PROSPECTS FOR THE MULTILATERAL ECONOMIC INSTITUTIONS*

Anne O. Krueger

One of the things of which I am most proud, as an American, is the way the United States led the world in seeking a suitable international economic framework for the post-Second World War period. Instead of using its undoubted economic power for its own short-term advantage, the U.S., along with the United Kingdom and other allies, pressed for and agreed upon multilateral economic institutions.

The International Monetary Fund (IMF) and the World Bank were conceived in the early years of the war, and their Articles of Agreement were set at Bretton Woods. The International Monetary Fund was intended to provide the international coordination of monetary and exchange rate issues across countries that would, it was hoped and expected, prevent a recurrence of the financial autarky and competitive "beggar-thy-neighbor" exchange rate policies of the 1930s. The World Bank, initially called the International Bank for Reconstruction and Development, was intended - as its name implies - to provide an official agency for long-term capital flows from capital-rich countries to those undergoing reconstruction or development.

During all the preparation for Bretton Woods, it was anticipated that there would be a third pillar to the international economy: a multilateral international organization, with status similar to that of the World Bank and the IMF (as specialized agencies with their own management and budget within the United Nations system). That was to be the International Trade Organization (ITO), which would provide coordination for international trading arrangements. For a number of reason, the charger for the prospective ITO was not drawn up until after the end of the war: and Congressionally-mandated Presidential authority for fast-track legislation (under which U.S. tariff negotiators could negotiate for cutting U.S. tariffs by 50 percent) expired the end of 1947 before the ratification process for the ITO articles could begin. However, part of the ITO charter was a series of commitments to an open multilateral trading system. This part was hastily adopted by Executive Decree in the United States in order to enable a first round of multilateral tariff negotiations in Geneva prior to the

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expiration of fast track authority in the U.S. That part, known as the General Agreement on Tariffs and Trade (GATT) did not form the basis for an international organization. GATT was, at best, a secretariat to the signatories to the agreement.

Nonetheless, in one form of another, the postwar era began with the inauguration of three major economic multilateral agencies: the IMF, the World Bank, and the GATT. The IMF was charged with "surveillance" of countries' policies, and IMF members were expected to commit to "fixed, but adjustable" exchange rates. This so-called "Bretton Woods" system was intended to permit devaluations in cases in which IMF officials deemed that there was a "fundamental disequilibrium" in exchange rates, while at the same time insuring against a repeat of the competitive devaluations of the 1930s. The IMF began its surveillance in the late 1940s, and the Bretton Woods system served the international economy remarkably well: although there were occasional exchange rate adjustments among the industrial countries (France 1968, and German appreciation in 1970, for example, not to mention the British pound), exchange rates were fixed for most industrial and developing countries throughout the 1950s and 1960s, and the international economy grew spectacularly. Exchange controls were first relaxed and then removed, as countries moved toward first current account, and then total capital mobility (It is often forgotten that, as late as 1958, only four countries in the world had convertible currencies under Article VIII of the IMF).

At the same time, the World Bank developed into the "premier development institution" in the world. Although it did extend loans for reconstruction (most notable in Japan), the postwar European and Japanese economic successes reduced the need for reconstruction lending and, by the 1960s, the World Bank's lending was almost entirely for development purposes.

Meanwhile, the initial round of multilateral tariff negotiations under GATT, and several subsequent rounds, began to reduce tariffs dramatically. Although there was no international organization, the "virtuous circle" of economic growth, making trade liberalization easier, spurring still more economic growth, contributed, along with international financial stability, to an era unprecedented in world economic history for sustained economic growth.

To be sure, developing countries were not full partners in this growth, although they benefited enormously from the rapid expansion of international trade and the

increased access to markets that the removal of exchange controls and tariff reductions permitted. Most of them - not including Korea - relied on import substitution industrialization to achieve growth and were increasingly isolated from international markets.

But for present purposes, the GATT, the IMF, and the World Bank were all established as successful and important international economic institutions by the early 1970s. The world had witnessed the most rapid economic growth of any quarter century in its entire history (and a greater percentage increase in world GDP than had occurred in the entire 19th century), and all three institutions were perceived to have contributed and played their roles well. Indeed, by the early 1970s, the United States as a deliberate policy choice, began scaling back its own bilateral foreign aid program to rely more on the World Bank for leadership in the development field.

At the pinnacle of its success, however, a number of factors served to undermine the system. For present purposes, it suffices to highlight two: the Vietnam-War-induced inflation which began in the United States in the late 1960s and undermined the dollar price increase of 1973 which dramatically altered the terms of trade for oil importing and oil exporting countries.

With the American inflation, fixed exchange rates were no longer a viable option, and by 1973 the major currencies of the world (except the yen) were floating vis-à-vis each other. At the same time, the oil price increase led to significant imbalances in a number of developing countries, especially in oil-importing ones with overvalued exchange rates and high walls of provide a basis for future growth.

Another significant event in the early 1970s was the oil price increase and its aftermath. When oil prices increased four-fold, many oil-importing countries found themselves incurring current account deficits that they could not quickly reduce to a sufficient degree without major economic disruption to their domestic economies. Meanwhile, private western banks found themselves in receipt of large deposits from oil-exporting countries. In part because these banks had already had excellent experience with Korea as a borrower on private international capital markets, the western banks "intermediated" between the oil importing developing countries and the exporters. Consequently, during the 1970s, long-term private capital flows to developing countries rose dramatically.

Until the second oil price increase, however, increased borrowing did not mean increased debt-service ratios, for a variety of reasons. But, with the second oil price increase and consequent recession, the first world "debt crisis" came about, as interest rates on outstanding debt rose dramatically and the prices of primary commodity export fell sharply. Both the IMF and the World Bank turned their attention to the needed adjustments in developing countries. But, at the same time, something interesting had happened: the World Bank, which had been the source (along with bilateral aid flows) of most long-term capital for developing countries, had been eclipsed by the magnitude of private lending.

Hence, the IMF had essentially lost its role as an arbiter of the global exchange rate regime internationally in the early 1970s; by the early 1980s, the outstanding volume of indebtedness and debt-serving obligations due to private creditors overwhelmed the capacity of the IMF and the World Bank to mediate international capital markets single-handedly.

Independently, the GATT - whose successive earlier rounds of multilateral tariff negotiations and been so success and contributed so heavily to sustained rapid growth of industrial countries - was also coming to be confronted with a challenge. After the success of the Tokyo Round, ministers met in Geneva to consider next steps for the GATT. For a variety of reasons, no decision to go ahead with a new round was taken, and the US Trade Representative, believing that the multilateral path to global free trade was blocked, announced that the U.S. would abandon its traditional commitment to the open multilateral system to the extent to being willing to enter into negotiations with "like-minded free-trading countries" to former free trade agreements (FTAs) among themselves, and that henceforth the U.S. approach to trade policy would be "two-track", with multilateral agreements where possible but FTAs when multilateral progress appeared blocked.

At first, and then after the Uruguay Round was launched, the USTR announcement seemed to have had little practical impact. But, 1n 1987 the Canadian government indicated its willingness to pursue an FTA with the United States, which was favorably received in Washington. Even before the FTA had become fully effective, Mexico followed suit, and the North American Free Trade Agreement (NAFTA) was negotiated.

Subsequently, the fall of the Berlin Wall and the need for former Comecon countries to secure visible trading arrangements led to a rapid increase in the number of FTAs and customs unions in effect. Of all the major trading nations, only Japan did not belong to at least one trading bloc by the mid-1990s.

The emergence of PTAs and the move toward preferential trading arrangements constituted and constitutes a significant challenge for GATT whose founding principle was the open multilateral trading system. It was hoped that this issue could be addressed in a new round of multilateral trade negotiations, but the failure of the Seattle meetings late in 1999 to launch a new round meant that the challenge to the WTO was two fold: on one hand, there seemed to have formed an international alliance against "globalization", and on the other hand, progress in trade liberalization threatened to stall if a new round were not started. Subsequently, the same sorts of demonstrators appeared at the spring meetings of the World Bank and IMF at the Interim and Development Committee Meetings in Washington.

Hence, at the present time, all three multilateral economic international institutes are under threat. This is unprecedented in their history: when the World Bank was apparently diminishing in importance in the late 1960s, a vibrant Fund and the success of the Tokyo Round meant that the other two institutions were in very good shape. When the IMF was realigning its role in the mid-1970s, the World Bank was being greatly expanded and assuming a greater role in the economic policies (through Structural and Sectorial Adjustment Lending) of developing countries. And, in the mid 1990s, when criticisms of the Bank and Fund seemed to be growing more strident, the Uruguay Round was finally completed successfully and in the agreement the World Trade Organization (WTO) was formed, thus permitting the multilateral trading institution to rise to the same status as an international organization as the Bank and the Fund had and as had been envisaged by the Bretton Woods architects.

For each of the three agencies, three are a number of specific issues which have given rise to criticism. In what follows, I outline the major issues confronting each agency in turn. But, in addition, there are systemic issues affecting all three, including the apparent backlash against globalization reflected in the Seattle and subsequent demonstrations an the inability of the member countries to come to closure quickly when choosing heads for the international organizations. After discussing the issues

affecting each individually, I will address to those systemic issues.

The World Bank

Until the late 1970s, the World Bank was almost exclusively a project lending institution. It not only helped finance, but also often provided guidance in organizing large infrastructure projects in irrigation, roads, ports, railroads, telecommunications, and other projects vital for the success of individual industries. To be sure, in its early days it went further and even supported activities more traditionally found in the private sector, such as lending in support of tourism or industry. But those activities were being phased out by the 1970s as it became evident that State-Owned Enterprises (SOEs) were not generally able to carry out these sorts of entrepreneurial functions without high costs.

Nonetheless, Bank staff came to recognize that projects - in sectors such as agriculture (such as research and extension), power generation and transportation - had much lower real rates of return, and provided fewer benefits to communities in circumstances in which the overall economic policy framework was inappropriate. Increased irrigation capacity, for example, had a far higher payoff in circumstances in which agricultural prices did deviate too far from world prices. Thus, the World Bank's focus on Structural and Adjustment Lending was designed to assist in providing a framework for higher and more rapid returns to the Bank's traditional core competence in project lending. This shift was widely welcomes, as it became evident that real returns on investment were considerably lower in countries where the overall policy framework was not conductive to satisfactory economic growth.

By the rate 1980s, however, this focus spilled over to major question of macroeconomic policy, which was admittedly also important for the prospective real returns on projects and for overall economic growth.

The change in relative emphasis toward recognition of the importance of the policy framework - the Bank still engaged in a great deal of project lending - was at first clearly a desirable shift. As time went on, however, several things happened: first, the overlap of functions with the IMF clearly increased significantly, given the IMF's focus on macroeconomic adjustment in developing countries. Second, many of the middle income developing countries grew to a point where their own engineer and economists

could devise and seek finance for projects and indeed, could manage their own macroeconomic crises arose (as in Mexico in 1994, Russia and the Asian countries in 1997), the Bank as well as the Fund become involved in crisis lending. Many observers asked how the World Bank's mandate spread to lending into crisis, and, in addition, questioned the overlap in jurisdiction between the Bank and the Fund. (There had earlier difficulties with conflicting viewpoints during the 1980s, which came to a head over policy toward Argentina. These issues were - at least temporarily - subsumed by agreement that the Bank and Fund would have joint "country framework papers" which set forth the viewpoint of both institutions with respect to each country to which they were both lending)

However, once into the policy arena, there does not seem to have been any logical stopping point. Today, the Bank is engaged in lending for a wide variety of causes, many of which are undoubtedly worthy, but which do not seem central to Bank's core competence or core mission. Thus, there is lending for saving monuments, for supporting minority ethic groups, and for a variety of other activities where many observers question the competence of a multilateral institution, and the relevance of the concerns (or at least the concerns as expressed in the projects supported) for development prospects.

At the same time as these changes were drawing attention and criticism, a growing number of voices were heard questioning the Bank's overall budget, its level of expenditures, and the degree to which it is well managed. Despite repeated "reorganizations" undertaken by a succession of Bank Presidents, an undertone of suspicion regarding the Bank's overall management has strengthened the support for calls for change.

Growing disquiet among observers of the Bank's activities has led to a number of calls for change. Proposals have been made to close down the Bank; to move it back to its project lending basis and to restrict its activities primarily or entirely to very poor countries; and, of course, to enlarge its scope. At the same time, environmentalists have called for more stringent environmental standards for Bank lending, advocates of labor standards have pushed to have the argued that the Bank should not lend unless other preconditions were met, and so on. A significant issue has arisen as the Bank has attempted to these demands, as non-governmental organizations (NGOs) have been accorded increased access to Bank decision-making.

In the United Sates, partially in response to these conflicting pressures, a bipartisan Commission, chaired by Professor Allan Meltzer, was appointed to examine the roles of the Bank and the Fund, and to recommend changes that might enable them to increase their effectiveness. With respect to the Bank, the Meltzer Commission recommended that the Bank restrict itself to lending (primarily on projects) to poor countries, and to move away from its efforts to cover all new concerns.

In a sense, one could summarize the current situation by saying that the Bank is caught between the pressure of NGOs to be all things to all people, and the realization on the part of many that is far away from the Bank's initial purpose. But the group rejecting the NGO direction is itself split, in part because of perceived excessive administrative costs, as mentioned earlier, and in part because of the extent to which the Bank has attempted to address every new issue. The ultimate decision as to the Bank's future role must, of course, be made by the member governments who constitute the owners of the Bank. Those same governments are, of course, also owners of the IMF and comprise the decision-making unit for the WTO. The political currents and cross-currents that affect the entire globalization debate and as reflected in the Seattle debacle, as well as other cross-cutting issues, are a significant factor in affecting the Bank's fate. I return to these issues at the end of this talk.

The International Monetary Fund

Whereas the Bank lost some of its function - of providing capital flows to developing countries in the absence of a well-functioning private capital market - when private capital flows rapidly gained in importance in the 1980s and early 1990s - the IMF lost its original mandate when the United States and Europe began permitting their currencies to float. The world of "fixed-but adjustable" exchange rates, at least among industrial countries, largely disappeared.

But as it became increasingly evident that many developing countries had severe macroeconomic problems, it was natural for the IMF to focus on issues of structural adjustment in developing countries with emphasis on macroeconomic stability, exchange rate policy, and the balance of payments. This attention was, in any event, much needed after the worldwide inflation (which was worse in developing than in developed countries) that was triggered by the events of the 1970s. When the IMF's focus turned almost exclusively to developing countries' macroeconomic difficulties in

the 1970s, the World Bank was still almost entirely a project lending institution. Over time, of course, the Bank's activities moved closer to those of the Fund, and the overlap in the institutions' apparent activities increased. The IMF retained exclusive domain with regard to exchange rates, but issues such as tax reform, fiscal consolidation, financial sector liberalization, and liberalization of trade regimes were increasingly addressed by both Bank and the IMF.

In the debt crisis of the 1980s - which, it will be recalled, was the first time that developing countries' official debts to private creditors greatly exceeded liabilities to the IMF and other official agencies - the IMF played a key role in coordinating necessary debt-rollovers on the part of the private sector with the receipt of new money from official sources. Without such a role, there was a serious danger - if not a certainty - which any monies lent by the IMF, would promptly be offset by claims for repayment on the part of private creditors.

In the 1980s, however, the debt crisis did not greatly threaten the banking systems in developing countries. While private lending to governments had taken place, the capital Accounts of most developing countries' balance of payments were still closely controlled, and a traditional IMF package entailing domestic credit ceilings, ceilings on sizes of the public sector deficit (or borrowing requirement), exchange rate (and sometimes interest rate) adjustments, and debt rescheduling could usually suit the purpose. With such packages, speculative capital outflows were normally rapidly reversed, and a resumption of export growth and drop in import demand usually led to fairly rapid improvement in current account deficits.

In some of the crises of the 1990s, however, some countries had attempted to maintain their nominal exchange rate at non-market determined levels, while simultaneously permitting individual borrowers to accept liabilities denominated in foreign exchanges. When these policies combined with rapid rates of increase in domestic credit (as they did in Mexico, Indonesia, Thailand, and Korea) and commitments to repay denominated in foreign currency, the mix was explosive. Non-performing loans (NPLs) resulting from the rapid and indiscriminate increase in domestic credit in the domestic banking systems had already weakened domestic banks considerably: increases in the prices of foreign exchange served to increase liabilities and hence to weaken the banking systems still further.

In these circumstances, the IMF had little choice (and almost no time) but to attempt support while at the same time seeking to address the underlying causes of the crises. These causes, in turn, lay deep in domestic policy: prudential supervision (normally inadequate) of the domestic banking system, issues of corporate governance, and related domestically politically-sensitive issues were all necessarily fool of attention for IMF conditionality.

These sorts of crises raised a number of new issues. Chief among them was the difficulty associated with simultaneously addressing a balance of payments crisis (resulting from excessive borrowing abroad at earlier dates) and a financial crisis. Addressing a balance of payments crisis typically calls for an increase in the price of foreign exchange of sufficient magnitude to still protectionist pressures and a tightening of monetary and fiscal policy. By contrast, addressing a financial crisis entails loosening monetary (and probably fiscal) policy and making money easy, with interest rates low. Currency depreciation only intensifies on debtors with foreign currency denominated assets.

Thus, the policies that can serve to correct a balance of payments crisis intensify a financial crisis and vice versa. Moreover, while both crises require imminent action, the very fact that financial restructuring necessarily takes time as the assets of the banking system are sorted out, often with financial restructuring of private entities implies that financial restructuring cannot be addressed as a "first generation" reform.

But for present purposes, the more salient set of issues surrounds the measures necessary to deal with financial crises. Removal of bad paper from the banking system, establishing the necessary prudential supervisory arrangements, and restructuring corporate finances all inevitably require time. While there are excellent reasons to go as fast as possible, the necessary measures cannot be taken overnight.

And in both financial and balance-of-payments crisis management, of course, there are judgment issues. Permitting greater exchange rate depreciation permits a smaller tightening of the money supply (and may reduce speculative attacks on a currency sooner). But exchange rate depreciation deteriorates bank's balance sheets more than does an increase in the interest rate, which, at least initially, increases the debt-servicing obligations of borrowers without a commensurate immediate balance-

sheet impairment. One crucial variable is the amount of domestic government debt (when there is more domestic debt, a larger exchange rate change is warranted than when foreign debt is relatively greater) relative to debt denominated in foreign currency.

These issues have been analyzed and examined extensively in the wake of the Asian crisis. But at the time of those crises, they were not well understood. Criticisms of the Fund were directed at the extent to which it tightened monetary and fiscal policy, which in fact is absolutely essential to calm foreign exchange markets. While both financial and balance-of-payments issues had to be addressed, it was - to use a medical analogy - necessary to stop the bleeding of foreign exchange before addressing the longer-term issues of the health of the circulatory (financial) system.

Some critics of the Fund have argued that the Fund should not be involved in financial deregulation, issues of prudential supervision, and so on. But as long as there is foreign currency debt which tips the bank's balance sheets at times of exchange rate changes, a financial reform package must necessarily follow before growth can resume.

A number of measures can make the likelihood of financial-cum-balance-of payments crises less likely. First and probably most important, there seems to be an emerging consensus that small open economies must either permit their exchange rates to float fairly freely or they must irrevocably fix (via dollarization or perhaps currency boards) their exchange rates. The Bretton Woods solution, of fixed-but-adjustable exchange rates, stopped working for industrial countries by the 1970s, and for developing countries by the late 1990s. Second, some of the BIS criteria for capital adequacy requirements can be changed to reduce incentives to lend short terms, and to recognize that short-term debt may be more risky than long-terms debt. Third, individual countries can work to achieve better incentives for banks to achieve safe portfolios as well as to provide appropriate prudential financial and bank supervision. Finally, any country desiring to prevent a combination of financial and balance of payments crisis could insist that domestic nationals may not longer incur foreign-exchange denominated obligations. This is not the same as capital controls: it would require only the refusal to enforce contracts denominated in foreign exchange in domestic courts.

Nonetheless, no set of measures can completely rule out the likelihood of a future financial balance-of-payments crisis. Proposals for reforming the IMF include a

"preapproval" facility under which the IMF would certify that a country's economic policies were "sound"; such certification would ensure that, if a crisis did occur, IMF lending would be automatic. The intent of this proposal is evidently to cut down the risk of speculative attack; in fact it can be questioned whether "preapproval" would not become politically motivated, an issue I shall return to in concluding these remarks.

The Meltzer Commission has proposed a reform of the IMF along these lines that would, in fact, be fairly stringent; the Commission proposed that the IMF become a lender of last resort, lending only in cases of crisis and only to a few preselected countries at high interest rates for a very short period of time. Most critics (including the United States government, and especially the U.S. Treasury) have regarded these proposals as too draconian, pointing out that Thailand would have had to repay its IMF debt within a very few months had the proposed policies been in place, and that many countries would have no foreign assistance in the event of crisis under the Commission's rules.

The Meltzer Commission and others have, however, rightly in my judgment, criticized the IMF's apparent spread of activities to cover such things as "anti-poverty" programs and other long-term development issues. Its proposal that the IMF should leave these issues to the World Bank, which in turn should focus primarily on very poor countries, makes a great deal of sense.

The World Trade Organization

As already mentioned, preferential trading arrangements (PTAs) were coming into vogue throughout the 1990s. By 1995, the WTO listed 105 PTAs of which it had been notified.

At the same time, however, the trend toward liberalization of trade rendered the GATT more important than ever, a fact which was recognized in its transformation to the WTO in 1995. In the Uruguay Round agreement (which came into effect in that year), not only was the WTO formed (incorporating the GATT articles as one part of its charter), but services trade was added to the domain of the WTO, an agreement was reached to dismantle the Multifibre Agreement (MFA), and the dispute settlement mechanism of the WTO was considerably strengthened. Issues remained especially with regard to liberalization of agricultural trade, bringing anti-dumping and

countervailing duty measures less susceptible to capture by protectionist interests, further progress with respect to agriculture, and increasing the resources of the WTO.

When it was agreed to hold a Ministerial meeting in Seattle in November 1999, it was anticipated that delegates could agree on an agenda for a new round of negotiations which could make progress on these issues. To be sure, some of the issues were very difficult, and it was expected that, consistent with past practice, a few topics would be left for working parties to resolve in the aftermath, of the meetings.

In the event, as is well known, the Seattle meetings were adjourned with no agreement. There is dispute as to the precise reasons for the failure: insufficient preparatory work had been done so that there were almost no elements of a communiqué agreed upon ahead of time; the U.S. administration was in its final year and it seemed, even ex-ante, inappropriate for trade issues to be brought to the fore of the agenda when the U.S. administration could not even get fast-track legislation through Congress (Which is necessary if there is to be a Round); and there were a number of other organizational decisions which were questionable.

But, to the surprise of almost everyone, there were very large demonstrations and protests against "globalization" at the time of the meetings. These protests certainly disrupted the meetings and gathered headline. In fact, the protesters also gathered in Washington at the same of the Fund-Bank Interim and Development Committee Meetings in April. The issues concerning the backlash against "globalization" affect all three international institutions (and much more) and are discussed in the final section.

For the WTO, the critical issues relate to getting agreement for starting a new round, in circumstances where there is a realistic change of moving forward on the issues mentioned above. Although there are some supporters for attempting to start a launch this year, it would appear more realistic to await a new U.S. administration in January before so doing. When they do so, it will be vital that countries with a keen interest in the open, liberal, economy, be prepared to support the round, even accepting issues on the table which are perceived to be politically difficult. It is clear that the U.S. will not go forward without consideration of agricultural and services issues; simultaneously, many developing countries have major concerns regarding agriculture and labor-intensive manufactures. For Europe and much of Asia, the primary issue

must surely be the importance of maintaining momentum for trade liberalization and preventing the rollback of liberalization already achieved. In addition, measures to curb AD and CVD abuses, to increase the likelihood that PTAs are trade-creating and not trade-diverting, and to achieve strengthened dispute settlement mechanisms (possibly obliging third countries to join the plaintiff in imposing trade penalties when the WTO panel finds that its rules have indeed been violated) are issues that should be of concern to all trading nations.

The Overarching Questions

So far, I have discussed the issues of concern for each of the three major multilateral economic institutions. There are, however, at least two - closely related - issues which concern all three, as well as affecting the overall global economic environment. These concern the ways in which national governments use and/or abuse their political influence within the organizations, and the extent to which the "globalization" backlash can negatively affect all three institutions.

Turning first to political pressures, it has always been true that governments have sought to have the three multilateral institutions undertake actions they perceived to be in their self-interest. These pressures have been on a whole range of issues: pressures for support (or nonsupport) of countries deemed vital for foreign policy reasons; pressures for or against individual loans because of domestic constituent pressures; and pressures to seek favored treatment of domestic nationals in the multilateral institutions.

Examples of pressures for support or non-support of countries include U.S. pressures on the IMF and World Bank to lend to Argentina prior to the democratic elections in 1989 despite the fact that the country's macroeconomic policies were clearly not conducive to supports and strong pressures by the American and European governments to lend to Russia in the mid 1990s despite the obvious failures of economic policy. France has been enthusiastic in support of lending to countries in the French-speaking parts of Africa; the U. K. has sought and enthusiastically supported lending for some of its commonwealth associates, and so on.

While all of this is understandable, its cumulative impact is to deprive these same governments of a very useful instrument for particular ends: technocratic support

of policy reforms and project lending conducive to economic growth. For once the World Bank and the IMF loans are seen to be the result of political pressures, the degree to which these institutions' policy prescriptions and advice can be respected and seen to be based on apolitical technocratic wisdom is diminished. As that happens, the usefulness of these institutions, as an arms-length mechanism for achieving policy reform, where issues are often domestically intensely political, is diminished.

It is probably incumbent on mid-size countries, whose stake in the global economy is largest, to continually bring pressures to bear to keep the processes of the Bank, Fund, and WTO as free from political pressures as possible. No single act will achieve this, but in the absence of countervailing pressures from countries with strong interests in the multilateral process, political pressures will be even worse.

The second issue of politicization concerns the appointments of staff, and especially of the heads, of the three institutions. One reason why the Bank and the Fund have been perceived to be more successful than the United Nations is that the Bank and Fund have been able, at least to a considerable degree, to insure that selection and promotion of staff is based on merit, and not on nationality. To be sure, any international organization that does not have a staff broadly representative of its nationalities cannot do its task, and the Bank and the Fund have always been sensitive to the broad demographics of their staffs. But, at the staff level, protecting this is essential: nothing can destroy the professionalism of any organization more rapidly than to have prospects for advancement dependent on nationality, rather than merit.

Recently, the problem of politicization has become even more serious at another level: that of selecting the heads of the multilateral economic organizations. When the time came for selection of a new Director-General for the WTO, a deadlock developed, and it took months-at the time when the communiqué for the new round of trade negotiations should have been being worked out-to reach a compromise under which two persons would each serve as Director General for half of a normal term. The costs of the deadlock, in terms of the lost opportunities as well as in the sad spectacle of countries pushing for their own candidate without regard to their leadership abilities or other issues, cannot be estimated. And, indeed, it can be argued that leadership of any of the multilateral institutions is so complex that it requires a year or two to learn the job; insofar as two persons each have three-year terms, their combined effectiveness must be considerably less than that achievable under one person with a

longer term.

More recently, the same issue has arisen with regard to the Managing Director of the IMF. In that instance, most observers thought that the best candidate was an American citizen, but he was ruled out because of his nationality; it had long been understood that an American would head the World Bank and a European the IMF, Again, the process was long and drawn out. There was little, if any, discussion of qualifications of alternative candidates, and certainly relative merits ware not the deciding criterion.

It is obviously difficult, if not impossible, for a public betting of potential candidates. It would be possible, however, for the governing bodies of the relevant institutions to establish some sort of search committees when top jobs become open. These committees could receive the list of qualifications needed for the job form the governing bodies, accept nominations, and then vet candidates, finally providing a "short list" of candidates deemed most meritorious to the governing body in question. Such a process could do much to legitimize the new appointee, and at the same time, could preclude the sort of debacle that arose over the IMF position. Alternative procedures can also be imagined, but the fundamental point is that a mechanism needs to be found to insure that very high quality people are selected for these demanding jobs.

The final issue of concern is the apparent backlash against "globalization". This backlash appears particularly strong in the United States, although it does not appear to be a significant issue in the Presidential election campaign to date. It is disturbing both because it occurs at a time when the American economy is booming (and therefore discontent should be low) and because the real sources of discontent are not evident. Much of the rhetoric seems to have little basis in fact: "globalization" is said to be causing insecurity; to be despoiling the environment; to be harming, in the American case, U.S. workers. The facts do not seem to bear these contentions out: average length of tenure in American jobs is about the same as it always has been; by most measures, the environment in the United States is in significantly better shape than it was twenty years ago, which in turn represented a significant improvement over earlier decades; and the U.S. unemployment rate is hovering at around 4 percent, a figure well below that realized at any time in the past three decades. Even the tendency for increased disparities between wages of skilled and unskilled appears to have diminished, if is has not disappeared, and real incomes appear to have been rising for all segment of

American society, even without correcting for biases in estimated rates of inflation which understate improvements in living standards.

Many of the demonstrators in Seattle represented "single-interest" groups in non-governmental organizations (NGOs). Those organizations, supporting a particular cause (such as planned parenthood, saving west coast forests, helping children in a particular poor country), are often extremely well intentioned, and effective in improving well-being in their particular areas of concern. But they are not governments, which by their nature must reconcile conflicting claims for scarce resources. When each NGO is convinced that its own cause is paramount, the lack of perspective on the overall issues driving the world economy is evident. This seems to have been the case in Seattle, and later in Washington.

It is to be hoped that recovery in East Asia and especially Japan, and in Europe will serve to mitigate much of the "globalization backlash" that has become evident in the past year. If recovery takes place in those economics and the U.S. economy continues to grow, albeit at rates below those of the past year or so, it can be hoped and expected that these demonstrations will diminish in importance or disappear. The real concern should probably center on the possibility of a serious slowdown in the United States before the recovery in Europe and Asia has gained sufficient momentum: in that case, support for the protesters might well increase.

As of June 2000, the American economy continues to amaze all, and there are signs of a slowdown in which a "soft landing" will take place. This is much to be hoped. Even if it is, however, issues regarding the futures of the three multilateral economic organizations will need to be addressed, and much greater support - especially from medium- sized open economies - will be needed to assure a healthy future growth of the international economy.

Q & A

Q: What should be the IMF's role in coordinating exchange rate policies of advanced countries, i.e., a dramatic yen-dollar movement in the 1990's? There is also a wide-spread perception that the IMF protects the interests of lenders from advanced countries at the expense of borrowers of the developing countries (lender's moral hazard problem). How should the IMF address its credibility problem?

A: Private financial institutions can obviously provide a lot of lending and financing for almost all purposes in Korea, Taiwan, and Southeast Asia. By the time one gets to some forgotten parts of the world, i.e., sub-Saharan Africa, no banker in his right mind will extend capital flows into that country. The same is true for much of central Asia, Nepal, Haiti and Bolivia. There are a number of countries that are so poor that the idea of private capital flows is not even considered.

I hope nobody thinks that the World Bank should be lending for individual industrial projects; those days are gone forever. However, the idea that private capital can finance infrastructure in i.e., sub-Saharan Africa is not viable. One of the things that the Bank has done very well is the designing of projects in such a way so that there was a huge training component built-in and people learned to design their own projects and so on. That confidence still needs to be enhanced in many poor countries. I would distinguish policy-based lendings that provide contacts for an individual project, where the Bank has to be involved.

From macro-economic policies in general, the Bank cannot lend to sub-Saharan Africa for a power project unless there is some assurance that the pricing of power is such that they will be able to get financial flows to maintain the project. So, in that sense, I think it should be policy-based. But it does seem to me that the overall macro framework really should be left to the IMF: it is not an area where the Bank has a lot of confidence.

What should be the role of the IMF in coordinating the exchange rate policies of developing countries? The honest answer is, I do not know. The reason is that namely, if I could design my ideal world, I would have every central bank doing its job to maintain price stability and we would have one world currency. We are not going to do that for obvious political constraints. I think, all things considered, we have about as good a set of policies on exchange rates as we can among the industrial countries. We have the Europeans trying for a single unified currency and it seems to be going relatively well.

What happens if there is a big U.S-Japan swing in the exchange rate? The fact of the matter is, it is realpolitik: if there is a problem with the Japan-U.S. exchange rate, then the U.S. and Japan will solve it. This is not going to be where the IMF will

get heavily involved in. That may not be how things should be run, but that is how it is.

Does the IMF protect the interests of the lenders more so than the borrowers? I really do not think so. It really is hard to think about the lenders in the sense of the institutions: if you think of the people who made the loans in many of those banks, those people would have lost their jobs. There is a strong incentive at the individual level. I think there is a big issue as to how to get more private sector participation when there are short falls. One can think of arrangements whereby there would be some standstill on the interest rates in the private sector until there were some sort of agreements. I can think of some such mechanisms, which may or may not be desirable. Until that happens, the real problem is that the flows of capital to developing countries have proved to be highly productive. We want to maintain an environment where those countries that do wish to access international capital markets can. Basically, we want to maintain some kind of a debt-rollover mechanism when capital outflows seem essential.

I really think that the moral hazard issue is over-done on both sides. To say that moral hazard exists on the part of developing countries in borrowing too much because they know they will be bailed-out by the IMF is ridiculous. I think there are ways to improve it, but that is not an essential issue.

I guess my answer is, look where Korea is two years later. At the time, everyone did not think it could happen. Korea was one of the most faithful followers of the IMF program and has come out very well. The country that has followed the program the least was Indonesia and it is still 12~14 percent below total GDP of what it was at the time of the crisis. Thailand is halfway back to where they were at the time of the crisis. I would say that Korea and Mexico, who have pretty much followed the IMF program, have turned around rather quickly and have done fairly well afterwards. So, where is this huge failure? I mean, if the IMF policy recommendations were so bad, how come things came out as well as they did, relative especially to the forecast?

Q: With specific reference to the Malaysian policies of capital control and loose macroeconomic policies, would you care to comment on the IMF conditionalities?

A: As best as I can figure out, I think Malaysia has a very high fraction of non-

performing loans in its banking system. And there is a lot of evidence that suggests that Malaysia is trying to fight against a massive financial crisis. Malaysia has not recovered too well and meanwhile, what they have done was postpone many of the problems that to some extent Thailand and Korea have faced up to. So, in that sense, it is way too soon to say whether the capital controls did anything. Malaysia relied too heavily on direct foreign investment, which Korea did not. Therefore, in Korea, controls on direct outflows were possible.

Q: Are there discussions on quota increase in the IMF? Is there a possibility of emergency loans that will exceed 200% of quota, or like the one Korea enjoyed at 1939% of quota in the future?

A: I think anything is possible. In fact, discussions on international financial architecture caused a lot of confusion because of this new phenomenon of the interaction of the balance of payments and financial crises. Given how well the recovery seems to be going, some of the somber second thoughts are rising everywhere. The U.S will not accept the Meltzer Commission recommendations. I think the IMF scope will be the same as it was before Korea, depending on how the executive directors are willing to vote.