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Louis Emmerij, Richard Jolly, and Thomas G. Weiss

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# *The UN and Global Political Economy*

## **Trade, Finance, and Development**

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## What Lessons for the Future?

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### The Contest for Global Economic Control

**Member governments** support the UN for a variety of very different motives. It is a point that one writer emphasized in the following way:

It is recorded that a traveller in France once came upon a wayside hotel named "The Immaculate Conception and Commercial." This is a very apt name for the house in which the world lives and might appropriately be hung up as an inn-sign outside the Headquarters of the United Nations. Human motives, whether expressed individually or collectively, are just such a mixture of the lofty and the base, the sacred and the profane, the sublime and the ridiculous. It is to this complexity that we have to address ourselves, and within the walls of this house we have to live and work.<sup>1</sup>

In seeking to draw lessons for the future, as we do in this final chapter, we shall bear this advice firmly in mind. Lessons that assume that human nature harbors, or can be easily made to harbor, only lofty aspirations and noble motivation will not be very useful ones. Our zeal to escape from the mistakes and muddles of the past should not lead us to call for a general march toward

Even in the earliest years of the UN, heady idealism was diluted by a strong dose of economic and financial calculation. Radically divergent views already existed about the constitutional relationship of the Bretton Woods institutions to the rest of the UN system. As we have seen in Chapter 1, both Harry Dexter White and Treasury secretary Henry Morgenthau were "determined that the United Nations was never going to tell the World Bank or the International Monetary Fund what to do."<sup>2</sup> The British firmly supported the Americans on this point, and in 1947 the Anglo-American position was entrenched in letters of agreement exchanged between ECOSOC and the IMF and the World Bank. Nevertheless, other countries had taken a different stance and were willing to see the IMF and the bank subordinated to some form of UN control.<sup>3</sup> The claim made by many developing countries that the Bretton Woods institutions should be part of a UN-based system of world government, although overridden in 1947, continued to compete with the established fact that they operated as independent executive agencies whose actions could be influenced only through their own contribution-weighted systems of governance. This conflict smoldered on, and it animated much of the history with which our volume has been concerned.

As UN membership began to change rapidly in size and composition with the grants of colonial independence of the 1960s, different groups of UN members increasingly vied for control of the organization. Developed countries tussled with developing countries about nothing less momentous than the appropriate forms of global economic governance, and the phases of the struggle were played out in the diplomacy of the North-South dialogue. The developing countries had lost this conflict by 1981, and indeed it is difficult to imagine how they could ever have won it. While it continued, it undermined the possibility that the UNCTAD secretariat could act successfully as a global think tank on trade and development, since they were also advisors to one of the parties to the contest. It would thus be misleadingly narrow to claim that the gradual eclipse suffered by the UNCTAD secretariat's view of the links between trade, finance, and development was simply the product of differential rates of investment in development-policy research between the North and the South. That is because the decisions about how much to invest in such research, and who should do it, were determined as part of the larger contest.

The campaign for SUNFED in the 1950s, discussed in Chapter 7, was a crucial moment of the struggle. Its protagonists aimed not only at setting up a soft-loan agency for developing countries; they also wanted to create a new financial executive agency under UN control. In the first aim it succeeded, but in the latter aim it failed. This failure came about not because the campaign could not muster the votes to outvote its opponents but because its supporters recognized

the need to compromise with the countries that would be expected to subscribe the necessary funds. It is a fact of international life that aid donors prefer to operate through international agencies where they have superior control. Even those who deplore this fact recognize it.<sup>4</sup> The compromise that emerged over SUNFED might therefore have served as a model for future cooperation between the main economic institutions of the UN and the Bretton Woods institutions. In this compromise, new policy proposals could be presented and negotiated in the UN and, when agreed upon in principle, implemented through the independent executive agencies.

Yet that was not the route that some of the developing countries wanted to take. When the trade and development issue flared up in the early 1960s, the Bretton Woods institutions did make some attempts to accommodate, by institutional innovation, developing-country concerns on issues such as fluctuating commodity prices and trade preferences. However, the developing countries sought the establishment of a new UN institution. Following the lead of Prebisch and Malinowski, they rejected the option of setting up a think tank with a mission to fashion new policy proposals on trade and development (see Chapter 8). That would have been in the spirit of the SUNFED compromise, which was to secure improvements within the existing international order.<sup>5</sup> Unsurprisingly, the basic lesson of the SUNFED episode was repeated at UNCTAD I. Despite the developing countries' greater voting power, Prebisch had to come to a compromise with the U.S. and its allies: although a new UN organization was eventually agreed upon, it was an anomalous addition to the existing institutional structure. After the NIEO declaration, Gamani Corea reopened the issue of UN control when pressed by leaders of the G77 to try to turn UNCTAD into a forum for trade negotiations. Once again, however, the mere weight of numbers did not bring ultimate success. The Brandt report recommended a World Development Fund with broadly based control, but at Cancún the Reagan-Thatcher axis successfully maintained the "integrity" of the IMF and the World Bank. When economic conditions of the 1980s weakened most developing countries and undermined G77 solidarity, the industrial countries took the opportunity to strengthen GATT (turning it into the WTO); that this would be at the expense of UNCTAD was clearly foreseen.

Ann Zammit, a delegate at UNCTAD III, clearly expressed the paradox of the Group of 77 and UNCTAD thirty years ago:

The developing world pressed for [UNCTAD] to be set up within the UN system, believing or hoping that their numerical preponderance organized in a bloc system would enable them to exert a powerful influence on the policies of the developed world. Yet in questions of trade and development sheer weight

of numbers cannot force the rich countries to share what they have already secured or make them change a system that benefits them only too well.<sup>6</sup>

However, the developing countries were very unwilling to draw from this prolonged and repeated experience the lesson that the power of the UN does not lie in its capacity to pass resolutions by majority votes. Their reluctance to do so has drawn some harsh criticism. The whole North-South dialogue has been called "little more than a laborious twenty-five-year-long exploration of an intellectual and diplomatic blind alley."<sup>7</sup> One surely has to concede that there is some truth in this charge, at least in terms of developing countries' obstinate perseverance in a strategy that repeatedly failed.

### An Economic Security Council?

The key to understanding this persistent conflict lies in the strengths and weaknesses of the UN voting principle of one country, one vote. This principle certainly has advantages. In particular, it safeguards the interests of relatively small countries by giving them their own voice in international decision making. This form of protection has become ever more important over the last sixty years as the number of small countries in the world system has grown (about half of the member countries of the UN now have a total population of 2 million or less). However, the variance of the populations of member countries has also grown, with the consequence that the principle of one country, one vote now conflicts more acutely than ever with the principle of one person, one vote, a principle that most would regard as more truly democratic.<sup>8</sup>

Another point must be made. The principle of one country, one vote pays no attention to whether the country casting the vote is democratic in its internal governance. Should a hundred small and undemocratic countries be able to frustrate the will of ninety-nine larger democratic countries? Would not most people be likely to judge that outcome anti-democratic? In the 1970s, in the days of the campaign for an NIEO, many countries in the Group of 77 were not internally democratic—not to mention the totalitarian regimes of the Group D countries (the Soviet bloc). Fortunately, the trend since then has been toward more democratic forms of government so that the disparity between developed and developing in that respect has now been markedly reduced. Even if had entirely disappeared, however, the first objection to relying exclusively on the principle of one country, one vote would remain a powerful one.

Since, because of size differences and governance differences between member countries, UN majority voting is and will continue to be inconclusive, some other means are necessary to arrive at binding global decisions. One way out of the impasse is to consider whether the UN voting system could be

modified in a manner that would make it acceptable to all countries as a method of global collective decision making. On the occasion of the 50th anniversary of the UN, a new Economic and Social Security Council was proposed with this in mind. The idea was to replace ECOSOC with a new council that would vote by a system halfway between the UN (one country, one vote) and the Bretton Woods (contribution-weighted) models of voting. It would be a small representative body of thirty-plus countries, both developed and developing, reminiscent of the size of the CIEC. Its decisions would require a simple majority of both industrial and developing nations, but no single country would be able to exercise a veto on double majority decisions.<sup>9</sup> This idea has received only modest support since then.<sup>10</sup> A major disadvantage was that it would require changes to the charters of all the UN agencies, and this could hardly have been achieved without prolonged negotiations. Behind the legal and diplomatic difficulties lay a more intractable political one. None of the more powerful countries are "sufficiently alarmed by present problems to want major reforms" of the UN constitution.<sup>11</sup> It may also be true that many developing countries are wary about allowing issues that affect their sovereignty to be decided by a council on which they do not sit. So UN reform in the 1990s has largely concentrated on administrative reorganization, reduction of bureaus and budgets, and the elimination of moribund intergovernmental committees. These may have brought increases in efficiency, but they have not affected the structural mechanisms of global control.

In economic and social affairs, the world continues to be governed by a twin-track system. The UN General Assembly provides a world forum where economic ideas, interests, and policy proposals are presented, discussed, and negotiated. Its authority is, and can continue to be, a moral authority based on the fact that very large numbers of people in the world believe that it is an organization that stands for peace, justice, equality, development, and human rights—in short, for all those values that people believe will ensure the survival of humanity. This widespread and growing belief was one of the most notable and heartening features of the Iraq crisis of 2002–2003. Even great powers that say they want to ignore the organization or that override its decisions find themselves trying to make use of it in a variety of ways. Surely the most obvious lesson for the future is that every effort must be made by all members of the UN to ensure that this moral capital is not dissipated. Once the process of UN discussion and negotiation produces agreements, however, their implementation is delegated to executive agencies in which the countries that will foot most of the subsequent bills place their confidence. In matters of trade, finance, and development, that implies bodies such as the World Bank and the IMF, which have weighted vote systems, or the WTO, which, despite hav-

ing a one country, one vote system, chooses to seek consensus rather than deciding matters by voting.

To make this twin-track system work tolerably, small countries need to be flexible in recognizing the greater responsibilities undertaken, and contributions made by, the larger countries. For their part, large countries need to be flexible in recognizing and catering to the needs of the smaller countries as well as to their own. The developing countries in the 1990s have adopted a partnership-based rather than a confrontational approach to trade, finance, and development. This change of attitude has to be reciprocated by the G8 countries if the twin-track global decision process is to remain a feasible way of settling the emerging international issues of the twenty-first century. *Faute de mieux* we must live with this twin-track global governance in which discussion and implementation are the responsibility of different world organizations. It would not make sense to recommend living with it, however, unless the degree of mutual flexibility necessary to make such machinery workable is forthcoming. All constitutional machinery works badly when it is abused, so restraint and prudent forbearance are indispensable elements in the statecraft of all UN member countries. That is why accusations of bad faith and double standards are such a serious matter and are so damaging to international intercourse.

Recommending living with a twin-track decision system certainly does not imply that the functioning of the international executive agencies leaves nothing more to be desired. On the contrary, setting aside the utopian prospect of the UN replacing them must inevitably bring into sharper focus the question of how they can be improved. As Sidney Dell put it shortly before his death: "there is no international agency that is dealing systematically with global questions of consistency and inconsistency" in matters of economic policy, and the triumvirate of the IMF, the World Bank, and GATT/WTO as they function at present is not up to this task.<sup>12</sup> How to reform this triumvirate is the issue to which we turn in the remainder of this chapter. We begin by considering reforms of the international financial institutions, the IMF and the World Bank, before posing the question of how the WTO could be made to function better.

### What Should Be Done to Reform the IMF?

Over the last twenty years, the IMF has become increasingly dysfunctional. Although its resources have been allowed to decline as a proportion of world trade, the number of fund programs in developing countries has steadily increased. Meanwhile, the conditionality in these programs has expanded greatly

in scope, going well beyond the traditional fields of monetary and fiscal policy and issues related to the exchange system. As the number of conditions, particularly structural conditions attached to loans, increased during the 1980s and 1990s, the rate of member countries' compliance with fund-supported programs has declined to below 30 percent in the 1990s, when compliance was defined as actions that permitted the disbursement of over 75 percent of the loan. This low rate of program compliance made it difficult to argue that these high levels of conditionality secured the repayment of loans and ensured the revolving nature of fund resources. Moreover, as compliance declined, the credibility of fund programs eroded and their catalytic character in relation to private financial flows became increasingly doubtful, a fact that again has implications for the size of IMF resources.

These trends point to the need for an expansion of the size of IMF resources, but under the existing IMF Articles of Agreement, this change would require an 85 percent majority vote. The U.S. is thus the only country that is in a position to veto this expansion. The U.S. policy of "graduating" countries from public to private funds dominates the international agenda in this area. However, this policy stance has been challenged by the arrival of a new type of financial crisis associated with financial globalization and volatile private capital flows. These new crises call for much larger amounts of support than the traditional crisis resulting from trade or current-account imbalances. The outbreak of the financial crisis in Thailand in July 1997 took the IMF unawares and led to dramatic falls in the exchange rates of Asian countries, losses of income and employment, and increases in poverty. There was an indirect effect in Africa as the preexisting recovery of primary commodity prices was reversed. This was the worst global recession since 1945. Although it hardly touched the U.S. or European economies, their governments were obliged to put together large rescue packages for the affected Asian countries.

In the aftermath of these events, the IMF came under strong criticism from different quarters. Some critics claimed that the IMF should have been aware of, and warned about, the fragility of the economies of East Asia; also that it should have been able to prevent the crisis from happening. Others charged that its remedies, especially its insistence on higher interest rates, were counterproductive and amounted to deflating the economy in the face of GDP contraction.<sup>13</sup> Finally, both these sorts of critics saw moral hazard in the fact that the financial costs of the crisis were borne wholly by the public taxpayers of developing countries, while the Western bankers who had made unwise loans were reimbursed in full.

The IMF's defense against the accusation that the conditions of its lending to the Asian crisis countries were misconceived was that in a short-term crisis, the

resources at its disposal are fixed and they cannot fully substitute for the private outflow (and indeed should not, given the moral hazard). Thus, private capital outflow has to be balanced by loss of foreign exchange reserves, by a depreciation of the exchange rate, or, failing these, interest-rate rises to make the adjustment via loss of output and/or to reverse the outflow of private capital. Practically, it appeals to the outcome from the IMF conditions, pointing to the speed of recovery of the countries, such as South Korea, that complied with them most fully compared with the slowness of recovery of those, such as Indonesia, that resisted most. Critics maintain that looser monetary and fiscal policy, combined with rapid corporate restructuring, would have restored confidence and reversed the capital outflow with less damage to the real economy.

Hopes of an effective early warning system for financial crises are fanciful and likely to be disappointed, because financial crises are the products of complex nonlinear causes. Government policy preferences, investors' expectations, and herd behavior all enter the equation alongside measurable economic quantities such as the assets and liabilities of the banking system, the balance-of-payments deficit, and the size of the foreign exchange reserves. Moreover, the fund's surveillance faces problems to the extent that countries deliberately hold back publication of information that might reveal fragility. The IMF has since promulgated new standards and guidelines for disclosure and transparency of information, but there is a clear danger here of loading responsibility for countering financial instability onto the capital-receiving countries and saddling them, through further increases in conditionality, with inappropriate and costly financial standards. In any case, limited disclosure is not the whole story. Much vital macroeconomic and financial information that should have rung alarm bells was actually in the public domain in July 1997. What is needed is to improve the systems of information evaluation, both by the International Monetary Fund and the World Bank and by the financial markets.

It is time to move beyond the tactics of crisis prevention to a more fundamental diagnosis. We have chronicled, in Chapter 10, the failure to negotiate an exchange-rate system to replace that of Bretton Woods. This failure has permitted what is the great defect of the current system of floating exchange rates, the large and frequent misalignment of the three key global currencies—the dollar, the euro, and the yen. There are no rules of macroeconomic policy, such as apply to trade, that discipline the policies that produce great fluctuations and gyrations of global currencies. The solution, which has been advocated for twenty years, is to specify exchange-rate targets for these currencies and find instruments to move them toward the specified targets. The U.S. and the rest of the G8 countries are still very reluctant to contemplate this and have intervened only in the most extreme of disorderly markets.

Their reluctance stems from the facts of global inequality. They have large economies with a moderate exposure to international trade and financial facilities to lay off foreign currency risks. By contrast, misalignments of key currencies inflict major instability on the economies of developing countries. The financial systems of developing countries are relatively small and often fragile. Poor credit evaluation and poor control of banks' foreign currency exposure are typical aspects of fragility. These weaknesses become much more dangerous after they liberalize their capital accounts, as the IMF has persistently advocated. When foreign capital inflows, induced by relative interest rates in combination with foreign investors' expectations of exchange-rate movements, are large in relation to the size of the developing country's financial system, substantial damage can be inflicted by their sudden exit. This is the new danger that developing countries face in a more financially integrated world, and it is doubtful if any exchange-rate system that they choose—whether free-floating or hard-peg—can guarantee stability as long as the rates of key currencies fluctuate as greatly as they do.<sup>14</sup> The international community will have to return to this issue; as a first step, the IMF's surveillance of key currency countries needs to be redirected to achieve greater policy coherence between them.

IMF insiders have argued that its resources should be increased but with the aim that it should eventually become a global lender of last resort.<sup>15</sup> A lender of last resort must lend in unlimited amounts and with no conditions apart from a penalty interest rate. Even if the IMF were put in the position to do this, it could create moral hazard, encouraging imprudent lending in foreign currencies and/or imprudent borrowing by public agencies in developing countries. What is needed is an alternative approach that accepts that crises cannot always be prevented but seeks to manage their damaging consequences better. We can sketch out a three-pronged approach to reform that has much to recommend it.

First, the IMF would in future provide adequate international liquidity on appropriate conditions to support necessary macroeconomic and exchange-rate adjustment. The issue of new allocations of SDRs is a costless and efficient method to create extra liquidity. Second, a new procedure would manage international bankruptcies when they do occur so that the country is protected against the worst consequences of insolvency until its creditworthiness is restored. A scheme of orderly debt workouts, an international equivalent to domestic bankruptcy proceedings, would have to involve (a) an automatic debt standstill or moratorium; (b) access to working capital on a preferred-creditor basis; and (c) financial and managerial reorganization to restore viability and then pay off pre-standstill creditors on an equal basis. There are

many detailed issues of legality, timing, and the prevention of abuse that are involved in deciding how such a scheme could be effectively brought into force for cross-border transactions, but its principle is sound.

The third prong would be advance provision for private-sector burden-sharing in the event of a bankruptcy to reduce moral hazard and inequity between the private and public sectors. It is in this policy area where least progress has been made in building an international consensus. The U.S. in particular argues that any form of private-sector burden-sharing will kill off foreign investors' interest in emerging markets. However, a scheme is now under consideration that would require debt contracts to include a clause providing in advance for collective-action agreements in the event of debt crises. The adoption of such clauses would render debt crises much more manageable. To the extent that the volume of private flows to developing countries was reduced as a result, this loss would be balanced by a reduction of the costs of financial instability.<sup>16</sup>

### What Should Be Done to Reform the World Bank?

The World Bank began to get into political difficulties in the U.S. in the middle of the 1980s, when several U.S. environmental NGOs attacked bank-financed projects in Brazil for encouraging environmental damage. They claimed that the bank's procedures for making environmental impact assessments of its projects were inadequate. The bank gave in under pressure from the U.S. Congress and Treasury and set up an Environment Department in 1987. Then in 1992, an independent review charged that the bank had breached its own guidelines for the conditions on which the people displaced by the Narmada dams in India were to be resettled. In the course of these controversies, the U.S. NGOs demonstrated their ability to harass the bank by means of well-organized lobbying of the U.S. Congress.<sup>17</sup> The bank has put in place new measures of accountability, including an independent inspection panel to make public reports on contentious cases. The ironies of this are that the NGOs themselves are, for the most part, not publicly accountable and that the bank has become more accountable to U.S. politicians rather than to the politicians of its client countries.<sup>18</sup>

The power of NGOs to move the U.S. Congress brought about a more widespread change of political stance at the bank. Since 1996, when James Wolfensohn became president, the bank has been proactively reaching out to its NGO critics and shaping its policies to reflect their concerns. Wolfensohn has pursued this political approach both in his public rhetoric and in a managerial style that

places him at odds with the bureaucratic culture of the institution. He has tried to ward off some of the NGO criticism of the bank by promoting his brainchild, the Comprehensive Development Framework (CDF), a matrix for coordinating all the development activities of a country. Being the guardian of the CDF allows the bank to adopt a central position in the development process, to provide a diverse range of services (loans, technical assistance, advice) to the entire development community, and to identify itself as a development partner and facilitator instead of as a bunch of arrogant bankers. Furthermore, bank lending has been increasingly diversified to support a new development agenda that would find favor with the U.S. NGOs—gender equality, participation, civil society, good governance, and environmental conservation.<sup>19</sup>

The bank has long suffered from multiple conflicting objectives—sound banking, promoting development, and policy advocacy are just three of them. In this context, a populist approach of coopting all the potential NGO critics of the bank has its own dangers. Despite the adoption of poverty reduction as the bank's paramount goal, it is leading to a loss of overall focus in strategic priorities. The bank is also failing to exploit fully the functions in which it has a genuine comparative advantage, and, by extending the responsibilities of its staff members into areas where they have relatively little competence, it is confusing and demoralizing them. The bank may well also be alienating the governments of developing countries, on whom it must rely as customers for its loans.

Given these distorting pressures on bank priorities, there is a case for reviving the proposal of an organic aid-SDR link. The idea of the link, discussed in Chapter 10, fell into abeyance in the 1980s because of U.S. reluctance to move forward with further creation of SDRs. Since then a further distribution of SDRs was agreed to in 1997. Yet it was not linked to the funding of multilateral aid agencies, although they remain strapped for cash to pursue internationally agreed-upon debt-reduction initiatives for highly indebted developing countries. Apart from the provision of necessary additional resources, funding of the World Bank by this route would do much to counteract the current tendency to make it a hostage of NGO fashions and the whims of the U.S. Congress and Treasury Department.

A direct link between SDR creation and aid would be simple to operate. The bank and other multilateral development agencies would have accounts with the IMF, into which the newly created SDRs would be paid. They would lend in the normal way, and when the loan recipient made purchases with the loan, the exporters from whom they purchased would be paid in SDRs out of the loan agency's IMF account. No doubt the old argument that this would be inflationary would then be heard again, but the scale of SDR creation remains very small (0.3 percent) relative to the GDP of the developed countries,

and their anti-inflation policies are unlikely to be changed because of anything on this scale.<sup>20</sup>

This new source of funding should be negotiated in return for a number of changes in the bank's lending practices. The need for the bank to continue project lending to middle-income developing countries (on IBRD terms) has been questioned on the grounds that private flows can do the job instead. Between 1970 and 1995, private flows to developing countries increased fortyfold while IBRD flows increased threefold in nominal terms, so the original post-1945 justification of this type of lending, in terms of imperfect private capital markets, is now much weaker.<sup>21</sup> However, private finance flows are quite concentrated geographically on about a dozen countries and they also tend to flow in pro-cyclically, so that they are there when they are least needed and absent when they would be most useful. Nevertheless, it would make sense to let the regional development banks complement private flows to the middle-income developing countries and to focus World Bank lending to low-income developing countries.<sup>22</sup>

It would also be necessary to look again at internal plans to reshape the bank's program lending. The policy conditions of these loans have big implications for low-income developing countries' politics and sovereignty, as explained in Chapter 11. Bank economists are now saying that these conditions have been ineffective as a means of changing the borrowers' economic and social policies, which are determined by broad political economy factors rather than by any action that the bank can take. This is true to a degree, but it is being used to argue that it would be better to lend to countries where policies are judged to be already conducive to growth and poverty reduction and where they are not conducive, not to lend.<sup>23</sup> Although this is described as the phasing out of conditionality, in logic it is the introduction of a new and stricter form of conditionality; the difference is that it would operate *ex ante* rather than *ex post*.

### WTO Rules: OK?

The new World Trade Organization, which swallowed up the former GATT, now goes much beyond it in scope and ambition. The overall aim has broadened, from nondiscrimination and the reduction of trade barriers to the adoption of policies in support of open markets generally. New agreements cover trade in agricultural goods, sanitary and phytosanitary (plant hygiene) standards, textiles and clothing, technical barriers to trade, trade-related investment measures, trade in services, intellectual property rights, and the removal of various nontariff barriers. The WTO is potentially much more intrusive on national policies because it is now making rules across this substantial new agenda,



rules that override the preexisting national laws of members. The WTO requires countries to change existing domestic laws that conflict with the obligations of WTO membership, and a new Trade Policy Review Mechanism requires members to give regular public accounts of the state of their compliance with their obligations. The WTO has also strengthened its Dispute Settlement Mechanism (DSM).<sup>24</sup> These five institutional innovations, taken together, have two general effects. They make considerable inroads on what were matters of domestic governance before the coming into force of the Uruguay Round agreements, and they further "judicialize" the process of trade cooperation.

Raúl Prebisch maintained that the attempt to elaborate a system of trade rules was backward looking and that what the world needed was an agreed-on set of policies to support the developing world (see Chapter 8). The emergence of the WTO was clearly a major defeat for that viewpoint. Yet it is widely believed that the changes to the world trade system inaugurated by the WTO are desirable in the interests of the developing countries because they create a stronger umbrella to shelter them from the arbitrary trade practices of large and powerful developed countries. It will be argued here that this general judgment needs to be qualified and that the appropriate question for the future is not one of rules versus policies but of how policies can better support a system of trade rules. The first task, then, is to show that WTO rules are not sufficient to regulate trade in a world of substantial economic inequality, and the second task is to explain how policies can support the working of a rule-based trade system in the presence of gross inequalities.

A major question for any rule-based system is whether the rules (whatever they are) are enforced fairly. Most would agree that the WTO handles trade disputes much better than GATT did. The WTO restored and strengthened the original GATT dispute-settlement process by making it more automatic and introducing specific time limits on procedures. Requests for panels on alleged violations are approved more automatically, as are the panel reports, the appellate body reports, and the authorizations of retaliation. Instead of requiring a positive consensus in order to proceed, they now need a negative consensus to fail to proceed.<sup>25</sup> These changes have allowed about 160 cases to be handled during the first five years of the WTO, roughly three times the previous level. Developing countries have been involved in more cases, about 25 percent of the new total.<sup>26</sup> This has been taken as a sign that the DSM is working well, including for the benefit of the developing countries.

Where then is there any lack of justice for developing countries? Unfortunately, it is still true that for them, serious deficiencies remain at every stage of the WTO dispute-settlement process, from inception through judgment and granting remedy to enforcement. These deficiencies arise from the interaction of the standard features of a legal process—its cost, absorption of time,

and uncertainty of outcome—with the incompleteness of international legal machinery and the great inequalities of wealth and power that currently exist between nations. Given the substantial cost of bringing a WTO case, in terms of legal and diplomatic person time, poor countries are deterred disproportionately from embarking on a dispute. Only governments can bring cases to the DSM, and poor governments will be disproportionately deterred from doing so by the prospect of antagonizing more powerful countries, on which they depend in many matters not connected with trade, such as defense or foreign aid. By convention, no compensation is paid by the loser for a violation, after a process that can still take over two years to complete, a fact that bears more heavily on poor states than on rich ones. If a country does not take measures to comply with its WTO obligations, there is no centralized sanction. The only sanction is retaliation. Since all economic sanctions are costly to the initiator, the ability of a poor country to sanction a rich one is much less than the reverse.<sup>27</sup> Thus, even if we assume an identical propensity to violate WTO rules between developed and developing countries and perfect formal justice in the panels in reaching their judgments on cases, developing countries will win fewer cases than they lose and will be less able to be sure of remedy in those that they do win.<sup>28</sup>

Obviously, differences in outcome that arise because of the different economic strength of the two parties cannot be remedied directly. Nevertheless, it ought to be possible to tilt the system in ways that counteract its acknowledged biases. In domestic litigation, legal aid is used to give the poor better access to costly justice; the injured party is awarded its costs by the court and centrally organized sanctions prevent the injured party from having to bear all the costs of punishing the violator. In the international sphere, these are three areas where, by analogy, progress could be made, given sufficient imagination and willingness to cooperate. An improved DSM in the WTO is still capable of further improvements in the interests of the developing countries.

Although in the WTO the formal justice of the institution has improved (and can be improved further), formal justice is not the only consideration. Formal justice can be at odds with substantive justice.<sup>29</sup> In the WTO, judicial improvement has coincided with the adoption of certain rules that, it seems to us, do embody substantive injustice because they carry serious implications for the possibility of economic convergence.

### WTO Rules, Industrial Subsidies, and Development

The rules of the WTO, like those of its predecessor GATT, reflect the ambivalent attitude of the U.S. and some parts of Europe to free trade.<sup>30</sup> This ambivalence, characterized as "embedded liberalism," inspired a distinctly

different set of international trade rules from ones that promoted free trade plain and simple. Its basis is open multilateralism, derived from the norms of nondiscrimination and reciprocity. While it inclines to free trade by facilitating multilateral and reciprocal tariff reductions, it also provides for "contingent protection"—that is to say, opportunities for individual countries to renege on tariff concessions under prespecified conditions to avoid injury to domestic industries adversely affected by tariff reduction.<sup>31</sup> Its "fairness" requires sharing both the benefits of any other country's tariff reductions *and* the burdens of any other country's "need" to reimpose tariffs to safeguard its domestic industry against so-called dumping.

Because anti-dumping actions are costly to contest, developed countries have long since found that the contingent protection provisions have a harassment value.<sup>32</sup> They used them to secure so-called "voluntary export restraints" on textile exports from developing countries.<sup>33</sup> Developing countries accepted this breach of nondiscrimination as part of a larger implicit bargain, in which their balance-of-payments deficits—worsened by trade restrictions—were met by offsetting flows of official financing from OECD country donors, or, in more familiar terms, by foreign aid. However, as Chapter 11 indicated, this bargain collapsed in the 1980s in the wake of the debt crisis and the policies of Reagan, Kohl, and Thatcher, and something had to be put in its place.

The Uruguay Round introduced new rules on the use of countervailing duties.<sup>34</sup> In an attempt at legal clarification, contingent protection is now permitted in the face of some subsidies but not others. Three kinds of subsidies, to research and development, to disadvantaged regions, and to the costs of complying with environmental regulations, if available to all firms or industries regardless of their status as exporters, are now not actionable with countervailing duties. All others remain actionable insofar as they inflict "material injury." If subsidies are "specific"—to an exporting enterprise or industry or to an exporting group of enterprises or industries—they can be countervailed if they cause material injury. The criterion of "material injury," already low, was further diluted.<sup>35</sup> Participation in this subsidies code, which developing countries could decline to join under the Tokyo Round rules, is now mandatory on all WTO members, although some have fixed transition periods before full compliance.

The effect of this is to outlaw the sorts of industrial subsidies that have been used successfully in the past to accelerate the growth and development of poor countries. It has been said that the Asian miracle of the period 1965–1995 could never occur again under present WTO rules. The phenomenal growth of the Asian tiger economies depended on selective departures from pure free trade regimes. Contrary to the opinion of the neoliberal consensus, the Asian

"miracle" demonstrated that an intelligent long-term development strategy—based on interventionist departures from free trade that are genuinely selective and temporary—can be made to work. Indeed, if the right conditions can be created, it can be made to work spectacularly well.<sup>36</sup> What is not so clear, however, is that the annexes to the WTO agreement of 1994 absolutely prohibit *all* the instruments of such a strategy. Despite the clear outlawing of specific subsidies, there are still some unplugged gaps that an imaginative and ingenious developmental state might want to try to exploit for its purposes.<sup>37</sup> Much will depend on how the DSM works in practice.<sup>38</sup>

It is up to the legal technocrats at the WTO how activist they decide to be, since legal activism is something that the WTO rules clearly permit. If they become bolder, the interpretation of the annexes will increasingly prohibit all protection of infant industries in developing countries. This will slam the door on a vital means of economic catching up, which at least some poor countries are capable of using, and so serve to solidify the existing unequal worldwide distribution of wealth and income. Claiming that the WTO rules on subsidies are substantively unjust requires clarity about what resemblances and differences between nations are relevant to the treatment of like cases alike and different cases differently. In the spirit of Prebisch, we believe that the existing inequalities of economic and political power between developed and developing countries do constitute a relevant difference for the purpose of deciding the substantive justice of these rules. If there is to be any derogation at all from free trade, it should be in favor of the economically weak rather than the economically strong.

If in the end both global justice and global order depend on the possibility of removing existing gross economic inequalities by the successful development of the developing countries, both goals will be ill served by quasi-judicial attempts in the WTO to block off the most promising (for some countries) fast track to development. There is a compelling case for developing countries to be given exceptional treatment on "specific" industrial subsidies for infant industry purposes, with one proviso. Such subsidies must always be selective, temporary, and performance related. That is the only way for developing countries to avoid repeating the errors of their previous international trade policies.

### Greater Developing-Country Participation in WTO Rule-Making

The WTO arrangements cannot be unjust, it is said, since every nation voluntarily agreed to them when joining the WTO, and voluntary agreement to an act implies that the gain and the loss from it are at least equivalent. In

weighing this rebuttal, one must bear in mind the evolution of the community of nations. For all the talk of the demise of the nation-state, they have in fact been multiplying fast. The members of the UN in 1945 were 51: now there are 190. Moreover, as a result of that quadrupling, the disparities between the strongest nations and the weakest nations have also multiplied. Yet new states necessarily emerge onto a stage where the international action is already well advanced. They do not face a moral or legal tabula rasa on which they can, jointly with others, inscribe a new compact. In a dynamic international setting, a new WTO member has to put up with whatever it cannot negotiate away. If it is economically and political weak, it may have accepted nontrade inducements to abide by the existing trade rules.

Formally, all WTO members are equal. Unlike the IMF and the World Bank, the WTO does not have an unequal voting structure in which rich countries control a share of the vote that is much greater than their numbers in the world community. Thus, poor countries, which form a majority of the members, could in principle outvote the rich countries. All the experience recounted in this volume, however, indicates that to do so would be a futile move. The WTO, like GATT before it, avoids taking decisions by voting. Instead, it "finds consensus" in an informal procedure which the director-general conducts. His discussions with selected members go on until the director-general thinks he has found a basis for consensus, which he brings for approval to the WTO Council plenary session. At this stage, member countries decide that a consensus exists, or not, as the case may be. Many small developing countries are effectively marginalized by this procedure.

The informal consensus-finding procedure allows the economic inequalities that exist between members to come into play. There are two main sources of inequality; differential access to information about which agreements will benefit one's country and differential power to influence the outcome of the informal negotiation. Since the inauguration of the WTO in 1995, the problem of evaluating trade offers has been aggravated by the broadening of the trade agenda. The effects on a country of a round of mutual tariff reductions are basically calculable—albeit by economists using general equilibrium models. The effect of a change of standards, by which a country's export products may suddenly be deemed substandard, is very much harder to calculate, to understand, and to negotiate. The problem of access to information boils down to a simple economic question: Can the developing country afford to maintain an embassy in Geneva? If it cannot, it is unlikely that it will be able to follow the trade negotiations, let alone take part in them.<sup>39</sup> This points to the need to assist countries whose resources are inadequate. What international help is available to assist it to acquire and process trade-related information?

There has been very little. The regular WTO budget provided \$741,000 in 1998 for technical assistance and training, about \$7,000 for each developing-country member.<sup>40</sup> Of aid donors' total expenditure on technical assistance, only about 2 percent is trade related.

There is a clear need to do more to counter the information bias against developing countries in future trade negotiations; the efforts of the UNCTAD secretariat to do so should be strongly reinforced. These efforts should be concerned with the provision of high-quality information, not only about actual trade and financial flows but also about tariffs and nontariff barriers to trade and regulatory and other obstacles to cross-border flows of investment. There is much about the process of trade and investment liberalization and its economic effects that is not properly understood and that cannot be successfully researched without the collection and dissemination of better data.<sup>41</sup>

An institutional role of custodian of the interests of developing countries is still recognized as legitimate by the international community, even after the demise of the North-South dialogue. It, too, belongs with UNCTAD, but its exercise remains surrounded with problems and dilemmas. In a less-confrontational era, the secretariat has to judge its advocacy more carefully. It cannot simply respond to the wishes of developing countries, yet it must not hold back from criticizing developed-country policies that hurt poorer countries just because the developed countries might be thereby offended. For example, there would seem to be a good case for sharper advocacy by the UNCTAD secretariat of the need for trade and investment liberalization of key sectors of the OECD economies, especially agriculture.<sup>42</sup> Such decisions, however, need to be taken on the basis of objective considerations and not in response to group pressure. The secretariat will better protect its judgments from criticism by member governments if it can maintain the highest professional standards in its work. Data analysis and general advocacy can then feed into advisory work and technical-assistance projects on trade and investment for individual developing countries, but this cannot be supplied on demand; access should be given on transparent criteria for the allocation of scarce resources.

Even when a country has discovered where its interest lies, it may not be able to achieve its goals because of lack of negotiating influence.<sup>43</sup> A country's influence or power in informal trade negotiations depends on the extent of its trade. In a negotiation based around tariff reduction, bargaining power depends not only on how far you are willing to cut your tariff but also on the size of the trade flows to which the proffered tariff cut will apply. Small tariff cuts on big trade flows are worth much more as bargaining chips than big cuts on small flows. This is very frustrating for countries with small trade sectors, but it is not *unjust* unless a country's trade sector is being deliberately kept small by others'

denial of market access.<sup>44</sup> This is true of some countries, but the external trade of others, notably in Africa, is constrained by unresolved difficulties of supply rather than by lack of access to markets. They cannot be helped by these kinds of trade negotiations, however they are arranged. They need other remedies, including financial aid and technical assistance.

The current political reality is that the U.S. (and to a lesser degree the EU) exercises preponderant influence on trade issues and that U.S. and European trade behavior is driven by the disparate interests of two groups of great business corporations, which are united only in their willingness to donate money to the major U.S. and European political parties. One group of such corporations, the exporters, want developing countries to liberalize and provide them with more markets, while the other group that is selling into domestic markets wants to block out foreign competition. For both their sakes, the U.S. and European governments would like to have it both ways. The ideal of embedded liberalism, when constrained by national producer interests, generates the practice of asymmetric liberalism.<sup>45</sup>

There is apprehension that anything that threatens U.S. and European dominance will be counterproductive. Some think that the more stringent rules and their increased formalization in the WTO will tilt the U.S. domestic political balance further in favor of protection.<sup>46</sup> That is valid up to a point, although it is easy to overstate the WTO's power to curb contingent protection.<sup>47</sup> Others argue in the same vein that further efforts to broaden the institutions of international governance would run the risk of undermining the support for it that exists in the U.S. and other industrial countries.<sup>48</sup> The retreat of the second Bush administration from multilateral arrangements in international affairs gives some credence to these fears. Yet in looking to the future, one should stand at some distance from the tribulations of the day and anticipate the emergence of an increasingly multipolar world.

In the long run, neither the developed nor the developing countries should be contemplating a retreat into protectionism but rather the reverse. At the highest level of generality, it is not free trade but its absence that they should beware of. The negotiation of further trade liberalization on a multilateral and nondiscriminatory basis must continue. Specifically, the promises made to developing countries during the Uruguay Round must be fulfilled so that they may gain confidence in further WTO negotiations. Then the failure of the Uruguay Round to eliminate administered protection in a wide range of intermediate industries must be rectified. The heavy protection of developed countries' agricultural sectors must be reduced. Tariffs on industrial goods of special export interest to developing countries must also be reduced.

At the same time, the idea of "special and differential treatment" of developing countries, which was added to GATT and survives in different forms in the annexes to the WTO Agreements, needs to be revisited, simplified, and given greater precision.<sup>49</sup> The present position, where "special and differential treatment" consists of an arbitrary deadline for full compliance with WTO obligations, unenforceable promises of technical assistance for transitional difficulties, and a wish to confine "special and differential treatment" to the forty-eight least-developed countries is highly unsatisfactory. It is true that for many years after 1955, developing countries were allowed to protect particular industries and to plead balance-of-payments reasons for adding to quantitative restrictions on trade.<sup>50</sup> The tragedy was that, in general, they did not use this exemption to carry out effective development strategies. They tended to protect chronically uncompetitive industries and did not implement timebound programs of selective protection to create competitive industries with the capability to export. The few, but hugely significant, exceptions to this—particularly, after 1965, the East Asian economic tigers—are the very countries that have begun successfully to converge on a Western standard of living.

The lesson here is that ultimately it is in every nation's interest that late developers succeed in catching up, because that is the only route to a world of less poverty and conflict. If their path is blocked "for legal reasons," the legitimacy of the present hegemonic ideal of embedded liberalism can only erode further, and then world trading arrangements are bound to become more disorderly. The Doha Round of WTO negotiations has the opportunity to establish the special and differential treatment of developing countries' trade on a more equitable basis than at present, although progress is as yet glacial.<sup>51</sup> If this could be done, the way would be opened to the eventual achievement of true freedom of trade in the twenty-first century, free trade in a world of economic equals—rather than what disfigures the world trade scene now, partly free trade between the enormously wealthy and the pitifully impoverished.

### Can International Organizations Be Creative Intellectual Actors?

This volume has traced the decline of the UN as the vibrant center of thinking on issues of trade, finance, and development, and the rise—particularly after 1980—of a neoliberal consensus on these issues, orchestrated by the World Bank. It has also argued, in Chapter 2 and elsewhere, that in international organizations the degree of creative thinking—as opposed to the synthesizing and recycling of existing ideas—is inversely related to the ability of their top management to exercise strong editorial control over the research process

for the purpose of preaching a doctrine that they think promotes the aims of the organization. The question for the future is whether international organizations can again be intellectually creative and if so, how this might be achieved.

In this context, it is intriguing that there should now be talk of the World Bank transforming itself into a "university of development." The proposal is that the bank would in future specialize in educational activities that can be justified as public goods and subsidize their provision with income from its subscribed capital and accumulated reserves. Lending selectively to safe borrowers would continue, but it would cease to be the bank's major function. This is a fairly astonishing proposal, given the past history of research and other types of intellectual work at the bank and seems to be problematic in various ways. Its practical success would depend in the first instance on the political feasibility of introducing greater selectivity into bank lending, an issue that remains underexplored. Second, success would depend on the extent to which the bank's research and publication activities could continue in the same way if its lending were indeed scaled back and reoriented. Finally, it would depend on whether the bank was willing to give up preaching a particular doctrine of development.

All the signs are that the bank continues to be vulnerable to pressure from the U.S. Treasury Department to defend neoliberal doctrines of economic development. Consider the case of Joseph Stiglitz, who was appointed chief economist of the bank in early 1997. He wanted to broaden the original Washington Consensus of ten policy thrusts (fiscal and exchange-rate reform, trade and financial liberalization, privatization, and deregulation, among others), by adding improved financial-sector regulation, competition policy, and technology-transfer policies. He also suggested multiplying the objectives of development policy by adding a sustainable environment, democratization, and a more egalitarian distribution.<sup>52</sup> He did not then question the idea that it was the bank's job to promote a consensus of some kind on development policy; he merely wanted to move away from a narrow version of neoliberalism. He also began an internal campaign against the deflationary policies recommended by the IMF during the Asian financial crisis.

The U.S. Treasury Department under Laurence Summers was unhappy with Stiglitz's intellectual ambitions and made his departure from the bank a condition of U.S. support for James Wolfensohn's second term as president. Stiglitz resigned in November 1999. Further U.S. pressure, this time to change the draft of the *World Development Report 2001*, led to the resignation of the report's independent editor-in-chief, Ravi Kanbur, in the following year.<sup>53</sup> After leaving the bank, Stiglitz moved from modifying the Washington Consensus to rejecting the bank's drive to promulgate a development formula as such:

Opposition to globalisation in many parts of the world is not to globalisation per se . . . but to the particular set of doctrines, the Washington Consensus policies that the international financial institutions have imposed. *And it is not just opposition to the policies themselves, but to the notion that there is a single set of policies that is right.* This notion flies in the face of both economics, which emphasizes the notion of trade-offs, and of ordinary common sense.<sup>54</sup>

Stiglitz's sudden conversion suggests that while in the bank, he was constrained to agree that the role of the bank is to provide the developing world with "the single set of policies that is right," an idea that he condemned as flying in the face of common sense as soon as he left. It seems that even "rebels within" cannot escape from the institutional imperative to preach a doctrine and that the U.S. will act to reinforce this imperative when it thinks it is necessary. In these circumstances, plans for the World Bank to become a "knowledge bank"—and what is more, one whose loans would carry *ex ante* conditionality—should be firmly discouraged in any negotiation to provide it with a more secure source of multilateral funding through SDRs.

Does the UN then offer a more fertile ground for intellectual creativity in the future? The implication of the inverse relation between management editorial control and creativity is that the UN, with its lighter hand and multitude of voices, is more likely to generate interesting new ideas. The 1990s showed some evidence of this in the UNCTAD *Trade and Development Report* and the UNDP *Human Development Report*. How can the UN build on these achievements? As we have suggested, more resources are needed if voices crying in the wilderness are to be heard and made influential in the crowded spaces of politics and business. Beyond that, it is hard to know what to suggest. The idea of weakening management's editorial control over UN publications is anathema to the industrial countries, which want to go farther in exactly the opposite direction. In any case, the proposal to manufacture some administrative chaos in the hope of stimulating intellectual creativity is on a par with the plea to manufacture an economic crisis in order to trigger a process of structural adjustment.<sup>55</sup> Both share an irreducible element of self-contradiction.

The answer seems to be to acknowledge that it is not realistic to expect that officials of the UN Secretariat, as distinct from other parts of the UN system, will be a major generator of fresh ideas. That it did so in its earliest years, before successive layers of managerial control over research could solidify, was a happy accident, but probably not one that could be easily replicated today. The Secretariat can still be a purveyor and a disseminator of ideas that its members may be just about ready to adopt. If the UN is to make a creative contribution in future, however, it will be most likely to do so by nourishing its university-like institutions and recruiting a new generation of managers

who understand how best to nurture creative work. The United Nations University was set up in 1975 but at first made little impact. In the field of trade, finance, and development, a new opportunity arose a decade later with the inauguration of WIDER, the World Institute of Development Economics Research. Its history to date has also been checkered and it has run into controversy, but its difficulties have never included struggles over publication of the results of research. Another university-like, but very small, UN organization is the UN Research Institute for Social Development (UNRISD), which has a good record as an innovative think tank on development issues.

There are three reasons why quasi-university public research institutes such as WIDER and UNRISD hold out a credible hope for sustaining a creative intellectual spark in UN economic and social work. Their mission is to conduct applied research, to undertake policy advocacy, and to strengthen capacity in the area of sustainable growth. This involves no conflict with other objectives of the organization because there are no other objectives. Although they have a research staff, these tasks are also carried out by visiting scholars and by a worldwide network of collaborators. The diversity of research modes dilutes the problems of motivation that bedevil organizations that rely only on a full-time permanent research staff. Finally, governments contribute funding to the individual research projects that they wish to support. This element of voluntary sponsorship introduces multiple accountabilities, and it reduces the scope for any single country—however wealthy and powerful—to exercise an overbearing financial leverage on the entire intellectual direction of the organization. For all these reasons, it is still possible to believe that international organizations can be creative intellectual actors and that there will be more intellectual history of the United Nations to be written in the future.

## Appendix: List of Archival Sources

### Online Resources and Electronic Databases

UN Intellectual History Project: <http://www.unhistory.org>  
 J. M. Keynes/Roy Harrod correspondence:  
<http://www.e.u-tokyo.ac.jp/Exhibition/keynes/contents/index.htm>.  
 Declassified Documents Reference System (DDRS), Farmington Hills,  
 Michigan, Gale Group, 2004.

### Papers of Organizations and Governments

League of Nations Archive, Geneva  
 UN Archive, New York  
 UNCTAD Archive, Geneva  
 GATT Archive, World Trade Organization, Geneva  
 U.S. National Archives & Records Administration, College Park, Maryland  
 Record Group 43, International Trade Files  
 Record Group 59, Office Files of the Assistant Secretaries of State for  
 United Nations Affairs, Lot File 58D33  
 Record Group 59, Office of Inter-American Regional Economic Affairs  
 Record Group 59, Records of Under-Secretary George Ball 1961–66  
 Public Record Office, Kew, London  
 Foreign Office files FO 475/3 and FO 371  
 Board of Trade files BT 241

### Papers of Individuals

Ernest Bevin Papers, Churchill College, Cambridge  
 Roy Blough Papers, Harry S. Truman Library, Independence, Missouri  
 R. H. Brand Papers, Bodleian Library, Oxford  
 R. W. B. Clarke Papers, Churchill College, Cambridge  
 Edmund Dell Papers, Bodleian Library, Oxford