

Reforming the Bretton Woods System for Inclusive Development and Democratic Global Governance



Introduction

The current global financial crisis, the most severe since the Great Depression of the 1930s, may turn out to be an epoch-making event in evolution of global governance. Starting as a mortgage crisis of subprime borrowers in the US it has now spread all over the world inflicting severe loss of income and employment on millions, in both the developed and developing countries. With massive globalization in financial services, global financial stability is now acquiring the characteristics of a global public “good”/“bad” where the poor in developing countries cannot escape the consequences of mismanagement of finance by the rich in developed countries. The last two years have also witnessed how speculative finance in the developed countries can push up the prices of the food and other essential commodities for the poor in many parts of the world leading to increased incidence of hunger for millions in the low income countries. This episode dramatizes the need for global action for preventing these excesses of speculative finance, particularly in rich countries. There are other vital areas such as climate change, cross-border terrorism, non-proliferation of nuclear weapons and transmission of diseases such as HIV/AIDS and Avian Flu where the need for global governance is becoming apparent.

For the sake of justice, the voices of the poor must be heard in designing programs and policies for provision of global public goods and for global governance. Just as democracy is the best instrument for giving a voice to the poor in national management, so is global democracy the best instrument for sound and fair global governance and inclusive development.

Apart from the political case for global democratic governance, economic case for democratization of the world economy is becoming

stronger. For the last two centuries, the developing countries (the South) have been at the periphery of world economy and global economic and financial system has been centered around the North. But now there are powerful tendencies for convergence in incomes between the North and the South. Table 1 gives some figures on how convergence is being achieved in many key areas of economic growth. GDP of the South in PPP terms which was only about 53 per cent of that of the North in 1990 became about 70 per cent in 2006 and with the current financial crisis hitting the North harder than the South, the process of convergence is likely to be accelerated. On the recent trends, the GDP of the South may exceed that of the North by 2013, i.e. in just five years. In electricity production, internet users, foreign exchange reserves and even patent applications by residents, convergence is likely to be achieved before 2020. And already the South exceeds the North in terms of rate of saving, investment and trade (as per cent of GDP), as well as in energy production, energy use, labor force, and military personnel. The center of gravity of the world economy is basically shifting from the North to the South. Thus the democratic ideals of freedom and equality will be increasingly relevant in international governance from economic as well as political angle.

In this policy brief we present some thoughts on how a more effective global governance can be promoted in one vital area, namely, the financial sector. We argue that lack of international surveillance on the country with “license” to print international money (namely, the US) was at the root of the current global financial crisis. We also argue that on present trends, the financial crisis may soon be transmuted into a major economic crisis with the risks of repetition of the nightmare scenario of the 1930s. In order to prevent that

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Table 1: South -North Convergence Process: Some Key Parameters

South as % of the North with respect to	1990	2000	2005	Years since 2005 for convergence with growth rate during 2000-2005 continued
GDP PPP (constant 2005 international \$)	53.2	55.9	66.2 (3.5%)	13 [In 2006 the relative GDP of South grew by about 6%, at which rate convergence will be achieved by 2013]
Electricity production(kWh)	56.4	59.3	73.3 (4.3%)	8
Internet users	0.0	24.9	75.1 (24.7%)	2
Total reserves (including gold)	18.7	47.1	83.5	Convergence achieved in 2006
Patent applications, residents	4.3	9.9	17.0 (11.4%)	17
Gross capital formation (% of GDP)	112.2	109.6	130.1	n.a.
Gross domestic savings (% of GDP)	113.7	116.7	144.7	n.a.
Exports of goods and services(% of GDP)	106.4	118.5	131.6	n.a.
Imports of goods and services (% of GDP)	103.4	111.6	120.5	n.a.
Energy production (kt of oil equivalent)	137.2	128.4	152.4	n.a.
Energy use (kt of oil equivalent)	95.2	85.1	100.1	n.a.
Population	474.1	515.1	531.6	n.a.
Labour force	449.3	485.8	507.3	n.a.
Military Personnel	241.4	398.3	384.8	n.a.
<i>Note:</i> Figures in parentheses in Col. 4 are annual growth rates during 2000-05.				
<i>Source:</i> World Development Indicators, 2008, The World Bank.				

outcome and restore growth momentum, there is an urgent need for a global economic stimulus of about \$2 trillion (or 4 per cent of global GDP) over the next two years. While some countries (such as China) can finance such stimulus from their own resources, many others (including the US) do not have domestic fiscal space for such stimulus and need support from international sources of finance. This in turn will require a major restructuring of the global financial system which can create a global currency to finance the needed stimulus for the world economy but does so in a framework of democratic global governance reflecting the current weight of income and population of different countries of the world.

Profligacy of the US with Early Warnings Ignored

In 1944, when the foundations of the present international financial architecture were being laid in Bretton Woods Conference, John Maynard Keynes argued that the creation of an international currency should not be the privilege of one country but decision of the international institution that was being created. However, his wise advice was ignored and the US dollar became effectively the main international currency with the pledge of the

US to redeem US dollars at the rate of \$35 per ounce of gold. That pledge was unceremoniously discarded in 1971 when the US delinked US dollar from gold. However, such was the power of the US that the US dollar continued to remain the principal currency of international transactions and reserves. In order to supply the world with international liquidity, the US could and had to run some deficits on current and/or capital accounts. The US had been playing that role over the last sixty years but with moderation until recently. While during 1970-1991, the cumulative current account deficit of the US was \$ 881.1 billion, during 1992-2000 it became \$1569.3 billion and during 2001-2006 \$ 3572.5 billion with deficit in 2006 alone at \$ 811.5 billion. These current account deficits reflected the fact of the US living beyond its means (at both households and government level). Household savings which used to be about 10.0 per cent of GDP in 1980 and 7.0 per cent in 1990 became 0.4 per cent in 2007. Federal budget which had a surplus of \$236.2 billion in 2000 was transformed into a deficit of \$400 billion in FY 2008. Mortgage debt ballooned from \$3.8 trillion in 1980 to \$14.4 trillion in third quarter of 2007 and consumer credit from \$ 0.35 trillion in 1980 to \$ 2.5 trillion in 2007. The US became a net debtor to the

outside world with the net investment position showing a negative balance of \$2.5 trillion in 2006.

There were many warnings of the unsustainability of these deficits and the risks of disorderly correction in these deficits. In a series of Policy Briefs and Discussion Papers in RIS¹, we highlighted that the international financial system which was supporting the profligacy of the US was unjust, inefficient and unsustainable and we proposed an alternative regional financial architecture to manage the risks of disorderly unwinding of the US deficits and accelerate growth in Asia. We argued that the unipolar global financial system was unjust, because the richest country in the world had been appropriating the seigniorage that was created by expanding world trade and that should be shared world-wide and preferably go to the poor. The system was inefficient because it was transferring savings from the less developed rest of the world to the richest country where the rate of return on foreign savings in real terms was not high, particularly because a large part of these imported savings were used for private and public consumption. The system was also unsustainable because over the medium and long term, the current account deficit of the US could not keep on growing at the prevailing rate. Unless an alternative source of demand was found, the deflationary tendencies in the world economy could become highly pronounced and the instability in US dollar will have serious adverse effects on Asia. Through these series of papers we have been proposing creation of a Reserve Bank of Asia which could use a part of the excess reserves of Asia to create a parallel currency (Asian Currency Unit) to finance the investments in social and physical infrastructure and for reducing greenhouse gas emissions and use the seigniorage generated by a reserve currency to subsidize these investments, as necessary.

While few in Asia dared to voice these concerns, there was an active debate in the US about the risks of US current account deficits. Noriel Roubini Global Economics Blog (www.roubiniglobal.com/archives/2005/05/globalimbalance.htm) provided a list of eminent economists who had warned of the high risks posed by the global imbalances, in particular, the high current account deficits of the US. The list included Messers Rubin, Sinai and Orszag, Summers, Peterson, Roach, Gross, Bergsten, Rogoff and Obstfeld, Eichengreen, and Volcker. As an illustration one can perhaps concentrate on statements of Larry Summers² a former Secretary of Treasury of the US. He argued eloquently how the large current account deficits of the US carry significant risks to the US as well as the rest of the world. For the United States, he emphasized the

risk of the incipient protectionist pressures that were generated by a large trade deficit, and that were connected with the prevailing furor over outsourcing. Secondly, he noted that dependence on foreign governments for short-term financing creates vulnerabilities in both the economic and political realms. He used the term “balance of financial terror” to refer to a situation where the US relied on the costs to others of not financing the US current account deficit as assurance that financing would continue. For the rest of the world, he noted that a great deal of money was being invested at what was almost certainly a very low rate of return.

However, such was the complacency in the US that these warnings were totally ignored. In fact some weird theories talking of “dark matter”, savvy investors and savings glut were invented to argue that exceptionalism of the US will allow the US to continue these deficits for the foreseeable future. The weaknesses and inconsistencies of these theories was articulated by Barry Eichengreen³ but the fatal attraction of “Punch Bowl” was too difficult to resist. And as the current imbalances continued for years without any obvious adverse effects, the faith in exceptionalism of the US was strengthened. However, that was only a lull before the storm of 2007/08. In the prophetic words of Larry Summers⁴ in March 2006:

“...my view thinking about past experience with tech stocks in the United States or with the Japanese stock market or with a range of emerging market situations is that the moment of maximum risk comes precisely when those concerned about sustainability lose confidence in their views as their warnings prove to have been premature and when rationalizations come to the forefront.”

There have also been warnings about the risks of rapidly increasing dollar supply in the world. As late as December 2007, Fred Bergsten⁵ raised concerns about free fall of dollar and proposed revival of the Substitution Account in IMF to deal with the problem. However, his warning and suggestions were totally ignored.

The Financial Meltdown and the Specter of Depression

Now the disorderly unwinding of the global imbalances is taking place. Households in the US who have been living beyond their means on credit are facing bankruptcies and the financial system that supported their profligacy is in a meltdown. Starting with subprime crisis, bankruptcies or equivalent of bankruptcies spread through the

¹ ‘Towards an Asian Economic Community: Monetary and Financial Cooperation’, *RIS Discussion Paper # 33*, 2002; ‘Towards a Multipolar World of International Finance’, *RIS Discussion Paper #46*, 2003; ‘Towards an Asian “Bretton Woods” for Restructuring the Regional Financial Architecture’, *RIS Discussion Paper # 133*, 2007; ‘High Risks of Global Imbalances: Role of Infrastructure Investments in Asia’, *RIS Policy Brief #16*, 2005; and ‘Towards an Asian Regional Mechanism for Addressing Excess Foreign Exchange Reserves, Infrastructure Deficits and Global Imbalances’, *Policy Brief #31*, 2007.

² Lawrence H. Summers, Third Annual Stavros S. Niarchos Lecture, Institute for International Economics, Washington, DC March 23, 2004.

³ Barry Eichengreen, “Global Imbalances: The New Economy, the Dark Matter, the Savvy Investor, and the Standard Analysis”, University of California, Berkeley, March 2006.

⁴ Reflections on Global Account Imbalances and Emerging Markets Reserve Accumulation, L.K. Jha Memorial Lecture by Lawrence H. Summers Reserve Bank of India, Mumbai, India March 24, 2006.

⁵ ‘How to Solve the Problem of the Dollar’, by C. Fred Bergsten, Peterson Institute for International Economics. Op-ed in the *Financial Times* December 11, 2007.

system like wild fire taking down, within one year, iconic institutions such as Bear Stearns, IndyMac, Lehman Brothers, Washington Mutual, Wachovia, Fannie Mac, Freddie Mac and the American International Group. The investment banks such as Merrill Lynch, Morgan Stanley and JP Morgan have all given up their special status and been transformed into banking institutions. The Citicorp, the largest bank in the world for years, had to be bailed out with official funds and guarantees which add up to \$ 320 billion. Each of these failures would be a shock to any system. But coming in succession they constitute a veritable earthquake for the US financial system. The total cost of bail-outs to the federal authorities is estimated to be about \$7 trillion. And the saga is by no means over. There are thousands of banks in the US saddled with troubled assets whose rescue will cost another hundreds of billions of dollars.

The contagion is now spreading from the financial sector to the real economy. The US consumer who has been the engine of growth in the world economy is now hanging up its shopping basket. In a dramatic illustration of what this loss of consumer expenditure can mean, the automobile sector in the US is facing a severe contraction of sales and the iconic trio of automobile industry in the US—GM, Ford and Chrysler—is facing bankruptcy and pleading for bailouts by the Government. The bankruptcies of retailers and real estate companies, big and small are daily news. In this atmosphere, private sector investment is sure to face a decline of substantial magnitude. Even exports which were beginning to grow rapidly in the wake of depreciation of dollar in early 2008 are likely to suffer as dollar has appreciated recently in relation to most of the major currencies in the world. A severe decline in output in the US over the next two years is now highly probable.

Even worse is the scenario on future of the US dollar. Through its bail-out and stimulus packages, the US is pumping more and more dollars into the world economy, seriously aggravating the burden of external dollar holdings of the US which according to Fred Bergsten was already over \$20 trillion in 2007. If the confidence in the US dollar is shaken and the dollar goes into a free fall, we may well have what Fred Bergsten has called “mother of all monetary crises.”

The ongoing financial crisis in the US now clearly poses a serious threat to the stability of the world economy. Already the crisis has spread to Europe, Japan and major emerging economies. Among the developed countries, UK resembles the US situation most closely with serious risks of downturn in the economy and loss of confidence in the British Pound. Faced with fall in demand

including exports, major economies may well embark on competitive devaluations and protectionism leading to a downward cobweb of production and employment in the world. The Depression scenario of the 1930s is a real possibility. We must not let that happen. We must make dispassionate analysis of the causes of the current crisis and devise corrective measures, however bitter they may seem.

The Root Cause and the Great Denial

In analysis of the current US financial crisis, it has become conventional wisdom to blame the “greed” of the financial players on the Wall Street. But what else do we expect from the financial players? Profit maximization is their job, their religion if you like. It is the job of the regulators to make them work within the rules which prevent individual’s greed turning into macro-economic imprudence. The real failure of the US system lies in its lax regulations which originated from a failed doctrine of self-regulating markets. Alan Greenspan in recent years epitomized that vision and his dangerous doctrine was eloquently expressed by him in his recent book, *The Age of Turbulence: Adventures in a New World* (Penguin Press, New York 2007). A strong believer in self-healing power of the market, he thought the financial innovations including hedge funds and credit default swap have initiated a new era of financial innovation which is attracting the best brains to the financial profession with big rewards and which is doing a signal service to the world economy. The only thing necessary to keep it rolling was to keep the heavy hand of government regulations away. In his words:

“...the benefit of more government regulation eludes me. Hedge funds change their holdings so rapidly that last night’s balance sheet is probably of little use by 11 a.m.—so regulators would have to scrutinize the funds practically minute by minute. Any governmental restrictions on fund investment behaviour (that’s what regulation does) would curtail the risk taking that is integral to the contributions of hedge funds to the global economy, and especially to the economy of the United States. Why do we wish to inhibit the pollinating bees of Wall Street? (p.370)”

With this mindset of the Chairman of the Federal Reserve Board what can be expected from the regulators? In essence it was a failure of the neo-liberal doctrine, not of individual regulators and fund managers.

Along with the lax regulations, the spending spree in the US was fully supported, nay,

encouraged by the authorities in order to prevent recession in the economy in the wake of dot.com crisis and 9/11. Federal funds rate was brought down from 6.24 per cent in 2000 to 1.35 per cent in 2004 and remained below the 2000 level in 2007. Federal budget balance was as noted above, changed from a large surplus in 2000 to a large deficit from 2004 onwards. President Bush pushed hard to expand home ownership, especially among minority groups, as an example of his compassionate conservatism. And there is evidence that mortgage lenders were pressured to keep up their lending particularly to economically weak sections of the public.

To some extent the economic stimulation policy to avoid recession after 2001 was an understandable motive at a national level. It was the job of international financial system to prevent the national stimulus spilling into national imprudence with dangerous consequences for the world economy. In a normal economy, the need for external finance will provide that discipline. But since the world has been on a US dollar reserve system, that regulatory mechanism was not available and the US consumers (both households and government) could experience the high of overspending without realizing the consequences. The dollar reserve system thus became a sort of opiate of the US where exuberance went to the point of exhaustion. The dollar reserve system also explains why the financial excesses in one country led to global crisis rather than a local crisis as happened, for example, in Sweden or Japan or East Asian countries in the 1990s. Over the last ten years, the US misused the license to print international currency and lived dangerously beyond its means by pumping trillions of dollars in the rest of the economy in the form of current account deficit and transfer of financial capital. The world was flooded in the red ink flowing from international deficit financing by the US. Between 2000 and the third quarter of 2007, the US ran a current account deficit of \$4.6 trillion!

Now we are in a world where neo-liberalism lies discredited and the US is no longer the economic hegemon. The cure lies in recognizing these realities and performing a fundamental restructuring of the global financial system by drawing upon the wisdom of Keynes. In order to prevent a global recession we need to increase public investment around the world and fund them by creating a true global currency (a *bancor* perhaps as Keynes called it at the time of the Bretton Woods Conference in 1944). And the *bancor* would be available to be exchanged for unwanted dollars in case of a run on the dollar, together with a time-bound

program of the US to redeem excess dollars in a phased manner. At this time, we are fortunate to have many sound infrastructure projects in developing as well as developed countries (including the US) which can be funded by *bancors*. And there are massive needs for “green expenditures” for mitigation of and adaptation to greenhouse gases which are truly global public goods and ideal candidate for funding by seigniorage created by a global currency.

In this context, it is disappointing to see how the western world is in a denial mode and is just beating around the bush in facing up to the challenge. Prime Minister Gordon Brown’s proposal for a new Bretton Woods was a timely one. But unfortunately it was formulated in terms of preventing a *future* financial crisis and not preventing the possible near-term economic and dollar crisis. The US proposal for a G-20 summit on November 15 put the program in even more unreal terms. That proposal was also formulated in terms of regulatory and institutional reforms for preventing a future a financial crisis but to cap the denial mode of the US, it concluded by the following: “The summit will also provide an important opportunity for leaders to strengthen the underpinnings of capitalism by discussing how they can enhance their commitment to open, competitive economies, as well as trade and investment liberalization.” One cannot but recall the episode of rearranging chairs on the deck while the Titanic was sinking.

The Declaration coming out of the G-20 Summit makes a token recognition of the need to “restore global growth” but there is not even a hint that under current conditions, public investment and other instruments of demand stimulation must play the key role. Instead it waxes eloquence about “shared belief that market principles, open trade and investment regimes, and effectively regulated financial markets foster the dynamism, innovation, and entrepreneurship that are essential for economic growth, employment, and poverty reduction.” What about the role of the government in such crises as Keynes argued so eloquently in the 1930s?

In analyzing the “root causes” of the current crisis, the Declaration puts emphasis on failures of regulatory framework. It totally ignores the role played by macro-economic policies of the US for stimulation of the economy post 9/11 and in weakening the regulatory restraint in the financial sector. The global imbalances (even as a euphemism for the US living beyond its means) were not mentioned as a contributory factor. No effort was made to even hint at the explanation as to why the subprime crisis originating in one country became a global phenomenon affecting even highly

regulated financial sectors in countries such as in China and India. As argued above, we believe that the license given to the US to print international “legal” tender was a key factor in the US profligacy and the contagion of US financial malady world wide. Without facing this “inconvenient truth” in whatever diplomatic language, there can be no understanding of the root causes of the current crisis nor its cure.

The Declaration is largely about regulation of the financial sector where actions have been taken, by and large. It is almost totally silent on what actions can be taken to stimulate world economy and prevent global recession or even depression. Calls are made for increased availability of resources to International Financial Institutions without even hinting at where these resources might come from. Instead of recognizing that in times like this, government is the solution, not the problem, homage is paid only to free market principles.

The Way Forward

We believe that urgent global actions are needed to prevent two imminent risks and ensure sustained development. First is the risk of serious decline in global demand which can lead to global depression (which we define as decline in global GDP in two consecutive years) and the second is the risk of a dollar crisis. According to the Managing Director of IMF, global stimulus of about 2 per cent of GDP (about \$1 trillion) is needed to prevent global slowdown. This, however, may be an underestimate. The sharp increase in consumer expenditure in the US and UK associated with bubble in equity and housing markets is going in reverse. Between 1981 and 2006, household consumption as percentage of GDP increased from 62.5 per cent to 70.5 per cent in the US and from 58.7 per cent to 64.1 per cent in the UK while the ratio was relatively stable below 60 per cent for Euro area and Japan. If this ratio in the US and UK goes back to its level in early 1980s, it may create a hole of about \$1.2 trillion dollars (at 2006 prices) in the effective demand of the world economy. To this must be added the decline on consumption and private investment due to decline in income in the developed countries in 2008/09 and slow down in growth in developing countries. Altogether, decline in global demand coming from private consumption and investment may be nearer \$2 trillion (4 per cent of global GDP) than the figure of \$1 trillion mentioned by the IMF.

There are some countries such as China which have fiscal and balance of payments space for taking bold actions to stimulate their economy. The proposed stimulus package of about \$600 billion

by China is thus a welcome step from national as well as international point of view. But there are many other countries where their budgetary and balance of payments situation may not allow much expansion without international assistance. We believe that the US belongs solidly to the latter category. As noted above, even before the current crisis, there were concerns about high fiscal deficits and external current account deficits of the US which had created external liabilities estimated to be at least \$20 trillion in late 2007. Since then the US has provided for bailouts and fiscal stimulus packages which are estimated to add up to another \$7 trillion. The budget deficits for 2008/09 earlier projected to be about \$400 billion are now estimated to be over a trillion dollars. In this situation can the US afford fiscal stimulus package of about \$1 trillion that is being currently proposed? Will this not be a repetition of the stimulus programs in 2001/02 in the wake of dot-com crisis and 9/11, with imprudent funding coming this time more from the public sector than the private sector? This may well precipitate the dollar crisis which is already a serious risk facing the world economy.

An alternative is to go back to the ideas developed in the 1970s with regard to substitution account and SDR as the principal international currency. Here a little bit of historical perspective may be useful. The risks of the dollar based international reserve system and the need for a truly international currency were highlighted, among others by Robert Triffin in the early sixties. Testifying before the U.S. Congress in 1960, Triffin exposed a fundamental problem in the international monetary system. If the United States stopped running balance of payments deficits, the international community would lose its largest source of additions to reserves. The resulting shortage of liquidity could pull the world economy into a contractionary spiral, leading to instability. If U.S. deficits continued, a steady stream of dollars would continue to fuel world economic growth. However, excessive U.S. deficits (dollar glut) would erode confidence in the value of the U.S. dollar. Without confidence in the dollar, it would no longer be accepted as the world's reserve currency. The fixed exchange rate system could break down, leading to instability. Triffin proposed the creation of new reserve units. These units would not depend on gold or currencies, but would add to the world's total liquidity. Creating such a new reserve would allow the United States to reduce its balance of payments deficits, while still allowing for global economic expansion. In mid-sixties even the US Government realized the difficulties of a

dollar-based system. In the words of Henry H. Fowler, U.S. Secretary of the Treasury (1965-68), “Providing reserves and exchanges for the whole world is too much for one country and one currency to bear.”

In the seventies, these ideas led to the creation of SDR system. Among its ardent advocates was J.J. Polak. whose paper, “Thoughts on an International Monetary Fund Based Fully on the SDR.” (Washington, D.C.: International Monetary Fund, 1979) elaborates how an SDR-based international currency system will operate. However, the short-sighted vested interest of the US in having free access to printing international currency prevented any progress on Polak’s ideas.

Most recently, Fred Bergsten has, as noted above, argued that we need to revive the substitution account in the IMF and provide a mechanism for exchange of unwanted dollars. He, however, does not specify under what conditions will IMF assume unwanted dollars. In our opinion, such a deal is possible only if jointly with the US authorities, IMF draws up a program of redemption of dollars over time by the US which will involve a structural adjustment program for the US. Among the components of such a program will be: a sharp devaluation of the US dollar in relation to major currencies of the world (which will provide stimulus to the US economy through promotion of net exports rather than domestic consumption), deregulation of high technology exports, debt-equity swaps, increasing energy efficiency of the economy and improving cost effectiveness in government and businesses including medical services. As part of the program of structural adjustment, SDRs would be provided for stimulating the economy particularly for improving infrastructure and increasing “green expenditures”

An SDR-funded program of stimulation of demand may well be needed in other developed economies with limited fiscal and balance of payments space such as the UK and developing countries such as India. Assuming that the world economy needs a stimulus of \$2 trillion dollars and half of it can be provided domestically by countries such as China which have fiscal and BOP space, an IMF program of creating SDRs equivalent to \$1 trillion dollars will be needed for restoring growth in the world economy.

Globalization of IMF

If the above perspectives on reform of the global finance are accepted, it would require a complete overhaul of the governance structure in the Bretton Woods Institutions. From inception till today, these institutions have been dominated by what we may call G-1, i.e. by one country (namely the US) under a pretense of operation in a group. Particularly since

1980 with initiation of the Reagan era, the Bretton Woods Institutions became openly an instrument for promoting the US ideology and US interests as was dramatized by the shock therapy administered to the former Soviet Union and handling of the Asian financial crisis of 1997-98. The results of these programs were in conflict with the objectives of IMF as stated in its Articles of Agreement which included a provision that IMF will “provid(e) them [members] with opportunity to correct maladjustments in their balance of payments *without resorting to measures destructive of national or international prosperity*”. (italics added). Nor has IMF been able to deliver on its mandate of promoting “exchange stability”. In general there are now widespread doubts about credibility and legitimacy of the IMF “to contribute [thereby] to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy” as the Articles of Agreement enjoin upon it. There is a need to globalize the institution with power shared according to the realities of today rather than of 1944 in order to achieve balanced global development.

For drawing up the new Articles of Agreement to reflect the current conditions, it would of course be necessary to conduct intensive studies and negotiations.⁶ However, some broad principles can be suggested for consideration.

1. The objectives of the IMF as stated in the Articles of Agreement seem valid even today with only a reiteration of some key objectives which seem to have been violated in practice.
2. The quota/subscription of IMF members should be in proportion to a combination of population and the GDP in Purchasing Power Parity (PPP) terms and subject to modification very ten years or so.
3. No country should have a veto power on major decisions which should be subject to support of the standard two-thirds majority.
4. The location of the Headquarters should be decided by two-thirds majority rather than the largest shareholder.
5. The staff and management should be selected on the basis of merit from all member countries.
6. An international currency (SDR) should be created to become the international reserve currency. The annual level of injection of the SDRs should be decided by two-thirds majority keeping in mind the needs of current and capital account payments. The SDRs will be

⁶ Over the years, there have been scores of proposals for reform of the international financial system. An overview can be found in <http://www.brettonwoodsproject.org/>

initially allocated to a Global Public Goods Fund which will finance expenditures on global public goods such as global peace and security (covering all expenses of UN agencies), climate change related expenditures, social and physical infrastructure development with global externality and under current conditions, for providing stimulus to the world economy.

Such a program of globalization of IMF will be possible only if it is acceptable to the US who has veto power for modification of charter of the IMF. With the President-elect Barack Obama, one dares to hope that the US will realize the need for democratic globalization and restructure the Bretton Woods Institutions along the lines needed to avert a world economic crisis.

However, with or without such agreement on reforming the IMF the South should get together to create a regional financial architecture which can help it to overcome the crisis and achieve rapid growth essential for poverty reduction and catching up with the North.⁷ We call it the Reserve Bank of the South (RBS) and among its salient features could be the following:

1. The RBS could combine the objectives of IMF and the World Bank as originally defined.
2. Members of the South will contribute \$1 trillion from their foreign exchange reserves on which the RBS will pay interest on 30-year Treasury Bills of selected member countries and invest passively in bonds and equity indices around the world.
3. Backed by these reserves, RBS will issue a Southern SDR (SSDR) to act as a parallel currency and freely convertible into any international currency. RBS will issue a certain amount of SSDRs every year to meet the funding needs of regional public goods. A certain part of the profits of RBS will be used to subsidize the funding of regional public goods.
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population and the GDP in Purchasing Power Parity (PPP) terms and subject to modification every ten years or so.

5. No country shall have a veto power on major decisions which would be subject to support of the standard two-thirds majority.
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With a strong resource base, RBS can supplement in the near term the domestic measures for economic stimulus adopted by member countries. Economically viable cross-border infrastructure investments such as roads, railways, gas and oil pipelines, electricity and water grids would be obvious priorities. Among other priority items will be: climate change related expenditure for adaptation to and mitigation of global warming and social infrastructure investments with regional externality such as management of natural disaster, communicable diseases, and money laundering.

For setting up such a regional financial architecture, the South does not need the approval of the North. But it faces the difficult task of obtaining consensus of the large and diverse group of countries that constitute the South. As in the case of original Bretton Woods Institutions, leadership of a selected few is needed to formulate the initial proposals which can then be reviewed and modified by a conference of all the countries as was done in the Bretton Woods Conference of 1944. Perhaps a committee of officials and experts of G-5 consisting of BRICSA countries (Brazil, Russia, India, China and South Africa) could be constituted to prepare the initial proposals in the near-term with a "Bretton Woods" Conference of the South convened within a year.

Is that possible? Let us dare to hope and say: Yes, we can

⁷ For a similar proposal at the Asian level, see *RIS Discussion Paper #133 'Towards An Asian "Bretton Woods" for Restructuring of the Regional Financial Architecture'* by Ramgopal Agarwala.

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