



The Evolving Role of the Bretton-Woods Institutions: Where Do We Stand?

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Summary of the Discussions

by

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In his opening remarks Christian Noyer, Governor, Banque de France, addressed all the key issues in the programme, expressing at the outset the view that “radical changes” in the structure of the IMF and in the way it went about its business were not to be expected. Nevertheless, it was possible to make a case for a more focused approach to the exercise of its many responsibilities. On the subject of global imbalances he referred to the impressive accumulation of reserves at the central banks of many of the larger Asian countries, the counterpart of the equally impressive current account deficit in the United States, both coexisting with an exceptionally low level of interest rates—both short and long-term. For many, these imbalances were not sustainable and had to be addressed as soon as possible. The IMF was, of course, expected to be an independent source of analysis on economic developments and should be given more of a role in the management of macro imbalances globally. It was not clear, however, whether the G7, the G20 or some other such cooperative grouping would be the best forum to address these issues.

On the subject of aid for development Noyer thought that more financing was desirable but the big question was: “In what form?” The cancellation of all debt for the Millennium Development countries was likely to be met. Nevertheless, there were issues that needed to be addressed as regards the role of the international financial institutions in low-income countries. Clearly, these countries should not be plagued by high debt levels and there was a need to put their public finances on a more sustainable footing. In this respect, the undue exposure of the IMF to a few debtors in the emerging markets was a source of concern. Noyer noted that the role of the IMF in debt restructuring operations for highly indebted countries remain to be resolved. Xavier Musca, Director General, French Ministry of Finance, added that public opinion about global development issues was increasingly mobilized. However, there were sharp differences of view about how to best manage the international financial institutions. It seemed, increasingly, that the business model of the IMF and the World Bank was being challenged; many thought it outdated. He noted that the IMF was embarked on a process of rethinking its overall strategies.

Rebalancing the world economy

Hervé Hannoun, First Deputy Governor, Banque de France, raised similar questions about the causes of global imbalances. Did they reflect mainly excess demand and insufficient savings in the United States or were they a reflection of insufficient demand outside the United States? And, depending on the answer given to this question, what should be the role of the IMF in managing these imbalances? Patrick Artus thought that we were witnessing a new form of specialisation in the United States towards non-traded goods and services such as leisure, IT services, and so on, compared to China which was increasingly showing patterns of specialisation in the production of traded goods. In the United States employment in manufacturing had fallen by some 20 percent since the mid 1990s. The United States in turn had a trade deficit with virtually all regions with which it traded. What did these parameters imply for the currency regime? The deficit in the United States was likely to keep growing. There were only 40 million people in China with an income in excess of \$6,000 per year. This, in his view, suggested that Chinese growth would remain fuelled by exports, not by consumer spending.

The stock market in China—excluding the state-owned companies—was equivalent to only 10 percent of GDP, but savings in the hands of the population were 200 percent of GDP. Chinese growth rates had averaged 9-9.5 percent in recent years but exports had grown by 24 percent, consumer spending by 12 percent and investment by 27 percent. These numbers, taken together, suggested that GDP growth recently had probably been closer to 14 percent per year rather than the officially announced 9 percent. Nevertheless, it was increasingly clear that China could not keep these investment rates at present levels. What would happen when China shifted to a different exchange regime? The more the United States specialised in non-traded services, the less likely was an exchange rate devaluation to affect the trade deficit in a substantial way. A 10 percent depreciation of the dollar would lead, in the best of circumstances, to perhaps a 0.5 percent of GDP reduction of the trade deficit. So, clearly, there were problems ahead in the US economy. A very large depreciation of the dollar would be needed to make a dent on the trade deficit. Indeed, the United States was not likely to run trade surpluses because of its increasing specialisation on non-traded services.

Hélène Rey noted that the large current account deficits of the US would have to be offset by future trade surpluses or by future high returns on the net foreign asset portfolio of the US. The “traditional” channel of balance of payments adjustment was through the exchange rate: dollar depreciation would boost net exports. However, an additional channel was through valuation adjustments: dollar depreciation also generated capital gains on the net foreign asset position of the US. Rey provided some interesting figures: at end 2003, US external liabilities were \$10.5 trillion, whereas US external assets were \$7.9 trillion, for a net foreign asset position of -\$2.7 trillion. However, US liabilities were almost 100 percent in dollars, but some 70 percent of US assets were in foreign currencies. This meant that a 10 percent depreciation of the dollar implied, other things being equal, a transfer of 5 percent of US GDP from the rest of the world to the US because the value of US assets would rise whereas the value of liabilities would not. Since the current account deficit in the US was 4.4 percent of GDP in 2003, the valuation channel was huge. Nouriel Roubini, commenting on Rey’s presentation, noted that net foreign direct investment during the last 3 years had been a negative \$200 billion—net factor income payments were decreasing rapidly. Furthermore, the current account deficit in the US in 2005 was likely to be in the neighbourhood of \$800 billion; since the US dollar in 2005 was appreciating there would

be capital losses in excess of \$300 billion. In order not to crowd out private investment fiscal adjustment was inevitable.

Richard Cooper thought that it was a mistake to focus undue attention on the balance of payments. In fact, in analyzing global imbalances there was a need to more closely integrate an examination of balance of payments trends with a proper understanding of the national economy. Private savings in the United States were, in fact, not so low. The national accounts were out of date; expenditures on consumer durables and education were classified as “consumption”, whereas in fact they were closer to savings. Research and development was classified as a “business expense” and therefore it did not enter the national accounts but, obviously, it is not a business expense. Excess savings in China and Japan were clearly a feature of the present global situation; the demand for housing in these countries was low and the fiscal deficits were high, particularly in Japan. They also had an ageing population problem; therefore it made eminent sense to have a current account surplus. This is where future savings would come from to address these emerging problems. Cooper made the case that postal savings in Japan should be invested abroad more liberally. He added that China was “on a roll”, it had seen the most rapid reduction in poverty in history; the international community should encourage and support this process. The fact is that the United States produced marketable assets which others were quite willing to acquire. Indeed, private capital inflows into the United States in 2004 greatly exceeded the current account deficit.

John Williamson thought that precisely because of persistent levels of poverty in China, with hundreds of millions of people with incomes still less than \$6,000 per year the focus of policy should be on the development of the country rather than on the production of “more trinkets” for sale abroad. Williamson saw, therefore, a need for a refocus and a reorientation of Chinese economic policy with more of an emphasis on internal domestic demand and less on the sale of cheap goods abroad.

Jim O’Neill made a number of interesting points. In less than 40 years Brazil, Russia, India and China (BRICs) could be larger than the G6 (US, Japan, Germany, UK, France and Italy). Only the US and Japan may be among the six largest economies in 2050. New demand from the BRICs economies could rival the G6 by the end of 2010, with Europe, in the absence of reforms, likely to account for a smaller share of the world economy. Income per capita in the BRICs, however, was still likely to be much lower than in the G6 economies, with the exception of Russia. These trends were likely to have the following implications: a further shift in economic power towards Asia and the reshaping of regional networks; changing consumption and production patterns; and a flow of capital back to the BRICs as the world rebalanced. The two key questions were: (1) would real appreciations of the BRICs currencies take the form of changes in their nominal exchange rates or through price adjustments?; and (2) how would the international institutions need to be reshaped to cope with these changes in a more effective manner?

Yung Chul Park noted that the 13 countries that make up East Asia had an aggregate imbalance with the United States of \$2.5 trillion and that these imbalances were likely to persist, although there was broad consensus that it was important to slow down their growth. China did not have a large current account surplus; it had, instead, a large capital account surplus. He did not think that China would change in a fundamental way its exchange rate policy but that it could liberalise capital outflows more aggressively. Japan had tried to expand domestic demand; this had led to a very sharp increase in the fiscal

deficit and a public debt to GDP ratio in excess of 165 per cent and real interest rates close to zero in the context of a floating exchange rate. In the absence of domestic demand Japan would continue to maintain a strong export performance to keep overall GDP growth at 1 per cent per year. He agreed with other speakers that the appreciation of Asian currencies would not have much of an affect on the US trade deficit.

John Lipsky questioned the conventional discussion on global imbalances – the idea that a huge United States current account deficit necessarily implied that there must be something terribly wrong with the global economy, that it is unsustainable, that it involves potentially large risks such as, for instance, a sharp decline in the value of the US dollar. He pointed out that markets remained rather sceptical about the possibility of a sharp dollar drop. He asked whether the rise of the US current account deficit reflected more organic changes in the global economy, not necessarily policy missteps on the part of US policymakers. First of all, there was no doubt that there was a global savings glut. Lipsky thought that the US fiscal deficit was coming down to, perhaps, 3 percent of GDP in 2005 and was projected to be even smaller the following year. The US private savings rate was also likely to rise. Productivity growth was strong in the three largest economies in the world. Also, since 1997 the US bilateral deficits with China, the European Union and with other members of NAFTA had remained broadly unchanged. There was, indeed, a massive restructuring of the North American economy and there was no doubt that developments in Asia were changing the global economic landscape.

Lipsky thought that the IMF Articles of Agreement were out of date and removed increasingly from the realities of the global economy. Current account convertibility had, no doubt, been an outstanding achievement of the first half century of the IMF. However, cross border private finance had grown greatly, dwarfing in magnitude official flows. The Articles of Agreement gave the IMF no jurisdiction over private capital flows. The world had become, in the meantime, more globalised and regionalised but the IMF still dealt with national authorities and individual member countries. The IMF was not likely to remain relevant without a move towards jurisdiction over capital account convertibility. He thought that the IMF should not waste time on countries that can borrow in their own currency. The promulgation of Collective Action Clauses (CACs) was, in his view, a favourable development. As their use became increasingly widespread, the issue of lending into arrears would become irrelevant. He thought that there would be dramatically less call on IMF resources in the future and that, therefore, it was important to think through the role of the IMF in a new globalised world.

Lorenzo Bini Smaghi thought that there was in general a lack of confidence in institutions and policies, specifically long-term fiscal policies. Savings ratios in the EU had increased, probably because of increased uncertainty about the future, particularly as regards the financial sustainability of pension systems and benefits and the ability of states to support the stability of the social contract. A similar phenomenon could be observed in key emerging markets; an excess of savings in China, for instance, reflected the lack of appropriate safety net mechanisms for the population coupled with uncertainty and expectation that there would be major changes in coming years. Unless many of these uncertainties about the fiscal position in the European Union and Japan were dispelled, then savings rates would continue to rise.

He asked whether a weak dollar was good for the United States and what was likely to be the effect of a move to a higher interest rate environment on the asset and liability position

of the United States. Peter Kenen thought that the US private sector did indeed save a great deal more than suggested by the savings rate but asked whether the global economy was vulnerable to over-investment in housing. If the Chinese currency appreciated vis-à-vis the US dollar it was not all clear what would happen to the euro vis-à-vis the dollar. There was, in his view, de facto, an Asian Monetary Fund being created.

Jack Boorman—responding to points raised by Lipsky—indicated that the Asian crisis of 1997 derailed capital account liberalisation at the Hong Kong Annual Meeting of the IMF and the World Bank in September of that year. To do regional surveillance the IMF needs a “partner” and it was not clear who this was in the context of specific regions. Who was the partner in Latin America or in Asia? He was sceptical that the creation of an Asian Monetary Fund would actually materialise because, in his view, neighbours do not and cannot impose conditionality on each other.

Musca thought that, to avoid losses of credibility at the international financial institutions, there was a need to reform policies and to boost their legitimacy; in particular there was a clear need to ensure better representation of the membership. On the first of these points he thought that it was important to do a reallocation of quotas. He thought that progress was possible without changing the broad thrust of the organisations’ mandate. For sure, the Asian countries deserved a higher quota which would in turn have a bearing on the EU. Considering its share of global GDP the share of the EU should no doubt be smaller; the key issue was the ability of the EU to speak with one voice. He said that we needed to be ambitious but realistic, to work harder to build a joint EU position; however expectations should be tempered as the process of political integration in Europe was likely to take time. There was also a need to review quota formulas with the aim of simplifying them. He thought that the quotas of Africa were bigger than their actual importance in the global economy; there were two African representatives among the twenty-four Executive Directors of the IMF but he suggested that it would not be appropriate or desirable to reduce their share—their voice was important.

Musca thought that in general the G7/G8 had an unduly large influence on the economic decision making and processes of the IMF and, therefore, ended up undermining its credibility and legitimacy. Lipsky added that there was a need for a re-conceptualisation of the role of the IMF in light of the large growth of cross borders flows which had taken place in recent decades, repeating his earlier assertion that there was a need to have an IMF that had a say on the rules regulating the flow of capital. John Williamson, however, thought that there was no international interest in terms of capital account convertibility; however there was a very keen interest about boosting the surveillance capabilities of the IMF.

Financing for development

Masood Ahmed made a number of interesting points in his discussion on aid. He suggested that an extra \$25 billion dollars of aid to Africa per year to 2010 would bring about a doubling of aid to the region. We would be financing recurrent expenditures in areas such as health, public sector wages, and so on and that the focus of the aid effort on Africa would be on fragile states. The multilateral institutions needed to be more imaginative on how to finance aid to poor countries, whose rate of growth was constrained by the rate of growth of bilateral financing flows.

Ahmed also addressed the issue of the type of official financing that the middle income countries needed. He thought that probably they needed long term flows to deal with marginalized segments of society. He thought that it was useful to debate the issue of the need for more funding because there are worthwhile projects waiting to be financed. Yes, there are absorption capacity problems but not everywhere and not, in any event, to the same extent.

Jean-Pierre Landau agreed that it was necessary to cover recurrent costs; salaries of teachers and health workers and the like. More money was also needed to finance communicable diseases research. He agreed that global taxes could, in the long term, be a central element of financing for development. Landau thought that global common goods such as radio and GPS frequencies were not appropriately taxed or priced. There was a need to ensure better against risks, to put early warning systems to deal with natural catastrophes, such as the recent tsunami. This would have cost \$100 million per year – a very small amount when compared with the destruction brought about by these calamities. This was a good example of global institutional failure. He thought that there was a need to have stable and predictable resources for development and that there was no need to create a new bureaucracy; rather the focus should be on core needs. Official development assistance (ODA) flows were in the neighbourhood of \$60 billion per year but only half was actually a cash transfer, the rest took the form of debt relief.

Luiz Pereira thought that there was a paradox underlying the recent development debate: namely, the considerable generosity at the level of the private sector as witnessed, for instance, by the many contributions made to the tsunami victims, but stinginess at the level of donor governments. True, ODA flows had risen in recent years but, in general, depended a little too much on the political cycles of donor governments. He asked whether private capital flows could be a substitute for the volatility of political cycles but concluded that private capital flows would be just as volatile because they, in turn, were a function of business cycles, asset bubbles, and so on. Pereira thought that traditional mechanisms of aid, such as the International Development Agency at the World Bank, needed to be strengthened. More funds were needed for sure; the elasticity of development indicators with respect to aid funding was indeed positive but the relationship was not linear. Levels of corruption and the capacity of countries to absorb resources were also important considerations. The political economy of aid, in his view, would remain complex. To the extent that donor countries continued to have difficult fiscal situations themselves aid flows would remain uncertain. He thought that ODA was most efficient when flows were predictable and stable. He then added that taxes might be a good way to go as a way of funding aid. He also thought that it would then be important to think of taxes as being commensurate to the externalities that the development process generated.

Cooper thought that there was a kind of disconnect in the discussion between the emergence of global imbalances in the economy and the development goals being pursued by the larger countries, on the other. He said that we had seen the biggest reduction in world poverty in history in India and China in recent decades. Much of the reason for this had been the growth of trade in both countries. To put pressure on China to revalue its currency was, in his view, unwise - especially if this pressure was in parallel to processes underway to raise money to finance development. He was in favour of a carbon tax to deal with the after affects of global climate change; it would be a huge revenue generator and only a small fraction of it could finance much of the development goals being pursued by the international community at present.

Augusto Lopez-Claros referred to a recent article published by William Easterly in which he had noted that, despite the disbursement of some \$580 billion in aid to Africa during the past four decades, there was not much to show for it in terms of growth; in fact, quite the opposite. While Cooper had noted that there had been large gains in reducing poverty in India and China during the last 20 years, the actual numbers of poor in Africa had been on a rising trend. Perhaps one needed to look further into the reasons why Africa had not grown as rapidly as might have been hoped, given these levels of aid. Had we put enough emphasis on the importance of nurturing respect for property rights, on curtailing the incidence of corruption, on improving the quality of public institutions? Was lack of public accountability in much of Africa linked to the poor results of the aid efforts on the part of the international community? Chile in Latin America had had the most success in the region in the area of poverty reduction during the past 15 years but had not been an aid recipient; instead good policies and transparent public institutions had played a key role in delivering the best growth performance in Latin America.

Pierre Jacquet thought that aid had helped to reduce poverty in Africa although it had not led to growth per se. Williamson agreed with Cooper that a global carbon tax would be a logical successor to Kyoto. He reminded the audience that the Zedillo Commission had endorsed it in 2002. Cooper said that the essence of development was moving people from agriculture to more productive activities. Chinese imports had risen from \$10 billion in 1980 to \$300 billion 2004 - along the way Chinese standards of living had risen dramatically. It was indeed a “smashing” success story and we should not throttle it. Aid was an instrument to achieve development; it was not an end in itself. Nouriel Roubini agreed that trade was extremely important for growth and thought that G7 political establishments were being hypocritical in key elements of the debate, as evidenced by rising protectionist sentiment in the United States and the emergence of calls for “managed trade.” He thought that “voluntary” export restraints would soon raise their ugly head because Asian currencies were undervalued.

Francois Bourguignon said that the end of the Cold War had made difficult an assessment of the linkage between aid and growth. In the pre-Cold War days aid was misused; there was broad agreement that this was the case. But in the post-Cold War period aid could be a better mechanism to fuel the development process. Ahmed noted that Africa was a highly disaggregated continent in terms of performance. There was a group of some 15 to 20 countries that were aid dependent where policies were much better managed than in the past (e.g., Tanzania). There was, however, also a set of countries that was mired in conflict and he agreed with Cooper that aid was not likely to be helpful in these countries.

Jacquet made a number of points on official development assistance. First he thought that the present momentum was favourable. The international community was thinking about how to improve its efficiency. It had come to the view that it was important to have more coherence, in terms of outlining its objectives, and that it would be politically wise to use taxes as a source of funding. Nevertheless ODA was an “archaic animal”; grants and concessional loans were its two most important components but the latter was not clearly defined. Guarantees, which could be a great instrument, were not included because of matters of definition, although, of course, the financial sector had become very sophisticated in the meantime. One could envisage a situation where, through financial engineering, it would be possible to leverage ODA for development, to adapt instruments to provide a cushion against various forms of uncertainty for instance.

He asked, rhetorically, “what constitutes good use of public resources?” There are global public goods many of which will have a positive effect on development. We should try to think of ODA as a catalyst to foster private sector participation in the financing of development and in poverty reduction. He noted that Jeffrey Sachs did not say much about this in his recent book “The End of Poverty”. Stephanie Griffith-Jones thought that it was important to focus on private flows and, in particular, how to make them more stable. In her view “negative net transfers” was still a serious problem. Private flows were extremely concentrated on middle-income countries but were also highly volatile, a characteristic that tended to scare developing countries. In her view there was a need for commodity-linked bonds to smooth revenue to debt service ratios. Maybe the industrialised countries should establish a precedent by introducing these bonds at the outset? She thought that there was a need to increase official aid flows in a countercyclical way, and that support should also continue to countries suffering external shocks that were beyond their control while at the same time de-emphasising conditionality.

Bourguignon thought there had been an impressive convergence of views on the need to increase aid to reach the Millennium Development goals. He said that the question of how much additional aid was needed was a difficult one. It is possible to absorb large increases in aid depending on the kinds of policies that are being implemented; there was flexibility across countries and within countries. The management of ODA by bilateral and multilateral donors was of course tremendously important. There is no doubt that there was a certain pessimism about the impact of aid because of the poor evidence on growth that comes out of empirical work done by a number of top economists. However, there was, in his view, reason for hope. In some of the more important African countries poverty had come down at a rate of 1.5 per cent per year over the last 10 years. Many of these countries had begun the 1990s with higher levels of ODA. There was a need for a long run commitment to aid to reach the MD goals. Aid, in particular, could be used as a mechanism to design better policies aimed at boosting investment in health, education and so on in these countries. He also noted that the successful conclusion on the Doha Round of trade liberalisation was tremendously important. Trade could become a very important mechanism for poverty reduction.

A number of other interesting points emerged in the course of the discussion on aid. Pereira thought that there was a role for middle-income countries such as Brazil in providing aid to poor countries in its neighbourhood, like Bolivia and Paraguay. Kenen thought that there was a need to talk about corruption but not only from the perspective of developing countries, but to acknowledge that corruption was a rich country problem as well. Vinita Watson thought that there was a need for technical assistance to developing countries to enhance their ability to better participate in the Doha Round and that additional resources were needed to help Africa reach the MD goals. She also noted the importance that multinational corporations needed to be good citizens in the poor countries and behave in these countries following the norms that they were expected to follow in their own countries of origin. Robert Gray thought that access to local capital markets maximises the impact of foreign direct investment and he asked why the World Bank was not allowed to lend at the sub-national level. He thought that if it were able to do so it would encourage public/private partnerships.

Boorman noted that China was not a model of good governance when it began to attract foreign direct investment. Foreign direct investment came because it was a very large and growing market. Africa could do more to broaden its local markets. The continent was

simply too fragmented; there were too many internal restrictions which posed obstacles to the growth of FDI from the outside. Richard Samans thought that the World Bank was only using half of its capital. The Asian Development Bank had not financed a single project in the area of infrastructure in the last several years. The International Finance Corporation, on the other hand, could not cope with the demands being made on its resources. There was, therefore, scope for insurance and securitisation mechanisms in the operations of the international financial institutions, as a means of better leveraging the development process. There was a dearth of good projects for financing in infrastructure, suggesting the need to build a pipeline of such projects.

Crisis prevention and resolution

Atish Ghosh made a presentation on the design of IMF-supported programmes, with particular emphasis on the objectives pursued by these programmes, the analytical frameworks underlying their design and the extent to which the specific content of macroeconomic and structural policies relate to the original programme goals. He said that there were three main types of IMF programmes. First, we have the “classis” type, where the primary goal is to address current account imbalances and restore reserves to a sufficiently comfortable level, often to give confidence to investors. In these programmes growth follows a U-shaped behaviour, picking up in later years, while there tends to be a significant improvement in the external position.

The second type can be called “capital account crisis” and the primary goal is “to reverse the impact on growth and inflation that follows the loss of external private financing.” Growth is V-shaped, with a sharp contraction in the year in which private flows are lost. The evidence suggests a quick turnaround for growth and an improvement in the reserve position. Finally “poverty reduction” programmes try to introduce reforms specifically aimed at boosting growth and reducing poverty, while securing macro stability. Growth performance in these programmes has been much weaker (“growth does not suffer” is about all that can be said for them), although investment tends to pick up over the life of the programme, while the current account deteriorates. Two areas identified by Ghosh where improvement was needed in programme design were: the tendency of Fund staff to be systematically overoptimistic about medium-term growth projections and the fact that external adjustment tends to be sharper than initially projected.

Nouriel Roubini and Brad Setser made several interesting points in their discussion on the responses to financial crises in emerging economies. They highlighted that the origin of crises was not always the same, with the currency, the banking sector, the corporate sector and sovereign debt playing varying roles. Currency crises often led to payments crises as well. Policy adjustments and financing were the main components of crisis resolution and bailouts tended to be partial in nature. In many of the recent crises the IMF had played the role of “proxy for lender of last resort”, by financing a temporary reduction in private sector exposure to the country in question and by allowing the monetary authorities to meet the rise in foreign currency coming from residents and non-residents. They identified three major waves of crises over the past decade: Mexico; Asia, Russia and Brazil; and Turkey, Argentina, Uruguay and Brazil again.

All of these countries had received some form of bailout, although with important differences in terms of amounts announced versus amounts actually lent, the speed of repayment, and the impact on private creditors. Their study of these crises had led Roubini and Setser to propose some principles for crisis resolution: it was essential to link the size

of financing to commensurate policy adjustments; it was desirable to match the financial response to the type of crises—different roles were required, some involving lender of last resort behaviour on the part of the IMF, others entailing assistance in a process of debt reorganization, for instance. The IMF's preferred creditor status should be preserved. However, the IMF should set more realistic access limits and, on occasion, it should be willing to finance a domestic lender of last resort. Last but not least, the IMF should not be used by large creditor countries “to save countries that are strategically too important to fail.”

