

# Reviewing the Global Economy the UN and Bretton Woods systems

## Introduction: the perennial search for systems

Humankind has been searching for millennia for ways to govern itself at large scale and over great distances. Overwhelmingly, the dominant solution had been the creation of empires, defined as multi-ethnic or multinational states with political and/or military dominion over populations who are culturally and ethnically distinct from the ruling imperial ethnic group and its culture.<sup>1</sup> In the modern Westphalian era of the past several centuries, a hybrid system of governance around the world emerged, comprising the nation state (in Europe and the Americas) and international empires (across Africa, Asia and Oceania).

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In the last quarter of the 19th century, the industrial, trade and finance activities of those empires gave rise to unprecedented internationalisation of economic activity. This was the first recognisable era of globalisation – political and commercial entities starting to operate on an international scale. However, the great conflicts inherent within the system led to world war. The experience put paid to rudimentary globalisation and the monetary, trade and financial systems on which it depended.

## Early 20th century: the failure of international economic planning

Post-World War One, various combinations of European and North American nations made six attempts in the 1920s and 1930s to re-establish what they took to be the three key planks of international economic co-operation: trade liberalisation, freedom of capital and fixed exchange rates. None was completely successful. The Paris Peace Conference of 1919 set a framework for restoring free

flows of trade and capital. The issue of fixed parities for currencies, however, remained unresolved because it was not a priority, and because the United States resisted. In Brussels in 1920, the League of Nations established an economic and financial section, but its powers were limited.

In Genoa in 1922 a group of mostly European countries re-established the gold standard for currencies. In Rome in 1930, the Bank of International Settlements was set up as 'the central banks' bank'. In London in 1933 the US again rejected a wider system of fixed parities. In London in 1936, the United Kingdom, the US and France signed a stabilisation pact, the Tripartite Agreement. It, too, failed to bed in.

The failure to establish an effective international trade, financial and monetary structure led to high tariffs and other damaging competitive policies. Economic nationalism became the main cause of the Great Depression, which lasted from 1929 for a decade. It was the longest, deepest and broadest depression of the 20th century: global GDP fell an estimated 15% (1929–32); international trade volume halved; unemployment rose as high as 33% (Garraty, 1986).

#### **Mid-20th century: the architecture of Bretton Woods**

In the early 1940s a process began on the monetary, fiscal and trade framework for a set of multilateral institutions that would incorporate the lessons of the previous two decades. The planning was overwhelmingly Anglo-American: in July 1944 the US and UK convened the International Monetary and Financial Conference at Bretton Woods, New Hampshire. Agreement was reached to create three multilateral institutions: a monetary authority, a development bank and an international trade organisation.

The first two – the International Monetary Fund and the World Bank (International Bank for Reconstruction and Development) – were established in 1945. The third failed to get agreement, with the US refusing to approve the trade body. The more modest General Agreement on Tariffs and Trade (GATT) came into existence in 1947.

#### *Financial stability: the IMF*

The IMF began operations in March 1947. The fund's capital, programmes and reach expanded rapidly over the following 20 years as North America and Europe enjoyed a post-war boom. During the 1960s the strong growth of the Japanese economy and development of other countries required the IMF to develop a bigger and broader-based capital structure. This led to the creation of special drawing rights, a basket of members' currencies, as the fund's key accounting 'currency' and capital.

By the late 1960s, however, the great expansion of the global economy, and great disparities between countries' economic, fiscal and trade performance,

support for economies in difficulties, and the policy conditions it attached to such support.

#### *Economic development: the World Bank*

The World Bank exercised many of the same policy prescriptions through its funding of national economic development. Its first loan in 1947 set conditions foreshadowing the institution's even stricter disciplines imposed on subsequent borrowers. It closely monitored how a borrowing country spent the funds; it required the government to produce a balanced budget; and it gave priority for repaying to the bank over other creditors.

Once the Marshall Plan was in place for European countries, the bank shifted its

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were generating considerable stress within the system of fixed-parity exchange rates, still backed by a vestigial connection to the gold standard. Under these pressures, the Bretton Woods architecture unravelled, beginning with the UK's devaluation by 14% against the US dollar in April 1967. The end of Bretton Woods came in August 1971 when the US terminated convertibility of the dollar to gold, devalued its currency, and imposed its first peacetime wage and price controls.

Within two years the currencies of most developed economies were floating. This fundamental transformation increased pressure on governments and central banks to manage national economies on policies that were deemed by investors, capital markets and foreign exchange traders to be suitable for this increasingly open globalised economy. The IMF rapidly became the leading arbiter on these issues, exercising great influence through its advice, its financial

focus beyond Europe, expanding its remit in the late 1960s to finance infrastructure. From 1974 to 1980 it focused on meeting the basic needs of the developing world. During the 1980s it emphasised lending to service Third World debt and for economic structural adjustment policies. Following severe criticism of the adverse environmental impact of its strategies, however, the bank began from 1989 to bring non-governmental organisations and other environmental groups into its processes. After the United Nations instituted the Millennium Development Goals in 2000, the bank oriented most of its programmes to helping countries progress towards the goals.

From 1980 until the global financial crisis in 2007–09 the bank experienced a shift in economic philosophy. But such changes reflected differing views on the nature of development and how to deliver help to countries rather than on the underlying economic rationale, which remained strongly US-centric.

### *Trade liberalisation: GATT and the WTO*

As noted, GATT came into effect in October 1947, under the auspices of the United Nations. In fact, GATT oversaw an enormous expansion in trade liberalisation. Some simple metrics tell the story:

- The first GATT negotiating round in 1947 involved 23 countries, lasted seven months and delivered reductions on 45,000 tariffs affecting US\$10 billion of trade.
- The sixth, the Kennedy round, began in 1964, involved 48 countries, lasted 37 months and achieved tariff concessions of US\$40 billion of trade.

has retrenched into a plethora of bilateral and regional multilateral agreements. Yet these too now seemed to have reached a stalemate. The EU and the US have lost sufficient political support at home to progress the Transatlantic Trade and Investment Partnership, and President Donald Trump has withdrawn the US from the Trans-Pacific Partnership Agreement, making almost certain its failure to come into effect in any form.

For its part, China is establishing new financial and economic entities to serve as alternatives to those long established under earlier Western leadership. These include:

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- The eighth, the Uruguay round, started in 1986, involved 123 countries, tackled tariff and non-tariff barriers, created the World Trade Organisation as GATT's successor and lasted 87 months.
- The ninth, the Doha round, started in 2001 and involved 159 countries. For four years it unsuccessfully tackled tariffs, non-tariff barriers, agriculture, labour, environmental issues, investment, competition, intellectual property and transparency issues before excessive complexity and multiple deadlocks caused it to fall into a nine-year coma of inactivity. The WTO finally declared it dead in December 2015. (Wikipedia, n.d.; Financial Times, 2015)

The failure of the Doha round has occasioned an historic, and perhaps fateful, regression from global to sub-global negotiation context. While the WTO is still useful as a trade rules and arbitration body, albeit a painfully slow and tortuous one, trade liberalisation

- negotiations on the Regional Comprehensive Economic Partnership as a counter to TPPA;
- the Asian Infrastructure Investment Bank, which is backed by 36 other states, including New Zealand, but rejected by the US, Canada and Japan;
- One Belt, One Road, its strategy for aid-backed western expansion of road and shipping lanes across Asia and ultimately to Europe;
- a global inter-bank payments system; and
- international exchanges and markets based in China for oil, gold and other commodities.

### **Late 20th century: crisis in the Bretton Woods system**

In the final three decades of the 20th century the emerging global economy wrestled with a series of interlocking crises: currency instability, resource stress, unequal debt distribution and emerging trade protectionism.

Through this period the IMF remained the unwavering developer, and enforcer, of the orthodox economic view of the world derived from the Bretton Woods system. Such orthodoxy, known as the Washington Consensus, was comprised of a list of policies:

1. fiscal policy discipline, with avoidance of large fiscal deficits relative to GDP;
2. redirection of public spending from subsidies ('especially indiscriminate subsidies') toward broad-based provision of key pro-growth, pro-poor services like primary education, primary health care and infrastructure investment;
3. tax reform, broadening the tax base and adopting moderate marginal tax rates;
4. interest rates that are market-determined and positive (but moderate) in real terms;
5. competitive exchange rates;
6. trade liberalisation: liberalisation of imports, with particular emphasis on elimination of quantitative restrictions (licensing, etc.), any trade protection to be provided by low and relatively uniform tariffs;
7. liberalisation of inward foreign direct investment;
8. privatisation of state enterprises;
9. deregulation: abolition of regulations that impede market entry or restrict competition, except for those justified on safety, environmental and consumer protection grounds, and prudential oversight of financial institutions;
10. legal security for property rights.

The impact of these tenets has occasioned considerable controversy. Stiglitz described the consensus as 'a blend of ideology and bad science' (Stiglitz, 2002). And Rogoff also commented as follows:

As the two Bretton Woods sisters turn 60, the tough love of the International Monetary Fund and even the free love of the World Bank go largely unrequited. Nowadays the twins, never universally admired, are constantly attacked from the left, from the right, from the centre and,

sometimes, by each other. (Rogoff, 2004)

### Early 21st century (part one): tinkering with orthodoxy

The early decades of the 21st century have witnessed a struggle by the architects of economic policy, steeped in Bretton Woods orthodoxy yet aware of its inadequacies in the face of a burgeoning global economy, to steer a course between defensively tinkering with the current institutions and contemplating fundamental reform.

For its part, the IMF continued to evolve to keep pace with the rapid growth and increasing complexity of the global economy and its markets. To that end, for example, it established its international capital markets department in March 2001, and began surveillance of international markets. Following the global financial crisis, however, the IMF, in common with other national and international financial regulators, was widely and heavily criticised for failing to adequately understand and police markets. Reviewing its performance after the onset of the crisis, the IMF focused its response in five broad ways:

- creating a crisis firewall: to meet ever increasing financing needs of countries hit by the global financial crisis and to help strengthen global economic and financial stability, the fund greatly bolstered its lending capacity after the onset of the crisis. This was done by increasing quota subscriptions of member countries and by securing large borrowing agreements;
- stepping up crisis lending: the IMF overhauled its lending framework to make it better suited to country needs, giving greater emphasis to crisis prevention and streamlining programme conditionality. Since the start of the crisis the IMF committed well over US\$700 billion in financing to its member countries;
- helping the world's poorest: the IMF undertook an unprecedented reform of its policies toward low-income countries and quadrupled resources devoted to concessional lending;
- sharpening IMF analysis and policy advice: the IMF provided

risk analysis and policy advice to help member countries overcome by the challenges of and spillovers from the global economic crisis. It also implemented several major initiatives to strengthen and to adapt surveillance to a more globalised and interconnected world, taking into account lessons learned from the crisis;

- reforming the IMF's governance: to strengthen its legitimacy, in April 2008 and November 2010 the IMF agreed on wide-ranging governance reforms to reflect the increasing importance of emerging market

### Early 21st century (part two): addressing fundamental change

The challenges that the international monetary and financial system faces in the early 21st century are different from those which the Bretton Woods system confronted in the mid-20th. Then, there were narrow issues of exchange rate stability and convertibility, trade and economic development involving a small range of countries. Today there are many broader, deeper and truly global issues of capital and trade flows, and of capital markets and financial system supervision. These current challenges have been heightened by the global

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countries. The reforms also ensured that smaller developing countries would retain their influence in the IMF. (IMF, 2016a)

However, the IMF's progress is not as complete as it suggests. While its member countries agreed in 2010 to double the IMF's capital, increase its borrowing and lending power and rejig its voting rights, this has not fully taken effect because of US opposition. The main stumbling block is the resulting dilution of the US stake below 15%, which would remove the US veto power.

Despite US intransigence, the IMF has continued to adapt as the global economy evolves. In November 2015 its members accepted China's renminbi as a reserve currency, giving it a weighting of 10.92% in the basket of currencies comprising the IMF's special drawing rights.

As Lastra noted, financial institutions are only global in good times; they retrench to national frontiers when things turn sour (Lastra, 2010). This state of affairs has to change if financial institutions and markets can credibly claim to be global.

financial crisis and its long-drawn-out impact on the global economy. There are, as Wolf observes, many unsolved issues in financial systems and economies. These are not inevitable but rather the predictable results of policy failures that will have long-term consequences (Wolf, 2014).

The extensive evidence includes historically low, and negative, interest rates, which suggest monetary policy is no longer effective at stimulating economic activity (*Economist*, 2016a); weak growth of trade and national economies, as the IMF reported in its October 2016 forecasts (IMF, 2016b); low growth of productivity; and rising debt. Two reports by the McKinsey Global Institute shed light on this landscape:

- Two thirds of households in 25 advanced economies suffered flat or falling real incomes between 2005 and 2014, affecting some 540 million people. (Dobbs et al., 2016)
- Global debt increased during the global financial crisis (from US\$142 trillion in 2007 to US\$199 trillion in 2014), and debt's share of global

GDP rose from 269% to 286%. China's debt quadrupled over that period, and government debt rose in 75% of countries and for 80% of households. (Dobbs et al., 2015)

Above all these issues have, in recent decades, taken on an intense ecological context which humankind has never before experienced on a global scale. Climate change, loss of biodiversity, acidification of oceans, and excessive nitrogen and phosphorous flows from the use of artificial fertilisers in farming are among the biophysical planetary boundaries we are comprehensively breaching, the Stockholm Resilience Centre reports.<sup>2</sup> As the World Economic Forum put it:

The challenge before us, to develop a well-functioning global economy that operates efficiently, alleviates poverty and operates within the safe planetary boundaries, is immense.

Global risks materialize in new and unexpected ways and are becoming more imminent as their consequences reach people, institutions and economies. We witness the effects of climate change in the rising frequency and intensity of water shortages, floods and storms worldwide. Stable societies are becoming increasingly fragmented in many regions of the world, and we note a weak global economy that is again facing headwinds. (World Economic Forum, 2016)

The World Economic Forum identifies the risks of the greatest likelihood and with greatest impact as failure of climate change mitigation and adaptation, water crises, large-scale involuntary migration, fiscal crises, asset bubbles, unemployment or under employment, profound social instability, interstate conflict and cyberattacks. Such is the impact of these ecological pressures,

human activity is now the determining factor in planetary change. To mark this, the International Geological Congress has begun the process for declaring this epoch the Anthropocene (*Economist*, 2016b). Fundamental change is urgently needed to help the ecosystem recover. As Gus Speth, former chief of the United Nations Development Programme, has noted:

I used to think the top environmental problems were biodiversity loss, ecosystem collapse and climate change. I thought that with 30 years of good science we could address those problems. But I was wrong. The top environmental problems are selfishness, greed and apathy ... and

to deal with those we need a spiritual and cultural transformation. We scientists don't know how to do that. (Speth, 2013)

#### **The UN and Bretton Woods: one system or two?**

As humanity increasingly perceives the planet to be small, finite and fragile, and as the Anthropocene imposes an unyielding responsibility upon us to find our own destiny, an underlying question unavoidably arises: what were the reasons for the fateful decisions of the mid-20th century to create two, separate multilateral institutional systems, the United Nations for political and military management and the Bretton Woods for economic and financial management? If the world is one, why are there two institutional systems?

As with Bretton Woods, the UN system was a child of wartime planning of the early 1940s. Determined not to repeat the grave mistakes of the peace and economic restoration process after the

World War One, Western leaders devoted substantial efforts from the early 1940s to designing and negotiating new global economic and political systems. More quickly than Bretton Woods, however, the UN system responded to the emerging global problems and the dawning of the Anthropocene. From the late 1980s on, the UN began wrestling with the intensely complex and interdependent issues of human development and ecosystem integrity. This work led to the United Nations Conference on Environment and Development convened in Rio de Janeiro in June 1992. The Earth Summit produced three key documents:

- the Rio Declaration on Environment and Development;
- Agenda 21, a voluntary, non-binding sustainability action plan for the UN, its agencies and member governments; and
- the Forest Principles, a non-binding set of principles for forest management.

It also created the Rio Convention, a suite of three legally binding agreements which were opened for signature: the Convention on Biological Diversity, the Framework Convention on Climate Change and the UN Convention to Combat Desertification.

The UN and its member states struggled woefully in the following years to generate meaningful momentum on their non-binding Rio decisions. One of the most critical examples was the tortuous and inadequate progress on climate change. By 2000, however, the UN did agree on its eight Millennium Development Goals. These included eradication of extreme poverty, achieving universal primary education and ensuring environmental sustainability by 2015. There was substantial progress on some of the goals, particularly poverty reduction, by the 2015 deadline. But economic, environmental, social and cultural sustainability remained a distant dream.

Seeking to build on these achievements, the UN devised its vastly more comprehensive programme entitled 'Transforming the world: the 2030 Agenda for Sustainable Development'. Adopted by member nations in September 2015,

it consists of 17 Sustainable Development Goals, backed by 169 targets. The Sustainable Development Goals are an admirable attempt to help people and societies, institutions and governments work on the extremely numerous, complex and interdependent issues of human development and ecological integrity. For its part, the UN is making unprecedented efforts to co-ordinate more than 50 of its agencies and the original Bretton Woods institutions on these herculean tasks.

Yet, while these economic, environmental and social challenges are truly global, constructive responses to them will inevitably be local. But in turn communities need local, national, international and global mechanisms to encourage, guide, prod and require action. Then an infinitely large number of local changes can aggregate into truly global progress towards sustainability. Such a view of the world suggests fertile territory for global studies. For example:

1. How can nations help their citizens achieve a deeper understanding of the interlinked human, ecological

and economic challenges their communities face?

2. How can nations learn to address and integrate these human, ecological and economic imperatives in their societies?
3. How can nations learn to build on such new approaches to achieve a far greater speed, scale and complexity of change?
4. How can nations apply these understandings to create and agree on new international systems, treaties, programmes and other measures to fast-forward progress?
5. How can institutions such as the UN, its agencies and allied entities such as the IMF, World Bank and the World Trade Organisation massively reinvent themselves so they can help lead these transformations?
6. What new technologies, such as ubiquitous communications, can help create new channels, informal systems and formal structures to empower individuals and their communities in ways local and international?

7. How will companies, markets and capitalism itself evolve rapidly so they can be ethical and effective forces for positive change?
8. What attributes of people and organisations might help guide such work?

The challenge before us, to develop a well-functioning global economy that operates efficiently, alleviates poverty and operates within the safe planetary boundaries, is immense. The New Zealand Centre for Global Studies is well placed to explore the above issues.

The greatest challenge we face is a philosophical one: understanding that this civilization is already dead. The sooner we confront our situation and realise that there is nothing we can do to save ourselves, the sooner we can get down to the difficult task of adapting, with mortal humility, to the new reality. (Scranton, 2015)

1 *Oxford English Reference Dictionary*, 2nd edn, 2001, p.461.

2 <http://www.stockholmresilience.org/research/planetary-boundaries/planetary-boundaries/about-the-research/the-nine-planetary-boundaries.html>.

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