

Reclaiming development: streamline the Bretton Woods institutions

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The Bretton Woods institutions – the World Bank and the International Monetary Fund (IMF) – are considered “specialised agencies” under the Charter of the United Nations (UN) in 1945 and the terms of their relationship with the UN are spelt out in respective “relationship agreements” entered into between the Bank and the IMF and the UN. Central to these agreements between these international financial institutions (IFIs) and the UN are clauses which respect the demarcation of roles between the respective organizations and the affirmation of the autonomy of IFIs in matters within their specific jurisdictions.

This decision to retain the organizational independence of the Bretton Woods institutions from the UN system, and the maintenance of their different governance structures favouring a small cartel of major industrialised countries, has had significant implications for global economic policymaking and international economic and financial cooperation, as well as on the social and economic development of developing countries. It has also largely prevented the institutions from undertaking the tasks they were originally created for – to provide for a stable and orderly international trade and financial system and to facilitate reconstruction and development.

Any reform of the multilateral governance institutions, including the current ongoing discussions on UN reform, must therefore include a reform of multilateral financial institutions to ensure the creation of truly international financial and economic governance organizations which better represent and service the interests of all member states and enable the better coordination among existing multilateral institutions to do the same. These institutions must also be subjected to the overarching universal principles which underlie all multilateral processes of decision-making which encompass not only the principle of equality among states but also a respect for human rights and the right to sustainable development.

An affront to the principle of sovereign equality and the erosion of multilateralism in global economic governance

The constitutional frameworks of the Bretton Woods institutions are an affront to the principle of equality among states and their operational practice over

the years since their inception reflects a progressive erosion of the principle of multilateralism in international affairs. Although both institutions justify their autonomy from the United Nations system on the grounds that each of them is “required to function as an independent international organization”,² neither of these institutions are truly “independent” nor “international” in character.

The governance structure of the Bretton Woods institutions is inherently asymmetrical in favour of developed countries and this asymmetry has been exacerbated over the years by both the development of the global economy and the shift in the nature of the work programmes of both organizations. The result is that those countries least affected by the decisions of the World Bank and IMF have the most influence and the most capacity to hold either institutions to account, while those who are subjected to their policies and who form the bulk of the institutions’ operations have the least say in how these institutions are run.

In a paradoxical twist, changes in the financial operations of both institutions over the years have resulted in borrowing members – the developing countries who have little power in the decision-making processes – shouldering the bulk of the costs of administering the Bretton Woods institutions and their activities. While the core capital of the World Bank and the IMF relies on the financial contributions of their wealthiest shareholders – through quota subscriptions for the IMF and paid-in and “callable” capital for the World Bank – the current administrative costs of both institutions are now largely financed by borrowing member states through the charges and interest on their loan repayments and, in the case of the World Bank, their track record in servicing their International Bank for Reconstruction and Development (IBRD) debts which contributes to the Bank’s ratings in the international capital markets (Mohammed, 2004).

There has also been a creeping “bilateralism” which has increased the control of specific developed countries over the policies of these supposedly multilateral institutions. As “a form of global collective action”, multilateral lending is seen as a type of redistribution and instrument of international economic cooperation in which richer states pool their resources to provide external financing to poorer countries to prevent the negative externali-

ties associated with international capital market failures and to assist in the provision of global public goods (Akyüz, 2006).

However the principle of multilateralism in the Bretton Woods institutions have been significantly weakened since the “introduction of donor-driven concessional windows” (Akyüz, 2006), such as the International Development Association (IDA) (with its three-year replenishment cycle) at the Bank and the Enhanced Structural Adjustment Facility, now the Poverty Reduction and Gross Facility (PRGF), at the IMF. These facilities require periodic replenishments from bilateral donors, providing opportunities for these countries to exercise leverage over the policies of the Bretton Woods institutions outside the usual decision-making process.

Expansion of constitutional mandates and failure in fulfilling traditional responsibilities

The administrative costs for running the World Bank and the IMF have increased substantially in recent decades as a result of policies pursued by their developed country members. After the collapse of the fixed exchange rate system in 1972 and particularly since the advent of the debt crisis in the 1980s, the World Bank and the IMF have greatly expanded the remit of their responsibilities, extending their reach into areas which were traditionally outside their jurisdiction while downgrading or abandoning other aspects of their work.

One of the most fundamental aspects of the Bretton Woods institutions ‘mission creep’ is the Bank and IMF’s shift of focus towards social and economic development policy of developing countries, including domestic economic regulation, trade policy, poverty alleviation, social welfare and even environmental protection. This shift has been most pronounced for the IMF in terms of divergence from its constitutional objectives although the World Bank’s expansion has been more extensive in scope.

The IMF no longer plays a role in ensuring international financial and monetary stability although the need for such a multilateral organisation has never been greater given the globalization of finance capital and the volatility of financial flows today. The institution no longer exercises any discipline over exchange rate policies of its member states and has no authority over the important players in the global financial system – the industrialized countries – whose domestic policies affect the stability of international financial architecture more than those of the developing countries for whom IMF regulation has been most pronounced.

² Articles 1(2) of the Agreement between the United Nations and the International Bank for Reconstruction and Development, 1947; and the Agreement between the United Nations and the International Monetary Fund, 1947.

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The Fund's extension of short-term current account financing to countries experiencing financial crises has been seriously circumscribed both by its introduction of conditionality as well as the policy prescriptions of the adjustment programmes which accompany such financing. The IMF's financing operations for crisis countries have also been focused on servicing external debt to private creditors and maintaining capital account convertibility (Akyüz, 2005) rather than assisting countries to manage with the social and economic repercussions of financial crises. Instead, many of the policies instituted by the IMF through conditionality in these countries have worsened the social and economic dislocations of the financial crisis.

Similar impacts have resulted from the Bank's foray into development policy lending and sectoral reform programmes which have promoted liberalisation of markets, market-based land reform, the privatization of essential services such as health, education and water, and the elimination of government subsidies and protection for infant industries and agricultural sectors. This policy-based financing has provided the opposite function to the Bank's mandate of providing capital for reconstruction and development: they are "fast-disbursing" loans serving primarily to meet short-term balance of payments needs and economic restructuring purposes as opposed to long-term developmental targets.

The Bank has also deepened its social and economic policy work, including through revisions of Structural Adjustment Programmes (SAPs) and other sectoral lending instruments to include emphasis on social sectors and poverty reduction; the promotion of various financing instruments for capacity building and technical assistance in a plethora of different issue areas; and through its non-financing activities, such as its dissemination of research and policy papers and consultancy work. A report by the Bretton Woods Project estimates that "between 1997 and 2002, USD 283 million was spent on reorganizing the Bank to be a knowledge institution", with studies indicating that "the Bank's analytical approaches influence policy-making across the world even if the Bank is not involved directly" (Wilks, 2004).

Over the same period, the role of the UN economic agencies, notably the United Nations Conference on Trade and Development (UNCTAD), have been progressively weakened, with these organizations' capacity in economic research, policy formulation and international economic negotiations eroded through financial and other constraints and pressures brought to bear on these agencies and their personnel by developed countries (South Centre, 1996).

These reforms have served to establish the dominance of the Bretton Woods institutions in issues of social and economic development in the international arena and significantly increased the influence of the Bank and IMF in key economic (and lately, even social and political) policy decisions in borrowing member states. The coinciding expansion of the Bretton Woods institutions work programmes with the reduction in the UN's role in economic policy agenda setting represented a slow but sure "transfer of power" from the UN agencies to the World Bank and the IMF, thereby "eroding and weakening those organizations which were *not fully under the major powers' control*" (South Centre, 1996, emphasis added).

"Conditionality" undermines principle of national sovereignty and non-intervention

The expansion of the nature and content of conditionality has taken place in tandem with the expansion of the Bretton Woods institutions' mandate. The scope of conditionality in Bank and Fund lending now encompass conditions which are neither relevant nor critical to the purposes of the financing or are conditions in areas which "neither the IMF nor the World Bank has the expertise to give proper advice", thus creating great margins for error and negative externalities (Khor, 2001: 12). Many of these conditions erode the policy autonomy of countries and constitute interventions in sovereign states' domestic affairs, such as the current proliferation of "governance-related conditionality" (GRC), most notably at the World Bank³.

Conditionality has also evolved to be a default regulatory instrument for disciplining developing countries, including prescribing social and political reforms. Conditionality has been used as a misguided means of ensuring compliance of World Bank and IMF borrowing countries to social and economic development priorities, ranging from poverty reduction to gender equity, as well as conformity with environmental norms. At the same time, these institutions, notably the World Bank, have failed to comply with internationally agreed standards of protection for social, political and economic rights, and environmental standards through their lending practices.

The use of conditionality in this manner is at odds with the Bank's own constitutional prohibition against political interference in borrowing member

states⁴. This practice is also an affront to the principles of international economic relations as enshrined in the 1974 UN General Assembly Resolution 3281 on the Charter of Economic Rights and Duties of States, one of the fundamental norms of international law. Chapter 1 of the Charter stipulates international economic and political relations should be governed, *inter alia*, by respect for the sovereignty, territorial integrity and political independence of states and the principle of non-intervention.

Meanwhile Chapter II of the Charter affirms the "sovereign and inalienable right" of states to choose their own economic, cultural and political system without outside interference (Article 1) as well as the right to "freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities" (Article 2(1)). These represent rights of their member states that the Bretton Woods institutions should respect, as the institutions are "specialized agencies" under the Charter of the United Nations.

The Charter of Economic Rights and Duties of States also provides that in efforts to fulfil their primary responsibility to economic, social and cultural development of their peoples, "each State has the right and the responsibility to choose its means and goals of development" (Chapter 2, Article 7) while the 1986 UN General Assembly Resolution 41/128 on the Declaration on the Right to Development provides that "States have the right and the duty to formulate appropriate national development policies" and "the primary responsibility for the creation of national and international conditions favourable to the realization of the right to development" (Articles 2(3) & 3(1)).

The Bretton Woods institutions pay little credence to such international norms in the design and implementation of their conditionalities. The content of Bank and Fund conditionality, has been based on the policies of the Washington Consensus which are premised on fiscal austerity and restrictive monetary policies, the liberalization of capital flows, trade liberalisation, deregulation and privatization. These policies have generally followed a pattern of "one-size fits all" or a "boilerplate template" in which one set of policies are applied to the vast majority of countries without due regard for individual circumstances. The practice of conditionality has therefore undermined the domestic policy space of borrowing governments and curtailed the right of these countries to regulate their economies.

3 For example, public expenditure management (PEM) conditions which constituted 48% of the total share of conditionality in Bank loans in financial year 2005 (World Bank, 2005b: Figure 11).

4 Article III, Section 5(b) of the IBRD Articles of Agreement; see also Article V, Section 1(g) of the IDA Articles of Agreement.

Need for reform and revitalization

The existence of the Bretton Woods institutions with their asymmetrical governance and administrative framework existing in concert with the UN and UN agencies created specifically for social and economic development – such as the UN Conference on Trade and Development, and the United Nations Development Programme – has provided a convenient alternative forum for the discussion of issues and implementation of policies of which the more equitable decision-making framework of the UN system have proven unconvective to the interests of the major political powers.

There is therefore a need to both *reform* the Bretton Woods institutions and *reinvigorate* the economic role of the UN in order to ensure sustainable development and to achieve the objectives of the Millennium Development Goals. Four recommendations can be put forward in this regard:

- **Reforming the governance structure of the World Bank and the IMF to ensure representativeness and accountability.** There has to be a fundamental overhaul of the archaic governance framework of these institutions predicated upon an outdated post-war model which no longer reflects the developments in the global economy today and which skews decision-making control in favour of the economically powerful at the expense of the economically weak. Developing countries must be given greater voice and representation at the Bank and the Fund.
- **Streamlining the Bretton Woods institutions and scaling them down to their original mandate.** The current workload of the World Bank and the IMF is too broad and too intrusive and the administration of their many activities unwieldy and costly. Streamlining the institutions so that they return to their original mandates of facilitating a stable international trade and financial system and providing financing for development would ensure greater efficiency and effectiveness of these institutions and restore policy autonomy to borrowing countries.

- **Revitalizing the role of the United Nations economic and social development agencies.** The reduction in the scope of work of the Bretton Woods institutions should also be accompanied by the revitalizing of the work of the United Nations agencies and other UN “specialised agencies” in the area of international economic cooperation and domestic economic and social development. This would not only reduce the influence of the powerful developed countries but also the influence of the pervasive institutional ideology of the Washington Consensus prevalent at the World Bank and IMF.
- **Removing the regulatory role of the Bretton Woods institutions and subjecting them to UN scrutiny.** The application of policy conditionality as a means of achieving internationally agreed social and development objectives, but especially, global environmental norms in borrowing countries must be reviewed as this has the effect of making the Bretton Woods institutions *de facto* governance organizations in areas for which they are not sufficiently competent. Instead, the Bretton Woods institutions themselves should be subjected to internationally agreed principles, including the rules of international law governing international economic relations, environmental safeguards, protection of minorities and indigenous communities, etc. As international organisations, they should be held accountable if their lending or non-lending practices violate such internationally agreed rules and conditions in lending should only reflect the fiduciary role of the Bretton Woods institutions in this respect and nothing more.

The way forward

The Bretton Woods institutions have undergone significant changes over the 60 years since their birth in the post-war period. None of these changes have sought to change the asymmetries and inequalities which exist within the institutions which impede their role in serving as truly multilateral economic institutions. Instead, the constitutional amendments

as well as shifts in operational policy and practice at the two institutions have served to reinforce such imbalances and, more worrying, to shift global economic governance away from more democratic institutions, such as the UN, to these organizations.

However as the discussion above has demonstrated, the solution lays not in increasing the authority of the World Bank and the IMF by granting these institutions more control over aspects of social and economic development but to reduce the remit of their work to their core responsibilities and revitalize the UN agencies which have been given mandate and have the requisite competence to undertake the aforementioned tasks in a more democratic manner. ■

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