

Power Shift

Do we need better global economic institutions?

Ngairé Woods
with a foreword by Hilary Benn

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List of abbreviations

ACWL	Advisory Centre on WTO Law
CPIA	Country Performance and Institutional Assessment
DFID	(UK) Department for International Development
GATT	General Agreement on Tariffs and Trade
IDA	International Development Association
IMF	International Monetary Fund
OECD	Organisation for Economic Cooperation and Development
PRSP	Poverty Reduction Strategy Paper
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
WHO	World Health Organization
WTO	World Trade Organization

Foreword

by Hilary Benn

The world is changing. We are now at the beginning of a new era, shaped by technological, economic and social progress and by global interdependence. What happens in one place now affects those of us who live elsewhere.

From climate change to international terrorism to the spread of disease to migration, no single country can solve the challenges it faces by acting alone. Nor can we consider issues in isolation: increased international migration is often a direct result of conflict, which may be in turn be the result of state failure. As we look to the future, it is clear that a deeper and more sustained multilateralism is the world's best hope for peace, progress and shared prosperity. Unilateralism will simply not cut it in the 21st century.

A deeper multilateralism will depend on better global governance. And this means reform that looks forward. The global institutions founded after the second world war have undoubtedly helped bring unprecedented stability to the world in recent decades, particularly since the end of the Cold War. This has been an enormous and unprecedented achievement we should celebrate, albeit tempered by some unacceptable failures. But we now recognise that global governance is increasingly unable to deal with the challenges we are facing today and no longer reflects geopolitical realities. As Ngaire Woods argues powerfully in this pamphlet, it is time for change.

We need a coherent and effective system of global governance for a world that is changing rapidly. Reform should be shaped by our deep understanding of the major trends. Perhaps the most obvious of these is the economic rise of China and India (among others). This global economic shift is beginning to radically alter developing countries' position in the world. We are now seeing more donors, new markets for exports and new sources of finance – often on very different terms to those offered by longer established donors. The challenge of rationalising aid flows so they go to those most in need is getting more complex.

And at the same time as responding to a changing economic and political order, global governance must also respond to emerging strategic challenges. Were we designing a global governance system now, our priorities would not be rebuilding Europe and Japan – the EU is now the world's largest donor, rather than the focus of efforts to rebuild. Nor would it be preventing the Cold War becoming a world war. The foremost challenges would be trade and investment, climate change and scarcity of resources, state failure, conflicts within states, the movement of people, international corruption, and organised crime and terrorism.

But we should not be pessimistic about the institutions we have inherited: they have served us well so far. Going forward, we need to think carefully about the appropriate role of each institution. Global *economic* governance cannot be understood or developed in isolation from changes in other aspects of governance. While the UN is unique in its ability to legitimise the international use of force, the International Monetary Fund retains a vital role in securing international financial stability, the World Bank is best placed to support developing countries in adapting to the effects of climate change and encouraging investment in clean energy, and the World Trade Organization offers the prospect – if it can reach agreement – of global trade working properly.

We need to maximise the effectiveness of the global system as a whole – ensuring that institutions are working together effectively to change things on the ground. And we need to recognise the political limits on potential reforms. I have always believed that the best politics should be both practical and imaginative: seeking the best way to make a difference in the real world.

So I welcome many of the recommendations in this pamphlet. It is a profoundly progressive contribution to our debate. There is much the author and I agree on – perhaps most fundamentally that improving global economic governance is central to development. As we set out in the Department for International Development White Paper earlier this year, we also see increased voice for developing countries and increased power for countries to take their own decisions as really important.

There is cause for optimism. We have pushed for UN reform at the highest level and are now seeing changes. We are helping developing countries prepare their case in trade negotiations, offering practical support and seconded staff.

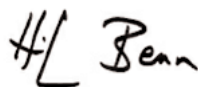
Partly thanks to British efforts, the World Bank now places far fewer economic conditions on developing countries and puts country ownership centre stage. Efforts are underway to decentralise. Although change in an organisation of 10,000 people does take time, it is undoubtedly heading in the right direction and we will continue to encourage it to do so.

The Government started the Extractive Industries Transparency Initiative (EITI), which now has more than 20 countries and most of the major oil and mining companies involved, and is already making an important difference. In Nigeria the results of the first audit of oil and gas accounts was published last year. For the first time, Nigerians now know how much money their government received from sales of oil. And if you know how much money is coming in then you can ask the next question: what have you done with the money and can you spend some of it on us?

Have we achieved all we want? No. But is this progress? Yes, it is.

We need more of it. And this will depend on two things: new ideas and public support. And as we look to the future, we have to keep asking ourselves about whether our approach to development is in fact the right one. Does it make a difference? This is why I welcome constructive contributions to debate such as this pamphlet. Democracy works best when political leaders are held to account for what they do, and I hope that I have encouraged a culture of debate in the three years I have been International Development Secretary. I also hope we have encouraged public support. Because this is how politics changes things!

Effective global economic governance may seem far removed from ordinary life. But putting global justice at its heart depends entirely on public support for international development. Because what gives political leaders the mandate and ability to take the right decisions is having people behind them. The past few years have shown just how much difference people and civil society, working with their governments, can make. In efforts to improve global governance, the one thing we cannot afford is cynicism; and the things we cannot afford to be cynical about are hope and encouragement for a better world.

A handwritten signature in black ink, reading "Hilary Benn". The signature is written in a cursive, slightly slanted style.

Rt Hon Hilary Benn, Secretary of State for International Development

1. Introduction

Over the past year, the powerful international agencies – the World Trade Organization (WTO), the International Monetary Fund (IMF), and the World Bank – have been emasculated. The WTO has been swept aside as multilateral trade talks collapse. Root and branch reform is being proposed for the IMF and the World Bank, most recently by the world's 20 most powerful finance ministers, because the institutions lack 'legitimacy and effectiveness' (G20 Communiqué 2006). Bypassed by global capital markets and unpopular for imposing tough conditions on poor countries, the IMF is in search of a new role. Meanwhile, the World Bank is curiously marginal to the plans of major donors who are talking of massively increasing aid to Africa and elsewhere.

Do we no longer need these agencies? Perhaps globalisation is fashioning a world in which these institutions are redundant. Not so, according to history. This is not the first era of globalisation. After decades of exuberant expansion of global trade and investment in the 19th century, the process collapsed in the 1920s and 1930s. The crash was driven by political fears and a crisis of confidence in the meagre international institutions that then existed to manage global trade and investment (James 2001). One contemporary lesson from that experience is that effective international organisations offer the equivalent of road maintenance and effective traffic rules to the global economy. The other lesson for today's policymakers is more political. International institutions influence the fears and aspirations of societies and in this they are crucial to managing globalisation.

Without effective international institutions, there is a real risk that the global economy will descend into accidents, chaos and gridlock. We get glimpses of this when the rules and processes we do have break down – even temporarily. Container-loads of underwear made in China lay in ships off European ports in 2004 in a case of trade gridlock. Millions of Argentinians were plunged into poverty for the first time in their lives by their country's financial crisis just a few years ago (Blustein 2006). Political chaos in Argentina highlighted the fact that market failures do not just create economic costs. They have an important social impact too. They exact a political price, feeding resistance to globalisation and a backlash against policies and institutions that facilitate it. In some ways, people are right to fear globalisation.

While globalisation proceeds apace, extreme inequality within and among countries is persisting. Within countries, inequality is rising. Having fallen for many years before 1950, it has risen since 1970 (Bourgignon and Morrisson 2002), and between 1988 and 1998 national inequality rose substantially (Milanovic 2004). Data from the UN Millennium Project shows that while some 80 per cent of the world's population lives in countries in which inequality is rising, only 4 per cent of the world's population live in countries in which inequality is narrowing (UNDP 2005, 55).

Similarly, the gap between rich and poor countries also seems to be widening (Pritchett 1995). Although population-weighted studies tell the opposite story (Bourgignon and Morrisson, 2002), if China and India (comprising around 40 per cent of the world's population) are excluded, even these studies show that inequality among countries is increasing. This is most obvious in Africa. Collectively, African countries' share of world trade collapsed from 6 per cent in 1980 to less than 2 per cent in 2002. Globalisation is having a highly uneven impact.

Perceptions of globalisation are also diverging. In rich countries' capitals, policymakers speak of freedom, liberty and the new opportunities arising from globalisation. Meanwhile on the streets of a globalising world, globalisation is associated with rising inequality, injustice, and disrespect for local culture, tradition, and faith.

International institutions should in theory be helping to bridge this gap. Instead, they seem to be magnifying it. A small group of rule-making countries have run the major economic institutions, setting the rules for a much larger group of rule-takers. The institutions we have reflect a world as it was in 1945, with too little accommodation of the subsequent revolutions of decolonisation, the end of the Cold War, and the rise of beliefs in democratic and accountable governance.

Reform is in the air. It is widely recognised that the WTO needs to open up to give its poorest members more access to the informal processes of negotiation and rule setting. Similarly, in the IMF and World Bank, more votes are being given to emerging economies and discussions are underway about how to give the poorest countries more voice at the decision-making table. The assumption is that these reforms will give each institution more legitimacy and enable it to be more effective.

But are these reforms enough? This essay examines why the world needs institutions to manage trade, money and development assistance. It assesses how well the agencies we have are currently performing, and suggests how they could be made more effective. The World Trade Organization (WTO), the International Monetary Fund (IMF), and the World Bank are widely seen as the most powerful organisations of global economic governance. Yet each is falling well short of the role it might play in better managing globalisation.

2. Beyond market failure: what should we expect of global institutions?

What should international institutions do? Economists tell us institutions are necessary to deal with market failures (Stiglitz 1989). For example, regulation is required to prevent monopolies strangling open market competition, or to reduce pollution, or to promote education.

Most conspicuously in the international system, institutions are required to produce public goods that markets under-produce (Kaul *et al* 1999, Kaul and Conceicao 2006). Public goods are things such as street lighting, which cannot be provided for one person without at once giving everyone else access. In this sense they are non-excludable. Furthermore, one person's enjoyment of the public good will not prevent the enjoyment of others (it is non-rival). This is easy to state but difficult to apply. Often-cited as global public goods are international financial stability, universal trade rules, and the containment of infectious diseases. But solutions to these problems are not always shared by all.

The last decade has shown that financial crises spread rapidly in and across regions, affecting not all countries, but those with particular exchange rate regimes and fragile banking systems that have rapidly liberalised into global capital markets. The result is a small club of countries with robust systems that have not developed rules to spread that stability to all others. Instead, the stable and wealthy countries have used their position in the IMF, the WTO, and the World Bank to push for rapid liberalisation in less-developed economies, which has accentuated the vulnerabilities of those countries to crisis.

Global trade rules are not so different. In theory, they constitute a global public good but in practice a small club of countries benefit much more than others. Even the containment of infectious diseases, which is in theory a global public good, seems to have been enjoyed much more effectively in some parts of the world than in others in recent history. These examples accentuate a bigger role for institutions.

Institutions do more than provide public goods. They define the values, aspirations, and the nature of a society that give rise to a desire for public goods. Institutions affect aspirations, hopes and fears. They bring governments together in ways that define not just who provides global public goods but who should believe they have a right to them and why. The existence of international institutions makes it possible for governments together to set goals such as greater equality, reducing global poverty, or increasing global literacy. Such global goals affect how people around the world conceptualise their own obligations, responsibilities, and rights. They also affect the extent to which people and their governments believe in and support international institutions. But is this what existing international institutions are doing and how could they do better?

3. The World Trade Organization, trade, peace and prosperity

'Peace is the natural effect of trade' argued Montesquieu in the early 18th century, as does the website of the US's chief trade negotiator some 300 years later (www.ustr.gov). The argument is that trade not only makes nations richer, it also makes them less likely to declare war on those with whom they trade. A hundred years after Montesquieu, on the brink of war, Britain and France instead signed a free trade agreement – the Cobden-Chevalier treaty of 1860. Likewise, after the second world war some 23 countries signed the General Agreement on Tariffs and Trade (GATT), which they hoped would help cement the peace (Jackson 1989). In 1994 that agreement was dramatically expanded and an institution was created to back it up – the World Trade Organization (www.wto.org).

But the WTO is not associated with 'peace and prosperity' in most minds. 'War by other means' is a more persuasive image of it among (some) governments' officials. 'Globalisation run amok' was among the more polite epithets screamed by hundreds of protesters at the notorious Seattle WTO Ministerial meeting in 1999. 'Big business doing secret deals' was clearly their belief (Public Citizen 1999). In the public mind, free trade has become associated not just with fears of low labour standards, poor-quality food, dangerous toys and fireworks, and environmentally unsound practices; it has become associated with anti-democracy – unelected trade negotiators and businessmen pursuing private deals at the public's expense.

The challenge for an effective global trade institution is tremendous. It has to address both the economic and the political effects of trade. Public confidence in international trade has to be rebuilt. At the very least, the global trading system has to be perceived as offering fair rules, with good effects, which are enforced. These core elements need urgent attention.

Fairer trade rules

Why do people say trade rules are unfair? The rules we associate with the WTO were negotiated in the Uruguay Round in the late 1980s. With hindsight, it is clear that the negotiations were dominated by large industrialised countries that stand accused of railroading poorer countries into hard and enforceable commitments, in return for vaguer promises to liberalise agriculture and 'do the right thing' (in other words, liberalise) on other issues (Jawara and Kwa 2004). The most recent trade talks – the ongoing Doha Round of multilateral trade negotiations, which began in 2001 – have not redressed this perception.

Institutions are meant to level the playing field, ensuring that the gains from trade are more evenly spread than might otherwise be. This is important for prosperity and for peace. Yet the WTO has not provided such a 'levelling' forum. The way trade rules are negotiated reinforces the power of rich countries or more precisely, well-organised businesses that seek access to markets for what they can competitively export and protection for what they cannot.

To some degree mercantilism has always been the name of the game in trade negotiations. However, it has now gone much further. In essence, the large trading nations have delegated the detail of trade policy in key areas to the private sector. The result is detailed agreements opening up trade access for financial services, pharmaceuticals, and insurance in poor countries while farmers, shoe-manufacturers and steel-makers are protected.

The devil is all in the detail and as agreements have become more and more detailed, the details elude government trade officials and are left to those with the most concentrated interest in them – typically private firms and business associations. As a result, trade negotiations as we know them are not a forum in which public interests and global public goods are balanced against private gains and interests. Rather they have become a new playground for commercial competition, providing new and complex instruments to gain competitive (or anti-competitive) advantage. One way to redress this problem is to roll back the scope of trade agreements, returning them to issues on which governments and government officials can themselves negotiate – including the crucial areas in which liberalisation has still to take place. Agriculture is one such area.

Trade in agriculture matters to developing countries because it covers so much of what they produce. But multilateral trade rules do not cover agricultural goods. In the European Union barriers are used to keep other countries' agricultural products out. In the US a massive farm programme is deployed to subsidise farmers, making it difficult for any other country to compete. Instead of being able to rely upon open markets, poor countries must rely on special discretionary deals or bilateral agreements that Europe and the US control and can use to divide and rule.

A further problem is the wide scope of trade rules. The WTO is structured around a deal known as the 'single undertaking'. When it was first invented by the US and Europe during the Uruguay Round in the late 1980s, it was called 'the power play'. It requires countries to accept everything or nothing. It is a power play because it was used by the big countries to railroad through an expanded trade agenda including a range of issues to which developing countries had in the past objected, such as intellectual property protection. The 'single undertaking' means that if developing countries want anything from the negotiations, they have to negotiate and accept agreement on everything.

The broader scope of trade rules poses severe problems for poorer countries. Rich industrialised countries have negotiated binding rules in the WTO that kick away the ladder that they themselves used to get to the top, proscribing the rich array of tariffs and industrial policies that Britain, Germany, America, Canada and Japan each used to ensure that their economies produced more and more valuable – and demanded – exports (Lall and Teubal 1998, Wade 1990, Chang 2002). South Korea, Taiwan, China and Vietnam – the fast ladder-climbers of today – each used combinations of industrial policies and tariffs to protect new basic industries, along with new and better technologies, access to markets, and other forms of national support for potential export successes. These mixtures of policies enabled them to industrialise and to export every higher value-added good. Obviously, not all the countries that use these policies succeed. Conversely, however, it is hard to think of a single successful globaliser that has not. However, these kinds of state intervention are now mostly outlawed.

Taking trade rules as a whole, developing countries are being asked to achieve what no other countries could: to industrialise without industrial policy or to develop rapidly without industrialisation. The latter is impossible while rich countries' markets in agriculture are protected. Meanwhile industrialisation is being made much more difficult (DiCaprio and Gallagher 2006). Sharp limits on access to technology have been imposed by new stringent intellectual property rules, which economists argue will increase dependence and lower welfare in developing countries (Hanns 2004, Chin and Grossman 1991, Markusen 1998). Industrialisation is also made more difficult by new barriers erected by rich countries. For example, by alleging that other countries are 'dumping' products (which means selling them at a price lower than the price normally charged on their own home market), rich countries erect barriers to imports. In 2003, for example, the US alleged that six countries were selling shrimps too cheaply in the US and on this basis, levied extra duties on Brazil, China, Ecuador, India, Thailand and Vietnam. On top of this, poor countries are expected to divert significant resources into compliance with detailed and complicated rules already agreed within the WTO.

The power-play of the Uruguay Round was doubtless satisfying to rich countries' trade negotiators, who got what they wanted. They did not reckon on a blowback. But this has occurred, from several quarters. Soon after the last trade negotiations concluded, trade negotiations became besieged by protesters. Environmentalists seized the opportunity to question how the rules were being made and in whose interests. Non-governmental organisations publicised the unfairness of the deal. The failure in earlier negotiations to take on the needs of developing countries soon led the trade talks to be relabelled the 'Doha Development Round'.

Trade talks within the WTO have failed to embrace broader public purposes. Not wild idealistic purposes, but commitments to which members of the WTO have signed up in other forums. For example, the global fight against poverty, global commitments to ensure access to medicines, and the Millennium Development Goals have all been declared as shared global purposes.

A first solution must involve coherence across institutions over such goals. Yet in the WTO these goals slip further away as trade negotiations fall further into the hands of those who can deliver highly detailed rules in ever-expanding new areas of trade. For this reason, a second part of the solution is to rein in the scope of trade talks – to walk before running. Straightforward residual protectionism in wealthy countries, such as trade in agriculture and the abuse of safeguards to apply protections, need to be addressed first. A third element of creating fair rules is to recognise the very different starting points of countries and to permit less developed countries to use the kinds of policies rich countries used to get to the top and to give them breathing space – or to use a golf analogy, a higher starting handicap – to enable them to compete. This more nuanced application of rules requires better quality information and enforcement.

Fairer enforcement of the rules

In theory, the creation of the WTO in 1994 offered a revolution to developing countries – a robust rule-based system that would be enforced by a less politicised body than ever before. Until 1994, the enforcement of trade rules had been highly political. A consensus of the Council of the General Agreement on Tariffs and Trade (GATT) would have to agree with a decision that a member had broken the rules, in order for that decision to be upheld. This gave all countries in the system a veto on the enforcement of any rule. In the WTO the consensus is reversed. Rulings are made by panels made up of experts. These rulings hold unless there is consensus against them. Does this work to the advantage of developing countries?

Developing countries face at least three significant barriers to bringing a case to a panel (let alone to the appellate body) against a large trading partner who is breaking the WTO rules. First, there is the self-restraint that any country dependent on a large trading partner will exercise in fear either of losing discretionary trade access, or jeopardising aid, military assistance or other foreign policy advantages (Bown and Hoekman 2005). It is worth noting that no aid-dependent country has ever brought a case to the dispute settlement process.

The way in which cases are prepared and brought to trial constitutes a second barrier. At present the dispute settlement mechanism relies on the involvement of the private sector. In the EU and the US, private firms and industry associations play a vital role developing the litigation agenda and pursuing and defending issues before the WTO. Their participation is vital because it is costly and time-consuming to prepare pre-litigation analyses of which policies are inconsistent with WTO commitments, the likely economic benefits to the removal of such policies, and the lobbying of governments to pursue the case (Shaffer 2003). The costs purely of litigation in bringing a typical case have been estimated at US\$500,000 (ACWL 2004). This does not take into account the resources necessary to investigate potential claims pre-litigation or the post-litigation expenses required for public relations and political lobbying to generate compliance. Put simply, the likelihood of a case even being investigated will depend heavily on how well organised exporters are, how high their profit margins are, and how good their access is to their government (to pressure it to bring a case).

Once a case has been adjudicated, will the ruling be enforced? In some cases, rule-breaking countries do remedy their policies. However, their willingness to do this is affected by several things. When large wealthy countries win, they can use the threat of retaliatory measures to push their opponent into compliance. In fact, trade negotiations speak of *threatening* a range of retaliatory measures beyond what they are permitted under WTO rules, precisely in order to stir up an appetite for compliance in their opponent country. Small countries, however, face the opposite problem. Because their market size is small, threatening retaliatory measures is likely only to produce political backlash against them by large and powerful countries. They must rely on goodwill and respect for the law in opponent countries (Shaffer 2006).

In theory, all countries can enforce trade rules. In practice, it takes strong and well-funded business associations to find possible cases and persuade their governments to bring them to the WTO. Once rulings are made, enforcement depends equally upon strong and well organised interests lobbying a government to push for compliance by trading partners or even to take (or threaten) retaliatory actions against the country in breach. Only a small number of developing countries have availed themselves of this (for instance, following the US cotton subsidies case, Brazil alleged that the US had failed to comply and formally requested the right to retaliate against US patents, copyrights, and service providers).

One small effort to bolster the capacity of developing countries to use the dispute settlement process is the Advisory Centre on WTO Law (ACWL), which was established in Geneva in 2001. It provides subsidised legal advice on WTO law and support in settlement proceedings of WTO disputes, as well as some training. But two obvious limitations affect the ACWL. First, its budget is partly funded by rich countries and several see a direct conflict of interest in funding a centre that helps to prepare cases against them (the US, France, Germany and Japan do not contribute). Furthermore, the Centre does not do pre-litigation work to find practices that are potentially in breach of WTO law and that could be amenable to a challenge. Nor does the Centre do the technical work – such as economic analysis – required to support cases (Bown and Hoekman 2005).

A more even-handed and robust enforcement of rules requires at least three elements. First, better information needs to be available to all countries about who is breaking the rules. The WTO could play a much stronger role in pooling and disseminating this information, not just from official government sources but

from others (more on this below). Second, better information could allow countries to group together more often in taking cases, not only to share direct costs but to spread the political pressures against taking action. Third, more robust enforcement, such as the direct application of fines or sanctions by the WTO, is required if the interests of smaller countries are to be upheld through enforcement.

Rebuilding beliefs in the multilateral process

The international trading regime has a bias in its rules and in their enforcement. This is no secret. Perceptions of this unfairness have fuelled opposition to the WTO that goes well beyond the traditional anti-free-trade forces. Trade reform requires a bolstering of belief in the fairness of free trade, which requires a bolstering of belief in the WTO process itself. What is the likelihood of this?

It is clear that business cannot go on as usual. The Doha Round of trade negotiations has come to a grinding halt. The European Union and the US have locked horns on who should move first to liberalise agriculture. Meanwhile, a group of emerging and developing economies have forged an alliance to protect their own interests in the round. Outside of the round, the US and EU have each been signing bilateral deals with individual countries but these cannot substitute for a multilateral agreement that gives their own businesses a clear set of rules, and applies to all members. Rich countries have strong interests in further extending trade rules through multilateral negotiations. The alternative is bilateral deals, of which there have been many. At first glimpse these may look attractive to rich countries. The US has achieved 'WTO plus' terms in bilateral agreements it has concluded with Chile, Jordan, Australia and Morocco. Each goes beyond anything the US could achieve in multilateral negotiations (full details of the agreements are at www.ustr.gov). Likewise, the European Union has concluded Economic Partnership Agreements (see www.ec.europa.eu/trade and for a critical appraisal, the European Centre for Development Policy Management at www.ecdpm.org). But bilateralism has real limitations for both of these trading giants.

Bilateral deals make life difficult for government agencies, which must field teams of negotiators to spend months with each trading partner knocking out a deal. Such agreements make business complicated and expensive for exporters that want to produce and sell globally. Bilaterals require them to sift through the fine detail of multiple agreements in order to forge their own production and export strategies – not to mention following the progress of each negotiation so as to be aware of prospective opportunities. Most global businesses prefer to work with one set of clear and universal rules. Furthermore, neither the EU nor the US believes it can strike bilateral deals with emerging giants such as China and India. For all these reasons, they have strong interests in the WTO multilateral negotiations.

Other forces are also pushing for a new trade regime. Outside the negotiating rooms, the social regulation of trade is changing. While trade negotiations are still the preserve of narrow producer interests, the negotiators and the lobbyists who surround them are more actively held to account. Websites, blogs, non-governmental organisations, non-trade specialised agencies of governments, and development agencies are engaging with issues of trade. And just as in other areas of global governance, technology and social change together make possible more innovative monitoring and accountability.

The monitoring of compliance with trade rules could readily be increased. Traditional state-centred regulation might be strengthened. The WTO has a Trade Policy Review Mechanism, which could be made part of a more robust compliance system, availing itself of clearer stronger inputs from other multilaterals such as the United Nations Conference on Trade and Development (UNCTAD), the United Nations Development Programme (UNDP), and the World Bank (Francois 1999). At the same time, a decentralised form of monitoring can underscore it, just as is occurring in other areas of global governance. For example, global health surveillance now relies on a decentralised network of non-governmental organisations, multilateral agencies, and governments collating and reporting information that can be tested, one against the other (Baker and Fidler 2006). So too in trade it is not difficult to imagine the expansion of a system of reporting over-compliance with WTO rules, anti-dumping, safeguard actions, product standards, and the like, undertaken by multiple parties.

Finally, pushed to the wall, developing countries have taken group action. They have a long and chequered history of attempting to bargain together (Narlikar 2003). However, in the Doha Round negotiations their ability collectively to put items on the agenda, and force greater consultation and participation is being reinforced by three underlying trends. First, large emerging market economies are now seen as significant future markets. Second, public attention to trade issues and negotiations makes it harder to ignore the

needs of developing countries. Third, developing countries themselves are forming informal networks of consultation and negotiation. They are doing this in order to establish their own agenda and view of what kinds of trade arrangements would best promote development within their own countries. These underlying trends suggest a larger role for developing countries in building a more responsive trade system. An influential group of countries led by India and Brazil formed the Group of 20 during the multilateral trade talks held in Cancun. This spurred considerable activity among all groups of developing countries, producing more informal networking among sub-groupings of the least developed countries, as well as groups with particular sectoral interests.

In sum, better managing of globalisation requires trade rules that are rolled back so that governments and not private business can negotiate them. Public purposes, embraced by all members of the WTO, need inserting into trade negotiations so that trade becomes a complement to the goals of development, stability, prosperity and peace. The WTO needs to pool and disseminate information about compliance more actively, to inform individual countries and also to give rise to actions taken by groups of countries. The WTO could also pool information about the impact of trade rules so as to enable its membership to tailor the trade regime to deal with countries in different circumstances, all the better to meet the broader purposes outlined above. In these ways, trade could indeed serve both prosperity and peace.

4. The International Monetary Fund and the highways of money and finance

Why do we need an IMF? The founders of the IMF lived through the Great Depression of the 1930s. They saw governments veer away from globalisation and smash into the foundations that had sustained the internationalisation of markets. By the 1930s the gold standard was discredited, as were orthodox fiscal policy (living within one's means), autonomous central banks (which helped discipline governments), and capital movements. What was popular were expansionary policies, pursued by governments unshackled by the gold standard or an autonomous central bank, protected by capital controls, and keen to erect barriers to slow the process of globalisation (James 2001).

The IMF was created in 1944 to build a better system for global money and finance. International monetary cooperation was top of the list to ensure exchange stability, and orderly exchange arrangements to prevent governments competitively devaluing their currencies. It was hoped that the IMF would foster economic growth and high levels of employment in member countries – a prerequisite for ongoing political support for globalisation. The IMF would also provide temporary financial assistance to countries with balance of payments problems, instead of leaving them to use tariffs and the beggar-thy-neighbour policies as they had done in the inter-war years. This is a key role of the IMF, as a lender of last resort; if we did not have it, we would probably need to invent it.

The IMF did quite a good job on exchange rates and emergency financing for about 30 years. But then in the 1970s the institution lost its role of managing exchange rates. A decade later the institution was embroiled in collecting repayments for private banks who had lent many millions of dollars to Latin American and other governments. The IMF was sent in to avert the international financial collapse that would occur if insolvent governments defaulted on the loans. In keeping with the Reagan and Thatcher neo-liberal revolution of the 1980s, the institution required individual countries to cut back drastically on public spending in order to meet their debt repayments. Before long, stabilisation and adjustment was presented not just as a way to meet debts but as a development model in itself – an alternative to investment and aid (Woods 2006).

The IMF was subsequently drawn into yet wider financing to countries in transition or in financial or development crisis. The 1980s reform recipe was broadened to include good governance. However, this did not abate criticisms of the conditions set by the IMF and their impact on poverty, on 'moral hazard' (increasing the incentive recklessly to invest), social services, and public investment. Hence, in the contemporary period there is much uncertainty about what the IMF can and should do.

Most simply put, the IMF should exist to help its members to meet the challenges of globalisation. To this end, three important sets of changes are necessary for the IMF.

First, the Fund should be the cornerstone of global monetary cooperation, and this requires a major shift in its largest members.

Second, the institution should help countries mitigate or cushion shocks from the global economy, which requires that the Fund should rid itself of some ideological baggage.

Third – and overarchingly – the institution needs to command the confidence of all of its members, and this requires major organisational reform.

Getting serious about monetary cooperation

The most difficult role for the IMF is perhaps its most important – helping to ensure stable exchange rates. Exchange rates are like traffic signals on the highways of the global economy. They manage and signal the intersections between economies. Ideally, exchange rates shift in a stable, predictable way since unstable exchange rates cause havoc in economies, by affecting exports, imports and external borrowings. Originally, the IMF oversaw a fixed exchange rate system but that changed in the 1970s, and since 1978 exchange rates have been a free-for-all with some floating, some managed, and some fixed.

In the free-for-all system of global exchange rates, the IMF attempts to promote stable exchange rates by its 'surveillance'. This means that the IMF regularly sends its professional staff members to undertake 'Article IV consultations' with member countries. They report back to the IMF Board on the state of member countries' policies. Additionally, the IMF undertakes multilateral surveillance, reporting on the state of the glob-

al economy in regular bulletins to all of its members.

Does the IMF's surveillance have any effect on exchange rates? Put simply, surveillance simply does not affect the big powerful countries in the global economy whose policies have the deepest effect on all other countries. It affects countries that borrow from the IMF or that need the IMF's stamp of approval as a way to ensure access to other kinds of funds such as bilateral aid or private capital flows or investment (Lombardi and Woods 2007). But these are not the countries whose exchange rate arrangements have far-reaching global effects. Wealthy, powerful members of the Fund whose exchange rate arrangements do have the largest impact on all other countries in the global economy remain fairly immune to judgments on their policies made by the IMF.

Neither in Europe nor in the US do economic policymakers worry about running foul of an IMF judgment. By contrast, in emerging markets policymakers fear an adverse judgment by the IMF – not least because investors will read into such a statement an unwillingness on the part of the IMF to intervene if things go wrong.

The alternative to the free-for-all system is a multilateral system of coordination. This requires a forum within which countries could agree and an institutional back-up to monitor and report on compliance. The goal could be one of two things: a free-floating system in which all major currencies agree freely to float their exchange rates, letting market transactions determine values; or a targeted band system where governments coordinate and each commits to keeping its exchange rate within the targeted 'band' (Joshi 2006).

At present, coordination – whether for a free-floating system or a targeted band system – is politically unlikely. Floating would require China and other Asian countries to put into jeopardy their extraordinary export-led growth. Targeting would require the US to bind itself into coordinated measures to manage the dollar so as to keep key currencies within a targeted band.

Coordination requires an international forum or institution in which all key members have confidence and that reduces the risks to them of defection, cheating, and free-riding by other countries. The IMF is supposed to be such a forum, in essence being a club in which all members have pledged to work with the organisation to promote stable exchange rates and to avoid manipulating exchange rates or the international monetary system to their own (unfair) advantage. However, in practice the IMF is not used by its members as a forum in which exchange rate arrangements are candidly discussed. Also, many of its newer members lack confidence in the institution as an even-handed monitor and enforcer of agreements. Nothing short of radical governance reform will rectify this.

In recent history, powerful countries in the IMF have used the organisation to exhort smaller, borrowing members to comply with standards and rules. They have moved away from using the organisation as a place where they commit themselves to self-restraint or the pursuit of shared global goals or goods. But exchange rate stability can only be achieved by cooperation among the powerful. This is why the US and UK founded the IMF in the first place.

To reinvigorate monetary cooperation requires two things. The governments of powerful countries have to commit to a new system. This is already beginning to happen as power shifts towards emerging markets and the wealthy countries – Europe and the US – realise that their best shot at influencing monetary arrangements lies in defending or reinvigorating the multilateral system. For example, the US has included the IMF in its search for strategies to influence China's exchange rate policy. Equally important will be the strengthening of the IMF as an effective institution to which countries can commit. An effective IMF would provide the right forum for the necessary political discussions and a set of trusted and proven technical ideas about how best to proceed. It would monitor and report on compliance and actively engage governments and the markets in peer review and accountability.

As I discuss below, reinvigorating monetary cooperation will take serious reorganisation of the IMF that recognises the power shift to new emerging markets, takes into account new models of regulation, and gives voice to the concerns of a wider group of countries.

Helping countries to deal with shocks

A second important role the IMF can play is to help buffer countries from the excesses of global markets. Global capital markets can send different kinds of shocks through small economies. Exchange rates can suddenly shift (in the absence of the coordination depicted above). Commodity prices can shift, devastating

small and poor commodity-producing countries. A crisis in another part of the world can cause short-term capital suddenly to leave the country. The result can be a triple crisis of devastating proportions. So how can countries insure against this? And how can the IMF help?

We have already established that stable exchange rates are very hard to achieve in the absence of coordination. Countries cannot individually fix their exchange rates without risking speculative attack – such as occurred after 1997 in Thailand, Russia, and Argentina. At the same time, governments that try more subtly to manage exchange rates require a huge amount of dollars taken out of their economy to keep in reserve so that they can buy and sell their own currency when the need arises. The result is a massive outflow of capital from developing and emerging economies to buy dollar-liquid forms of reserves such as US Treasury bills from the rich industrialised countries. Among other things, this sustains ‘global imbalances’ (a polite term for a very large US deficit).

One part of a solution recently proposed by Joseph Stiglitz to the problem of global imbalances is to provide for an international currency or unit of account for reserves, using ‘global greenbacks’ (Stiglitz 2006). Key to the proposal is the presumption that countries stockpile reserves in order to guard against a speculative attack on their exchange rate. This is costly and destructive to their own prosperity. For this reason, Stiglitz argues that these countries would probably be willing to forego their own holdings of reserves in favour of the new fiat currency held by (and only convertible through) a global reserve system.

There are two serious problems with this. First, countries do not stockpile reserves just for a rainy day. Rather, China and other Asian economies are sustaining their rapid export-led growth by intervening to keep their exchange rates low¹. This is an important part of the reason why they end up buying such large quantities of US Treasury bills. No system of pooled reserves will resolve the underlying trade issues. For a solution to this problem, we must shift our attention to the global trading system (as above) and ask what alternative means are left for developing and emerging economies to move up the ladder of export-led industrialisation.

Second, a global reserve system would need an institution at its core. The obvious contender is the IMF. However, for the IMF to operate as a pooled system of reserves, its members would need confidence that the institution was as much ‘theirs’ as their own reserves are. But officials from the Asian countries, who are currently building up massive reserves, speak in private of the IMF as too much of a US institution. The kind of IMF that would command their confidence would have to be restructured to overcome this perception. Stiglitz gives us one potential solution – a reformed global system of reserves. An alternative system would build on arrangements already emerging among Asian countries. The Association of Southeast Asian Nations plus China, Japan and South Korea (ASEAN plus three countries) have swap arrangements among themselves to bolster their reserves and at the same time, make use of IMF conditionality as a back-stop or agency of external restraint.

Currently what the IMF does in an exchange rate crisis is a combination of lending or emergency support and conditionality. This marries two of the IMF’s original roles: maintaining stable exchange rates, and helping countries to resolve their short-term balance of payments crises. This marriage is deeply problematic.

The IMF was created to offer short-term loans to countries (with a balance of payments problem) in a world of controlled (not mobile) capital. But today, as trillions of dollars slosh around the globe, a country’s balance of payments crisis becomes rapidly inseparable from its exchange rate and banking system. The IMF finds itself trying to deal with an exchange rate crisis, a current account crisis and a banking sector crisis with one rather crude instrument – conditional lending. Meanwhile, short-term investors flee and the institution is castigated for bailing out reckless investors. Left behind are the tough policies imposed by the IMF that go far beyond the immediate causes of the crisis – as occurred so publicly and obviously in South Korea in 1997.

Missing from the IMF toolkit have been tried and true measures that economists sometimes call ‘second-best’ solutions – highlighting that the ‘best’ theoretical policy can often be the enemy of a good policy. For example, countries can use prudent measures to buffer shocks from global capital markets in the event of a crisis. Such measures helped countries such as Malaysia, Singapore, India, and South Africa to buffer the effects of the 1997 Asian financial crisis, which each weathered much better than its neighbours (see Special

1. I am particularly grateful to Vijay Joshi for his clear exposition of this

Issue of Global Governance 2006). Each had liberalised carefully, leaving in place measures that permitted them some control over incoming and outflowing capital. Yet the IMF does not give practical advice to countries on how they might use capital controls or prudent measures. Instead it has advocated much less state intervention (the key factor in ensuring capital controls).

For a long time the IMF pushed capital account liberalisation in a fairly undifferentiated way, on all its borrowing members (IMF Independent Evaluation Office 2004). This reflected the preferences of powerful members with strong financial systems, and an attachment to a particular kind of theorising about economics. The result was more faith-based than fact-based advice. Subsequently research within the organisation highlighted vulnerabilities and problems with the policy (Prasad *et al* 2003).

What the organisation now needs to do is to evaluate seriously and unideologically what kinds of capital controls or precautionary measures can work and to weave this into its advice to members (see Joshi 2003). At present it is only halfway towards this goal, not least because its most powerful members continue to push for capital account liberalisation. What many of the IMF's members need is practical advice on how to use capital controls, not a blanket prescription not to.

In financial crises, there are other practical solutions the IMF could be better at identifying for its members. Recall that a core part of the IMF's mandate is to preserve the livelihoods of people within its members' countries. Financial crises shatter economies and the societies in which they occur. But in some countries the results are worse than others. Why? And what can a government do in its macroeconomic policy when caught in a crisis, better to protect its citizens' livelihoods? In recent history, the IMF was pushed into the mode of debt-collector for private banks in the 1980s, for bilateral aid agencies in poor developing countries in the 1990s, and now for a raft of public and private sector creditors. But a new space to offer more objective advice has emerged.

The extreme solution – default – has long been taboo for the IMF. For obvious enough reasons, as a creditor (indeed a preferred creditor) in most emerging market economies prone to financial crisis, the IMF was hardly going to advocate default. However, circumstances have changed. The IMF is no longer a creditor to many emerging market economies. Argentina has opened up the option of default on external debt, demonstrating that under some circumstances the markets will return even to a defaulting country more rapidly than anyone predicted.

The IMF needs to dump a certain amount of ideological baggage – even though it has served several uses for the organisation. Capital account liberalisation and sovereign debt repayment have been two such items. Support for privatisation as a preferred means of restructuring an economy has been a third. Advice in these areas has been almost entirely driven by economic theories, with little attention given to the difficult economic, social and political realities on the ground in member states (Woods 2006). A theoretical approach makes it easier and quicker to produce advice and also avoids accusations of different treatment for different members. That is all well and good. But the members of the IMF want something else. What is more, the IMF is uniquely positioned to offer something else.

Unlike the economics departments of the best universities in the world, or the OECD, or the research departments of large banks, the IMF has practical experience of working with economic policymakers across 184 countries. It is that practical experience that it needs to share with its members in a non-ideological way.

What will push the IMF to change? First, the organisation is already having to concede a larger place to emerging countries – major countries agreed in September 2006 to slightly increase the voting share of China, Korea, Mexico and Turkey (see www.imf.org for full details). These countries will sideline the institution unless it offers them some of what they value and need. A second force for change is the new competing forms of regulation that will emasculate the IMF's role unless it adapts. The organisation needs to draw its members into a system that relies on peer review bolstered by market incentives, and that requires a political process that directly engages its full membership.

Finally, the organisation's day-to-day finances rely on its fee-paying clients taking loans from the organisation and repaying with interest. During the Reagan and Thatcher years, creditor countries insisted that borrowers pick up the bill for most of what the IMF does. Since then, borrowers have paid charges that cover the lion's share of the IMF's expenses, including paying interest to wealthy creditor countries on the reserves they lodge with the IMF, and the costs of most of the additional surveillance and other new activities the IMF has entered into (Woods 2006). As the IMF's big borrowers (such as Brazil and Argentina) walk

away from the institution, it is left with no one to pick up the bill. For this reason, the IMF has a strong incentive to tailor its work to that clientele. However, at present it does not because there are yet bigger incentives from powerful members.

Commanding the confidence of all members

Much is written about the IMF governance needing greater legitimacy. Power, ideology, and governance, all need updating. Voting power and shares in the organisation have long been based on an outdated model of economic power. In theory, each member enjoys power proportionate to their economic weight in the world economy. In practice, the determinations are more political. Small revisions have recently been made. But small voting increments do not redress the core problem of a lack of confidence in the institution as a multi-lateral – a members' institution in which all members can have confidence. That requires larger reform, which also tackles two other weaknesses.

Ideologically, the Fund is struggling to operate in a world where its carefully honed tools are aimed at macroeconomic stabilisation and structural adjustment. However, it is failing to address what its members now expect of it – standard-setting, institution-building, and poverty-reduction, and aid-effectiveness in its poorest borrowing members. The institution needs to be closer to its borrowing members, producing less lofty and more practical solutions for them. IMF research needs to be closer to the ground and structured so as to provide policymakers with practical insights drawn from the experiences of other IMF members. Either the IMF should use its research funds to support people based in borrowing countries using (and building) local data and answers, or it should decentralise its own research department, basing it in regions where it could add the most value.

When it comes to the IMF's wider surveillance function, the Fund needs to function far more effectively as 'machinery for collaboration' (to quote its Articles of Agreement). It should be pooling information and analysis from a wide range of sources and networks. That information should be presented to members not as a lengthy series of bureaucratic reports but to highlight problems needing collective action and offering clear collective strategies for overcoming them. The debate about cooperation should be one that engages member countries.

Governance is at the heart of the problem. The IMF is governed by a Board, which might be described as semi-representative, semi-technocratic, and semi-efficient. It neither makes countries feel represented, nor acts independently of them. It fails to make countries feel represented not least because most countries are bundled into groups and represented by a technocrat they do not know and cannot hold to account (Woods and Lombardi 2006). Although the Board is supposed to oversee the management of the organisation – ensuring that member countries hold the organisation to account – in fact it is chaired and run by the Managing Director. The result is a Board locked into a pattern of approval or veto, which flies in the face of modern norms of corporate governance. Also, although a full transcript of Board debates and discussions is kept, it is not made public.

The Governor of the Bank of England recently proposed getting rid of the resident IMF Board and replacing it with a non-resident group of policymakers meeting periodically. This could well solve some problems. It would put 'heavy-weights' on the Board, who could give strategic direction to the organisation and ensure more effective oversight of the management and staff of the organisation. More direct and high-level representation might also make countries feel more directly represented.

What the non-resident Board idea misses is the elephant in the room. Privately, policymakers across the developing world concede that to them the IMF is a US institution. It is located in Washington DC very close to the US Treasury. By convention its First Deputy Managing Director and Chief Economist are chosen by the US, which is also the only country that can single-handedly veto significant decisions in the organisation. The thin veneer that separates the US from the IMF is in essence the Board of the organisation, which sits in Washington DC, manfully attempting to hold up a semblance of multilateralism and accountability to the membership (Woods 2006). At the very least that Board should elect its own Chair and not the Managing Director. However, much clearer reforms are needed to win countries' confidence in the IMF as a really multilateral institution.

The most obvious change would be to move the IMF out of Washington DC, relocating it in a capital that does not have the power to impose its own imprimatur on the institution. This would be an immediate signal to emerging countries that the IMF is a multilateral rather than a US institution.

To which region should it go? Not necessarily wholly to one place. An alternative answer is to develop a more federal structure for the IMF. As mentioned above, Asian countries have already begun to develop regional monetary arrangements that nevertheless rely on the IMF as external disciplinarian. They retain control over their reserves but delegate an agency of restraint function to the IMF. Such arrangements could be developed in each major region of the world, with a high degree of autonomy but also with links to a central hub where information can be pooled and disseminated and standards set. Those who pay will have control over their funds at the regional level, but also reap the benefits of a set of international standards and restraints. This radically different IMF would capture the changes described above, embedding them in a political structure in which members have confidence. Only when it has gained that confidence can the IMF be an effective machine for global monetary cooperation, or a welcome and trusted adviser on how to deal with shocks from the global economy.

5. The World Bank and effective development assistance

Left to themselves, global capital markets will not necessarily direct investments to the most needy countries or regions of the world. Indeed, the World Bank was created in the aftermath of the second world war because it was feared that devastated European countries simply might not get the investment they needed for rapid recovery. The idea behind the World Bank was that it would raise capital in the private markets (by issuing bonds guaranteed by all the Bank's members) and lend to needy countries.

The World Bank still raises money in capital markets to lend to developing countries for investments in physical capital such as electricity, roads, ports and telecommunications as well as for investment in human capital such as education and health. A special arm of the Bank (which gets its money from direct contributions by countries) also makes grants and loans to the poorest countries at heavily concessionary rates. Overall, the World Bank Group sits at the heart of global aid efforts.

The logic for having a multilateral agency at the heart of the aid system is impeccable. It permits countries to pool their aid efforts. In theory this should mean more effective, better informed development assistance with fewer transaction costs. The Bank raises money more cheaply than any single member country. It does this by pooling its members' guarantees and issuing bonds. The Bank can also draw on a wide experience of different situations in many different countries in preparing and evaluating loans. The Bank's multilateral character also offers some insulation against the plague of special interests which distort bilateral foreign assistance, often tying it to procurement from the donor's own companies or other special commercial deals.

In theory the World Bank should permit all countries to do better. Rich countries can direct their foreign aid through the organisation and equip it to ensure that it is more effective than any national aid agency can be in promoting growth and human development in poorer countries.

Whose Bank? Re-anchoring the Bank's model of development

In its early days the World Bank made loans and offered technical assistance for building infrastructure: railways, roads, power plants, port installations, and communications facilities. Some 78 per cent of its loans to poor countries in the 1950s were for power and transportation projects (Kapur *et al* 1997). The knowledge the Bank was building during these years was practical. It focused on investment planning, engineering, and the like.

Throughout the 1960s and 1970s, the lending expanded to embrace projects in education, nutrition, literacy, family planning, and employment, spreading the Bank's knowledge base more thinly. However, by far the most dramatic effect on the Bank's advisory work occurred in the 1980s when the institution was thrust into supporting the IMF in managing Latin America's debt crisis. Structural adjustment – a prescription proposing liberalisation and deregulation as central to growth – took centre stage.

The Bank's policy advice since the 1980s has been anchored in liberalisation and deregulation and inseparably linked to the IMF, even as other ideas have emerged and been debated. New 'add-ons' to the core remedy have included conditions aimed at enhancing good governance, building social safety nets, and fighting corruption.

However, efforts to get the Bank to consider an alternative set of principles have failed. Pushed by Japan to conduct a study on the East Asian model of development, the Bank's report did little to redress the core emphasis on what used to be called the Washington consensus (Rodrik 1994). Subsequently, although a lively variety of research is reported across the Bank's web pages, the conditions imposed by the Bank when it makes loans continue to focus on a paradigm with liberalisation and deregulation at its core. We see this even in the Bank's lending to the poorest countries.

The World Bank's International Development Association (IDA) is a special branch of the World Bank that makes interest-free loans and grants to some 81 countries eligible to apply because they are poor, lack access to market credits, and are deemed to perform well in economic policy. But how does the Bank measure which country is most deserving and how much it should get?

The Bank uses a Country Performance and Institutional Assessment (CPIA), which assesses economic management, structural policies, policies for social inclusion/equity, and public sector management and institutions. For seven years these ratings were kept secret within the Bank. Since 2005 they have been published and we can examine what they comprise.

A country wanting a top score in the CPIA needs first to show that it has liberalised and deregulated its economy. It needs to have reduced its tariffs on imports to less than 7 per cent of their value. It needs a strong financial sector and functioning capital markets, public spending that does not crowd out private investment, public debt in a low ratio to GDP, and employment laws that allow workers to be hired and fired at low cost. These criteria reflect one particular model of development (Kanbur 2005). Rooted in the structural adjustment of the 1980s, the recipe is to deregulate, liberalise and wait for growth.

The Bank has invested a lot in models and research, which are said to back up its push for liberalisation and deregulation. One of the most widely cited World Bank studies uses a cross-country analysis of data to argue that liberalisation indeed leads to growth and poverty reduction (Dollar and Kray 2000 and 2002). The study provoked debate both within and outside the Bank, with several leading scholars highlighting flaws in the work (Milanovic 2003, Easterly *et al* 2003, Rodrik and Rodríguez 1999).

Dollar and Kray define globalisers as countries that experience increases in trade and foreign direct investment – as opposed to countries that in fact made ‘liberalising’ policy decisions. Critics point out that growth may well have driven openness. Indeed, in China, India, and Vietnam, all countries that have outperformed their peers in terms of growth in recent years and whose growth (especially that of China) drives the positive result found by Dollar and Kray, domestic economic reform was undertaken behind a screen of capital and trade controls before any serious attempts were made to globalise (Galbraith 2002). This puts into question the remedy so often drawn from Dollar and Kray’s analysis.

Politically, the Dollar and Kray findings have been very influential – being used by the likes of the US’s trade negotiators as well as the World Bank to argue that ‘we know’ that very poor developing countries should liberalise trade. Yet politically, poor countries have been ill-served by the Bank, pushing them to liberalise trade on their own. When ‘good performers’ arrive at the WTO to negotiate a trade deal, they quickly find that the World Bank has inadvertently persuaded them to give away all their trump cards – unilaterally to disarm in the face of powerful countries, which do not do the same. The currency of trade negotiations is access to markets. Countries that drop their tariffs unilaterally often have little bargaining power in the first place. But having dropped their trade barriers before negotiations even begin, they soon find that they have even less to bargain with.

Economically, the case for liberalisation depends (much more than the Bank has ever admitted) on careful planning and sequencing (Rodrik 1992, Rodrik and Rodríguez 1999). The social and distributional effects of liberalisation are also highly disputed. The Dollar and Kray work cited above has led to a sharp debate about whether globalisation increases inequality within and among countries (Wade 2004). Dollar and Kray argue that globalisation is a ‘powerful force for equality’, reducing inequality between countries and having a neutral effect on inequality within countries (Dollar and Kray 2002).

One of their World Bank colleagues, however, argues that increased openness (measured by trade as a percentage of national income) does not have a neutral effect. Rather it reduces the income share of the bottom six deciles, thus increasing national inequality (Milanovic 2004)².

Seen from the vantage point of many developing countries, the Bank’s aspirations in lending and policy advice have gravitated over the past two decades towards pushing a particular model of economic development, generated by large-scale statistical work, against which the Bank’s most needy members have found it difficult to argue. This is interpreted as reflecting US trade preferences and ideological predilections more than responding to the political and economic needs of its borrowing (and fee-paying) members. This is a great pity, for in theory the World Bank is a conduit for development assistance that is insulated from particular members’ interests.

The Bank was born with constitutional guarantees against political interference both in its Articles of Agreement, and in its funding and governance structure (Woods 2006). That said, the Bank was quickly drawn into the politics of the Cold War, giving aid to cement alliances (Kapur *et al* 1997). Subsequently, the role of the US in shaping the Bank’s organisational structure, lending patterns, and conditionality has been very significant. The headquarters of the Bank are in Washington DC; the US always gets to appoint its President; it is the only country that alone can exercise a veto over major decisions; and the US Congress, more than any other legislature in the world, has regularly pushed the Bank around, including threatening

2. Milanovic notes that since Dollar and Kray use purchasing power parity (PPP)-adjusted income figures, the importance of traded prices to the economy is massively reduced; when he removes this PPP adjustment the result changes.

to reduce (and in fact reducing) US contributions to its special concessional lending facility, the IDA.

All that said, the World Bank is changing. Decentralisation has pushed some of its work out into the field. Rich countries have systematically reduced their own contributions to the main lending arm of the Bank (for the details, see Woods 2006) and this makes the institution more dependent on its fee-paying clients. To sustain its income, the Bank will have to become more responsive to its borrowers. This means reviewing the conditions on which it lends and making its advice more useful to, and valued by, borrowers. It means the Bank will have to lend for what its borrowers want and need. It also means that the Bank will have to cut down on the bureaucratic processes that have grown up within its walls – principally as a way for the large bureaucracy to mitigate risks to its own portfolio or reputation.

Analysts of the World Bank have begun to argue that the Bank needs ‘to deliver aid differently to countries with different capabilities and qualities of governance’ (Radelet 2006: 110). This requires the Bank to root its knowledge within countries, providing advice specific to their circumstances. This might require some significant out-sourcing of research (Birdsall 2006), which might in turn deliver benefits by building capacity for development research in places other than Washington DC (Kapur 2006).

Shifting the way the Bank produces knowledge and transforms its policy advice would align the Bank’s lending and advice more closely with the needs of its poorest members – and indeed with what is most likely to work in those countries. Both the IMF and the World Bank could be much better at ‘lesson-learning’. The incentives within both organisations are structured so as to make it difficult for new or country-specific policies to be tried. The result is often a continuation of policies that have not worked.

The Bank and the international aid regime

The World Bank is at the centre of an international development assistance regime that is notoriously fragmented, duplicative, and cluttered with a large number of donors tripping over each others’ bilateral rather than multilateral efforts. In theory, the World Bank, by pooling information and resources should vastly reduce transaction costs on both sides of the aid relationship.

Perversely, the major donors such as the US, Japan, and the UK, do not rely on the World Bank. Instead they sustain and expand their own separate aid agencies and processes, creating a cacophony of donors making different demands on over-stretched governments. The governments of these countries speak daily to developing countries through dozens of megaphones including their own national agencies and special initiatives alongside several multilateral agencies (the UNDP, World Bank, IMF, WHO, WTO and so forth). The result is that already over-stretched government officials in very poor countries are forced to spend most of their time and staff strengthening and maintaining external relations with donors and doing their bidding.

More perversely still, even when donors use the World Bank, they encumber it with special demands, special funds and additional procedures.

This practice can be traced by the increasing use of ‘trust funds’ in the World Bank. These are funds given to the Bank for a particular use – often supplementary to the institution’s core work. As described by a former UK government aid official, ‘we construct an elaborate mechanism for setting priorities and discipline in the Bank, and then as donors we bypass this mechanism by setting up separate financial incentives to try to get the Bank to do what we want’ (Ahmed 2006: 90).

There is some evidence that the Bank can be a coordinator. On debt relief, for example, donors assigned an important role to the Bank, helping countries to prepare Poverty Reduction Strategy Papers that worked as a coordinating mechanism for donors giving debt relief. On the face of it, although beset with many problems, the Bank’s work in this area improved coordination among donors and at the same time, took a key step forward in promoting policy ‘ownership’ by borrowing or aid-receiving countries.

Ownership has become the mantra of the World Bank and of modern development assistance more generally. It reflects a clear lesson of the 1990s that aid works best when an aid-receiving government is committed to the policies and projects to which the aid is being put. Conversely, even the most stringent conditions imposed by donors do not work unless a government receiving the aid is committed to such conditions, or, following the mantra of ownership, it ‘owns’ them. This finding has led the Bank to focus much more on consultation and building a stronger presence on the ground in borrowing countries. Many other donors are doing the same. Indeed, if the test of ownership is whether donor-recipient consultations are increasing,

the answer would doubtless be positive. However, critics argue that more and more donors 'on the ground' means more and more interference in policy with the result that ownership is reduced.

How might we test whether more ownership is emerging? What would tell us if this were the case? Let me propose a four-part test³.

First, we might well ask where projects or programmes are being initiated. Are the ideas being generated within the country or by the UK's Department for International Development (DFID), the World Bank, or the numerous think-tanks that produce papers for them? Put another way, how often are beneficiaries articulating a demand for the aid or policy?

Second, what resources of their own are aid-recipients committing to projects or programmes (the answer to this surely reveals the priority assigned to the policy or project)?

Third, what kind of control over the resources being made available is being exercised by aid-receiving countries?

Finally, has clear responsibility been assigned to the aid-recipients and are they participating in decisions regarding the continuance or non-continuance of a project or loan?

Many development assistance grants and loans would fail the first two parts of this test. Seeking to enhance 'ownership' in borrowing or grant-receiving countries brings an obvious tension to the work of the Bank and other aid agencies. On the one hand, aid agencies wish to exercise the proprieties of financial responsibility over aid, to prove to their contributors that aid is not being misspent, and to achieve targets such as the Millennium Development Goals. On the other hand, aid agencies want their efforts to be effective, and that is most likely to occur when they are supporting initiatives that people and/or governments within developing countries prioritise. These will not always be the same goals as donors prioritise, nor will they fit easily within donor agency budgets and auditing requirements. Squeezing development assistance into these donor agency requirements takes it further and further away from ownership. It also takes it further and further away from another ideal – coordination.

At the highest level, donors have engaged in a discussion about how they might better coordinate, harmonise and align their aid efforts (OECD 1996, 2005). That said, the rate of progress on the ground has been glacial. For example, one area in which donors have agreed to streamline their efforts is public financial accountability, on which a 2004 joint assessment, completed by the World Bank, European Commission and DFID, reports that:

- Too many different audits were taking place in each country in the area of public expenditure and financial accountability (their role is important but limited in enhancing capacity or fiduciary assurance)⁴.
- Existing tools pay too little attention to other institutions (the legislature, civil society, institutional and governance factors, and asset management) and what a government can realistically achieve.
- Existing instruments have been too short-term and inadequately linked into key in-country planning instruments such as the Country Assistance Strategy and the Poverty Reduction Strategy Papers.
- Heavy transaction costs have been imposed in-country, which are related to the inadequate sharing of information among international development partners. (Allen *et al* 2004)

These findings highlight the yawning gap between the talk about coordination and ownership, and actual donor practices, which are neither coordinated, nor linked to instruments or institutions within aid-receiving countries.

One concrete result of donors' commitments to coordination and ownership has been the unleashing of competition among aid agencies as to who should 'lead' on coordination and ownership. The OECD/DAC (the Development Assistance Committee) won out as the forum for the debate. From a practical point of view the World Bank is well-placed to take the lead, having led on the PRSP and developed its role from there. Snapping at its heels, however, the UNDP is keen to lead in preparing national development strate-

3. This test is inspired by the excellent study Ostrom *et al* (2001)

4. The Bank subsequently integrated its own assessments (for example, in Philippines, Bosnia and Herzegovina, Turkey, and Zambia).

gies and formal mechanisms for dialogue. The result is a somewhat perverse situation in which officials from DFID, the World Bank, the IMF, the UNDP, and other bilaterals seem to be arguing over who should have the lead role in generating a 'country-led' strategy. Meanwhile, in Paris, donors create elaborate concordats for high-level cooperation and coordination among themselves. Squashed out is a genuine space for countries to take a lead in formulating their own solutions.

The Bank has the potential to be a good multilateral forum on development assistance, as well as to harness the benefits of pooling the delivery of development assistance. That will require the Bank to re-anchor its vision of development assistance, away from the Washington-consensus and away from its Washington DC base. The Presidency of the Bank will have to be wrested away from the US and made into an appointment in which all member countries exercise their rights as stakeholders. The decentralisation of the Bank must be carefully managed, to ensure that it does not become a way for the Bank to take over in-country policy processes. Decentralisation does not mean shifting Bank bosses to capitals where they can more easily run a country's policies. Rather it must reinforce the Bank's capacity to build practical knowledge of development conditions among all of its members. This is what former Bank President James Wolfensohn called 'the listening bank'. These moves are necessary preconditions for a wide range of countries to use the Bank as a way to pool their development assistance resources.

6. Three innovating forces in the governance of globalisation

The WTO, the IMF, and the World Bank each need to be reformed. This is no empty exhortation. In fact, three innovating forces in global politics are pushing towards a reshaping of international institutions.

The first change is the rewriting of rules by new powers claiming a place on the international scene. Individually, countries such as China, Russia, India, Brazil, Argentina and Venezuela have begun to change the rules governing exchange rates, energy, trade, and sovereign debt rescheduling. The 'G20' coalition of developing countries has taken a strong stance on trade. Equally powerfully, emerging markets have voted with their feet – walking away from borrowing from the IMF and World Bank. And they have benefited from it, for instance, when China ignored IMF prescriptions, Malaysia refused IMF assistance, and India postponed capital account liberalisation – in each case actions that helped these countries weather the Asian financial crisis.

Europe and North America risk looking like the colonial powers of the early 20th century – clinging to an order that they no longer have the power or will to sustain. Take two of the rising revolutionaries: China and Russia. What are the choices? Can they be isolated or subjugated?

They cannot be isolated. China's foreign exchange reserves – held in US Treasury Bills – are keeping the US economy afloat and Russian gas is keeping European lights on. Subjugation is proving just as difficult. China has been brought within the WTO on stringent terms that some say echo the 'Unequal Treaties' of the 19th century. There will be blowback from this. Attempts to force Russia to sign up to an energy charter that provides Europe with a sense of energy security have failed. As policymakers are keenly aware, integration is the only real option. This means attending seriously to the concerns and voices of these countries in international institutions. Their emergence is one driver of change. It will force a new configuration of power, which will at least balance the existing powers, even if the new powers simply push their own agendas.

A second driver of change is the transformation of global regulation. The old model was state-centred. Governments regulated within their borders with some cross-cutting commitments to other governments entrenched in treaties. In the 1970s the debate about regulating multinational corporations was all about inter-state rules – treaties on the economic rights and duties of states and a bolstering of the law to enable developing country governments to regulate. The new model harnesses communications technology, non-governmental organisations, and consumers. It opens up and redefines the interests of some companies to include labour and environmental standards. It uses multiple sources of information – as we are seeing in global health surveillance. It is carefully tailored to the needs of the private sector, as we are seeing in codes of conduct in capital markets.

The new regulation is not enforced by formal sanctions. Rather, it relies on bloggers, newspapers, transnational advocacy groups, third-party monitors, and pressures on companies from shareholders, auditors, insurers, and clients. This opens up exciting new possibilities for monitoring and pooling information from a variety of sources.

As a system of regulation, however, this is undoubtedly the Americanisation of global regulation. It is more individualised, more legalistic, more reliant on after-the-fact exposure and class action suits, more market-based, and more insurance-reliant. In the US it grew out of a federal system comprising 50 states with multiple identities and little overall social cohesion, common trust or values. What contemporary analysts of business tell us is that this kind of regulation is a very costly and inefficient substitute for the bonds of trust, reciprocity and common purposes associated with old-fashioned institutions, including the state⁵. It is here that global organisations can play a key role: fostering common institutions, shared purposes and trust among countries so that collectively achievable goals become possible among states. The new regulators can help global institutions to achieve this.

Networks present a third source of innovation in global governance. It has become popular to describe global politics in terms of networks of regulators, firms, lawyers, accountants, and judges. Experts in each of these areas are increasingly connected. As they work together, learn from one another, and emulate each other, this leads to a global convergence in norms and rules. But networks are highly political. Like the gentlemen's clubs of global politics, they serve to cement common interests and forge informal agreements –

5. I am grateful to Colin Mayer for his elaboration of this argument.

principally among the powerful. In the global economy, the G7, the Group of Seven Finance Ministers, is a prime example. The group comprises seven large industrialised countries. It has no formal authority or rules of operation. But since the late 1970s it has served as a network within which the US, Britain, France, Germany, Italy, Japan, and Canada can coordinate their policies. Quietly and discreetly, the G7 has long been at the helm of the International Monetary Fund.

The benefits of networks are clear for the powerful. They offer a way to coordinate, quietly and informally. For less powerful states and peoples the benefits of attending networks of the powerful are not obvious. Smaller, poorer states who are invited to attend a G7 dinner are like guests in a gentlemen's club. Unlike their attendance at an IMF meeting, they attend a G7 meeting with gratitude, not with any of the formal rights they have in international institutions such as to vote or collectively to veto. Rather than from joining networks of the powerful, developing countries stand to gain most from forming their own networks, exclusive of the powerful, and using them to identify and elaborate shared problems before such expression is pre-empted by louder and more powerful voices. Such networks of less powerful states could play a key role in making international institutions stronger and more responsive in aggregating and responding to the concerns of all countries affected by globalisation.

7. Conclusion

The new globalisation of the late 20th century is not just economic. The rhetoric and politics of international relations have been globalised – including the case against globalisation. Spurred by a sense of inequality and injustice, people across the world are forging a new politics of resistance. Until now, multilateral institutions have failed to address this. But they now have an opportunity so to do.

In the world economy, institutions exist not solely to deal with market failures. As the Great Depression of the inter-war years demonstrated, institutions are also vital for defining shared values and purposes. They can create – or erode – confidence in cooperation.

There are some immediate priorities for multilateral cooperation that could redefine the politics of globalisation. Trade is key. It touches on the livelihoods of rich and poor in all countries. A rewriting of trade rules to make them fair is urgent, as is a far more even-handed and robust approach to applying and enforcing the rules. Global money and finance also needs attention.

The IMF is well placed to help countries to deal with globalisation – particularly those most vulnerable to the harmful excesses of markets. To do this more effectively the Fund needs to drop some of its ageing ideological baggage, and its most powerful members, in concert with emerging powers, need to reorganise the organisation so that it can command the confidence of the newcomers whom they so very much wish to engage in multilateral cooperation.

Finally, development assistance can play a key role in managing globalisation. The World Bank has a major contribution to make both, technically as an adviser to countries, and as a forum for cooperation among donors. To take up this role effectively, the Bank will have to establish a new *vision* of development that it is closer to what countries need. The Bank's decentralisation is already moving in this direction. At the same time, as a forum for cooperation, the Bank needs to corral donors more robustly, at least into doing less harm if they fail to make further progress towards aid effectiveness.

The argument against reforming the WTO, IMF and World Bank is often expressed as a trade-off between effectiveness and legitimacy. Effective institutions get things done. This is because they enjoy 'hard power' and can make rules but enforce them with pressure and even coercion where required. By contrast, legitimate institutions are talking shops. They spend time and effort ensuring representation and participation, but get little done (the United Nations General Assembly is often cited). Opening up the WTO, the IMF, and the World Bank, it is said, will render them ineffectual.

But this is false reasoning. Different institutions derive their legitimacy from different sources. A central bank's legitimacy may derive from its fulfilment of inflation targets while a parliament's legitimacy derives from its representativeness, not its impact on inflation. In each case, legitimacy gives reasons for why others should accept the decision or actions of the institution.

Seen in this more precise light, legitimacy is a prerequisite for effectiveness. And this is why participation has in fact been opened up a little, not just in the relatively visible organisations such as the IMF, the WTO, the World Bank, and the G7 Finance Ministers in the wake of the Asian financial crisis (they created a broader G20), but also in more technical organisations such as the Financial Stability Forum, and the Bank for International Settlements. In each case, wider participation has been seen as an efficient way to gather information and to improve compliance. In short, it reflects a bid for greater effectiveness.

Europe and the US face new political, economic and security challenges. They will soon also be challenged in their position as rule-makers by newcomers emerging in the global economy, determined to rewrite some of the rules. The ways of old are equally challenged by new networks that will strengthen the position of the newcomers, and the transformation in global regulation to something more open-textured, responsive and market-centred. Those who drew up the rules of the status quo face an opportunity either to reform existing institutions, or simply to leave them to wither alongside their own power.

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