developed and developing countries violate WTO rules to the same extent, and dispute panels render perfect formal justice, developing countries will win fewer cases than they lose, and will be less able to sure of remedy in those that they do win.<sup>xlv</sup>

Obviously, differences in outcome that arise because of the different economic strength of the two parties cannot be remedied directly. Nevertheless, it ought to be possible to tilt the system in ways that counteract its existing biases. In domestic litigation, legal aid is used to give the poor better access to

costly justice; the injured party is awarded its costs by the court and centrally organised sanctions prevent the injured party from having to bear all the costs of punishing the violator. In the international sphere, these are three areas where, by analogy, progress could be made, given sufficient imagination and willingness to co-operate. An improved DSM in the WTO is still capable of further improvements in the interests of the developing countries.

However, formal justice is not the only consideration. Formal justice can co-exist with substantive injustice.<sup>xlvi</sup> In the WTO, judicial improvement has coincided with the adoption of certain rules that embody substantive injustice because they could jeopardise the possibility of economic catch-up.

### **9b WTO Rules, Industrial Subsidies and Development**

The rules of the WTO, like those of its predecessor the GATT, reflect the ambivalent attitude of the US and Europe to free trade. This ambivalence, characterised as “embedded liberalism”, inspired a distinctly different set of international trade rules from ones that would promote free trade, plain and simple. While they incline to free trade by facilitating multilateral and reciprocal tariff reductions, they also provide for “contingent protection”, that is to say, opportunities for individual countries to renege on tariff concessions under pre-specified conditions, to avoid injury to domestic industries adversely affected by tariff reduction.<sup>xlvii</sup> Their notion of “fairness” requires sharing both the benefits of any other country’s tariff reductions *and* the burdens of any other country’s “need” to re-impose tariffs to safeguard its domestic industry ‘dumping’.

Because anti-dumping actions are costly to contest, developed countries find that the contingent protection provisions have a harassment value.<sup>xlviii</sup> They use them to secure so-called “voluntary export restraints”, originally on textile exports from developing countries and now more generally.<sup>xlix</sup> Developing countries initially accepted this breach of non-discrimination as part of a larger implicit bargain, in which their balance of payments deficits - worsened by trade restrictions - were met by flows of official development financing—a grand bargain abandoned after the 1980s debt crisis.

The Uruguay Round introduced new rules on the use of countervailing duties.<sup>1</sup> In an attempt at legal clarification, contingent protection is now permitted in the face of some subsidies, but not others. Three kinds of subsidies, to R & D, to disadvantaged regions and to the costs of complying with environmental regulations, if available to all firms or industries regardless of their status as exporters, are now not liable to countervailing duties. All others remain actionable, according as they inflict “material injury”. If subsidies are “specific” - to an exporting enterprise or industry, or to an exporting group of enterprises or industries - they can be countervailed if they cause material injury. The criterion of “material injury”, already low, was further diluted.<sup>li</sup> Participation in this subsidies code, which

developing countries could decline to join under the Tokyo Round rules, is now mandatory on all WTO members, although some have fixed transition periods before full compliance.

The effect of this is to outlaw the sorts of industrial subsidies that have been used successfully in the past to accelerate the growth and development of poor countries. It has been said that the government interventions used to achieve the Asian miracle growth of 1965-1995 would not be permitted by present WTO rules. The phenomenal growth of the Asian tiger economies depended on selective departures from pure free trade regimes. Contrary to the opinion of the neo-liberal consensus, the Asian “miracle” demonstrated that an intelligent long-term development strategy—based on interventionist departures from free trade that are genuinely selective and temporary - can be made to work. Indeed, if the right conditions can be created, it can be made to work spectacularly well.<sup>lii</sup> What is not so clear, however, is that the Annexes to the WTO Agreement absolutely prohibit *all* the instruments of such a strategy. Despite the clear outlawing of specific subsidies, there are still some unplugged gaps that an imaginative and ingenious developmental state might want to try to exploit for its purposes.<sup>liii</sup> Much will depend on how the dispute settlement mechanism works in practice.<sup>liv</sup>

The legal technocrats at the WTO can decide how activist to be, since legal activism is something that the WTO rules clearly permit. If they become bolder, the interpretation of the Annexes will increasingly prohibit all protection of infant industries in developing countries. This will preclude a vital means of economic catching up, which at least some poor countries are capable of using, and so serve to solidify the existing unequal world-wide distribution of wealth and income. The claim that the WTO rules on subsidies are substantively unjust certainly demands clarity about which characteristics of nations are relevant to the treatment of like cases similarly, and different cases differently. Yet is it not evident that the existing inequalities of economic and political power between developed and developing countries do constitute a relevant difference for the purpose of deciding the substantive justice of the subsidy rules? If there is to be any derogation at all from free trade, surely it should be in favour of the economically weak, rather than the economically strong.

There is a compelling case for developing countries to be given exceptional treatment on “specific” industrial subsidies for infant industry purposes, but in a rule-bound way. Such subsidies must always be selective (not across the board), temporary (not open-ended) and performance-related (not unconditional). Rule-bound specific subsidies will safeguard developing countries from repeating the historic errors of their previous international trade policies, but keep alive the future possibility of their catch-up growth.

### 9c Greater Developing Country Participation in WTO Rule-making

The WTO rules cannot be unjust, it is said, since every nation voluntarily agreed to them when joining the WTO, and voluntary agreement implies that the loss from it cannot exceed the gain. However, new states necessarily step on to a stage where international action is already well advanced. They do not face a moral or legal *tabula rasa* on which they can, jointly with others, inscribe a new compact. In a dynamic international setting, a new WTO member has to put up with whatever it cannot negotiate away. If it is economically and politically weak, it may have accepted non-trade inducements to abide by existing unfair trade rules.

Formally, all WTO members are equal. Unlike the IMF and the World Bank, the WTO does not have an unequal voting structure, in which rich countries control a share of the vote that is much greater than their numbers in the world community. Thus poor countries, which form a majority of the members, could in principle out-vote the rich countries. Experience has shown that this is not a practical proposition. The WTO, like the GATT before it, avoids taking decisions by voting. Instead, it “finds consensus” in an informal procedure which the Director-General conducts. Discussions with selected members go on until the D-G thinks he has found a basis for consensus, which he brings for approval to the WTO Council plenary session. At this stage, member countries decide that a consensus exists, or not, as the case may be. Many small developing countries are effectively marginalized by this procedure.

The informal consensus-finding procedure allows the economic inequalities that exist between members to come into play. There are two main sources of inequality; differential access to information about which agreements will benefit one’s country, and differential power to influence the outcome of the informal negotiation. The broader trade agenda of the WTO complicates the problem of evaluating trade offers. The effects on a country of a round of mutual tariff reductions are basically calculable - albeit by economists using general equilibrium models. The effects of a change of standards, by which a country’s exports may suddenly be deemed sub-standard, is very much harder to calculate, to understand and to negotiate away. The information access problem boils down to a simple economic question: can the developing country afford to maintain an embassy in Geneva? If it cannot, it is unlikely that you will be able to follow the trade negotiations, let alone take part in them.<sup>lv</sup> This points to the need to assist countries whose resources are inadequate. Trade-related technical assistance continues to be inadequate and needs further expansion.<sup>lvi</sup>

Even when a country has discovered where its interest lies, it may not be able to achieve its goals because of lack of negotiating influence.<sup>lvii</sup> A country’s influence or power in informal trade negotiations depends on the extent of its trade. In a negotiation based around tariff reduction, bargaining power depends not only on how far you are willing to cut your tariff, but also on the size of

the trade flows to which the proffered tariff cut will apply. Small tariff cuts on big trade flows are worth much more as bargaining chips than big cuts on small flows. This is very frustrating for countries with small trade sectors, but it is not *unjust* unless a country's trade sector is being deliberately kept small by others' denial of market access.<sup>lviii</sup> This is true of some countries, but the external trade of others, notably in Africa, is constrained by unresolved difficulties of supply, rather than by lack of access to markets. They cannot be helped by these kinds of trade negotiations, however they are arranged. They need other remedies, including financial aid and technical assistance.

The current political reality is that the US and the EU (with a growing challenge from China) exercise preponderant influence on trade issues. The behaviour of the US and Europe in trade matters is largely driven by the disparate interests of two groups of businesses. One group, the exporters, want developing countries to liberalise and provide them with wider market access, while the other group that is selling into domestic markets want to block out foreign competition. Responding to both, the US and European governments would like to have it both ways. Embedded liberalism, when constrained by national producer interests, generates the practice of asymmetric liberalism.<sup>lix</sup>

There is apprehension that anything that threatens this US and European dominance will be counter-productive. Some think that the more stringent rules and their increased formalisation in the WTO will push the US and the EU further towards protection.<sup>lx</sup> That is valid up to a point, although it is easy to over-state the WTO's powers in this regard.<sup>lxi</sup> Others argue in the same vein that further efforts to broaden the institutions of international governance would run the risk of undermining the support for it that exists in the US and other industrial countries.<sup>lxii</sup> The recent US retreat from various multilateral arrangements in international affairs gave some credence to these fears. The scene is now changing and the US currently seems more willing to participate in the evolution of an increasingly multi-polar world.

In the long run, neither the developed nor the developing countries should retreat into protectionism, but rather the reverse. Ultimately, it is not free trade, but its absence that should concern all countries. The negotiation of further trade liberalisation on a multilateral and non-discriminatory basis should continue. To this end, the promises made to developing countries during the Uruguay Round must be fulfilled, so that they may gain confidence in further WTO negotiations. Then the failure of the Uruguay Round to eliminate administered protection in a wide range of intermediate industries must be rectified. The heavy protection of developed countries' agricultural sectors must be reduced. Tariffs on industrial goods of special export interest to developing countries must also be reduced. None of these aspirations of the Doha 'development' round have yet come to fruition.

At the same time, the idea of "special and differential treatment" of developing countries, which was added to GATT and survives in different forms in the WTO Agreements, needs to be re-visited,

simplified and given greater precision.<sup>lxiii</sup> The present position where “special and differential treatment” consists of an arbitrary deadline for full compliance with WTO obligations, unenforceable promises of technical assistance for transitional difficulties and confining SDT to the 48 Least Developed Countries is unsatisfactory. It is true that, for many years after 1955, developing countries were allowed to protect particular industries and to plead balance of payments reasons for adding to quantitative restrictions on trade.<sup>lxiv</sup> The tragedy was that, apart from the Asian tigers, they did not use this exemption to carry out effective development strategies.

Nevertheless, it is in every nation’s interest that late developers retain the opportunity of catching up, because that is the only route to a world of less poverty and conflict. If their path is blocked, the legitimacy of the present hegemonic ideal of embedded liberalism can only erode further, and then world trading arrangements are bound to become more disorderly. The Doha Round of WTO negotiations could still establish the special and differential treatment of developing countries’ trade on a more equitable basis than at present.<sup>lxv</sup> If this were done, the way would be opened to the eventual achievement of true freedom of trade in the twenty-first century, free trade in a world of economic equals - rather than what disfigures the world trade scene now, partly-free trade between the enormously wealthy and the pitifully impoverished.

## **10 Models of economic development and the realities of economic development**

From this brief account of the dilemmas of development in an interdependent world, it would seem that neither the structuralist nor the neo-liberal models have been effective in leading to development breakthroughs. Perhaps this is not wholly surprising. Models of economic development are highly simplified representations of a complex and only partly understood reality. They normally include only the variables selected by their author as being the most important for understanding the phenomenon in question. Their use is normally to illustrate with logical rigour a few critical aspects of the interaction of the selected variables. A model is therefore like a map. Unless it is simplified to the point where it can be folded and put in one’s pocket, it cannot be used as a guide at all.

Moreover, at any time several models exist of the same phenomenon, competing for public attention. The choice of models for policy-making thus depends the framing of the policy problem and on a much broader and vaguer array of background theories, often called ideologies. Ideological currents shift gradually over time and influence the popularity of particular models of development. Over the last sixty years they have moved across a very wide ideological spectrum. Starting from a renunciation of the laissez-faire and nationalistic policies of the 1930s, they first of all shifted towards models of state-promoted capital accumulation within a thick network of international rules on trade and finance. After the end of the “golden age” in 1973, confidence in the state as an agent of development began to ebb and concern for the accumulation of capital without co-operating labour skills, technological up-

grading and sound economic governance lost credibility. Internationally, it was accepted that a collectively-managed international monetary system was dispensable and that international prudential regulation did not have to keep up with financial innovation.

If neither the early structuralist models of development nor the later neo-liberal codes of best economic practice provided guaranteed guides to successful economic development, the trivial reason for that is that every model is only a guide. Even if one could have satellite navigation systems to lead us to development, they would recognise that deviations from the optimal route sometimes have to be made for perfectly good reasons. At a more serious level, a variety of political problems obstruct the implementation of any simple development model. Economic development is usually not the only goal of developing country governments. Territorial integrity, relations with neighbouring countries, balancing ethnic and religious rivalries and responding to natural calamities are competing goals to which economic development may at times have to be sacrificed. The strategies that are deduced from models also have to be given concrete organisational forms to be effective, but all organisations are vulnerable to deliberate or accidental internal subversion by those who operate them. Only constant vigilance and re-organisation can remedy this vulnerability. One reason why the tide of opinion moved in favour of the neo-liberal model was precisely its promise that the free market would perform this monitoring, evaluation and correction function automatically. Unfortunately, this proved to be no more than a half-truth.

Perhaps the problem has been trying to rely on someone else's model as a guide. Successful developers may have to pioneer their own national models, cannibalising those of others in the process. The willingness to do this implies that the government has given a high priority to the goal of economic development. It may have concluded that economic development is a means of resolving the other problems—external security, internal unrest, geo-physical constraints and so on—and so have made it their paramount objective. Institution building to achieve economic development thus becomes the vital national interest of the political leadership. The state may be ready to take the lead in this task, but its leadership will be aimed at energising and co-operating with the private sector. When the private sector has become strong and internationally competitive, the state will be ready to reduce the scope of its economic operations again. .

This approach is therefore less ideological and more pragmatic in its policies. What matters is not the ideological purity of the methods, but the measurable evidence of good results and a willingness to change methods when they fail to generate good results. East Asia provides examples of this kind of economic pragmatism. Korea changed in the 1960s to a much more free market environment, but then engineered a range of substantial state interventions that brought it rapid industrial growth, then subsequently it reduced the role of the state. China's rapid growth is another example of a highly pragmatic approach. It radically changed its economic development policy in 1978 without changing

its ideological stance or the nature of its political regime, although in subsequent years these have been modified. Vietnam is another example of successful growth with very flexible policies.

These successful East Asian strategies seem anomalous and confusing to Western eyes and are conducive to controversy over alternative interpretations. That is because they are both ideologically synthetic and country-specific—the organisational forms of the East Asian miracle in Korea and Taiwan were quite distinct, for example. Although the designation of these success stories as “miracles” invites us to view them as exceptional and unrepeatable experiences, their impact on development thinking has been more positive than merely to generate puzzlement and debate. They have also paradoxically encouraged a degree of convergence in development thinking. As a result of the controversy, extremes positions at both ends of the ideological spectrum have been truncated and opinion is now more clustered around the middle.

From the left of the spectrum, several key ideas have virtually disappeared. It is rare now to hear it argued that a policy of cutting trade and finance links with the rest of the world would be beneficial for national development, although due diligence when making new links is clearly advisable. The advocacy of development via state-owned and state-managed industries has also flagged, although state management of investment regimes for private enterprises can accelerate the absorption of foreign technology. Finally, suspicion of macro-economic stabilisation as a policy goal has eroded, although argument persists about how it is best attained.

At the neo-liberal end of the spectrum, the series of financial crises that have followed on after financial liberalisation have muted the cry that free markets work well provided that they are left alone. The excessive size and the excessive risk-taking of poorly regulated banks clearly damage the financial system and depress the activity of the enterprise economy. Secondly, the argument that poverty reduction is a luxury that must wait until growth has been achieved is heard less these days. There is much wider recognition that there is a mutually reinforcing relationship between economic growth and the reduction of poverty and inequality. Finally, the claim that the pursuit of individual self-interest will produce a socially optimal outcome has forfeited belief. To function well all markets require a broad ethical foundation of trust and reciprocity. Credit and confidence simply cannot flourish wherever greed and corruption dominate.

The abandonment of extreme positions in the development debate gives hope that a social learning process is taking place under the pressure of adverse events, and that new solutions can be found for the old issues of development in an interdependent world.

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**ENDNOTES**

<sup>i</sup> For a simple exposition of the basic equations of international balance, see Bruce Greenwald and Joseph E. Stiglitz “A Modest Proposal for International monetary Reform” in Stephany Griffith-Jones, Jose Antonio Ocampo and Joseph E. Stiglitz (editors), *Time for a Visible Hand*, 2010, Oxford, Oxford University Press, pp. 315-6.

<sup>ii</sup> After 1933, “There began to crystallize . . . a conception of ‘economic order’ that included norms, rules and frameworks for . . . decision-making on a multinational level – this to supply the deficiency of the liberal ideal, in which the key legal, institutional and “moral” context was simply taken for granted”: Neil De Marchi, “League of Nations Economists and the Ideal of Peaceful Change in the Thirties”, *History of Political Economy*, Vol. 23, Annual Supplement, 1991, pp. 143-178 at p. 144.

<sup>iii</sup> Leroy Stinebower, Oral History 9 June 1974, pp. 29-30, Harry S. Truman Library, Independence, Missouri.

<sup>iv</sup> R. H. Brand to Wilfrid Eady, 22 Apr. 1946, R.H. Brand papers, Bodleian Library, Oxford.

<sup>v</sup> See Alfred Kleinknecht and Jan ter Wengel, “The myth of economic globalisation”, *Cambridge Journal of Economics*, 22, pp. 637-647.

<sup>vi</sup> For a critique of the IMF’s CFF and the EEC’s STABEX schemes, see John Toye, “Supra-national compensation schemes for temporary export losses: a critique” in David Sapsford and John-ren Chen (editors), *Development Economics and Policy*, 1998, Basingstoke, Macmillan.

<sup>vii</sup> For details, see Rolf J. Langhammer and Andre Sapir, *Economic Impact of Generalised Tariff Preferences*, 1987, Aldershot, Aldershot UK, pp. 16-9.

<sup>viii</sup> According to Hans Singer, “some of us in the United Nations never had any illusions” that a soft loan facility would be set up in the UN, rather than the World Bank. H. W. Singer, “The Terms of Trade Controversy and Soft Financing: Early Years at the UN”, in Dudley Seers and Gerald M. Meier (editors), *Pioneers in Development*, 1984, Washington DC, The World Bank, p. 298 and n. 52.

<sup>ix</sup> The UN Intellectual History Project Oral History Interview of Janez Stanovnik, 7-8 January 2001, p. 55

<sup>x</sup> J. Ann Zammit, “UNCTAD III: End of an Illusion”, *IDS Bulletin*, Vol. 5, No. 1, p. 3.

<sup>xi</sup> David Henderson, “International Agencies and Cross-border Liberalization”, in Anne O. Krueger (editor), *The WTO as an International Organization*, 1998, Chicago, University of Chicago Press, p. 111.

<sup>xii</sup> On the changes in the World Bank Research Department at this time, see Kapur, D., J. P. Lewis and R. Webb 1997, *The World Bank: Its First Half Century*, Volume 1, Washington DC, Brookings Institution Press, pp 1193-5, notes 47 and 48.

<sup>xiii</sup> The figures in this paragraph are taken from *Economic Growth in the 1990s: Learning from a Decade of Reform*, Washington DC, World Bank.

<sup>xiv</sup> See Adrian Wood, “Heckscher-Ohlin in Theory and Reality” in Philip Arestis and John Eatwell (editors), *Issues in Economic Development and Globalization: Essays in honour of Ajit Singh*, 2008, Basingstoke, Palgrave Macmillan, pp. 161-4.

<sup>xv</sup> This suggestion was made by Ravi Kanbur, “The Development of Development Thinking”, Working Paper WP 2005-16, Cornell University Dept of Economics and Management, Ithaca, 2005, p.18.

<sup>xvi</sup> Dong Hyeon Kim and Shu-Chin Lin, “Trade and Growth at Different Stages of Economic Development”, *Journal of Development Studies*, 45.8, 2009, pp1211-24.

<sup>xvii</sup> As quoted in John Toye and Richard Toye, *The UN and Global Political Economy*, Bloomington, Indiana University Press, 2004, p. 105.

<sup>xviii</sup> See, for example, Robert Wade and Frank Veneroso, “The East Asian Crash and the Wall St.-IMF Complex”, *New Left Review*, No. 228, 1998, pp. 3-23 and Joseph E. Stiglitz, *Globalization and its Discontents*, London, Allen Lane, 2002, pp. 43-52.

<sup>xix</sup> For an detailed narrative of the sequence of events leading up to the global financial crisis of 2008, see Gillian Tett, *Fool’s Gold*, 2009, London, Little, Brown Book Group.

<sup>xx</sup> The explanation also applies to famines in poor countries. Famines come as a surprise because fearful politicians ignore what the famine early warning systems are telling them until it is impossible to ignore them any longer.

<sup>xxi</sup> The seminal work is Mancur Olsen, *The Logic of Collective Action*, 1965.

<sup>xxii</sup> Sidney Dell, “Relations between the United Nations and the Bretton Woods Institutions”, paper presented to the North-South Roundtable on the Future Role of the UN, Uppsala, 6-8 Sept. 1989, p. 33.

<sup>xxiii</sup> Mahhub al Haq, “An Economic Security Council”, *IDS Bulletin*, Vol. 26, No. 4, pp. 20-7.

- <sup>xxiv</sup> Louis Emmerij, Richard Jolly and Thomas G. Weiss, *Ahead of the Curve?*, 2001, Bloomington, Indiana University Press, p. 202.
- <sup>xxv</sup> Frances Stewart, “The Governance and Mandates of the International Financial Institutions”, *IDS Bulletin*, Vol. 26, No. 4, pp. 28-24.
- <sup>xxvi</sup> See James M. Boughton, “The Case for a Universal Financial Institution” in James M. Boughton and Domenico Lombardi (editors), *Finance, Debt and the IMF*, 2009, Oxford, Oxford University Press, p. 66, Figure 4.1
- <sup>xxvii</sup> ‘Compliance’ is defined for this purpose as actions that permitted the disbursement of 75 per cent of the loan.
- <sup>xxviii</sup> Ariel Buira, “An Analysis of IMF Conditionality” in Ariel Buira (editor), *Challenges to the World Bank and IMF: Developing Country Perspectives*, 2003, London, Anthem Press, pp 63-6.
- <sup>xxix</sup> Yilmaz Akyuz, “Towards Reform of the International Financial Architecture: Which Way Forward?” in Yilmaz Akyuz (ed.), *Reforming the Global Financial Architecture: Issues and Proposals*, London, Zed Books, 2002, pp. 8-12.
- <sup>xxx</sup> See the Final Report of the Committee on IMF Governance Reform, dated March 24 2009, pp. 15-21.
- <sup>xxxi</sup> See Greenwald and Stiglitz, “A Modest Proposal”, Figure 17.9, p. 326.
- <sup>xxxii</sup> See Stanley Fischer, “Capital Account Liberalization and the Role of the Fund”, Washington DC, International Monetary Fund, September 1997.
- <sup>xxxiii</sup> Yilmaz Akyuz, “Crisis Management and Burden Sharing”, in Akyuz, *Reforming the Global Financial Architecture*, pp. 117-56.
- <sup>xxxiv</sup> For an account of these episodes see Robert Wade, “The Greening of the Bank: the Struggle over the Environment 1970 – 1995”, in Kapur, Lewis and Webb, *The World Bank*, Vol. II, pp. 611 – 734.
- <sup>xxxv</sup> Ngaire Woods, “Order, Justice, the IMF and the World Bank”, in Rosemary Foot, John Lewis Gaddis and Andrew Hurrell (editors), *Order and Justice in International Relations*, Oxford, Oxford University Press, 2003, pp. 80-102 at 100-2.
- <sup>xxxvi</sup> See Michelle Miller-Adams, *The World Bank. New Agendas in a Changing World*, London, Routledge, 1999.
- <sup>xxxvii</sup> For a brief synopsis of the history of the SDR link proposal, see Harold James, “Bretton Woods and the Debate about Development” in Boughton and Lombardi (editors), 2009, pp. 43-5.
- <sup>xxxviii</sup> See A. P. Thirlwall, *Growth and Development*, 7<sup>th</sup> edition, Basingstoke, Palgrave Macmillan, 2003, pp. 729-35.
- <sup>xxxix</sup> A. O. Krueger, “Whither the World Bank and the IMF?”, *Journal of Economic Literature*, Vol. XXXVI, No. 4, 1998, pp. 1983-2020.
- <sup>xl</sup> As recommended by the Meltzer Commission, which reported in 2000.
- <sup>xli</sup> The full text of the Understanding on the Settlement of Disputes is given in John H. Jackson, *The World Trade Organization: Constitution and Jurisprudence*. London, Pinter for Royal Institute of International Affairs, 1998, pp. 145-69.
- <sup>xlii</sup> B. L. Das, *The World Trade Organisation. A Guide to the Framework for International Trade*, London, Zed Books, 1999, p. 7; Gary P. Sampson, “The World Trade Organisation After Seattle”, *The World Economy*, 23:9, 2000, pp. 1112-3.
- <sup>xliiii</sup> B. M. Hoekman, and P. C. Mavroidis, “WTO Dispute Settlement, Transparency and Surveillance”, *The World Economy*, Vol. 23, No. 4., 2000, pp. 527-8.
- <sup>xliiv</sup> Das, *The World Trade Organisation*, p. 397 regards this as a “serious limitation” of the DSU. On these four major systemic deficiencies, see Hoekman and Mavroidis, “WTO Dispute Settlement”, pp. 529-32.
- <sup>xliiv</sup> The fact that developing countries have started to bring disputes to the DSM does not detract from this point if, as seems to be so, these are disputes mainly with other developing countries: Jackson, *World Trade Organization*, p. 74.
- <sup>xlivi</sup> Formal justice is the equal application of the existing rules of an institution in its legal or administrative processes. See Herbert L. A. Hart, *The Concept of Law*, Oxford, Clarendon Press, 1961, pp. 156-8; and John Rawls, *A Theory of Justice*, Oxford, Oxford University Press, 1972, pp. 58-60.
- <sup>xliiii</sup> Judith Goldstein, “International Institutions and Domestic Politics: GATT, WTO and the Liberalization of International Trade”, in Krueger (editor), *The WTO as an International Organization*, pp. 139, 146-9. According to John G. Ruggie, “International regimes, transactions and change: embedded liberalism and the postwar economic order”, *International Organization*, Vol. 36, No. 2, 1982, pp. 79-415, at p. 398, “. . . that multilateralism and the quest for domestic stability were coupled and even conditioned by one another reflected the shared legitimacy of a set of social objectives to which the industrial world had moved, unevenly but ‘as a single entity’. Therefore, the common

tendency to view the post-war regimes as liberal regimes, but with lots of cheating taking place on the domestic side, fails to capture the full complexity of the embedded liberalism compromise.”

<sup>xlviii</sup> “Frequent investigations, even if the complaints are finally rejected, amount to a kind of harassment of the defendants because of the uncertainty and expenses such actions create”: P. K. M. Tharakan, “Political Economy and Contingent Protection”, *Economic Journal*, Vol. 105, No. 433, 1995, pp. 1550-64, at p. 1551. See also H. P. Marvel, and E. J. Ray, “Countervailing Duties”, *Economic Journal*, Vol. 105, No. 433, 1995, pp. 1583-4 and I. M. Destler, *American Trade Politics: System under Stress*, Washington DC, Institute for International Economics, 1986.

<sup>xlix</sup> Ruggie, “International Regimes”, p. 411. “Most governments . . . [negotiated] a ‘voluntary’ export restraint with the presumably reluctant exporter who had been previously ‘softened’ by threats of emergency action under GATT (Article XIX).” The 1962 Cotton Textiles Arrangement (later the Multi-Fibre Agreement) was a VER administered by the GATT, which was only fully phased out 2005.

<sup>l</sup> Although ADs and CVDs are analytically and legally distinct, they are linked in practice. In most US cases they are sought jointly by the complainant industry, and granted together by the US ITC. This is evidence that they are being used for protection and not for their original purpose of removing trade distortions. See Marvel and Ray, “Countervailing Duties”, pp. 1587-8.

<sup>li</sup> Robert E. Baldwin, “Imposing Multilateral Discipline on Administered Protection” in Anne O. Krueger (editor), *The WTO as an International Organization*, Chicago, University of Chicago Press, 1998: 311.

<sup>lii</sup> See Robert Wade, *Governing the Market. Economic Theory and the Role of Government in East Asian Industrialization*, Princeton, NJ, Princeton University Press, 1990 and Ha-Joon Chang, *The Political Economy of Industrial Policy*, Basingstoke, Macmillan., 1994, pp. 91-129.

<sup>liii</sup> Y. Akyuz, Y., H-J. Chang and R. Kozul-Wright, “New Perspectives on East Asian Development”, *Journal of Development Studies*, Vol. 34, No. 6, 1998, pp. 4-36, at p. 30-2.

<sup>liv</sup> That the new WTO rules allow developing countries to pursue industrial strategies that use subsidies is argued by Alice Amsden, “Industrialization under New WTO Law” in John Toye (editor), *Trade and Development: Directions for the 21<sup>st</sup> Century*, 2004, Cheltenham, Edward Elgar. This is true, but the problem is that the developmental use of subsidies requires them to be temporary, selective and conditional on the performance of the beneficiary firm (see W. H. Kaempfer., E. Tower and T. D. Willett, “Performance Contingent Protection”, *Economics and Politics*, Vol. 1, No. 3, 1989, pp. 261-75 at p. 272). If the selection criteria include *export performance*, it will be difficult avoid the charge of giving a “specific” subsidy.

<sup>lv</sup> Gary P. Sampson, “The World Trade Organisation After Seattle”, p. 1100.

<sup>lvi</sup> L. Alan Winters, “Trade Policy as Development Policy: Building on Fifty Years Experience”, in John Toye (ed.), *Trade and Development: Directions for the 21st Century*, 2003, Cheltenham, Edward Elgar.

<sup>lvii</sup> “. . . powerful countries have far more bargaining chips to use . . . to leverage less powerful countries into ‘agreeing’ on the preferred ‘consensus decision’ ”, according to Gary P. Sampson, “The World Trade Organisation After Seattle”, p. 1101.

<sup>lviii</sup> This would breach norms of non-discrimination and universality.

<sup>lix</sup> Asymmetric liberalism is a polite term for double standards.

<sup>lx</sup> Judith Goldstein, “International Institutions and Domestic Politics: GATT, WTO and the Liberalization of International Trade”, in Krueger (editor), *The WTO as an International Organization*, pp. 149-151.

<sup>lxi</sup> Das, *The World Trade Organisation*, p. 425.

<sup>lxii</sup> Peter Evans, “Economic Governance Institutions for a Global Political Economy: Implications for Developing Countries”, in John Toye (editor), *Trade and Development: Directions for the 21<sup>st</sup> Century*, pp. 288-307 at 301-4.

<sup>lxiii</sup> See the discussion of SDT in M. Pangestu, “Special and Differential Treatment in the Millennium: Special for Whom, and How Different?”, *The World Economy*, Vol.23, No.9, 2000, pp.1285-1302.

<sup>lxiv</sup> *Ibid.*, pp. 1285-9.

<sup>lxv</sup> Christopher Stevens, “If One Size Doesn’t Fit All, What Does?”, *IDS Bulletin*, Vol 34, No. 2, 2003, pp. 1-11.