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# Bretton Woods in a New World: Navigating the New Economic Landscape

**Masood Ahmed**

*Remarks as prepared for delivery at the Global Economic and Financial Stability Conference, in Seoul, South Korea, on September 3, 2024. Accompanying slides are available here. A video of the conference is available here; Masood's keynote address starts at 31:30.*

## Introduction

Before I begin, I would like to thank the Ministry of Economy and Finance, Governor Rhee and the Bank of Korea, and the Korea Development Institute (KDI) for hosting this important and timely conference. Thanks also to Vice-Minister Kim and Dr. Cho for their excellent opening remarks and kind welcome. It is an honor to give the keynote address, and I look forward to the engaging discussions and valuable exchanges that will no doubt follow.

This conference marks the 80th anniversary of the Bretton Woods institutions. Anniversaries are both moments of celebration and of stress. There is pleasure in just getting there but also a moment of reckoning and then uncertainty about what should come next. For organizations, the stress is compounded by how important stakeholders assess the past and how to reconcile their diverse views about future direction.

Anniversaries also have a way of making you feel old. In my case, I remember well Bretton Woods at 50, 60, and 70! The good news is that by historical standards, on this 80th anniversary, the Bretton Woods institutions find themselves in a relatively good place.

In 1994, the dominant theme of external stakeholders was the campaign slogan "50 Years is Enough."' There was even a book written with that title with a preface by none other than Muhammad Yunus, the founder of Grameen Bank and current head of the interim government in Bangladesh. And those of you who were at the Madrid annual meeting that year will remember the drama of protestors both inside and outside the meeting hall

This year, no one is saying "80 years is enough." Rather the criticisms are whether the Bretton Woods institutions are adapting enough, and fast enough, to a changing world. We want them to do more and di erent things; we don't want to shut them down.

What are the contours of this new world? The context within which the Bretton Woods institutions will have to operate? Kristalina Georgieva, the managing director of the IMF, said it well two years ago:

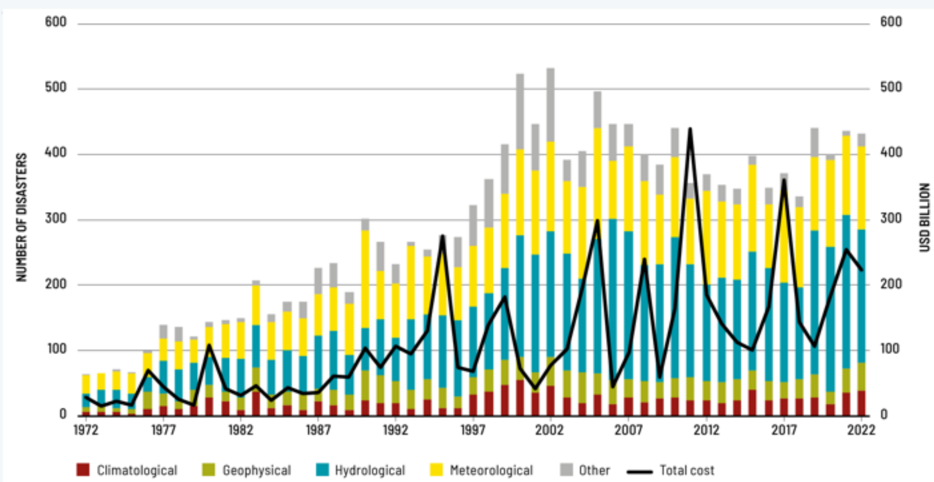
> *"We are entering a new danger zone—a world that is more fragmented, more fragile, and more prone to shocks that can quickly knock countries off course—often through no fault of their own."*

That's a good way to group the challenges that the Bretton Woods twins will need to navigate going forward and I want to say a few words about each of them.

## Helping countries cope with shocks

The quick succession of Covid, Russia's war in Ukraine and the attendant spike in food and fuel prices, record-breaking summer temperatures, and the end of low interest rates brought home to policymakers everywhere that larger and more frequent shocks are likely to be part of the new normal. The graph below gives a sense of the magnitudes: it shows the increased frequency and cost of natural disasters but doesn't include the enormous human and financial cost of the Covid pandemic.

**Number of Disasters by Hazard and Economic Loss**



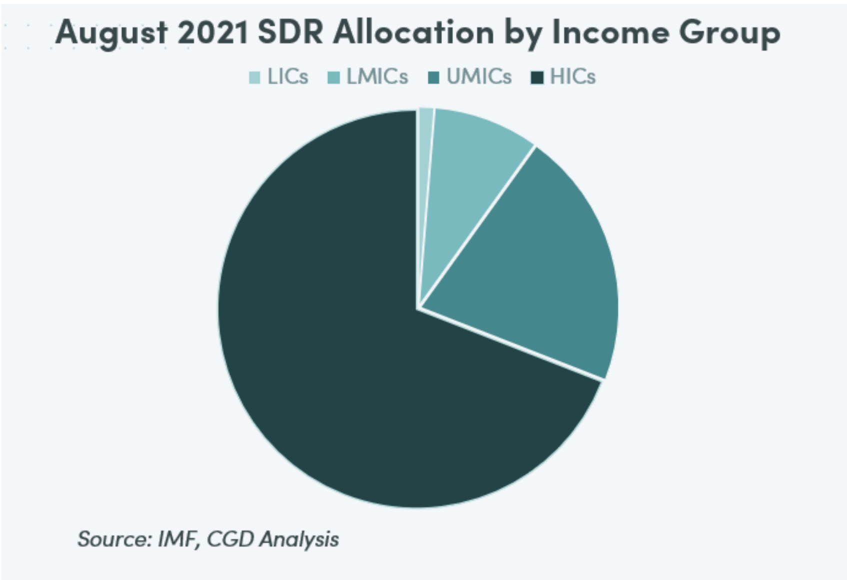

*Source: UN FAO, EM-DAT Database*

The experience of the last few years also demonstrated that while high-income countries had the reserves and borrowing capacity to counter shocks through public spending, this was much less the case for emerging markets and even less so for low-income countries with much more limited reserves and access to financial markets. They needed to rely on official sources of finance to scale up their response to shocks. Hence the focus on asking both the IMF and the World Bank to review their approach and toolkits to helping countries deal with these more frequent shocks.

Helping countries deal with shocks is, of course, a core function of the IMF. It sees itself as part of the international financial safety net, alongside bilateral swap lines and regional pooling arrangements. And the need to bolster this safety net is the core rationale for raising IMF quotas. But many people questioned why during the latest round of global financial stress more of the IMF's resources were not used by members. Between March 2020 and March 2023, the IMF committed $191 billion (and disbursed less than $75 billion) of its trillion-dollar resource base.

Some say the problem is demand, and demand is held back partly by the stigma attached to accessing IMF resources. That is understandable because in recent years the most likely reason for a country to have an IMF program was that it had run into payment difficulties caused largely by misguided policies and inadequate buffers to deal with market downturns. But when many countries are hit simultaneously by a common exogenous shock, accessing the IMF's resources should carry no stigma.

The 2022 allocation of $650 billion equivalent of SDRs was an effective response to an exceptional shock but it was slow in coming and not an efficient instrument as the majority of SDRs went to countries that didn't need them. Unless the rules for SDR allocation across countries can be fundamentally revised and the process made faster and more automatic, it would not be wise to rely on this channel to meet future systemic shocks.




Is this then the moment to create a separate identifiable IMF facility that would be triggered by a defined systemic shock and provide resources to all emerging markets and low-income countries in good standing (except perhaps those with pre-existing programs or with identified weaknesses in their policy ramework). This would be different rom the existing precautionary IMF credit lines, which are only available to a handful of countries and where drawdown is not automatically linked to an exogenous shock. And it should not carry any surcharges which penalize countries that rely on large IMF support.

Another type of shock to which the Bretton Woods institutions need to respond is helping countries that are hit by natural disasters. They already have mechanisms to do that but there is an issue whether these countries should be able to defer their debt service to the World Bank and the IMF in the immediate aftermath of a natural disaster.

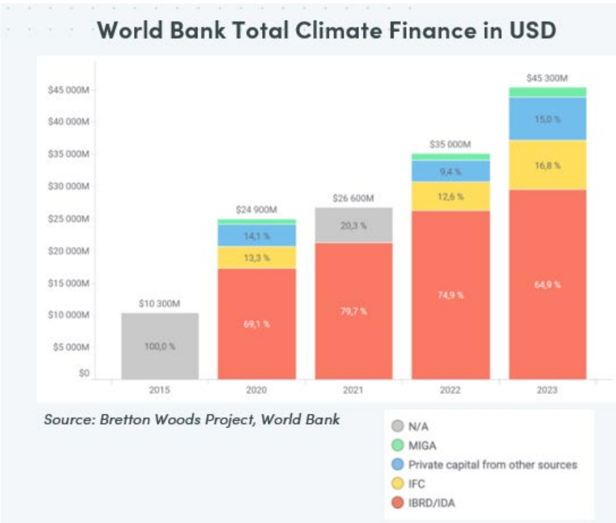
The World Bank recently introduced this option for a limited number of small countries, but why not make it available to all borrowers? And is there a compelling reason why the IMF should insist on being repaid during the immediate aftermath of an extreme natural disaster instead of also deferring its debt service for two years or so?

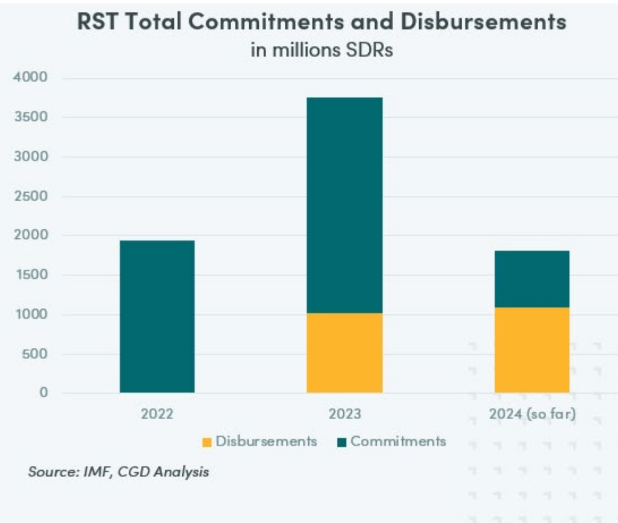
## The challenge of fragility

Fragility has many dimensions. I want to deal with two that have a particular impact on the work of the Bretton Woods institutions.

First, climate change, which is making lives more fragile for millions now and, if addressed inadequately, will make the planet less livable for all our children. It is inconceivable to me that dealing with the impact of climate change on LMICs and helping them to mitigate their future emissions trajectory will not become a larger focus of the work of both the World Bank and the IMF.

Indeed, both organizations have expanded their focus on this issue in recent years. The World Bank now allocates 36 percent of its lending for climate-related projects and has gone further by changing its mission statement to include a reference to “a livable planet.” The IMF has introduced the Resilience and Sustainability Trust as a new lending window and is adapting its analytical and policy toolkit to integrate the implications of climate change.

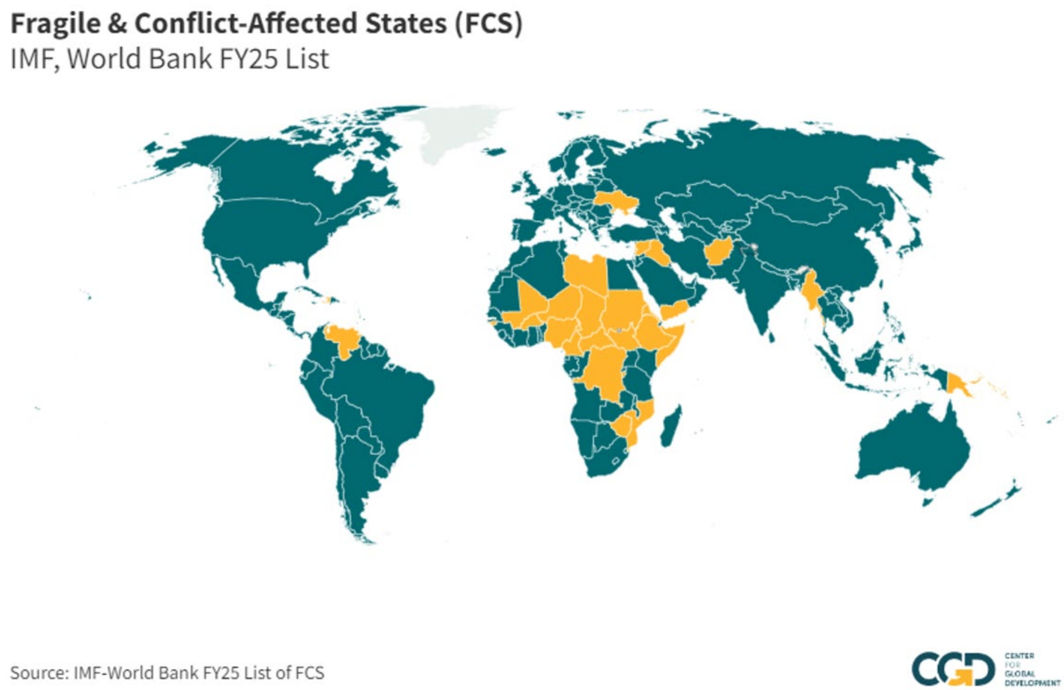


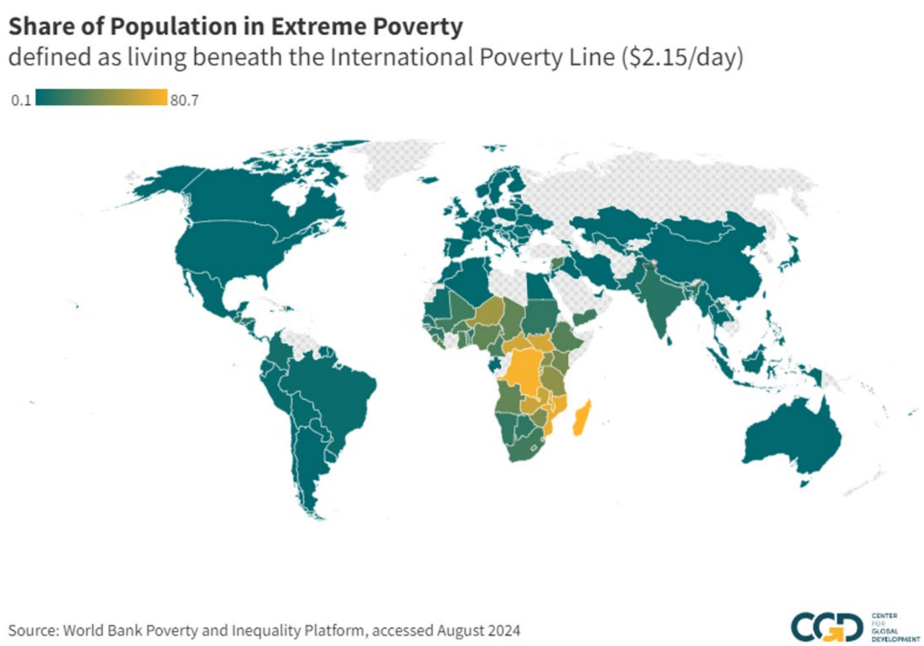



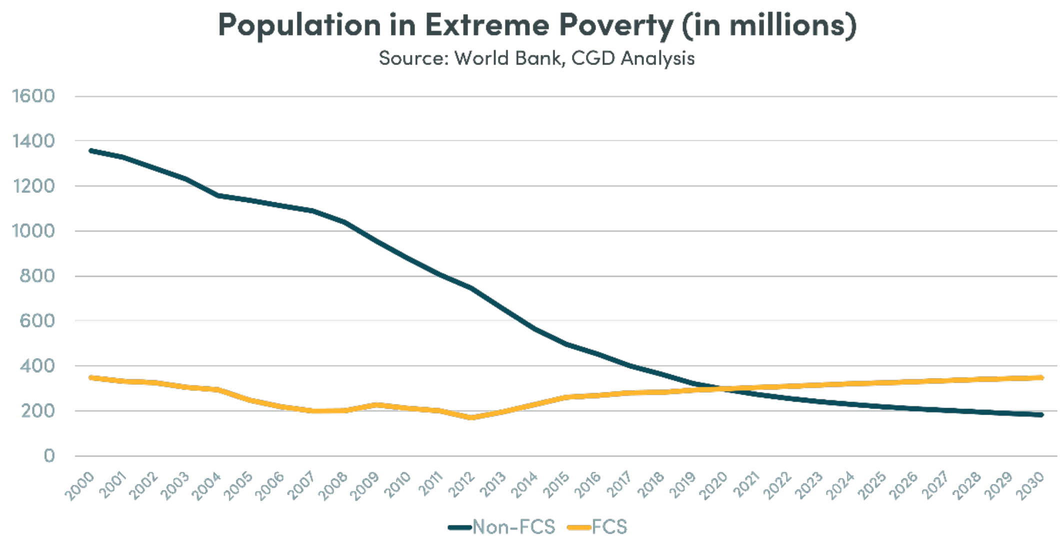

Some of you will be familiar with the report produced by an Independent Expert Group commissioned by the Indian G20 presidency and co-chaired by Professor Lawrence Summers and Mr. N.K. Singh. That report set out an ambitious vision for a much expanded and more catalytic MDB system that would play a central role in helping developing countries to finance their climate and development investments. While the report was received with enthusiasm, the implementation of its recommendations has been patchy at best. Shareholders have not been sufficiently forthcoming with additional financing to support the vision and the institutions themselves are turning out to be more like super tankers in terms of their ability change direction and business models. Many borrowing countries remain concerned that the Bank’s focus on climate change will come at the expense of its traditional development work. This one quotation from a senior emerging market official captures well the concern: “Letting the climate effort overshadow the World Bank’s broader objectives would be a grave injustice.” This concern is exacerbated by the worry that incentivizing middle-income countries to borrow for climate mitigation will likely require concessional financing at a time when it is proving hard to raise enough money for the replenishment of IDA, the World Bank’s concessional lending window for low-income countries, and when many donors are prioritizing bilateral channels or Ukraine for their limited grant funds.

In the IMF, there are a number of issues raised by climate change and the green transition that fall squarely within the institution’s remit – among them, the change in global capital flows, how to finance the huge investment needs while maintaining macroeconomic and debt sustainability, and, of course, dealing with the shocks that are associated with climate change. Yet, respected external observers and even some staff and executive board members believe that the institution would be more effective (and more credible) if it stuck to its traditional focus on macroeconomic and financial policy and left dealing with climate change to others. The debate is far from settled as I noted in the latest issue of the IMF’s Finance and Development, which has an excellent collection of articles on the future of the IMF.

A second and different dimension of fragility is helping countries that are in a fragile state often as a result of violent conflict. Using the IMF’s listing, there are about 40 fragile and conflict-affected states, which are home to a billion people. Many of them have a high incidence of extreme poverty and even where per capita income levels are above the extreme poverty threshold, insecurity and poor access to health, education, and public services impact the lives of their populations. More worryingly, the projections for poverty numbers and economic prospects show little improvement in these countries. By 2030, fragile and conflict-affected states (FCS) will account for 60 percent of the global poor. And finally, the dire conditions in most FCS are not just a problem for them but have regional and global spillovers which increases the motivation for major shareholders of the World Bank and the IMF to get the institutions to engage.






Both institutions have drawn up elaborate FCS strategies (in the case of the IMF, only recently) and recognize that these countries will be a focus of operational support for many years. However, specialists from the FCS community also point to additional changes that will be needed in operational policies, staff skills, risk appetite, willingness to work with international and regional security and peace-keeping agencies, and on the ground presence and engagement with state and non-state actors operating in these areas.

The IMF appears to operate under a particularly restrictive framework including in its ability to provide essential technical assistance in cases where there have been unconstitutional changes of government, which is unfortunately sometimes the case in fragile states. It is also hard for both institutions to provide financing to FCS countries even though these are often the most vulnerable to exogenous shocks and least able to respond from their own limited reserves.

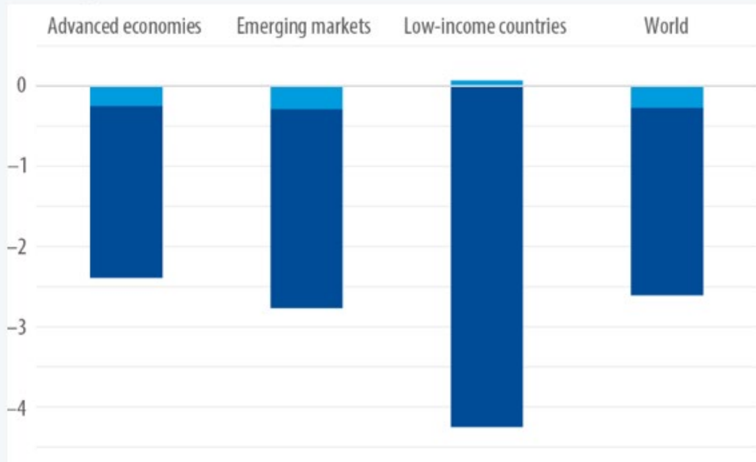
These changes will not come easily to organizations for whom FCS work is seen as a sideline from their main operations. But as global poverty and risk become increasingly concentrated in these countries, both the World Bank and the IMF will need to step up their game and overcome some of the internal procedural and cultural barriers that limit their effectiveness in FCS situations.

## A fragmented world

Fragmentation was the third attribute of the "danger zone" which the managing director signaled in her speech two years ago. Fragmentation has political and economic dimensions, and both will have an impact on the Bretton Woods institutions.

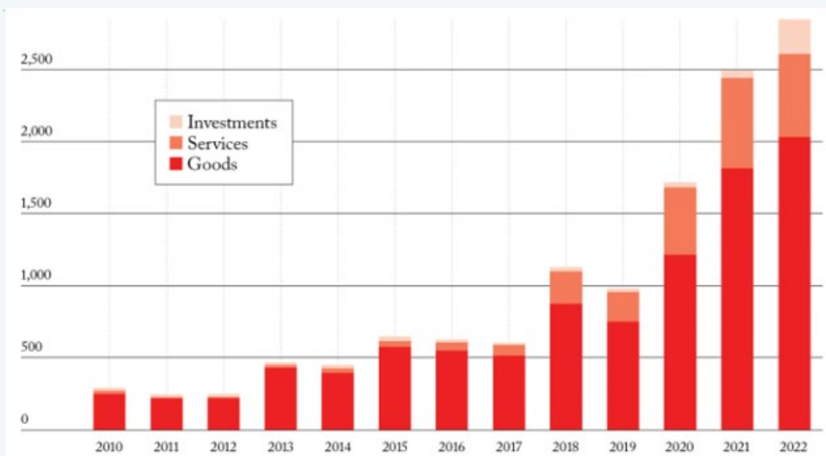
On the economic front, the IMF has done considerable work to demonstrate that the longer-term cost of severe fragmentation in trade alone would be as much as 7 percent of global GDP, the combined output of Germany and Japan. And yet, trade restrictions are being imposed at an unprecedented scale, mostly by large, advanced economies.

**Projected GDP Losses in Two-Bloc World**




*Source: Marijn Bolhuis et al., "The Costs of Geoeconomic Fragmentation," Finance & Development, June 2023.*

**Number of Trade Restrictions Imposed Annually**




*Source: Kristalina Georgieva, "The Price of Fragmentation," Foreign Affairs, August 22, 2023.*

These restrictions are often justified on national security grounds and the international political outlook gives no reason to assume this trend will be reversed or even arrested in the near future. But they are also justified on the basis of a renewed belief in the role of the state in guiding economic strategies, a kind of "new industrial policy," if you will. The EU's Green Deal Investment Plan and more recent introduction of the Carbon Border Adjustment Mechanism and the IRA and CHIPS act in the US all point to a resurgence of economic nationalism that leaves much of the IMF-World Bank membership perplexed as to how they should respond.

There have always been advocates for "industrial policy" in most developing countries, who now feel strengthened and validated by the perceived change of heart on the part of the world's leading economies. But there are also those with longer memories who remember the costly bill left behind by the failure of previous state-guided economic initiatives.

Not all attempts at industrial policy worked but that does not mean that none did. We are, after all, meeting in Korea, which holds many lessons on how to make industrial policy work to make the economy more competitive internationally and more resilient. We also need to recognize that not all subsidies are alike. Some have positive externalities – such as subsidies for renewable energy supply chains that reduce global emissions and other countries' cost of carbon transition.

The challenge facing the IMF and the World Bank is to provide constructive and evidence-based advice on the options for state guidance on economic strategy. This has to go beyond a simple admonition to "be careful and remember the failures of the past," but it also cannot be a completely idiosyncratic, "every country is unique, so anything works" approach. And it has to be distilled by the research and policy staff but then filtered through to the operational teams at the front end of client engagement.

The other side of fragmentation is, of course, geopolitical. Whatever the outcome of the US election eight weeks from now, the relationship between the United States and China will remain fraught and difficult. To a lesser extent, the same applies to Europe's relations with China. Middle powers, including leading developing countries, are reluctant to take sides and want to keep their options open in a world of shifting power dynamics.

These factors matter for the IMF and World Bank for two reasons. First, advancing substantive policy proposals on many areas of their work requires a degree of consensus among the major shareholders. The painfully slow progress made in dealing with excessive debt and debt service in some 34 low-income countries illustrates well the difficulty of organizing a framework for collective action involving both Paris Club and emerging creditors. In the case of the World Bank, moving ahead with strong support for renewable technology and digitalization will run into tensions about the heavy reliance on equipment manufactured in China but funded through World Bank or IDA loans. Navigating these tensions will be a key task for the future leadership of the two institutions.

Geopolitics also matters because of its links to governance and legitimacy of the Bretton Woods institutions. There is a broad consensus that the evolution of the relative shareholding structure of the IMF and World Bank has failed to keep pace with changes in the global economy, notably leaving China and some emerging markets underrepresented. Raising their relative shares runs not only into the usual resistance associated with any zero-sum game but also with the difficulty that any US administration would have in getting congressional approval for a proposal to increase the weight of China in institutions where it is the largest shareholder.

At the same time, failure to recognize the changing structure of the global economy fuels the charge that these institutions reflect an outdated global order and are not truly global. The perception is not helped by the associated practice of nationality-based appointment of their leaders (with the increasingly noncredible accompanying announcements of the outcome having been the result of an open and international process).

There are no easy answers in addressing these issues, but the key lies in convincing the principal protagonists that it is in their own interest to retain the Bretton Woods organizations as a safe space for cooperation on a few key shared challenges, even in an overall competitive and contested relationship. The leadership of the Bretton Woods institutions clearly has to play a critical role in making this case, but I also see a very important role for middle powers, both high-income countries and emerging markets. Middle powers have a core interest in a rules-based system and in the institutions for global cooperation to solve global problems. The Bretton Woods twins are a key part of this infrastructure.

## Conclusion

I have talked mostly about challenges that will become more important in the future, and it is important for the World Bank and the IMF to make this 80th anniversary a forward-looking moment. But many a mighty corporation with a grand strategy for the future is laid low by inattention current problems. So, a frank and objective look at what is not working well in terms of operational practice or institutional culture should also be part of the work program for this anniversary. Recent media headlines say it eloquently.

In the case of the IMF, it is striking how often professional economists in program countries complain about a focus on excessive austerity and unrealistic assumptions on growth or debt sustainability in IMF-supported programs. At a minimum, more engagement to explain, and if necessary, modify, the program parameters would be warranted.

In the case of the Work Bank, President Banga has rightly focused on fixing the plumbing and making the institution faster, more agile, and more responsive to borrowers, but the market is impatient for results. So also for the results from the bank's plans to engage better with the private sector and catalyze more financing from them. And the World Bank needs to work well with other development banks – regional and national. It is only by drawing upon the innovations to improve impact and effectiveness that are happening in both the World Bank and in these other development banks that the development banking system as a whole will be able to deliver on shareholder expectations.

Finally, I mentioned debt in passing but for many developing countries this is an urgent and overwhelming problem and one which features prominently in the international agenda. The current muddling through strategy is looking increasingly unsustainable and gives rise to calls for greater leadership and urgency from the two institutions.

These problems are not new. Indeed, they were often cited by the protesters who said 50 years is enough in 1994. We need to make sure that they don't become the Achilles' heel that holds back the Bretton Woods twins from playing the critical role that is essential for the next decade.

*My thanks to Charley Ward for his research assistance and to the colleagues who provided feedback and comments on earlier drafts.*