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Washington after Fortaleza

Written by Christopher Wood

The Development Committee is addressed by World Bank Group President Jim Yong Kim, at the IMF / World Bank Annual Meetings, October 11, 2014.
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Four months after the BRICS (Brazil-Russia-India-China-South Africa) launched their New Development Bank and Contingent Reserve Arrangement (CAR) at a Summit held in Fortaleza, Brazil, the World Bank and IMF convened for their Annual Meetings. For all the fanfare that met the announcement of the BRICS' new financial infrastructure, not a lot has changed.

The new Bank is less than a quarter the size of the World Bank, and the CAR only a fraction of the IMF. The BRICS themselves have lost their shine, caught in the sliding growth expectations of the emerging world. For now, the BRICS New World Order looks unlikely to make it across the Potomac, never mind the Rubicon.

But the Fortaleza institutions still matter. They are a statement of the emerging world's continued dissatisfaction with the Washington financial infrastructure. The World Bank and IMF have done an incredible amount of good in the developing world, and have made extensive efforts in recent years to shake off their old ideological dogmatism in favour of a more open, responsive structure. But these efforts have failed to address the underlying scepticism of the two as the primary agents of an ideological perspective that has never truly won over the developing world.

Regardless of the merits of this scepticism, the fact of these doubts has the capacity to undermine the prime actors of global development. Fortaleza is the pinnacle of efforts by the emerging world to water down the influence of two organisations that, with sufficient commitment, can do a tremendous amount of good in the developing world. The Washington organisations will have to respond, and this year's set of annual meetings (October 10-12, 2014) offered the first chance to do so.

It is nigh-on-impossible to list all the changes that are needed. The Washington organisations' mandates are large and unwieldy, with discussions at this year's meeting looking at issues ranging from youth empowerment and inclusive growth, to the future of the global financial system. But four broad, overarching issues should have been kept in mind during the discussions.

Reform the IMF

As it currently stands, France has more influence in the IMF than China. Belgium has more than Brazil, Saudi Arabia more than Russia, and Canada more than India. It is preposterous that these four slow growth countries with a population of 142 million people have more influence than the 3-billion-person BRIC grouping. The governance structure of the IMF belongs to a world that no longer exists.

A package of reform that takes the first step to correcting these imbalances has been passed by nearly all of the Fund's membership, but remains stuck before the US Congress, which refuses to ratify it. The Obama administration and many in Congress have made efforts to pass the bill, but the overriding symbolism of the stalemate seems to confirm all the worst criticism of an IMF held captive to Western interests. The leadership of the Fund must start work on a Plan B that reasserts their commitment to building a fairer and more inclusive governance structure. While this will be extremely difficult without US support, it is doable, perhaps through democratising the New Arrangements to Borrow (NAB) - additional funds that, unlike the core quota funding, do not confer additional voting rights.

The NAB now overshadows core funding, by $570 billion to $367 billion. They would be reduced under the reform package, in favour of a fairer distribution of vote-carrying quota allocations, and this approach is certainly the best option. But with the reform package stuck, it might be time to at least start a discussion of a separate governance structure for future NAB-like funds. Doing so might be enough to wake the US Congress up to the need to finally throw their weight behind an IMF reform agenda that cannot be put off any longer.

Respond to Monetary Diversity
The IMF will need the full commitment of the world's superpowers, including those in the emerging world, as it faces a global financial system that remains mired in uncertainty and volatility. The financial crisis was a nightmare to deal with, but crisis management at least offers clear objectives and a unifying logic of international cooperation.

But as the recovery has progressed, the impact of the crisis has diverged. The United States is experiencing a quiet competitiveness revolution that promises growth unseen in the last decade, while Europe remains mired in chronically low growth rates and seems politically unable to make the changes necessary to get back on track. Between the two is the developing world, the wild card of the equation, continuing to grow but at much lower rates than prior to the crisis.

Managing a multidirectional monetary system requires the IMF to be more flexible than has historically been the case. There are no cookie-cutter solutions for a world of divergent monetary fortunes, and the IMF will need to acknowledge and work through this diversity, carefully tailoring each intervention to each unique case.

Accept Alternative Growth Models
The World Bank, with its more proactive mandate, is facing a different challenge: remaining relevant. The Bank's core historical mission has been to provide development funding to nations that have limited access to funding from anywhere else. But that list is growing smaller. It has previously been dominated by African states, but many of those now have access to private bond markets and alternative development banks, such as the African Development Bank (AfDB).

The World Bank still remains immensely important, but it is no longer at the wheel of development finance, it is just another passenger. By necessity, this new role demands that the Bank assume a more open stance on development and that it embraces alternative growth models. Large debt-funded infrastructure projects or dirty energy projects in the emerging world might sit uncomfortably with the beliefs of many in the bank, but they are the vision chosen by many in the emerging world. The Bank must embrace its role as a facilitator, rather than a crafter, of that vision.

Look to Ghana
Ghana will be the test case for the direction taken by the World Bank and IMF. Long regarded as a golden child of the Washington establishment's vision of liberal economic growth, the country had to turn to the IMF for assistance following a collapse in the value of the cedi. Ghana has signed up to a package of fiscal consolidation, and received assistance in return, but it now finds itself facing a Faustian decision. Despite the recent shocks, it makes sense for the Ghanaian government to spend liberally, because of the presence of high-return items like infrastructure investment and weak take-up of credit by the private sector. But, having accepted the IMF loan and its conditions, the government may find its ability to lend constrained by the Fund's demands of fiscal adjustment.

Ghana cannot develop without the government playing a proactive role in the economy. A strict commitment to old-style fiscal consolidation will make for a government that can pay the bills, but a society that cannot. If the demands for an involved government are ignored in Ghana, then the future of the IMF’s relationship with an untrusting developing world will be very much in doubt.

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