# At issue: Bretton Woods 2
## What should be on the drawing board?

***What roles should twenty first century international financial institutions (IFIs) play, and how should they be structured? This paper sets out some of the key issues that would need to be resolved at a second UN monetary and financial conference – a 'Bretton Woods 2' – and discusses the road ahead.***

The first United Nations monetary and financial conference held in Bretton Woods, USA, in 1944, fundamentally redesigned the international economic architecture. Many of today's 192 UN member countries were colonised at the time, and the US and UK dominated the meeting, their economists having spent the previous two years designing a blueprint for the post-war economic order.

The chaos unleashed by the current international financial crisis is a sign of the failure of international financial institutions, which have changed little since 1944. Despite recent rhetorical calls by many world leaders for a so-called Bretton Woods 2 conference to fundamentally redesign the international economic architecture, the G20 has so far focussed on narrow aspects of financial sector regulation. The ambition required to create the kind of institutions needed in the 21st century has been sorely lacking.

## What institutions do we need?

We highlight ten key roles that might be played by IFIs in the twenty first century, in order to structure discussion and spark debate. Increased complexity of international trade and finance, and fundamental changes to the world and our collective understanding of it would make today's task more difficult than in 1944.

*The world has changed immeasurably since 1944, but IFIs have not. Serious change is needed.*

**The big issue:** IFIs can only be regarded as successful stewards if they help to recreate the global economy so that it (a) operates within the ecological limits of the planet; (b) eradicates poverty, and radically reduces inequality; and (c) ensures that the human rights of all are met. These outcomes would be the litmus test for any modern day economic architects with global ambitions.

First, at least one preoccupation of the 1944 delegates remains: **how to manage exchange rates and deal with persistent trade deficits and surpluses**. The problem blamed for the great depression of the 1930s – 'beggar-thy-neighbour' policies and competitive currency devaluations – may be rearing its head again today. The par value exchange rate system created in 1944 served the world fairly well until 1971, when it was abandoned unilaterally by the US. Some have said that the persistent trade surpluses in Asia and corresponding deficits in the West laid the groundwork for the current crisis. The creation of an international currency, international clearing union, or system of globally managed exchange rates should be on the agenda. As the hegemony of the US wanes, there is a practical limit to how long the anachronistic system of a single country's currency serving as the vehicle for all global reserve holdings can be maintained.

Second, closely tied to the exchange rates issue, is the creation of an **international lender of last resort**. Such an institution would not only be useful in supporting a managed exchange rate regime, but could also help overcome balance of payments crises caused by fluctuations in financial or other markets, or other exogenous events. This is one area where there is significant scope for regional solutions, such as the prototype Asian Monetary Fund.

Third, an **international debt workout mechanism** would help to work out defaults and deal with situations where countries are unable to service debt payments. There are cases where countries cannot repay their debts without causing unjustifiable harm to their citizens, their economy, or the environment. Lenders do not always act in a legitimate manner, so issues of odious or illegitimate debt would need to be examined. To be effective, this kind of international mechanism would need to be fair, transparent and independent.

Fourth, **trade rules and the settlement of trade disputes** are areas where international negotiation is inevitable. Three key dilemmas continue to confront us. Firstly, the need to structure trade rules, treaties and negotiations so they serve the ultimate purpose of creating a just world, living within ecological limits. Secondly, how to prevent the richest and most powerful countries from unfairly dominating and structuring rules and institutions to suit their needs. Thirdly, how to tackle structural problems in many sectors, particularly commodities produced by developing countries, which suffer from unbalanced supply chains and devastating fluctuations in price. Past treaties and rules would need to be re-examined in the light of these key points.

Fifth, the **cross-border flow of capital** would be a particularly pressing issue, given the ample evidence from the current crisis of the huge risks arising from speculation and sudden reversals of capital flows. Capital flight from developing countries remains a huge problem, creating reverse flows of resources from poor to rich regions. Creating systems to manage this could vary from a minimum of collecting much better data about flows, to encouraging the use smart capital controls that could reduce risks, simplify macroeconomic management, raise revenue and improve tax collection.

Sixth, though national jurisdictions will implement their own taxation policies, improving **international tax cooperation** remains a serious issue. As with exchange rate policies, international competition has often produced beggar-thy-neighbour (and thyself) policies in the form of tax holidays, investment incentives and regulatory exemptions. The proliferation of tax havens has created secrecy spaces for those seeking to avoid paying their tax. A race to the bottom on tax limits the ability of governments to redistribute income to tackle inequality, and invest in providing basic services to eradicate poverty and ensure human rights.

Seventh, **regulating multinational businesses** presents challenges on a far bigger scale than ever before. A host of issues would be tackled, including developing legitimate accounting rules that cannot be manipulated in unintended ways, ensuring that human rights, social and environmental standards are upheld, and cooperating to avoid damaging regulatory competition. The thorny question of whether the sheer size of multinationals creates problems such as unacceptable risks for taxpayers, as has been the case with recent banking failures, would need to be tackled.

Eighth, if delegates remained committed to allowing banks to operate across borders – a position which need not be taken as given – their attention would turn to improving cooperation on **financial regulation and supervision**. However, care would have to be taken to avoid one-size-fits-all policies such as the Basel II accords on capital adequacy, which have been criticised for being pro-cyclical, disadvantaging smaller developing country banks, and undermining investment in developing countries. Eliminating the shadow banking system, which operates outside effective regulation, should be a minimum agreement.

Ninth, there is a clear need for **international income redistribution**. The current model of "aid" has faced fierce criticism for providing small, unpredictable transfers, heavily tied to the interests or preferences of rich countries. A model based on adequacy and justice would be a better starting point. A system of international transfers that operates without conditionality, untied to demands from the source countries, has been sketched out. There is need for additional transfers to redress the unbalanced global contribution to human-induced climate change. Inevitably, attention would turn to funding sources, with international taxes, such as the currency transaction tax in the forefront. There would also be discussion of meeting the need for subsidised finance for developing countries, in addition to redistributive transfers; one of the original purposes of the World Bank.

Finally, finding ways of equitably and sustainably managing **global public goods** could not fail to permeate all discussions at the conference. A huge range of issues would arise, focussed on ensuring that the global economy is fundamentally restructured to preserve the global commons and the essential life support systems of the planet. Whilst this discussion would underpin all others, care would have to be taken to ensure that existing processes, such as the UN climate negotiations, would be respected.

Cases can no doubt be made for putting other issues in the top ten. For example, IFIs currently invest considerable resources in data collection, collation and provision. Serious issues remain about effectively ensuring that data actually captures the most important issues, that it is accurate and comparable, and that it supports, not drives decision making. Closely tied to this is the thorny issue of managing research and 'knowledge' to ensure that it is not ideologically driven, is useful to those who need it, with any international role limited to where it strictly adds value to what can be produced at lower levels.

## How do they measure up?

It is clear that the current international economic architecture does not fulfil the above ten roles, though in some areas coverage is better than others.

Since 1971 there has been no coherent system for exchange rate management, and the IMF's governance arrangements seem to preclude new arrangements under its auspices. The IMF's Special Drawing Right (SDR) has been proposed as a global currency, but the US has never approved the amendment to the IMF articles of agreement that would have facilitated this. As a lender of last resort, the IMF has been beset with complaints about the harsh conditions attached to its loans, the slow speed at which they are disbursed, and the inadequacy of available resources to meet needs.

There is no legal mechanism for sovereign debt workouts. Whilst the WTO provides a forum for all countries to negotiate trade rules, rich countries have used it for self-serving interests and often reneged on promises. Rich countries, through an extensive network of bilateral treaties and agreements have been cementing liberalisation of capital flows, which are poorly monitored and highly opaque.

Efforts to promote international tax cooperation continue to make slow progress, with the recent UN Doha conference falling short of upgrading the UN tax committee to give it real powers. The inadequacy of democratic, effective public regulation and scrutiny of multinationals is demonstrated by the fact that existing international accounting standards are set by an unaccountable private-sector body. The failures of national, regional and international regulation of banking and financial services have been exhaustively documented of late.

Currently, evidence suggests that global income redistribution actually flows from poor to rich rather than the other way round. Finally, the threat of runaway climate change is a stark indicator of how our economic model is failing to protect global public goods.

## The road ahead

Cooperation at all levels, especially international, is difficult. However, more than ever, we recognise the interdependence of our societies and our dependence on a healthy planet. A number of thorny issues would have to be tackled to design or redesign IFIs to be fit for purpose today. We highlight five of the most critical.

First, there should be no *a priori* assumption that international institutions are needed in all areas. The fundamentally important principle of first seeking national, then regional solutions should be followed – the principle of subsidiarity.

Second, states, and particularly developing countries, need the space to design policies according to their needs. Care will have to be taken to ensure there can be no repeat of the ugly experience of recent decades where ideologically driven IFIs promoted one-size-fits-all policies across the world.

Third, opinions are divided over whether a plethora of institutions each specialising in one particular topic is better than giving one or a few institutions powers across a range of areas. Of course, no effort at tackling these issues will make sense unless it is coherent.

Fourth, all institutions have to be paid for, but current funding models have provided inadequate resources, and have skewed decision making towards the biggest donors. Fair models that provide stability of adequate funding, without skewing governance arrangements, such as through international taxation, will need to be considered.

Finally, equitable and effective governance arrangements will be fundamentally important for success. Democracy is the only legitimate yardstick at national level, and should become so in the international arena. Some of its demands would be easier to meet than others. Clear standards for transparency of IFIs have already been set out by the Global Transparency Initiative. Nascent mechanisms for accountability and redress exist at some international institutions and could be improved and extended to all. The thorny issue of dividing voting share among nations will be at the centre of ongoing discussions about World Bank and IMF governance reform this year. It is clear that the 'one dollar one vote' model is an anachronism, and ways of aligning voting share more closely with population need to be found. Ensuring that the poorest countries can interact with others on an equal footing cannot be assumed as it currently is; equality of voice requires affirmative action.

These issues cannot be tackled overnight: a fair, transparent process would be needed: one that involves all countries of the world, and is open to civil society and parliaments, under the auspices of the United Nations.

The world has changed immeasurably since 1944, but IFIs have not. Serious change is needed. Time for a Bretton Woods 2? The case could hardly be stronger.

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