Bretton Woods and World Bank at 75

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Introduction

- The Bretton Woods conference, with 734 delegates from 44 nations, opened on July 1, 1944, less than a month after the D-Day landings.
- The conference lasted for three weeks and is commonly thought to have provided the platform for the shape of the post-war global financial architecture through the creation of two institutions—The IMF and the World Bank.
- In this talk I will focus one of the two institutions which emerged out of the conference, the World Bank.
- I will first elaborate on the role of John Maynard Keynes in its conceptualization and creation, and his design of the World Bank's signature sovereign loan instrument.

Introduction

- I will then look to the future and ask what the World Bank is good for now, three quarters of a century after is creation, with a particular focus on recent discussions of its possible role in the provision of global public goods.
- It should be clear to even a casual observer that all Is not well with the World Bank.
- Staff morale is low. Discourse on “Mission creep” co-exists with “Lack of Mission”.
- The recent news of agreement on a capital increase for IBRD does not dim the search light of questions about the World Bank’s activities relative to the ever growing suite of Multilateral Development Banks (MDBs)

Introduction

- As we shall see, this was not always so.
- The World Bank was a prized institution, credited with its share of glory for the post second world war recovery.
- Even when it was criticized and reviled by civil society in the years of structural adjustment and the Washington consensus, at least it demonstrated its relevance.
- The risk now is growing irrelevance as its financial base recedes relative to financial needs of countries on the one hand, and alternative supplies of finance on the other.

Introduction

- So much for the World Bank.
- Coming to the World, there is now a growing understanding, to the point of a crescendo of recognition, of the problems of cross-border spillovers and externalities, and of the inadequacy of global instruments to address these problems.
- Obviously, the problems include financial contagion, infectious diseases, climate change and migration.
- Our Westphalian world of nation states is struggling to address these problems, for the equally obvious reason that there are insufficient incentives for any single country to invest in the solution, which must necessarily be cross-national.
- Mechanisms to address these cross-border issues are “Global Public Goods”.

Introduction

- We thus have a global institution which is falling into difficulties and irrelevance; and a set of problems which need a global institution to address them, to supply the Global Public Goods.
- Could there be a match? And what would need to happen for the match to be made and for it to succeed?
- These are the questions which I try to begin answering in this presentation.
- Although my motivating focus is on a single institution, The World Bank, and its potential role in addressing the problem of Global Public Goods, I hope that the issues raised will be general enough to merit broad discussion.

World Bank Origins

- While the origins of the IMF can be located in the huge exchange rate and balance of payments instabilities of the inter-war period, the origins of the World Bank, at last in the mind of its creator John Maynard Keynes, can be said to be located in the Treaty of Versailles.
- Keynes was a member of the British Treasury team at the Paris Peace conference in 1919, and resigned in disgust at the reparations being demanded from the defeated Germany.
- His *Economic Consequences of the Peace* was a brilliant, angry polemic on how victors should help the vanquished re-enter the community of nations rather than exacting vengeful retribution.

World Bank Origins

- “..the spokesmen of the French and British peoples have run the risk of completing the ruin which Germany began, by a peace which, if it is carried into effect, must impair yet further, when it might have restored, the delicate, complicated organization, already shaken and broken by war, through which European peoples can employ themselves and live.”
- “if the European war is to end with France and Italy abusing their momentary victorious power to destroy Germany and Austria-Hungary now prostrate, they invite their own destruction also…”

World Bank Origins

- Roll the clock forward 25 years from 1919.
- The British Delegation to Bretton Woods, led by John Maynard Keynes, sailed from Britain on 16 June 1944, 10 days after the D-Day landings.
- On board for a week, they worked on what have become known as the “Boat Drafts” of the British proposals, one on the IMF and one on the Bank, in response to the latest versions of the American proposals which they had just received.

World Bank Origins

- It may seem very odd to us that the design of the post-war financial order was to be discussed in the month after the Normandy landings, when victory was far from clear.
- But, in fact, discussions on post-war economic arrangements, especially on exchange rates and balance of payments, had been going on for quite a while.
- In July, 1940, Walther Funk, Hitler's economics minister, put forward a plan for a new international financial order under Nazi rule.
- The British Ministry of Information saw the propaganda threat and asked Keynes to respond.

World Bank Origins

- The key American at Bretton Woods was Harry Dexter White, a US Treasury official who had also started work on a post-war plan for more than two years:
- “Sunday morning phone calls from the office weren’t unheard of in the White household. Even so, the call that came from the Treasury Secretary at 10.00 am on Sunday, 14 December, 1941 was unusual. Shortly after White picked up the receiver Morgenthau began telling him about a dream he had the previous night….that after the war there would be a world with an international currency, and a central fund to administer it…..Could White look into whether such a thing was possible?” (Ed Conway, *The Summit*, 2014).

World Bank Origins

- Of course this was 7 days after the attack on Pearl Harbor.
- So there emerged a White Plan and from Keynes there emerged a Keynes Plan.
- “While they would have much in common, there were also key differences—most of them deriving from the contrasting situations of the two sides. Britain was a debtor nation; if it were to win the war, it would be a bankrupt nation, in desperate need of support. The United States was set for world domination; White’s plan would be designed not merely to secure its rise, but to ensure that the outgoing superpower would be shuffled even further from centre stage.” (Conway, *The Summit*).

World Bank Origins

- Thus began a dance of comments and revisions of the two plans, during 1942, 1943 and the first half of 1944, with American power plays based on their dominance, and British rearguard action relying on Keynes's intellectual and rhetorical brilliance.
- Two things emerged clearly.
- First, it was on the plans for the IMF that the major battles were fought. It was here that key issues like the role of the dollar as the unit of account, with Keynes arguing for a new international currency altogether, were debated. The Bank was a secondary consideration.
- Second, on all of these battles, White (ie the US) won and Keynes lost.

World Bank Origins

World Bank—Origins

- Of the two main protagonists Keynes gave more thought to and wrote more on the Bank than did White.
- This was also true on the boat to New York in June 1944:
- “Meanwhile, almost single-handedly, Keynes was writing a detailed proposal for the shape of the World Bank…Keynes suddenly found himself possessed with a new-found enthusiasm for the Bank—to the extent that his colleagues started to wonder if he had forgotten about the Fund entirely.” (Ed Conway, *The Summit*).

World Bank Origins

- The reason for Keynes's focus on the Bank, as an instrument of post-war reconstruction, is perhaps rooted in his experience of the Versailles treaty, which he predicted would reap the bitter harvest of the next world war.
- But it was also, perhaps, because he had realized he would essentially lose each time he contested American proposals on the IMF. The Americans were less exercised about the World Bank, seeing it as a side show.
- Indeed, when it came to the Bretton Woods conference itself, Harry White got Keynes "out of the way" by making him Chair of Commission II which was to deliberate on the Bank. As might be guessed, Commission I, which was to deliberate on the IMF, was chaired by White.
- (There was a Commission III—"other means of international financial cooperation"—headed by the leader of the Mexican delegation, which has gone into obscurity).

World Bank Origins

- So it is that the World Bank bore the stamp of John Maynard Keynes (albeit that its location was decided as Washington DC and its head as an American).
- Keynes had been thinking about this in one form or another since 1919, but his thinking crystallized in the two or three years before 1944.
- And this thinking, and his hopes and aspirations are laid out in his opening Chairman’s remarks to Commission II.
- This is a remarkable statement, combining soaring rhetoric with a clear and crisp statement of the novelty of the Bank (which Keynes kept saying was in fact a fund while the Fund was a bank!).

World Bank Origins

- Opening remarks of John Maynard Keynes, as Chair of "Commission II" on the Bank for Reconstruction and Development," 3 July, 1944.
- "…it will be authorised in proper cases and with due prudence to make loans to the countries of the world which have suffered from devastation of war, to enable them to restore their shattered economies and replace the instruments of production which have been lost or destroyed."
- "…as soon as possible, and with increasing emphasis as time goes on, there is a second primary duty laid upon it, to develop the resources and productive capacity of the world, with special attention to the less developed countries…."

World Bank Origins

- “Herein lies the novelty of the proposals which will be submitted to you….The proposal is….that all the member countries should share the risk in proportions which correspond to their capacity. The guarantees will be joint and several, up to the limit of any members’ subscription.”
- “…I fancy that the underlying conception of a joint and several guarantee of all the member countries throughout the world, in virtue of which they share the risks of projects of common interest and advantage even when they cannot themselves provide the lump sum loan original required, thus separating the carrying of risk from the provision of funds, may be a contribution of fundamental value and importance ….”

World Bank Origins

- “The bonds [issued by the World Bank] will be good for several different reasons. In the first place, they will have behind them the vast resources of the Bank available in gold or free exchange. In the second place, the proceeds will be expended only for proper purposes and in proper ways, after due enquiry by experts and technicians….In the third place, they will carry the guarantee of the borrowing country….the consequences of improper action and avoidable default to so great an institution will not be lightly incurred.”

World Bank Origins

- Keynes concluded his Chairman’s remarks by the type of flourish he was well known for, saying the that the Bank would be central to “those difficult, almost overwhelming tasks which lie ahead of us, to rebuild the world when a final victory over the forces of evil opens the way to a new age of peace and progress after great afflictions.”

World Bank Origins

- Note that despite the fact that are not mentioned explicitly, GPGs do make an appearance in the original Bretton Woods discourse in at least two senses.
- First, the very general sense that recovery of war torn economies is in the interests of the world as a whole—a very different perspective than the one taken in the Treaty of Versailles.
- Second, the cooperative design of funding, the “joint and several guarantee” mechanism, is itself a Global Public Good. It addresses insufficient incentives on the part of any one country to bear the risks of investment to rebuild infrastructure destroyed by the war.

World Bank Origins

- However, cross-border issues are not present in the uses of the funds generated by the Bank. In the original conception the use of funds is for country level investment. There is no mention of the modern cross-border issues of climate change, infectious disease control, migration, or financial contagion as being part of the remit of the World Bank.
- As we shall see, this design feature of country specific lending, which is part of the DNA of the World Bank, acts as a constraint in addressing emerging GPG issues.

The World Bank and the World Today

- The Keynesian design succeeded brilliantly in the post-war period. Financial intermediation between sources of funds and uses of funds was successful, and contributed to the rapid post-war recovery and growth. (There were other contributors also, like the Marshall Plan).
- After the first phase, the model was modified to include concessional lending with the advent of IDA, as the newly independent developing economies came on the scene.
- Even the contentious debates of the 1980s and the 1990s on "structural adjustment" showed the relevance and significance of the World Bank as a key player in development.

The World Bank and the World Today

- Imitation being the sincerest form of flattery, the basic model of sovereign loans from a multilateral cooperative was also replicated through the Regional Development Banks and sub-Regional Development Banks.
- The reasons for this proliferation of the model, which continues to this day through AIIB and NDB, include the political, but the proliferation is testament to the power of the basic model.
- Added to this is the greatly expanded reach of bilateral aid programs and the multilateral aid program of the EU.
- Further, of course, private flows to countries have increased dramatically.

The World Bank and the World Today

- So in terms of pure financial clout the World Bank’s positon has diminished significantly.
- The recent agreement for a capital increase has been much trumpeted as allowing an increase in lending from about $60b annually to $100b annually. This is a big increase for the World Bank, but miniscule compared to the investment needs of the developing world. And it will remain fixed till the next capital increase perhaps a decade hence.
- The quantitative financial relevance of the World Bank for country specific investment will decrease at the rate of growth of developing countries in the coming decade.

The World Bank and the World Today

- But, as noted in the introduction, cross-border externalities and spillovers are rife in this globalized world.
- Could the World Bank find new relevance in addressing these issues?
- Let us turn then to some conceptual foundations for how an agency like the World Bank might interact with GPG issues.

Global Public Goods: Principles and Division of Labor

- There are many externalities and spillovers across sovereign nation states.
- Four obvious ones mentioned earlier are financial contagion, infectious diseases, climate change and migration. One set of issues that goes beyond these is the race to the bottom in taxation and regulation as countries try to attract mobile capital and skilled labor.
- But another important aspect of these spillovers is their reach and spread.
- Many are restricted to a contained number of contiguous nation states. For example, riparian rights across countries sharing river basins and water tables, or when forest cover or wildlife movements stretch across borders, or when conflict in one country leads to refugee flows only to a neighboring country.

Global Public Goods: Principles and Division of Labor

- There are conflicting tradeoffs in designing mechanisms and institutions to address these externalities. And it is these mechanisms and institutions which are the public goods.
- The principle of subsidiarity says that all other things equal, and if the setting up of mechanisms were costless, the mechanism addressing a problem should be located closest to where that problem is.
- Thus the principle would resist an immediate jump to a global institution to address multi-country issues in Africa, or in Latin America, or in Asia.

Global Public Goods: Principles and Division of Labor

- But, of course, mechanisms and institutions are not costless. There are large fixed costs of setting up institutions, which suggests a small number of institutions. But how many and of what type?
- A detailed cost-benefit would be difficult if not impossible to conduct, but suggests a split between Regional Institutions for within-region spillovers and Global Institutions for spillovers which are global in the sense that they encompass countries from across regions.
- There is no reason why a three-country riparian rights issue in Asia, for example, should necessarily be handled by a global institution like the World Bank if there is a regional institution capable of handling it.

Global Public Goods: Principles and Division of Labor

- If the subsidiarity argument has validity, then regional Public Goods (RPGs) should be handled by Regional Institutions, and GPGs by Global Institutions.
- Thus for a Global Institution like the World Bank, the rationale for involvement in cross-border externalities cannot simply be that they exist, but that they are Global and cross-regional in nature.

Global Public Goods: Principles and Division of Labor

- There is yet another type of question on the division of labor. For truly global issues, should there be a global institution per issue, or should there be a global institution handling multiple issues?
- There is a tension or tradeoff between issue focus and design of the mechanism at the global level (which is the GPG), for example for infectious diseases, and implementation of the mechanism at the country level. A smooth translation from one to the other is necessary, and this may be best achieved by having both under one roof, but the trade off has to be recognized.

Global Public Goods: Principles and Division of Labor

- Let us turn now to a fundamental point about the trade offs in use of resources of the development banks, the World Bank in particular. Should they be used for development and poverty reduction on a country by country basis, or should they be used for provision of GPGs?
- Of course one could avoid the question by saying that GPGs address development and poverty reduction as well. But this does not face up the tradeoff that the marginal dollar could be spent on building schools or health posts versus developing clean energy devices to reduce fossil fuel usage.

Global Public Goods: Principles and Division of Labor

- This is not an easy question to answer definitively and quantitatively.
- But it can be argued that up to now resources of the development banks have only been minimally devoted to GPGs.
- There should be a shift towards (i) financing the setting up of global mechanisms to address GPGs and (ii) financing the country specific investments required by the global mechanism.
- However, Ray Offenheiser provides an alternative perspective in a dissenting note to the recent Center for Global Development report on Multilateral Development Banks:

Global Public Goods: Principles and Division of Labor

- “What separates the MDBs in this fast-changing context, however, is their specific mandate to reduce poverty…..While I would certainly recognize the role of global public goods (GPGs) in addressing different dimensions of poverty and inequality….and perhaps even recommend making it an explicit and major pillar of work, I would continue to argue that the overarching mission and mandate of the World Bank (and other MDBs) must remain the fight to eliminate extreme poverty.”
- This is surely a different voice on the division of labor between financing for GPGs and financing for country specific investments for poverty reduction.

Global Public Goods: Principles and Division of Labor

- However, the financing issue immediately brings up another fundamental question—the suitability of the development banks' signature instrument, the sovereign loan, for financing GPG mechanisms.
- Since the whole point about GPGs is the difficulty of attributing country specific costs and benefits, the sovereign loan instrument is peculiarly unsuited to the task. Various related mechanisms (eg Apex lending) have been tried, but the fundamental issue remains unchanged.

Global Public Goods: Principles and Division of Labor

- The answer has to be that the core financial instrument for GPGs has to be a grant instrument.
- Nancy Birdsall puts this proposition eloquently in a recent critique of the interim update of the G20 Eminent Persons Group on Global Financial Governance.
- “What is disappointing is that the update makes no reference to the hidden limits on the MDBs’ current ability to do so at sufficient scale and scope and effectiveness. (They all try to “green” their lending and the World Bank hosts and manages various trust funds and other special initiatives in health and climate—but these are ad hoc, and their financing is not secure over the long term.) That limit is the MDBs’ reliance, intrinsic to their business model, on the country-based loan to generate sufficient net income to cover the long-run cost of their operations.”

Global Public Goods: Principles and Division of Labor

- “The simplest approach would be for all MDBs to have a mandate from shareholders to secure grant financing dedicated to subsidizing their standard loan rates to encourage countries to borrow for investments that have positive global “spillover” benefits.”
- “The current limit to more lending of these kinds is the reasonable unwillingness of borrowers to pay standard rates to finance investments that have substantial co-benefits for other countries.”
- “This approach is hard to realize without a collective decision by all the shareholders of the MDBs, because it has no champion among any group of shareholders—low-income, middle-income or high-income countries.”

Global Public Goods: Principles and Division of Labor

- “Moreover It raises a host of related questions. Where would this grant financing to cover subsidies come from? How much should loans be subsidized? Should the mandate to raise financing from its members be concentrated initially at the “global” World Bank?...And if such subsidies were available at any of the MDBs, how should member countries ensure and monitor adequate partnership with WHO on disease surveillance and emergency pandemic response, and with other UN agencies with expertise in other areas?”

Global Public Goods: Principles and Division of Labor

- These questions stem from the recognition that the core financial instrument for GPGs has to be a grant instrument (even if ti is in the form of subsidies to loans).
- This is recognized in a recent Center for Global Development Report which proposes a new grant financing window for the World Bank alone of $10b annually. It raises the question then of whether similar windows should also be opened for the regional development banks.
- And it is the use of grant resources in this manner, rather than for direct poverty reduction, which Ray Offenheiser is dissenting from.

World Bank Specifics

- So, what is the World Bank good for?
- As an institution for country specific investment for development and poverty reduction, the world community has revealed a preference for other institutions—regional development banks, new development banks, and other multilateral and bilateral vehicles.
- Despite the good news for the World Bank in its recent capital increase, it is not clear if this trend can be reversed.

World Bank Specifics

- There appears to be more global support for a generic GPG argument for financing. But:
  - For region specific cross-country public goods, regional institutions are superior in principle.
  - For genuinely global GPGs, there is the question of whether the world community should primarily go for issue specific global institutions.
  - The sovereign loan instrument is not suitable for GPGs, for which grants or grant equivalent instruments are more suitable.
  - And there are strong tradeoffs in use of grant resources for GPGs rather than country specific poverty reduction.

World Bank Specifics

- However, there are good arguments for using the World Bank to advance the GPG agenda:
  - It is indeed a global institution, with a global mandate and an as yet inadequate but potentially reformable global governance structure.
  - Its country specific operations give it a platform to implement the country level actions needed in a global mechanism.
  - It has experience of and is trusted in, managing trust funds for grant funding.
- If the international community wished to , it could build on these strengths and develop a GPG mandate for the World Bank, as argued in the Center for Global Development Report.

World Bank Specifics

- Beyond the standard GPGs there is, in particular, one GPG for which the international community already relies on the World Bank, and which the World Bank could do more of.
- GPGs are contentious issues and it is not easy to arrive at a global consensus on the way forward, in general and in specifics. And without a consensus there is no way forward—that is almost definitional for a GPG.
- But the development of global consensus is itself a GPG. Thus consensus on GPGs has all the issues of underinvestment faced by other GPGs. No single party has the full incentive to achieve consensus, because the costs are party specific but the benefits are dispersed.

World Bank Specifics

- The international community needs institutions which help to develop global consensus, and to maintain it. The role of globally acceptable data and analysis is crucial.
- And the issue of data and analysis itself as a GPG is forefront in the World Bank and many other international agencies justifying their existence.
- For example, SDG 1.1 is to eliminate extreme poverty. But who is to define extreme poverty? Who is to collect, collate and manage the data to monitor this global goal? Who is to develop and maintain global consensus on these seemingly technical but often starkly political questions?
- The recent report of the Atkinson Commission on measurement of global poverty, commissioned by the World Bank, is an example of a consensus building exercise which can help the global community come together around SDG 1.1 and other SDGs. It is a significant contribution to an underappreciated GPG.

World Bank Specifics

- Consensus building of this type has two prerequisites—technical excellence and actual and perceived independence. Both of these were satisfied in the case of the Atkinson Commission.
- But the governance structure of the World Bank mitigates against perceived and perhaps actual independence of consensus building exercises. These structures have to move to reflect the economic realities of mid 21st century, rather than the realities of the mid-20th century.
- And, of course, such activities require grant resources.

Conclusion

- The IMF and the World Bank were born of the Bretton Woods conference in 1944, the two institutions created at that conference and envisaged as an essential part of the post-war global financial architecture. The World Bank was decidedly the junior partner, and caused less heat in the deliberations among the delegations.
- John Maynard Keynes showed great enthusiasm in its design; he was allowed (sidelined) by the Americans to have the lead in the deliberations on the Bank.
- The Bank's signature instruments, borrowing from markets guaranteed by member nations and the sovereign loan for country specific investments, are still pretty much as they were set out in Keynes's opening statement to Commission II of the conference.

Conclusion

- At the end of the war, the Bank was pretty much the only institution of its type in the world.
- 75 years on, it faces a crowded field of official finance, along with an explosion of private financial flows, for country specific investments.
- But issues not mentioned at all in Keynes’s opening statement to Commission II are now in the forefront. These are the issues of cross-border externalities and spillovers--GPGs.
- Could the Bank take on issues Keynes did not have in mind and did not design it for?

Conclusion

- Despite the good news on the recent capital increase, the World Bank is in the doldrums, or worse.
- The GPG argument is often put forward as a way of reviving and even rescuing the institution.
- But the argument needs to be unpacked and examined critically.
  - First, GPG has to be genuinely global, not just regional, for a global institution to be given the lead in addressing the issue.
  - Second, there may be an argument for issue specific global institutions, for example for infectious diseases.
  - Third, the central instrument of the World Bank, the sovereign country loan, is unsuited to financing of GPGs.
  - Fourth, there is the question of tradeoff between country specific investment and GPG investment.

Conclusion

- However, the World Bank does have certain advantages, including
  - Technical excellence and convening power to help build consensus on a range of GPG issues, although this needs to be enhanced by reform of its governance structures.
  - Experience with managing concessional and grant resources which will be central to financing GPGs mechanisms.
  - Experience with country operations to implement the country specific dimensions of GPG mechanisms.
- Thus, a combination of (i) continued country specific operations of the conventional type but a relative expansion of (ii) focus on consensus building on and design of GPG mechanisms and (iii) their implementation at the country level seems to be the road to viability for the World Bank.

Conclusion

- But for this the governance structures will have to be reformed to reflect the economic weights not of 1944 but of 2019, 75 years after Bretton Woods.
- That's what the World Bank is good for now, three quarters of a century after Keynes's brilliant opening statement as Chair of Commission II at the Bretton Woods conference.

Thank You!