GLOBALIZATION AND GLOBAL ECONOMIC GOVERNANCE

MARTIN WOLF
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This article focuses on the World Trade Organization (WTO) and the International Monetary Fund (IMF). It starts by noting that the case for creating such institutions is not self-evident, since the liberal order of the nineteenth century lacked comparable ones. Nevertheless, these institutions perform valuable functions. The article then considers the criticisms of the WTO and the IMF. It finds most, thought not all, unjustified. It concludes that the WTO could be improved. But, without it, the big powers would do what they want to an even greater extent than they already do. Similarly, while the IMF has made significant mistakes, notably in its promotions of capital-market liberalization, prior to the Asian financial crisis, the charges against it are exaggerated. Finally, the article considers the possibility of creating new institutions to cover investment, migration, taxation, and the environment.

I. INTRODUCTION

Why do we have institutions of global economic governance? Do the ones we have do a decent job? These are the questions addressed in this article. It focuses on the two institutions that define and apply the underlying principles of a liberal international economic order: the World Trade Organization (WTO) and the International Monetary Fund (IMF). It does not consider the World Bank, the third of the triad of founding institutions of the post-Second-World-War economic order. This is partly for lack of space. It is also because the Bank is an operating agency, designed to promote a specific goal: economic development. The WTO is not an operating agency. The IMF is one, as a lender to governments.

1 This article is drawn in large part from Wolf (2004).
2 The WTO was agreed in 1994, at the end of the Uruguay Round of multilateral trade negotiations, and established only at the beginning of 1995. But it is directly descended from the General Agreement on Tariffs and Trade (GATT). The GATT, in turn, was originally the commercial chapter of the Havana Charter, agreed in 1947, which was intended to establish an International Trade Organization (ITO). But the ITO was still-born. When it became evident that the charter would not be ratified by the US Senate, the Truman administration withdrew it from consideration. The GATT was applied, provisionally, for 48 years. Finally, in ratifying the WTO, the world created a formal institution to govern international trade, though one different from the ITO in important respects.
in difficulties. But it is also an institution that codifies norms of economic behaviour to which, in theory at least, its members subscribe. In this respect, the Fund is more like the WTO than the World Bank.

The article is divided into four further sections. Section II looks at the rationale of the WTO and the IMF. Section III focuses on criticisms of the WTO. Section IV looks at criticisms of the IMF, particularly at its relatively recent role in managing liberalization of the capital account. Section V brings the discussion to a conclusion.

II. LOGIC OF THE INTERNATIONAL ECONOMIC INSTITUTIONS

The WTO exists to facilitate, embody, and arbitrate over trade and trade-related agreements among its sovereign members. The IMF was created to finance short-term disequilibria in a world of fixed exchange rates and commitments to achieve convertibility on current account. As members have moved towards capital-account liberalization and floating-rate regimes, the focus of the Fund’s attention has shifted, but its concern with the macroeconomic stability and fiscal sustainability of member countries has continued throughout.

Why do we have such institutions? It would, after all, be perfectly possible for countries to decide their trade and exchange-rate policies independently. This was what happened in the nineteenth century. The UK had been on the gold standard since 1819. But Germany went on gold in 1871 and the USA in 1879. Members of the Latin Monetary Union (France, Belgium, Switzerland, and Italy), formed in 1875, were initially on a bimetallic standard which transmuted into a gold standard in the 1870s. ‘The gold standard as an international system was not the result of any international agreement’ (Dam, 1982, p. 23). It was managed by no international economic organization. To the extent that any institution had primacy within the system, it was the Bank of England.

The nineteenth-century trade regime was similarly free of formal international organizations or multilateral treaties. The UK adopted free trade unilaterally with the repeal of the protectionist corn laws in 1846. Subsequently, it signed the Cobden–Cheva-lier treaty with France in 1860. A web of bilateral treaties then spread the principle of unconditional most-favoured nation treatment, or non-discrimination, throughout Europe and the European empires (Tumlir, 1985, pp. 19–20). Tariffs, the dominant form of protection, were generally bound for periods of 10 years. Moreover, the USA was never a participant in this system. The role of the USA as a powerful outsider was one of the reasons for the increase in protectionism from the 1870s.

The argument for unilateral liberalization is also grounded in theory. In the post-war era, liberalization by the high-income (first) world and a few exceptional less developed economies (Hong Kong and Singapore) benefited those who liberalized, even though most of the developing (third) world and all the communist (second) world decided not to follow suit. The same argument had been made by the British free-traders in the 1840s. Following Adam Smith and David Ricardo, they argued that it was in the country’s interest to follow free trade, regardless of what others did. If the latter followed their example, that was well and good. If not, so be it. Similarly, a country can have a financially open economy in a world of restrictions on currency convertibility.

Why then were international organizations established in the aftermath of the Second World War? There are four overlapping sets of answers to this question: logical, historical, political, and economic.

If states interfere in the transactions of their citizens, others will necessarily be affected. Inherent conflicts exist, therefore, between global economic integration and independent sovereign states. One solution has been hegemony or, in its extreme form, empire. But between roughly equal states, a struggle for hegemony can lead to war. One obvious solution is an international regime, with powers of adjudication. The European Union (EU) is the world’s most developed economic regime. But the WTO and the IMF are also international regimes, in this sense.

History provides a second set of answers. The rise of the United States to its dominant position brought with it the birth of international institutions. It was partly because, as a state with a highly articulated constitutional order, the United States was inclined
towards the creation of formal institutions, rather than the informal arrangements the British had favoured during their period of hegemony. But leading figures in the United States also wished to replace the world of conflict between would-be imperialist states with one that respected the norms of inter-state behaviour embodied in the United Nations Charter and the principles of the trading and international monetary systems. The GATT and then, since 1995, the WTO were designed to institutionalize and multilateralize the system of bilateral agreements that had spread non-discrimination throughout Europe in the nineteenth century, but had then foundered in the twentieth. In addition, by providing support for countries in balance-of-payments difficulties, the IMF would, it was hoped, encourage the move to convertibility on current account and so support the desired shift towards liberal trade.

The third set of answers is political. It is hard to persuade the public of the virtues of unilateral liberalization. To many this looks like unilateral disarmament, in keeping with the general (and mistaken) view that trade is a form of war. Most people—and most governments—are mercantilists: they believe that exports are the aim of trade. The United States has always been mercantilist in this sense, unlike the United Kingdom in the nineteenth century. Yet there are also more positive political reasons for agreements with other governments. They engage economic interests in favour of greater access to foreign markets, thereby creating coalitions against the protectionist special interests that, for reasons explained by the late Mancur Olson (1965), possess disproportionate influence in the democratic political process. Politically, unilateral liberalization looks to policy-makers like a prisoner’s dilemma, in which both countries do best if they cooperate, but each has a temptation to cheat, thereby exploiting the liberalism of the other. For this reason, cooperative liberalization has proved more successful than unilateral liberalization. As a result of this, in the post-war era, the trade policy of the high-income countries has become more liberal than at any previous time, with average tariffs below 4 per cent in both the USA and EU (Bordo et al., 1999, Table 3). In the United States, use of the administration’s powers to reach agreements with foreigners has also been a way to bypass the constitutionally mandated, but historically catastrophic, log-rolling of congressional trade legislation.

The last set of justifications for international economic regimes is economic. If many countries liberalize simultaneously, the gains are multiplied. Furthermore, agreements create a framework of international law that provides greater security for all. Last, but not least, countries can commit themselves to liberal policies through international agreements in a way that is impossible on the basis of domestic legislation. Among the biggest gainers from such commitments therefore, are countries with poor reputations. They gain not only from constraints on the actions of stronger partners, but also from credible constraints on their own behaviour. Ulysses, too, saw the value of binding himself to the mast.

A different set of economic arguments can be advanced: those for assisting countries to cope with shocks created by the behaviour of markets. In the case of the IMF, the worry has always been over the behaviour of financial markets. Because of these worries, the Bretton Woods conference in New Hampshire, in 1944, agreed to establish the IMF, in order to help sustain fixed exchange rates in a world of controls on capital account. The IMF’s role was to finance temporary disequilibria in the balance of payments, thereby replacing what were believed to be destabilizing financial markets. The argument for official assistance, to reduce the costs imposed by the vagaries of markets, then changed its nature, but continued to apply, as capital account liberalization spread. Similar sorts of argument can be advanced in the case of trade: the need to curb restrictive practices and other forms of anti-competitive behaviour by powerful private companies. This is one direction in which the WTO could go if it were extended to cover issues of competition, as some high-income countries, notably the European Union, suggest.

In sum, there are powerful arguments for the existence of international agreements and institutions to oversee them. Yet the WTO and the IMF have become among the world’s principal bugbears. It is to these criticisms that we turn.
III. CRITICISMS OF THE WORLD TRADE ORGANIZATION

The WTO, it is alleged, is an anti-democratic organization, which imposes unwarranted limitations on the legitimate exercise of sovereign discretion, particularly on developing countries. In the 1970s, few people were aware of the GATT’s existence. Now the WTO has become a hated symbol of globalization.

The force and persistence of such complaints demonstrate that the trading system has become more visible, intrusive, and potent than ever before. It has, accordingly, far more enemies. That the WTO is a different institution from the GATT of two or three decades ago is clear. First, the WTO now has an increasingly active membership of almost all the countries in the world. Soon it will become universal. Second, with the addition of agriculture, services, trade-related investment (TRIMs), and trade-related intellectual property (TRIPs), in the course of the Uruguay Round, the system covers almost all trade. Third, as liberalization has advanced, the WTO has increasingly come to affect what were thought of as purely domestic regulatory decisions. Examples of such ‘deep integration’ are the Uruguay Round’s agreements on sanitary and phytosanitary standards, which accompanied liberalization of agriculture, and on technical barriers to trade. Fourth, the WTO is also a single undertaking with universal participation in all its disciplines. All members, including developing countries, have found themselves forced to make commitments, some of them onerous. Fifth, the dispute-settlement system has become both more potent and more legalistic than ever before. No longer can a party to a dispute block the adoption of a panel finding. On the contrary, it is unable to halt the inexorable progress of cases.

To address the implications of this evolution and the criticisms it has evoked, this discussion will focus on three questions. How does the WTO work? Does the WTO infringe sovereignty? Where does the WTO need to change?

First, then, what does the WTO do? The broad answer is that it helps provide the international public good of open markets, as suggested in the previous section. In practice, this good has largely been provided by economies that possess the biggest markets, foremost among them the USA and the EU, which provide roughly 40 per cent of the world’s total markets for imports (excluding intra-EU trade). Such large players have entered into reciprocal commitments to liberalize trade whose benefits have been spread worldwide through the principle of non-discrimination. As Douglas Irwin argues, ‘the WTO is useful because it changes the political economy of trade policy in a way that tends to facilitate trade liberalization as an outcome’ (Irwin, 2000, p. 353). The combination of reciprocity with non-discrimination has created a liberal, law-governed trading system, on the basis of agreements among sovereign states, each acting in its own perceived self-interest.

Within these agreements, the sanction against violations is withdrawal of a concession. The aim is to restore the situation before the agreement was disturbed by one of the parties. Thus, it is wrong, strictly speaking, to view a trade measure taken in response to a violation as a ‘sanction’. It is better to think of such actions as re-balancing the agreement, subsequent to a violation. This system evidently needs a body to determine whether or not a country’s rights have been violated. This is the logic of the dispute-settlement system. It is a way for sovereign nations to secure protection from the arbitrary actions of others, by accepting that their freedom to retaliate should be governed by an impartial procedure. The inequality in the power of nations is not removed by the WTO. It remains the case that countries with

3 The literature on the world trading system, the GATT and the WTO is enormous. This discussion draws directly from Wolf (2001) and Jackson (2001). A good general discussion of how the WTO works is contained in WTO (2001).
4 This idea of deep integration is discussed at length by Birdsall and Lawrence (1999).
5 On the costly consequences of parts of the WTO for developing countries, see Finger (2000).
6 A pure public good has two characteristics: first, nobody can be prevented from consuming it; second, it can be consumed without being depleted. The first quality makes the good ‘non-excludable’, the second makes it ‘non-rival’. Such goods cannot normally be provided adequately by the market. A global compact to liberalize trade has strong public-good elements. Many of these take the form of network effects. Thus, every member country (and often non-members as well) gains from a trade agreement between the USA and EU, on the basis of non-discrimination.
big markets have greater ability to secure market access and deter actions against their exporters than countries with small markets. In practice, dispute-settlement remedies are of little use to small countries, unless the big players voluntarily submit. This reflects the fact that the WTO is not a system of global government, but rather a way of organizing and disciplining the intrinsically unequal capacity for self-help of member states. But to the extent that countries abide by non-discrimination, this capacity for action is effectively at the disposal of all.

For all its merits, the WTO has limits as a tool for liberalizing trade. The first limit is that the WTO is not the only way to liberalize. On the contrary, both high-income and developing countries have liberalized extensively, both unilaterally and in the context of preferential trading arrangements. The second is that international rule-making is not always and necessarily liberalizing. Anti-dumping is an egregious example of bad trade policy that is enshrined in the WTO. The balance-of-payments exemption for import restrictions is another. The third is that the WTO’s clout has become attractive to those who have no interest in liberalization. The extension of the trading system beyond the explicit goal of trade liberalization began, in the Uruguay round, with TRIPs. Nowadays, however, a rich assortment of activists have realized the potential value of the WTO’s enforcement mechanisms for their own purposes. Yet a WTO that raises regulatory barriers worldwide and eliminates both valid diversity among regulatory regimes and competition among them could well be worse than no WTO at all.

Now turn to the second big question: does the WTO infringe sovereignty? The broad answer to this question is no. The bedrock of the trading system is enforceable agreements among states, most of them embodied in domestic law. Only governments, with their monopoly of legislation and law-enforcement, can make law. For this reason, the system is unavoidably inter-governmental. The WTO has merely a tiny secretariat (with a budget of less than $100m in the early twenty-first century) servicing a structure of inter-governmental agreements. It is not a government. But once there is a multilateral agreement, there also needs to be a dispute-settlement mechanism. An agreement interpreted by each party individually would not be worth the paper it was written on. Equally, interpretation cannot be left to the parties to the dispute, since they are, by definition, in disagreement. For a multilateral agreement to amount to anything, its dispute-settlement system must be out of the direct control of any party or parties to a dispute.

It follows that the place for democratic accountability is the legislatures of each of its members. This is where the governments engaged in the trading system need to explain what they are doing and why. It also follows that each individual legislature can no longer determine its own country’s trade policy, on a day-to-day basis, even though it continues to set the negotiating authority of its government and retains the ultimate (and decisive) power of ratification of any results. This self-imposed constraint on the freedom of legislatures does not subvert democracy. It is an expression of it. All modern democracies are constitutional. That is they recognize that limits can properly be imposed on the discretion of a temporary majority (or plurality) within a legislature. In general, two kinds of interests tend to be over-represented in such legislatures: concentrated producer interests (producer lobbies); and groups with strong emotional commitments to particular policy goals (notably, non-governmental organizations (NGOs)). As the late Robert Hudec noted, reliance on international negotiations to ‘circumvent’ a legislative process dominated by such groups may be a rational and desirable way to secure a better outcome for the public at large than is likely to emerge from the domestic legislative process (Hudec, 1993).

Those who find their ability to determine domestic legislation reduced resent the international process that has this result. The question is how far the WTO should accommodate the desire of such groups to influence the processes of negotiation and dispute settlement directly. Daniel Esty argues that public support cannot be founded on government authority. Individual acceptance is what matters. The organization must therefore demonstrate that it has genuine connections to the citizens of the world and that its decisions reflect the will of the people across the planet. Non-governmental organizations represent an important mechanism by which the WTO can reach out to citizens and build the requisite bridge to global civil society. (Esty, 1999, pp. 97–8)

Yet how is the ‘will of the people across the planet’ to be defined and assessed, other than through
elected governments? There is no reason to accept that a collection of NGOs, dominated by the relatively well-resourced institutions of the North, represents the ‘will of the people across the planet’. At present, the WTO works on the basis of a consensus among states, with the biggest and most economically significant having, informally, the greatest influence. This seems a reasonable accommodation to the realities of a world in which public goods are provided by a collection of governments. What, after all, is the alternative? One-person-one-vote would give India and China close to 40 per cent of the votes. This is not the sort of world most radical activists appear to have in mind, though one of them, George Monbiot (2003), has recommended just this.

Demands for popular democracy within the WTO are misplaced and misguided. Almost as problematic is the desire to open up the dispute-settlement system to the voices of non-governmental actors. There can be no objection to the wish of panels to obtain the views of qualified experts, including those working for—or funded by—NGOs and private business. But if such voices are to be heard, as of right, a number of important theoretical and practical concerns must be addressed. The first is that the non-governmental voices that have a right to be heard must not be limited in some arbitrary way. The second is that members of the WTO and private corporations, neither of which have this right at present, must also be heard. The third is that some way must then be found to fund the involvement of governments and private organizations based in developing countries. The fourth is that a way must also be found to increase funding of the dispute-settlement process, to ensure that it is not overwhelmed.

This leaves the wider issue of transparency to the public at large. Here, the way ahead should be relatively uncontroversial. The WTO needs to take forward its programme of symposia and seminars with non-governmental actors. It also needs to improve further the dissemination of documents. The web site is an extremely important step in this direction. More of the WTO’s activities could also be opened to the press. But, for these things to happen, and particularly for voices from developing countries to be heard, the WTO must be better funded.

Finally, where does the WTO need to change? Here, experience of recent years suggests the following big issues need to be (re)considered.

First and most important, the idea of a single undertaking needs to be looked at again. Insisting that everybody signs up to everything creates two contradictory pressures—a move to the lowest common denominator and the imposition of what turn out to be politically intolerable obligations. This would be one way round the impasse now likely to be created by further negotiations on services or by negotiations on investment and competition. Naturally, those who do not participate in such negotiations cannot expect to benefit from the outcome. If the idea of a single undertaking is re-examined, it might also be possible to re-examine consensus. If countries are not bound by everything, they cannot expect to be consulted over everything.

Second, the dispute-settlement procedure needs to be reconsidered in at least one important respect: where the underlying meaning of the texts is obscure, panels should not try to invent law. They should, instead, encourage parties to return to negotiation. If necessary, they should honestly admit that the law is unclear.7

Third, the range of compensation needs to be broadened, to include financial compensation, since compensation through trade often imposes unfair costs on unrelated parties. It should become quite normal for an impasse between two parties to be settled through financial compensation. The beef hormones case between the USA and the EU seems ripe for such treatment.

Fourth, the question of legitimate infant industry protection and subsidization needs to be re-examined. The constraints imposed by the WTO upon the freedom of developing-country members can be exaggerated. Even Alice Amsden, a staunch advocate of interventionist policies, concludes that ‘the liberal bark of the WTO appeared to be worse than its bite’ (2001, pp. 268–71). Nevertheless, without endorsing the wisdom of infant industry protection as a general idea, the international community should re-examine whether developing countries could have greater freedom to introduce export conditions,

7 The idea that dispute settlement should become less legalistic and more diplomatic is advanced by Barfield (2001).
export subsidization and other means to promote early-stage industrialization.

Fifth, some sort of legal resolution needs to be made of the relationship between the WTO and multilateral environmental agreements.

Finally, the focus of the organization must, once again, be placed on liberalization, rather than the harmonization of regulatory standards, as was begun, so dangerously, with the TRIPs agreement.

In all, however, the complaints against the WTO are exaggerated, where not misconceived. It is not a tyranny; on the contrary, it is weak. It is not undemocratic; on the contrary, it is an expression of democratic choices. It can be improved. But, without it, the big powers would do what they want to an even greater extent than they already do.

IV. CRITICISMS OF THE IMF

Now, let us turn to the IMF. The wisdom of currency convertibility on current account has been largely accepted. Similarly, the attempt to run a system of adjustable pegged exchange rates among countries with increasingly open capital accounts foundered in the early 1970s. Increasingly, therefore, the focus of the IMF’s attention has been the management of the consequences of partial, or complete, capital-account liberalization by developing countries. (In a companion article in this issue, Joseph Stiglitz argues that movement toward capital-market liberalization by developing countries is a mistake.) The discussion ignores the IMF’s role in facilitating the transition of former communist countries towards the market economy.

It would take a book to address all the complaints made against the Fund. This section focuses on five.

- It has created moral hazard by lending too much and bailing out the imprudent lenders who are its true masters, at the expense of innocent people in crisis-hit countries.
- It is too subservient to the interests of the Group of Seven leading high-income countries and especially the USA.

First, let us consider the charge of a one-size-fits-all approach to policy. Joseph Stiglitz has made this complaint, along with many others, writing (2002, pp. 36–7) that

it’s unlikely that an IMF mission, on a three-week trip to Addis Ababa, Ethiopia’s capital, or any other developing country, could really develop policies appropriate for that country. . . . Outsiders can play a role, in sharing the experiences of other countries, and in offering alternative interpretations of the economic forces at play. But the IMF did not want to take on the mere role of an adviser, competing with others who might be offering their ideas. It wanted a more central role in shaping policy. And it could do this, because its position was based on an ideology—market fundamentalism—that required little if any consideration of a country’s particular circumstances and immediate problems. . . . Suffering and pain became part of the process of redemption, evidence that a country was on the right track.

Furthermore,

The IMF has done a good job of persuading many that its ideologically driven policies were necessary if countries are to succeed in the long run. . . . But IMF programmes go well beyond simply ensuring that countries live within their means.

These are sweeping charges. How far should they be accepted? The answer is that Stiglitz is right only up to a point. The IMF has been a secretive and arrogant organization, though both charges are less applicable today than a few years ago. Its technical approach to both monetary and fiscal policies has been questionable. Its conditionality has been too complex and intrusive. It has lent, too often, to the same incompetent borrowers. It has also assumed excessive responsibility for running many developing countries, particularly small and poor ones. This has confused political responsibility. Policies mandated by a mixture of adverse circumstances and incompetence are too frequently blamed on the IMF. That may be politically convenient for the
governments of crisis-hit countries. But use of the IMF as a scapegoat conceals from the population both the locus of responsibility for a crisis and the consequent necessity of fiscal and monetary restraint.

It is said that IMF stands for ‘it’s mostly fiscal’. Unfortunately, it mostly is. As even Stiglitz admits, countries must live within their means. The right criticism of the Fund is that it is a hedgehog pretending to be a fox. But what the hedgehog knows is right: usually it is mostly fiscal. Countries with solid fiscal positions rarely experience serious economic crises. In the Asian crisis of 1997 and 1998, countries with apparently sound public finances turned out to have a mountain of off-balance-sheet liabilities. More frequently, the lack of fiscal sustainability is evident. Beggars, so the saying goes, cannot be choosers. Countries that have to turn to the IMF are beggars. They cannot choose but adjust. The only question is how.

If the ‘one-size-fits-all’ charge has force, it is only because governments fall so often into the same predicament: they spend beyond their means and run out of credit, at home or abroad. The solution is also the same: whether or not they default, governments must reduce their spending in relation to revenue. The IMF has no more responsibility for the calamity than an ambulance crew for the car crash they are attending. Yet it does offer a palliative: additional funds that reduce the rapidity and so the shock of adjustment.

Now turn to the second charge: that the IMF failed to foresee—and warn against—the risks of premature, ill-planned, and worse-implemented capital-account liberalization. Of this the IMF is guilty. It is in good company—that of the US Treasury, to name but one party. As the institution charged with responsibility for global macroeconomic instability, it bears blame for failing to warn of the dangers. In its assessment of the IMF’s handling of the Indonesian, South Korean, and Brazilian crises of 1997, 1998, and 1999, the newly established Independent Evaluation Office (2003, p. 15) concluded that ‘IMF surveillance was more successful in identifying macroeconomic vulnerabilities than in recognizing and analyzing in depth the risks arising from financial sector and corporate balance sheet weaknesses and the governance-related problems that contributed to those weaknesses.’ This is bureaucratic phraseology for ‘the Fund blew it’.

Then consider the third charge: Fund recommendations for dealing with the Asian crisis amounted to screaming ‘fire’ in a burning building, thereby turning a problem of illiquidity into one of insolvency (Stiglitz, 2002, p. 97). A similar attack was made by Jeffrey Sachs, in collaboration with Steven Radelet (Radelet and Sachs, 1998). This is not the place for a detailed evaluation of the way the IMF handled the Asian crisis. Nevertheless, it is important to identify where it went wrong, including the points on which its fiercest critics were right. Nobody would now doubt, for example, that the Fund failed to warn adequately of the dangers of capital-account liberalization. Yet it is also more evident today than it was to observers at the time that a number of these countries had mishandled not just the liberalization of their financial systems and controls on foreign exchange, but also exchange-rate management and macroeconomic policy. The Fund is perhaps to blame for not having discovered this sooner. But it was not to blame for the decisions with which policy-makers persisted well beyond the bitter end. Several countries, for example, encouraged short-term foreign currency borrowing. South Korea, astoundingly, permitted only such short-term borrowing, principally via the banking system.

Again, both Thailand and South Korea allowed the defence of their exchange-rate pegs to continue to the point at which their foreign currency reserves were exhausted, while concealing this fact from the IMF, the markets, and their populations. Similarly, the long Asian boom had concealed the increasingly unsound state and, indeed, corruption of sizeable parts of the financial system. In the case of Indonesia, for example, the Suharto family and its

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8 For a relatively neutral account of the Asian crisis see Barry Eichengreen (2003, ch. 9). Stanley Fischer, first deputy managing director of the IMF at the time of the crisis, provides his version of the story in Fischer (2001, 2002).

9 World Bank (2001, Figure 1.11) provides an astonishing demonstration of the tentacles of the Suharto family. The wider problem was the pyramid structures that allowed control over companies by families and individuals with small equity stakes. This has also tended to mean high ratios of debt to equity. Prior to the Asian crisis, much of this debt was in foreign currency, since the interest rates were (apparently) very low.
associates had behaved far worse than most outsiders had realized. For none of this was the IMF responsible, and, by the time it was called in, it was equally far too late to achieve the painless remedies sought by Stiglitz.

Now turn to the remedies the Fund imposed. It is universally accepted that the initial requirement that fiscal policy be tightened was an inappropriate throwback to standard IMF remedies. To be fair, this requirement was abandoned quite swiftly. Equally, it is widely agreed that the host of loan conditions imposed by the IMF—some at the behest of the US Treasury, some even at the urging of economic reformers in the afflicted countries—was a mistake. In general and rightly, the IMF has since decided to prune the range and intrusiveness of its conditionality.

Some—the Wall Street Journal, for example—criticize the IMF for allowing currencies to depreciate. But how countries with no foreign-currency reserves and huge net short-term foreign-currency liabilities were to avoid a devaluation is unclear. More legitimately controversial were the linked decisions to provide large ‘bail out’ packages (though not as large as they seemed, since much of the money supposedly available from bilateral donors was a mirage) and raise short-term interest rates to minimize the fall in currencies. Stiglitz (2002, p. 95) protests that the money . . . enabled the countries to provide dollars to the firms that had borrowed from Western bankers to repay the loans. It was thus, in part, a bailout to the international banks as much as it was a bailout to the country; the lenders did not have to face the full consequences of having made bad loans.

Similar complaints were made by those Stiglitz would call ‘free market fundamentalists’ to the effect that the big bail-outs were creating serious moral hazard. Indeed, the Asian crisis, some would argue, was a direct consequence of the Mexican rescue of less than 3 years before.

Similarly, Stiglitz, Sachs, and a host of others protested against the decision to raise interest rates, to slow the currency collapses. Given the highly indebted state of the corporate sector, high interest rates were, they argued, bound to increase the extent of bankruptcy and so the economic depression. Against this, the IMF argued that accelerated declines in the value of the currencies would, given the foreign-currency indebtedness of the banks and corporate sectors, also accelerate the rate of bankruptcy and so the slide into recession. To this the critics responded that, in an environment of financial fragility, high domestic interest rates were more likely to undermine confidence in the currency than increase it, thereby achieving the opposite of what the IMF intended. They also added that there was at least some justice in the bankruptcy of those who had borrowed heavily in foreign currency, but far less so in the forced insolvency of those who had relied more heavily on domestic currency borrowing. Finally, they noted, if the aim were to prevent a run across the exchanges, it would have been far better to impose a standstill on withdrawals of funds and, if necessary, temporary controls on capital outflows.

To these points, in turn, the IMF and its defenders have replied that the high interest rates were in effect only briefly and that rates were lowered as soon as currencies stabilized. Furthermore, it was impossible to separate the deserving from the undeserving in a crisis that, one way or another, was bound to affect everyone. Finally, the IMF did not have the ability to impose a standstill on withdrawals. In the case of South Korea, the G7 governments did, indeed, do this at the very end of 1997, but were able to do so only because of the concentration of lending by the international commercial banks. At the same time, all the governments of the crisis-hit countries were desperate to avoid a default. This was, beyond question, a sovereign decision. It was not, on the evidence of what default usually means for a country, an irrational one either.

So who is right? The IMF cannot be found definitively ‘not guilty’ of the charge of blundering its way through the crisis. The case is, in the Scottish legal terminology, ‘not proven’. This ignorance is partly because we are unable to run controlled experiments in economics. Moreover (and fortunately), crises on this scale do not happen that often. When a crisis of confidence of this magnitude occurs, there are no painless escapes. The big mistakes
were made before the crisis hit. After the crisis
started, all options were difficult.

Have the IMF bail-out packages created serious
moral hazard, which was our fourth charge? Both
the assumption that the answer must be a resound-
ing ‘yes’ and the view that the right response is to
stop providing support in crises are unwarranted.\(^\text{10}\)
It must be stressed, in the first place, that the fact of
moral hazard is insufficient to rule out a policy. We
do not close down fire brigades because they en-
courage householders to take risks with fire. Nor-
mally, we would combine whatever causes the
moral hazard with some sort of regulation. Houses
are subject to fire regulations, for example.

In the second place, it is far from clear that the moral
hazard has been as important as some critics argue.
Those who think it has been tend to start from the
assumption that markets are incapable of making
mistakes. But we know that they can make huge
ones. It is important also to remember that a sizeable
part of the flow to Asian crisis countries took the
form of portfolio equity and bonds whose holders
suffered large losses. In addition, prior to the crisis,
spreads on bonds to what turned out to be the crisis-
hit countries fell to low levels, only to explode
upwards, once the crisis hit. This strongly suggests
that the investors had underestimated the risks. If
they had been confident of being bailed out, spreads
need not have risen. Similarly, if commercial banks
had been confident of being bailed out, they need not
have taken their money out. In which case there
might have been no crisis.\(^\text{11}\)

Finally, whatever may have been the case for
lenders, the governments of the crisis-hit countries
cannot have been under any illusions about what
such a crisis would mean for them and their coun-
tries. IMF bail-outs have never spared countries
considerable pain. All the governments in power at
the time the crisis hit have since fallen, with the
exception of Malaysia’s.

This is not to argue that moral hazard played no part
in the crises, merely that international lending was
not its prime source. Government guarantees to
banking systems in capital-importing and capital-
exporting countries have been of decisive impor-
tance in one financial crisis after the other. But these
guarantees were not given by the IMF, but by
governments, including by the governments of the
G7 countries. If the effects of moral hazard on the
financial system are to be eliminated, this is where
one would have to start.

The final charge against the IMF is that it is a tool of
the G7, particularly, of the USA, and, more particu-
larly still, of Wall Street. The answer to this charge
is obvious: guilty. The institution responds to the
realities of power and the self-defined interests of its
dominant player. If Japan had, for example, been
willing to take on the US Treasury and set up its
suggested Asian Monetary Fund, the position of the
IMF would have been very different. It is intriguing
that Stiglitz, who strongly supports that idea, is also
against the bail-outs that such a fund would surely
have made possible. It is quite possible to imagine
changing the IMF’s governance arrangements to
give greater voting weights to countries likely to
borrow from it. But it is equally clear what would
then follow. The creditors would use other instru-
ments for dealing with debtors, probably bilateral
ones. The trick of making multilateral institutions
work is to recognize the realities of power, without
succumbing to them entirely. The question is rather
whether the IMF has gone as far as it can towards
achieving the practical degree of independence
from the pressures of the powerful. It was too
subservient to the USA during the 1990s. This was
made possible by the relatively informal way in
which decisions were, in practice, taken. Greater
transparency and openness and greater willingness
by other G7 countries to take on the USA, where it
is wrong, would be a big help.

Where then do we come out? ‘In the uncomfortable
middle’ is the answer. Did the IMF do a wonderful
job in the 1990s? The answer is an unambiguous no.
Would the world be better off with no IMF? The
answer is probably not. If the IMF did not exist,
countries would not be left alone to sink or swim. If
crises hit, they would have to deal directly with
the US Treasury, instead. That would be no

\(^\text{10}\) This assumption lay behind the recommendations of the so-called Meltzer Commission, after Allan Meltzer, its chairman (see

\(^\text{11}\) On the question of moral hazard, see Dobson and Hufbauer (2001, pp.130–3) and Willett et al. (2002).
improvement. Can we create an all-wise, self-disciplined, transparent, and democratic IMF? The answer again is an unambiguous no.

V. CONCLUSION

The case for global economic regimes is strong. But, inevitably, those we have are highly imperfect. This is partly because they must reconcile fundamental tensions: between national sovereignty and global economic integration; between a few hugely powerful states and the host of weak ones; between rich countries and poor ones; and between believers in untrammelled market forces and sceptics. Any international regime must be a compromise. Since the one we have is widely condemned, from left and right, it is probably doing a reasonable job.

This is not to suggest that no progress can be made. On trade, the priority is to make liberalization once again the focus of the WTO. The institution has become too concerned with the harmonization of regulatory standards, starting with TRIPS. Too many countries are involved in negotiations. The WTO is, as a result, becoming like the UN, an arena for windy debate, rather than effective negotiations among countries that wish to liberalize, first and foremost in their own interest. For most countries, unilateral liberalization remains far more sensible than engagement in protracted negotiations over whose outcome they will have very little influence.

On finance, the principal goal must be to let countries decide how far they wish to liberalize controls on capital account. The IMF can be an advisor to such governments, but it does not have the means to protect them from the consequences of either their own mistakes or the vagaries of capital markets. Governments must take their decisions in full awareness of that fact. Again, the instability of floating exchange rates, not least among the world’s major currencies, imposes large costs. The case for a mechanism to reduce this instability can be made. In practice, this option is off the agenda for the foreseeable future. It would also not now be done through expanded Fund financing, but through an enlargement of the swap arrangements among the central banks. The Fund could provide some advice, but it cannot plausibly obtain the resources needed to manage global exchange rates.

If it is better to have international rules than not to do so, there is a case for extending them into other areas. One example is investment. The global investment regime is in much the same state as the trading regime in the nineteenth century. Countries have already signed many bilateral investment treaties. In 1990, a total of about 400 such treaties were in effect. By 1997, as the case for inward investment became increasingly well accepted in developing and former communist countries, the number had jumped to 1,300, with more than 160 countries participating in at least one treaty (Graham, 2000, p. 174). It seems to make sense to bring these bilateral treaties into a multilateral framework. Among many other aims would be to reduce the competition among governments for the favours of foreign investors.

Similarly, there may be a case for a general regime to govern the movement of people. Migration has become one of the most controversial political issues almost everywhere. Deciding who can enter a country is a sovereign matter. But the development of some minimum rules governing the treatment of migrants would seem logical. Temporary migrants are providers of labour services. Some of the economic aspects of the movement of people can, therefore, be handled through the services regime of the WTO (that is, through the General Agreement on Trade in Services). Achieving this is, indeed, one of the goals of developing countries in the Doha round negotiations. But there are bigger economic issues (not to mention questions concerning the human rights of migrants). Perhaps the most important is that the export of human capital from poor to rich countries represents reverse aid. A case can be made for global rules on how importing countries compensate the exporting ones for this loss.

One possible way to achieve this objective might be taxation, with importing countries handing over some of the revenue they raise on the income of migrants to the exporting ones. This is one element in a wider case for some kind of global taxation regime in our current world of capital mobility, trans-national companies, and large-scale migration. Such a regime
would deal with, among other things, cooperation among fiscal authorities over evasion. It could also look at cooperating over defining the tax base, particularly for the taxation of trans-national companies. Steps in some of these directions are, in fact, now being taken by the EU and the Organization for Economic Cooperation and Development.

Finally, the global environmental regime remains undeveloped. As international environmental externalities become more evident, the case for developing a global environmental regime with some teeth will also seem more compelling. An important part of such a mechanism will become paying for the services of the global commons. In this, the rich countries owe a huge debt to the poor ones, notably over the use of the atmosphere as a carbon sink. Paying back that debt, as part of a mechanism to deal with global warming, may become a big issue in global politics in the twenty-first century.

Yet none of this is likely to change the fundamental reality that sovereignty remains with individual states. The tension between that political and economic reality and the demands and constraints of international economic integration will endure for the indefinite future.

REFERENCES


