

theirview

Frozen in time: World Bank, IMF

The Bretton Woods twins have not adjusted to the tectonic changes in the global political economy

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is a civil servant.
These are his personal views.

The Bretton Woods conference of 1944 put in place the institutional framework to rebuild the financial and economic system destroyed by the Great Depression and the War, spawning two of the most influential institutions of global economic governance of the post war period, namely the International Monetary Fund (IMF) and the World Bank (WB).

The international monetary system was repaired by pegging the dollar to gold, and other international currencies to the dollar. This system broke down in 1971 when the dollar went off the gold standard. In Bretton Woods Mark-2, major reserve currencies floated against each other.

East Asian economies, including Japan and China, leveraged Bretton Woods Mark-2 to grow at record levels by supplementing domestic demand with external demand by pegging their exchange rates against the dollar. Accumulation of large hard currency reserves by emerging market economies (EMEs) reduced IMF's effective role as global lender of last resort (LOLR). Indeed, EMEs, notably China, provided the liquidity for an unsustainable leveraged private consumption boom in Western economies where real wages were stagnant.

This sowed the seeds of the global financial crisis. Bretton Woods Mark-2 broke down, signalling a permanent downward shift in demand and trend growth. Under Bretton Woods Mark-3, public debt took over the burden of private debt to revive consumption as monetary policy fell in a liquidity trap. This is, however, sustainable only in the US on account of the large international demand for dollars, and perhaps in Japan where public deficits are funded by private surpluses. Market forces have forced Europe to adjust.

The World Bank was the second leg of the Bretton Woods system. It helped reconstruct the infrastructure

of war ravaged Europe, following which its resources were redeployed to developing countries. At some point however it shifted its focus to 'poverty' alleviation, even as the infrastructural requirements of emerging markets rose exponentially through accelerating growth. The World Bank's net disbursements of around \$15 billion a year, of which half comprises concessional 'International Development Assistance (IDA)' for poor countries, could finance few major infrastructure projects. Its majority shareholders missed a trick by not using the Bretton Woods system to redirect the global savings glut to fill the infrastructure gap in developing countries, the new engines of global growth as trend growth declined in ageing advanced economies. Instead, capital flowed uphill from emerging markets.

Even as World Bank lending was subject to supply constraints, the IMF faced demand constraints. It now duplicated activities of the World Bank through initiatives like the Poverty Reduction and Growth Facility (PRGF). The crisis underscored the irrelevance of the IMF as countries that needed additional support to reassure markets turned instead to the US Federal Reserve, whose deep pockets and nimbleness the lumbering IMF could not match. The Bretton Woods system was transformed from growth enhancing and stabilizing mechanisms to aid giving institutions for small developing economies.

The crisis provided a historic opportunity to make the Bretton Woods institutions relevant again. Their shareholders however missed a second trick. They moved to substantially enhance the resources of the IMF by a factor of 4 to 5 through the G20 as these were required for Europe. Europe now accounts for over 80% of outstanding General Resources Account (GRA) credits.

IMF resources however were too



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modest to bail out Europe. It was the ECB's 'whatever it takes' Outright Monetary Transactions (OMT) announcement that stabilized sovereign bond yields. Their requirements could have been met without IMF intervention by resolving flaws in the monetary union through a closer fiscal and monetary union. This could have freed up resources to enable the World Bank redirect global savings on a large scale into financing infrastructure investment to sustain high growth in the stuttering new engines of global growth, and also rebalance global demand.

The Bretton Woods institutions appear frozen in time because their governance structure has not adjusted to the tectonic changes in the global political economy. Their resources ceased to grow meaningfully once the European project was complete. The voting share of BRICS, the rising economic powers, is now only about half their share in global GDP at market prices, and just over a

third at purchasing power parity. Organisation for Economic Co-operation and Development (OECD) countries' unwillingness to share ownership with emerging markets is matched by their unwillingness to expand their resources on account of growing fiscal stress from ageing and declining growth.

As the Bretton Woods twins unravel, emerging markets endeavour to put in place alternative institutions to intermediate their own savings, such as the Asian Infrastructure Bank and the Chiang Mai initiative in East Asia, and the New Development Bank and Contingency Reserve Arrangement of the BRICS.

Whether the rising economic powers can achieve the geopolitical cooperation to work collaboratively in the manner the US and Europe did in the post war period remains to be seen.

Comments are welcome at theirview@livemint.com

otherviews



Why 2014 is a big deal

Thomas L. Friedman
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I was just about to go with a column that started like this: When they write the history of the global response to climate change, 2014 could well be seen as the moment when the balance between action and denial tipped decisively toward action. That's thanks to the convergence of four giant forces: São Paulo, Brazil, went dry; China and the United States together went green; solar panels went cheap; and Google and Apple went home.

But before I could go further, the bottom fell out of the world oil price, and the energy economist Phil Verleger wrote me, saying: "Fracking is a technological breakthrough like the introduction of the PC. Low-cost producers such as the Saudis will respond to the threat of these increased supplies by holding prices down". In the meantime, though, he added, sustained low prices for oil and gas would "retard" efforts to sell more climate-friendly, fuel-efficient vehicles.

So I guess the lead I have to go with now is: When they write the history of

the global response to climate change, 2014 surely would have been seen as the moment when the climate debate ended. Alas, though, world crude oil prices collapsed, making it less likely that the world will do what the International Energy Agency recently told us we must: keep most of the world's proven oil and gas reserves in the ground.

Technology is a cruel thing. The innovators who've made solar panels, wind power and batteries so efficient that they can now compete with coal and gas are the same innovators who are enabling us to extract oil and gas from places we never imagined we could go at prices we never imagined we would reach. Is a third lead sentence possible? There is. In fact, there is an amazing lead waiting to be written. It just takes the right political will. How so?

Let's go back to my first lead. The reason I thought we were decisively tipping toward action was, in part, because of news like this from the BBC on 7 November in São Paulo: "In Brazil's biggest city,

a record dry season and ever-increasing demand for water has led to a punishing drought." When a metropolitan region of 20 million people runs dry because of destruction of its natural forests and watersheds, plus an extreme weather event scientists believe was made more intense by climate change, denialism is just not an option.

Then you have the hugely important deal that President Barack Obama and President Xi Jinping of China struck on 12 November under which the United States will reduce its carbon emissions 26-28% below 2005 levels by 2025, and China will peak its carbon emissions by or before 2030.

But what if Verleger is right—that just as the cost of computing dropped following the introduction of the PC, fracking technology could flood the world with cheaper and cheaper oil, making it a barrier to reducing emissions? There is one way out of this dilemma. Let's make a hard political choice that's a win for the climate, our country and our kids: Raise

the gasoline tax.

Gasoline prices at the pump are falling toward \$2.50 a gallon—which would be the lowest national average since 2009—and consumers are rushing to buy SUVs and trucks. The "clear solution," said Verleger, is to set a price of, say, \$3.50 a gallon for gasoline in America, and then tax any price below that up to that level. Let the Europeans do their own version. "And then start spending the billions on infrastructure right now. At a tax of \$1 per gallon, the U.S. could raise around \$150 billion per year," he said. "The investment multiplier would give a further kick to the U.S. economy—and might even start Europe moving."

So there is a way to make 2014 that truly decisive year in confronting both climate and rebuilding America, but only our political leaders can write that lead.

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