

## GLOBAL ECONOMIC GOVERNANCE AND THE 2007-09 CRISIS

Andrew Heywood, Global Politics, Chp. 19 459-480

# Global economic governance: The evolution of the Bretton Woods System

- 1944 Bretton Wood Agreement was negotiated just before the end of the WWII. The major factor behind the agreement was the desire not to return to the economic instability and sometimes chaos of the interwar period.
- The chief lesson of the Great Depression of the 1930s was that protectionist policies implemented at the time were economically self-defeating and politically dangerous.

## Making of the Bretton Woods system

- There was a need for establishing a framework of norms, rules and understandings could be established.
- The most significant outcome of the Bretton Woods process was the establishment of three new bodies (in due course known as the “Bretton Woods” system).

## Making of the Bretton Woods system

- These bodies were:
- The International Monetary Fund (IMF) which came into operation in March 1947.
- The International Bank for Reconstruction and Development (IRBD) better known as the World Bank-came into operation in June 1946.
- The General Agreement on Tariffs and Trade (GATT) which was replaced by the World Trade Organization (WTO) in 1995. (GATT was created by the UN Conference on Trade and Employment and came into operation in January 1948.

## Making of the Bretton Woods system

- USA emerged from the WWII as the world's predominant military and economic power and dictated some key outcomes.
- The USA's priorities in relation to Bretton Woods were twofold:
  - First, having massively increased its industrial output through rearmament and the expansion of exports before and during the war years, USA aimed to re-establish full employment and for that the USA needed to ensure that domestic growth levels could be sustained in the postwar period.
  - This required an construction of an open and stable international economic system.

## Making of the Bretton Woods system

- Second, US thinking was shaped by a growing awareness of the threat posed by a growing awareness of the threat posed by the Soviet Union and the need to contain the spread of communism. This encouraged the USA to seek ways of promoting reconstruction and recovery in war-ravaged Europe, as well as in defeated Germany and Japan.

## Making of the Bretton Woods system

- At the centre of the Bretton Woods system was a new monetary order, overseen by the IMF, which sought to maintain stable exchange rates. This was achieved by fixing all currencies to the value of the US dollar, which acted as a 'currency anchor' , with the US dollar being convertible to gold at a rate of \$35 per ounce.
- World Bank provided loans for countries in need of reconstruction and development, while GATT existed more as a multilateral agreement, while GATT sought to advance the cause of free trade.

## Making of the Bretton Woods system

- Bretton Woods was shaped by the fear that an unregulated international economy is inherently unstable and crisis-prone, tendencies most dramatically demonstrated by the Great Depression itself.
- In line with the ideas of John Maynard Keynes, markets had to be managed. After the war, industrialized states increasingly adopted Keynesian techniques of economic management, in which fiscal policy (government spending and taxation) was used to deliver growth and keep unemployment low.



## Making of the Bretton Woods system

- Bretton Woods reflected an attempt to establish a Keynesian –style regulative framework for the international economy.
- Bretton Woods system was based on free trade, free capital movement and stable currencies.
- For at least two decades the Bretton Woods system appeared to be a remarkable success. During the ‘golden age’ of the 1950s and 1960s, OECD member states consistently achieved average growth rates of four to five per cent a year.

## Fate of the Bretton Woods system

- How far Bretton Woods contributed to the economic boom of the postwar period is however, a matter of debate. Many people argued that ‘national Keynesianism’ had a greater impact than ‘international Keynesianism’.
- Long boom of the postwar period started to decline in the late 1960s, leading to the stagflation of the 1970s, in which economic stagnation and rising unemployment was linked to high inflation.

## Fate of the Bretton Woods system

- The US economy was troubled because it was attempting to cope with spiralling spending at home and abroad, and for the first time since 1945, facing increasingly stiff foreign competition.
- In 1971, the USA abandoned the system of fixed exchange rates, signalling the end of the Bretton Woods system in its original form.
- Eventually, during the 1980s, the institutions of global economic governance were reorientated around the ideas of the so-called 'Washington consensus'.

## Evaluating global economic governance: the International Monetary Fund

- The chief purpose was to encourage international cooperation in the monetary field by removing foreign exchange restrictions, stabilizing exchange rates and facilitating a multilateral payment system between member countries.
- Member countries were committed to a system of fixed, but adaptable, exchange rates, with the IMF acting as a kind of 'currency buffer' granting loans to countries experiencing temporary balance-of-payments deficits.

## Evaluating global economic governance: the International Monetary Fund

- The system of fixed exchange rates established by Bretton Woods was based on gold exchange standard, with the US dollar acting as an anchor.
- Following the transition in the early 1970s from fixed to floating exchange rates, the function of the IMF was significantly transformed.
- The IMF increasingly focused on lending to the developing world. A particular concern of the IMF was to prevent financial crises such as in Mexico 1982, East Asia in 1997-98 and Russia in 1998 from spreading and threatening the entire global financial and currency system.

## Evaluating global economic governance: the International Monetary Fund

- The most controversial aspect of the loans that the IMF provided was that 'conditionalities' were attached to them. From the 1980s onwards these conditions were shaped in line with the thinking of the Washington consensus.
- This led to an application of a neoliberal template based on the control of inflation ahead of other economic objectives, the immediate removal of barriers to trade and the flow of capital, the liberalization of the banking system, the reduction of government spending on everything except debt repayment, and the privatization of assets that could be sold to foreign investors.

# Evaluating global economic governance: the International Monetary Fund

- Structural adjustment programs rarely provided good results- e.g South Korea, but often they inflicted more harm than good on developing countries.
- Shock therapies: by reducing government spending and rolling back welfare provision increased poverty and unemployment, while economic openness exposed fragile economies to intensified foreign competition and expanded the influence of foreign banking and corporate interests.
- IMF-led structural adjustment deepened, rather than reduced economic crises and it did so because the IMF responded to the 'interests and ideology of the Western financial community'.

# The World Bank

- Partner organization of the IMF. Both organizations created by the Bretton Woods agreement, have very similar weighted voting systems that take account of countries' strength in the global economy, and particularly in the 1980s and 1990s, they shared a common neoliberal ideological orientation, shaped by the Washington consensus.
- Yet World Bank has essentially redistributive function. This initially concentrated on assisting postwar recovery in Europe, but from the 1960s onwards, increasingly focused on the developing world. It does this by providing low interest loans to support major investment projects, as well as by providing technical assistance.



# The World Bank

- Initially, it mainly supported large infrastructure projects in areas such as energy, telecommunications and transport. After 1968, its priorities shifted towards projects dealing with basic needs and what were perceived as underlying causes of poverty and drove the Bank into areas such as population control, education and human rights.
- However, after 1980s, a shift to a narrowly focused concern with IMF-style structural adjustment policies. The emphasis was on deregulation and privatization, and a stress on export-led growth rather than protectionism.
- Through this emphasis, World Bank helped to maintain dependency and poverty.

# The World Bank

- Yet, from early 1990s it has responded to criticism from both without and within and accepted the need for reform.
- This has involved a greater awareness of the environmental costs of industrialization, urbanization and major infrastructure projects, helping to convert the Bank to the idea of sustainable development.

# The World Trade Organization

- The WTO was formed in 1995 as a replacement for GATT, established in 1947.
- GATT was an agreement amongst member countries to apply the multilateral principles of non-discrimination and reciprocity to matters of trade. This was guaranteed by the requirement that each country had to concede most favoured nation status to all trading partners. No trading partner could therefore be treated more favourably than others.

# The World Trade Organization

- The GATT had certain limitations: its focus was restricted to the reduction of tariff barriers against imported manufactured goods- agriculture and service sector were largely off the agenda of GATT.
- The emergence of WTO was a response to the changing imperatives of the international trading system in the 1980s, linked to the wider triumph of neoliberalism and the acceleration of globalization. This created stronger pressure to advance the cause of free trade through a more powerful trade organization with broader responsibilities.

# The World Trade Organization

- The WTO is stronger than GATT, especially in the issue of dispute settlement. In comparison to GATT, under the WTO, settlement judgements in the case of disputes can only be rejected if they are opposed by all members of the Dispute Settlement Body, to which all member states belong.
- In effect this has made the WTO the primary instrument of international law in the area of trade.

## Global economic governance and the 2007-09 crisis

- The global financial crisis of 2007-09 posed a series of deeper and more challenging problems. In the first place, it was deeper than the previous crises of modern global capitalism, amounting to the most severe downturn in the economy since the 1930s.
- According to the World Bank, global GDP fell in 2009 by 1.7 %, the first decline in world output on record and the volume of world trade dropped by 6.1 %.

## Global economic governance and the 2007-09 crisis

- Second, although its severity varied from country to country, and region to region, its impact was genuinely global.
- Third, instead of occurring in emerging markets, it originated within the US.
- Therefore, it is not surprising that the 2007-09 crisis led to calls for the urgent reform of the architecture of global economic governance.

## Global economic governance and the 2007-09 crisis

- But what would reformed global economic governance look like? There is no single model of reformed global economic governance, but rather a number of models.
- The only thing that these competing models have in common is that none of them envisages a fully-fledged return to Bretton Woods. None of them proposes a return to the dollar-based gold exchange standard.



## Global economic governance and the 2007-09 crisis

- From the market fundamentalist perspective, the most appropriate response to the crisis has been to do nothing.
- In this view, financial and economic crises are a small price to pay for almost thirty years of sustained growth in the world economy.
- For regulatory liberals on the other hand, what is needed is specific reforms of the global financial architecture as well as the new regulatory regimes at the domestic level. The excesses of neoliberalism shall be curbed.

## Global economic governance and the 2007-09 crisis

- Even though a series of ideas have been expressed, most of these ideas have not been implemented.
- A significant result: The role of G7/8 declined whereas the role of G20 acquired a further significance. G7 was established in 1973 (USA, France, Germany, the UK, Japan, Italy and Canada plus Russia in 1997). G20 was set up in 1999. (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the UK, the USA and the EU).
- Why? The distribution of power increasingly shifted towards emerging economies.

## Global economic governance and the 2007-09 crisis

- However, apart from this, the institutional response to the 2007-2009 crisis has been modest.
- Although there has been some adjustment in the allocation of voting rights within the IMF and World Bank in favour of developing countries, fundamental power balances within these bodies remain substantially unchanged.

# Global economic governance and the 2007-09 crisis

- The chief institutional development: the establishment of the Financial Stability Board (successor to the Financial Stability Forum) in April 2009. The purpose is to coordinate at the global level the work of national financial authorities and international standard-setting bodies and to promote the implementation of effective regulatory, supervisory and other financial sector policies.

## Obstacles to reform

- “Business as usual” after 2007-2009 crisis. Why? Crisis was initially managed by the G-20 coordinating swift action at the domestic level to salvage the banking system and push through Keynesian-style reflationary policies (policies aimed to boost the level of economic activity), appeared to be effective. People became optimistic, thinking that the crisis may end shorter than widely feared.

# Obstacles to reform

- Another factor: changing balance of power within the world economy. The USA has no longer the ability to reformulate the global economic governance system at its will. Views, interests and requirements of new powers, esp. China, India, Russia and Brazil matter.

## Questions for discussion

- What was the thinking behind the creation of the Bretton Woods System?
- Is the IMF merely an instrument of powerful economic interests in Northern economies?
- How successful has the World Bank been in helping the world's poor?
- Is the global trading system created by the WTO fair and effective?
- How has the 2007-2009 crisis affected the processes of global economic governance?