Editorial: The Revival of the Liberal Creed — the IMF and the World Bank in a Globalized Economy

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Summary. — This editorial reviews problems arising from the popular “Washington consensus” economic package as economies become more globalized, and the reasons why they occur. Suggestions for improving the performance of the institutions behind the policies — the World Bank and International Monetary Fund — are provided. © 1997 Elsevier Science Ltd. All rights reserved

1. INTRODUCTION

Half the people and two-thirds of the countries in the world lack full control over their own economic policy. Expatriate “experts” managed by industrial country nationals and based in Washington DC regulate their macroeconomics, investment projects, and social spending. The principles guiding these instructions from afar are even known as a “Washington consensus” (after Williamson, 1989).

The foreigners who fly in with policy packages for developing and post-socialist countries staff two international agencies — the World Bank and the International Monetary Fund (IMF). Arguably, many actions that the Fund and Bank “recommend” to governments are intellectually ill-founded and counter-productive in practice. Their suggestions however, are heeded for several reasons. The two institutions are backed by the United States and other economic powers such as England and (less enthusiastically) Japan.

Their emissaries arrive in local capitals with substantial hard currency credit lines in hand — a strong incentive for the authorities to take their proposals to heart. Finally, the proposals are based on the “neoliberal” or “market-friendly” brand of policy analysis that has become intellectually predominant over the past dozen years. They have been even more enthusiastic about neoliberalism than their friends from Washington.

In economic and social policy during the 1980s go far toward recreating the environment prior to the Great Depression; advocates of “neo” liberalism say little unfamiliar from debates now many decades past.

Progressive critiques also exist. The great social scientist Karl Polanyi provided one in The Great Transformation, ironically published in 1944, the year in which the Bank and Fund were founded:

Nowhere has liberal philosophy failed so conspicuously as in its understanding of the problem of change. Fired by an emotional faith in spontaneity, the common-sense attitude toward change was discarded in favor of a mystical readiness to accept the social consequences of economic improvement, whatever they might be (Polanyi, 1944, p. 33).

In the 1920s “economic liberalism made a supreme bid to restore the self-regulation of the system by eliminating all interventionist policies which interfered with the freedom of markets” (p. 231).

The catastrophic responses to this “bid” in the 1930s and 1940s exemplify Polanyi’s grand theme that a fully liberalized market system is socially and politically impossible. “Self-regulating” markets cannot endure, particularly in the key areas of labor, finance, and international trade. Attempts at full deregulation give rise to unstable, speculative behavior or else to such concentrations of income and wealth that there is a social reaction leading to imposition of the state’s latent powers of market control. In Polanyi’s phrase, there is a “double movement,”

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first toward deregulation and then (as financial instabilities and social tensions mount) toward its reversal.

Polyani’s theories speak to the present debate on globalization under which national capacities to reconcile market and social contradictions are increasingly impaired by external economic and financial constraints. From the disaster of WWII emerged an international consensus for “economic collaboration of governments and the liberty to organize national life at will” (p. 254). The will to establish global coordination led to the formation of the Bank and Fund. Paradoxically, for developing countries these institutions today represent the intellectual backbone and political force behind the dismantling of the truly utopian ideas of the 1940s.

2. GLOBALIZATION AND THE INSTITUTIONS

The charters of the Bank and Fund were written at a New Hampshire ski resort, the reason why they are dubbed the “Bretton Woods institutions” or BWIs. Their histories after 1944 help show how they attained economic suzerainty over the Second and Third Worlds, why they adopted the policies that they support, and the reasons why the policies often fail in practice.

The goal of the Bretton Woods conference was a well-ordered international economic system. There was general agreement that governments should play a central role in regulating both national and international economic systems; the theoretical basis had been provided in the 1930s in the intellectual revolution led by John Maynard Keynes.

This attitude was to reverse over the next decades. One reason was the apparent inability of social democratic/Keynesian policies in the industrialized countries to deliver sustained output growth and high employment after the post-WWII “Golden Age” that ended around 1970. Thereafter, first transnational corporations (TNCs) and then international financial markets extended their domains, leading to increased pressures on poor economies to liberalize the current and capital accounts of their balances of payments respectively.

The international economic environment also changed dramatically. Many small, poor countries (especially in sub-Saharan Africa) were hit hard by the oil shocks and a long term downturn in the primary commodity terms of trade beginning in the late 1970s. At first, middle-income countries benefited from recycled oil rents, which they borrowed at low or negative real interest rates in the 1970s. But they were soon adversely affected by the world interest rate hikes after 1979 (engineered for anti-inflationary purposes by industrialized country Central Bankers and sustained by global capital market liberalization which encouraged financial investors aggressively to seek the higher bidders for their funds) and the debt crisis in 1982.

The outcome for both sets of countries was massive macroeconomic adjustment. In the wake of the debt crisis, for example, erstwhile borrowers were forced to switch from trade deficits of several percent of GDP to surpluses of the same magnitude as “fresh money” ceased to come in while interest obligations mounted. An external shock approaching 10% of GDP is difficult to handle for any economy; inflationary, contractionary repercussions were observed worldwide.

Occam’s razor notwithstanding, mainstream economists attributed these problems not to macroeconomics but to past policy “errors” including the pursuit of import-substituting industrialization or IS1 which was said to have distorted the price system so badly as to make the economy unmanageable. The increasing difficulties and final collapse of the Soviet system also meant that ideological backing for IS1 and “planning” more generally along with political support for non-free market policies faded away.

As the residual intellectual claimant, neoliberalism took the center of the policy stage. It was directed there by the rich shareholders of the BWIs, on the basis of their own new economic predilections along with the objective interests of their TNCs as they integrated their operations worldwide and of their financial centers as they invested in “emerging” markets. The staffs of the Bank and Fund helped create the new policy line and have been adjusting it gradually. Whether they would be willing to accept major changes, however, is a question postponed to the final section of this paper.

3. THE ROLES OF THE INSTITUTIONS

Basically because the United States decided not to foot the bills, the IMF as it emerged from Bretton Woods has always been too cash-strapped to advance money for the long periods that many countries require for “soft landings” from big current account deficits. To make sure that it could restrain its borrowers, “conditionality” attached to IMF loans became standard practice. Policy limitations and “performance targets” tied to credit lines advanced under “standby agreements” were universal by the 1960s. The fiscal and monetary details have scarcely changed since they were worked out by the IMF’s (then) research director Jacques Polak in 1957. Costs and benefits of Polak’s “financial programming” techniques are assessed below.

In contrast to the IMF, the World Bank has changed its orientation several times. It was created to finance large public infrastructure projects, first in Europe and later in developing countries. In the 1970s when Robert McNamara became its President, the
Bank responded to Washington’s spirit of the times by discovering that “trickle-down” from its investment projects was not benefiting the poor. Poverty alleviation became the Bank’s conceptual focus and in effect a moral goal. Its loans were redirected toward investments which were supposed to help targeted poverty groups.

In the 1980s, this vision was superseded by an emphasis on “market friendly” economic reform. Thinking among the Bank staff began to focus on stimulating economic growth precisely to enhance trickle-down, because more directed anti-poverty policies did not seem to be having much impact. The means toward the growth stimulation end took the form of neoliberalism, in response to the ideological sea change represented by Prime Minister Thatcher and Presidents Reagan and Bush. The Bank moved alongside the Fund into the business of providing balance-of-payments support to countries afflicted by the debt crisis and falling export prices, adding newly invented “structural adjustment loans” to its project credits.

These policy gyrations informed the Bank’s contributions to the debate about economic development and growth. McNamara launched an eclectic research program. With Washington’s ideological shift of 1980s, however, its main thrust switched toward papers “demonstrating” that government interventions in the market slow economic growth and similar neoliberal assertions.

This bias provoked reaction. For example, prodded by the Japanese delegation which circulated a paper stating that the Anglo–American influence on its thinking was too strong, the Bank reviewed the interventionist development strategies that Japan and its neighboring economies historically pursued. Contrary to Japan’s apparent intentions, the resulting East Asian Miracle report (World Bank, 1993) presents an interpretation of the role of the East Asian state which differs significantly from that of many scholars.

Although as demonstrated by Wade (1995) the arguments are stretched, the gist is that East Asian governments “got the fundamentals right” by economy-wide, functional interventions such as providing ample public education and keeping the real exchange rate stable. Their selective actions such as aiding specific enterprises or undertaking sectoral interventions were allegedly counterproductive. In fact, Wade (1995), Amsden (1989), and many others argue that both functional and selective policies played essential roles in supporting the region’s rapid economic growth.

So to speak, the Bank’s 1993 stand is more realistic than the extreme anti-state rhetoric that it emitted in the 1980s. But the half-way position is still disquieting. Rewriting history is tempting for any bureaucracy, and the Bank’s ability to affect the policy climate in developing countries makes the practice more than usually harmful. As Amsden (1994) observes, “What makes the Bank so powerful is that it has no real rival. The Bank has become a virtual monopoly, if not in its lending then in its research work.” Disguising a multimillion dollar ideological marketing operation as research has not been a heartening trend over the past dozen years for the World Bank.

4. THE WASHINGTON CONSENSUS

This history shows that the Washington consensus is a phenomenon of a particular time and place. It amalgamates long-standing IMF macroeconomic stabilization policies, the World Bank’s adoption of the market deregulation and supply-side economics ideas in vogue in Washington early in the Reagan period, and London’s zeal for privatizing public enterprises which crossed the Atlantic a few years later.

As the East Asian Miracle episode illustrates, the consensus has evolved over time, often away from originally extreme positions. The essentials, however, have not changed. Synthesized in the 1980s to attack problems in poor countries which are long-standing and largely stem from their insertion in the international economic order, Washington’s remedies have not been able to overcome these difficulties as they persist years later. To see why, we have to examine the strategy’s details.

The first one is that there is an explicit division of labor in market-friendly packages. They try to assure economic “reform” with pay-offs in the form of faster output growth and rising real incomes by first “stabilizing” the macroeconomy and then “adjusting” the market so that it can perform more efficiently. This sequencing reflects concerns of the BWIs dating from long before the Washington package was assembled.

(a) The IMF contribution

Stabilization has always been the domain of the IMF. Unchanged over 40 years, its central policy prescription aims at reducing the trade deficit (especially the volume of imports) by cutting aggregate demand. Inflation may also be a target, but it is often less amenable to policy control. The most important components of Fund programs are the following:

Fiscal and monetary austerity, which causes lower GDP growth, perhaps slower inflation, and almost always a reduction in imports. Typical policies include cuts in public spending, high interest rates, and credit restraints (especially for the public sector). “Financial programming” based on the country’s balance of payments, fiscal, and monetary accounts is used to set “performance criteria” for indicators such as the permissible growth of the money supply and the proportion of the fiscal deficit to GDP. Polak’s macro-
economic model presupposes that reducing the fiscal deficit automatically leads to a lower trade deficit with no effects on output. Such projections frequently turn out to be false.

Exchange rate adjustment is the second main component of most Fund packages. It raises complex issues.

The nominal exchange rate is a key “macro” price because it affects the economy through many channels. In developing countries, three are especially important. A trade deficit can be attacked by devaluing (or weakening) the local currency, which is supposed to make production for export more profitable and imports more expensive. Complications are that exports may not respond rapidly, and that devaluation drives up internal prices of traded goods, cutting purchasing power and aggregate demand. These inflationary, contractionary side effects are rarely mentioned in IMF country documents, but in practice can be politically disruptive enough to derail a program.

The impact of exchange rate adjustments on the price structure is the second channel. One implication is that lowering internal prices of internationally traded products by strengthening the exchange rate can help control inflation. Using a fixed exchange rate as a “nominal anchor” for inflation has been a key component of Fund-backed stabilization packages (especially in Latin America and Eastern Europe) since the 1970s.

A typical outcome in the case of Argentina is analyzed by Chisari, Fanelli, and Frenkel (1996). After stabilization in the early 1990s the consumer price index (dominated by non-traded goods) increased by more than the nominal wage, which in turn increased by more than the wholesale price index (dominated by traded goods in an economy in which the current account of the balance of payments had been heavily liberalized). Hence, workers’ real purchasing power declined at the same time as real labor costs for producers of traded goods went up. This distributional conflict à la Polanyi and inadequate incentives are built directly into such a relative price regime.

When controls on external trade and capital movements are relaxed (more details below), the exchange rate becomes an asset price to which foreign investors pay close attention when deciding whether to direct funds toward the economy concerned — this is the third channel. Rate movements either way can have violent repercussions in the thin capital markets of most poor economies, with potential adverse (or favorable) feedbacks into domestic interest rates and financial markets. In the case of real exchange appreciation, likely deterioration of the trade account means that steps have to be taken to secure capital inflows. One obvious move is to raise real internal interest rates, with consequent ill effects of investment demand and capital accumulation.

On the whole, Fund packages in small, poor countries tend to emphasize devaluation — the aim is to improve the trade balance through the mechanisms discussed above. Devaluation may also be undertaken to “reassure” investors when they begin to pull money out of the country. This maneuver is tricky, because it reduces the foreign currency value of the national assets that investors already hold but makes future acquisitions cost less. Sometimes it is effective — as in India in 1991 — and at other times a disaster — Mexico in 1994–95. The difference between the two cases may be that Wall Street suffered billions of dollars of capital losses because it has already invested heavily in Mexico before its economic authorities devalued.

Use of the exchange rate to fight inflation can also be a two-edged sword. Combined with its role as an asset price, the adverse trade and production effects of the exchange rate pegged as a nominal anchor can upset a stabilization effort. Especially when capital movements in and out of the economy have been decontrolled, a worsening trade balance under an appreciating (but nominally pegged) exchange rate can provoke capital flight leading to an unavoidable “maxi-” devaluation and associated price jumps and output losses. Form Latin America’s Southern Cone in the late 1970s to Mexico in late 1994 and Argentina (again!) in 1996, the Fund and Bank have repeatedly supported combinations of exchange rate appreciation and capital market liberalization which were doomed to fail. Was it because the financial communities of their main shareholders were pushing them in that direction?

Despite such anti-inflationary misadventures, the basic aim of most Fund packages is still to reduce trade and fiscal deficits to “sustainable” levels of a few percent of GDP. Such efforts may well make sense — an economy with large financial deficits on its external, government, or private sector accounts is skating on thin ice. In practice, however, the IMF moves fast and imposes several contractionary policies at once. The impact is often to slice imports by generating a recession — this familiar outcome is the reason why the IMF is accused of policy “overkill.” Historically, the IMF’s chief target has been to cut the trade gap, and its policy package hits that mark. Whether it reduces inflation (sometimes) or leads to renewed, equitable economic growth (rarely) are altogether different questions.

(b) World Bank adjustments

The World Bank’s specialty is “adjustment” aimed at raising GDP growth. Since around 1980 when it decided to fight poverty with market friendliness, the Bank’s main thrust has been to improve the allocative efficiency of the price system. The basic idea is that removing price “distortions” will produce visible out-
put gains, e.g., cutting “artificially high” real wages will induce companies to hire more workers who will make more goods. Such a negative correlation between wages and output is often not observed. Much more common is a positive correlation with both variables going down. Like devaluation, wage cuts can reduce effective demand and lead to more income concentration; the political reactions can easily sink an adjustment program.

In a bit more detail, attempts to improve resource allocation in Bank-sponsored adjustment packages include the following policy moves:

Foreign trade should be liberalized, beginning with replacement of import quotas by tariffs, and subsequent reduction of the tariffs and export subsidies. By driving internal relative prices toward world levels, these maneuvers are supposed to underwrite exports via cost reductions and efficiency gains, but there are few such cases on record (Helleiner, 1994).

Simultaneously or a bit later, barriers to external capital flows such as controls on foreign exchange transactions and profit remittances should be cut back, to make it easier for external suppliers of funds to invest in the local economy. The fact that foreign money (some of it “hot”) can move out as fast as it moves in has not been stressed by the BWIs until very recently.

A third target is deregulation or “derepression” of the home financial market. The aim is to equalize rates of return to different financial assets. The view in the 1980s was that raising interest rates that had been held down or “repressed” as a subsidy to borrowers would stimulate saving. Such a response proved impossible to detect empirically, and is no longer emphasized. Rather, the current Washington view is that positive real interest rates lead to better resource allocation along standard neoclassical lines.

There was also little discussion in the 1980s about the need for prudential regulation of money and capital markets, in the form of careful audits by the authorities of the risk and performance of portfolios combined with sanctions on financial institutions in trouble. This omission is surprising, because liberalization packages that the agencies have supported have led to speculative booms and crashes all over the Second and Third Worlds (the Mexican peso crisis of 1994 is only one recent example).

As Akyuz (1994) points out, simultaneously decontrolling two inherently volatile market systems — for external capital movements and internal financial instruments — is an explosive policy mix. The powder may be especially dry in the emerging stock markets that have been expanded by public enterprise privatization campaigns and an influx of portfolio investment from rich countries. A 1995 IMF report on International Capital Markets suggests that the BWIs are beginning to grasp this problem, but their learning curves before the 1994 Mexican crisis were not steep.

Fourth, there should be deregulation of labor markets and business decision making.

Fifth, taxes should be rationalized. In conditions such as those in sub-Saharan Africa, they may need to be raised to provide a financial base for badly needed civil service reforms. Despite Washington’s rhetoric (but in practice in programs that the BWIs support), growth in such “success cases” as Ghana and Uganda has been driven by states, not private sectors, and has been accompanied by visible increases in the size of the government.

Sixth, privatization of public enterprises began to preoccupy the Bank in the late 1980s, as doctrines put into practice by British Conservative governments drifted westward. This effort is based on the idea that privately owned enterprises are intrinsically more efficient than firms owned by the state — a proposition which careful reviews of the evidence by scholars such as Chang and Singh (1993) fail to endorse. In practice, selling off state-owned firms often amounts to a fiscal stop-gap to close budget deficits opened by rapid tax reductions. As noted above, the new shares in the hands of the public also served to launch not necessarily stable stock markets all around the world. The Bank enthusiastically supported this process.

Finally, by reducing state intervention and adding “transparency” to the economy, liberalization and privatization are supposed to reduce unproductive resource diversion due to corruption and seeking for “rents” or the returns garnered from a state-assured market position, e.g., the possession of an import quota. But as Boratav, Türel, and Yeldan (1996) observe,

... in most Third World countries the bourgeoisie itself is a creation of the state. This historical phenomenon has created cultural, sociological, and economic traits which do not disappear with changes in the policy model.

They deduce that liberalization is not likely to do away with rents arising from advantageous positions of specific business groups, because “... the very process of rent-seeking emanates from the bourgeoisie, [and] not the state per se.”

In countries undergoing adjustment, instead of disappearing under market-friendly policies, corruption has surged over recent years, spawned by export incentives, speculative urban finance, privatization and stock exchange operations, and fiscal incentives — the popular soap opera starring Mexico’s (ex)-Presidential Salinas is just the best-known example. Such social developments are beyond the ken of the Washington model, which cannot absorb the fact that rents and corruption often rise instead of declining when old forms of market regulation are suppressed. In many countries, these sins have not been absolved by any notable accelerations of economic growth.
5. POLICY OUTCOMES AND THE DISTRIBUTION MATRIX

Many country examples presented by Taylor and Pieper (1996) suggest that attempts by the authorities to stabilize, liberalize, and privatize so that all economic decisions will be taken by the market can backfire for reasons not just confined to the sphere of economics. The unfavorable consequences include the following:

- Contractionary, possibly inflationary impacts of stabilization efforts which can hold down output growth rates for extended periods of time — overkill, in the jargon.
- Badly unbalanced relative price structures, especially in the wake of exchange rate-anchored attempts at stabilizing inflation coupled with external liberalization: high domestic interest rates, overvalued exchange rates, reductions in the purchasing power of the real wage combined with labor cost increases in the traded goods sector.
- Financial instability, often centered around stock markets which have been held down to accompany public enterprise privatization. This fragility is exacerbated by violent movements of capital in and out of the local economy via a liberalized external capital account.
- Visibly increased corruption unaccompanied by faster growth, even though liberalization is supposed to abolish rents arising from state interventions.
- Rising unemployment and/or regressive income redistribution and deeper poverty which in some cases have provoked political reactions strong enough to derail BWI adjustment packages completely.

Facing such problems, what sorts of political coalitions will back economic "reform"? In Chile, Mexico, Turkey, Eastern Europe, and elsewhere, a Washington style policy mix has been supported by the BWIs and other foreign actors, industrialists who can gain from liberalization and an export push (by no means comprising most national firms), financial speculators, households in the top 10-20% of the income distribution who can afford a fine array of new consumer goods in a liberal import regime, and the economic technocracy which puts the new policies in place.

The losers include people in the bottom 80% of the distribution, many industrialists, and old political elites. When the problems just mentioned rear their heads, reform coalitions have come under pressure. Observed political outcomes have differed according to circumstance, and surely will change over time. It is safe to say that the political economy of all reforming countries remains highly uncertain, especially when mounting social tensions come to the fore.

6. REFORMING THE INSTITUTIONS

What can this discussion tell us about prospects for reforming the BWIs? There have been recent improvements in their policy stance: recognition of the importance of at least functional public interventions and the need to provide supporting revenues; realization that controls on external capital movements and prudential regulation can help contain financial fragility; abandonment of the doctrine that raising the local interest rate will stimulate saving and thereby growth; initiatives to roll over or forgive the bulk of official debt owed by the poorest economies. Whether there will be further steps toward policies truly supporting economic development will depend on political and ideological conjunctures.

The main shareholders of the Bank and Fund are the nations comprising the G-7 (or more to the point the G-3 or the G-1 made up of the United States only). Their past management demonstrates that they are committed to conditionality; hence it will remain. History also suggests that the agencies will not be granted large increments in their resources relative to the size of the world economy. As will be noted, however, it would make sense to extend their financial base selectively in certain directions.

Perhaps less firmly given is the present trend toward globalization of financial markets, which has underwritten huge capital flows to Turkey, Mexico, economies in Southeast Asia, and elsewhere. Along "double movement" lines, a fair question is whether private capital markets can be counted on to supply finance to developing countries reliably in the long run. Kindleberger (1985) pointed out that there have historically been 20- to 40-year cycles in lending from rich nations to poor colonies or countries. In this century, there were flows of bond finance to Latin America in the 1920s and the bank loans of the 1970s which led to the debt crisis. Now fresh money takes the forms of direct foreign investment and portfolio allocations by mutual funds. In all previous cases, a wave of "loan pushing" was followed by "revulsion" when the market turned soft.

Of course, this past pattern need not recur — whether Mexico '94 is a precursor of greater financial turmoil or an aberration remains to be seen. But there is at least some chance that developing and post-socialist economies will face revulsion over the next few years. If that occurs, then the BWIs will be virtually the only sources that poor countries can tap for credits in hard currency. The bank could enhance its role as an intermediary between its client borrowers and global capital markets. The Fund could sell gold and even dust off its underutilized machinery for creating SDRs to the benefit of debtor countries, a proposal frequently mooted but never addressed seriously over the past 25 years.
Another not-so-given may be the ideological underpinnings of the Washington consensus — a piece of patchwork with straining seams in the best of cases. The Fund will presumably hew to its demand-limitation package, which does improve a country’s external position when it gets into trouble. But after the IMF applies its performance criteria and conditionality, will it and the Bank relax their insistence on neoliberal verities which often do not seem to apply? Can the two institutions be pushed in new directions?

Possibilities will depend on politico-ideological trends. Forecasting them is an even less exact science than economics, but some leeway may emerge. For five decades, the rich countries have pushed for increased integration of poor countries into the world economy, for reasons discussed above. Earlier, there was more tolerance for planning and “developmentalist” states such as those in Japan and South Korea, with neoliberalism being the recent trend.

Along Polyanyan lines, such attitudes may reverse, especially if market-friendly packages continue to deliver minimal economic benefits per capita (true believers, inside and outside the BWIs, really thought that the outcomes would be better). If ideological and rich country interest constraints relax, obvious modifications to the Washington package have been suggested, many by developing country economists, e.g., in the papers collected in UNCTAD (1994):

First, there could be less conditionality — less nit-picking by the Fund and withdrawal by the Bank from micro-management of investment projects and price formation via its “policy matrixes.” Clearly in Latin America and Asia and increasingly in Africa, in-country economists now are better qualified technically than the lower rung PhDs from US and European universities to whom the BWIs entrust their missions. They can run through financial programming and the Bank’s macro model (the “revised minimum standard model” or RMSM) and do investment project analysis. They should be given a chance to apply their knowledge of their own economies to the fullest extent.

Indeed, it might make sense to institute “reverse conditionality” in which countries would propose economic programs to the BWIs, instead of the other way around. Disagreements between BWI staff assessments and those of the country concerned could be resolved directly, or conceivably via mediation or arbitration by management or third parties (teams of independent economists with experience in developing countries have been proposed for the latter task). The scope of macro conditionality could be restricted, for example just to a balance-of-payments target while the country could pursue its own agenda regarding inflation, income distribution, and growth.

Second, BWI resources could be redeployed toward their original intent of supporting countries in difficulty with the external account. Long-term and cheap (in terms of both the interest rate and degree of conditionality) finance could be directed to countries exporting raw materials and agricultural products, in Africa and elsewhere. A tax or voluntary contribution along the lines of the “Okita plan” for recycling Japanese trade surpluses (Okita, Javawardena and Sengupta, 1986) could usefully be deployed to such ends.

Given their downward international price trends since the 1970s, trade specialization in primary products is a dead-end street for countries which cannot produce an income-elastic, diversified commodity basket. But the street is not easy to back out of. Financial and technical opportunities for export diversification should be provided, if only because rich countries forced their trade specializations on many poor countries in the past, and benefit from their continuing enslavement to low prices. The Third and Second Worlds would also benefit greatly if steps were taken to restructure the commercial debt overhand from the 1970s, for once and for all. With regard to debt from official sources (mostly owed by very poor countries), recent write-down proposals originating from the Bank are a breath of hope.

Third, over the past couple of decades the BWIs deserve credit for making countries aware of the dangers of fiscal imprudence and the benefits from alleviating balance of payments restrictions by export promotion (ideally not of primary products!). They have shown how growth can be retarded if prices such as the agricultural terms of trade and real exchange and interest rates are highly distorted. At the micro level, they have aided enterprise reform.

All these are positive steps, but they must be offset against the problems catalogued above. Spokespersons for the BWIs claim that they have “learned” from their mistakes. There is a fundamental contradiction however, in the way that the agencies respond to errors: They do not pay the costs.

A staff member flying home in a chastened frame of mind represents one sort of response to a liberalization attempt which collapsed; a local health worker trying to help malnourished infants recover from the effects of a drastically lower national income is quite another. In the between-World Wars “calculation debate” about the merits of central planning, von Mises (1935), a patron saint of neoliberals, criticized socialism on the grounds that “as if” planners could never improve upon capitalism because they would just “play” a market game without being disciplined for their mistakes. The same doubts apply to bureaucrats “playing” at running national economies with their attention focused on career advancement in the institutions back in the United States. Can they really do right by the developing world?

They might have a better chance, were the BWIs decentralized. Their staff members are grossly overpaid in comparison to their counterparts in developing...
countries and earn more than Ivy League university professors. When on missions they interact with each other more than with the economists of the country they happen to be visiting, and they communicate virtually only among themselves in the office.

Why not use the BWIs’ huge salary base to send one or two thousand professionals from each institution to work at the country level, earning generous local wages while undertaking relevant research and participating on equal terms in national policy debates? The benefits from intellectual stimulation and crossfertilization of ideas could be enormous in comparison to bureaucratic self-absorption in Washington DC.

REFERENCES


