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The Democratic Deficit of International Arrangements

José Antonio Ocampo

The chapter by Stijn Claessens and Geoffrey Underhill lends a lot of support to the thinking of one of my predecessors in ECLAC, Raúl Prebisch, that the current global economic system has become increasingly a centre-periphery system. Second, it lends a lot of support to the ideas of Karl Marx, that private interests can be powerful in determining what sort of regulation they are under. And, third, it lends support to the European discussion on the democratic deficit of international arrangements. Because of these three things I like the chapter very much.

The three basic ideas of the chapter are, first, that changes in the system are too much driven by the developed countries, or actually by the dynamics in the private sector in the developed countries. Second, that the lack of transparency that the rule-making under those international arrangements generates, facilitates the capture of the regulatory authorities. And third, that there are significant “legitimacy” issues in the international system – to put it more gently and more in the terms of the authors.

It is interesting how the dynamics work in the discussion on Basel II, or in the discussion of debt restructuring mechanisms. The chapter by Stijn and Geoffrey points this out very clearly. However, in the case of the Sovereign Debt Restructuring Mechanism (SDRM), it does not mention the important issue that some large or well-organised developing countries can have a powerful role in the debate. Because after all, the only developing countries that have been able to influence the debate are the largest, or the best organised developing countries.

In the case of the SDRM, some powerful developing countries were part of the coalition that killed the initiative.

Groups versus Institutions

An important issue that Stijn and Geoffrey stress is the legitimacy of institutional versus ad hoc arrangements such as the G-7, G-20, and G-77. Roy Culpeper has written a paper on this issue¹ and one of the problems of institutional arrangements that he identifies is the fact that we have competition among different institutional arrangements without any clear way of establishing who coordinates the various agencies at the global level. But the main problem is of course that the decisionmaking in institutional arrangements is much tougher than in a restricted group and that this has led to the emergence of the various Gs. The Gs have the basic problem that they are not legitimate and that they will never become legitimate. They are able to rule outside the institutional arrangements and use their coalitions to enter proposals in the institutional arrangements. That is, I think, the best use one can make of Gs.

The Gs exist, they are natural, but they should work within the context of institutional arrangements. However, they also give much power to powerful forces, and especially to one powerful force which is the United States. And they also allow initiatives to be launched of which the costs are not borne by those who have launched them. For example, the US announces debt cancellation for Iraq but then does not incur most of the costs of the cancellation. And when the HIPC Initiative was launched, many of the middle-income countries had to pay for it even though they were not consulted at all. As a proportion of GDP, the highest costs of the HIPC Initiative were incurred by Costa Rica. Costa Rica was never consulted while it had two HIPC countries next to it which were highly indebted to Costa Rica. Also, some of the HIPC countries were indebted to the Central American Bank for Economic Integration (CABEI) without the CABEI ever being involved in the discussions. This shows some of the peculiarities of the current fragmented system of decisionmaking where some of the actors receive merit for something they don't pay for.

¹ Roy Culpeper, "Reforming the Global Financial Architecture: The Potential of Regional Institutions", Paper presented at the Seminar on Regional Financial Arrangements, UN-ECLAC and UN-DESA, New York, 14-15 July 2004.

It should be made clear that we have an international system, not a supranational system. The European Union is the only case where you are really moving from an international system to some elements of a supranational system. But the world as a whole has an international system and that is why I would not use the word “supranational” to characterise the system. And that is why I think Stijn and Geoffrey’s points about how competition among governments plays in the system is so interesting. Whether it leads to a race to the top or a race to the bottom in terms of policy is a very interesting part of the chapter that could be developed further.

In this regard, I would like to mention one of the characteristics of the current system, which you can elegantly call the policy competition, or the beauty contest, between finance ministers of developing countries going to financial markets. I played that game in one of my former duties and I can tell you that it is a very peculiar game. The rules are set by markets, so the only way you can play that game is by presenting yourself as the best player in the game – which creates policy competition between the different actors. Generally speaking, as Stijn and Geoffrey point out, it may be true that sometimes it is a race to the top, as happened with protecting property rights. But one should also recognise that this game maximises the private influence too. Whatever you do under those rules, the outcomes will always maximise the private interest because the system is built, as Stijn and Geoffrey say, around that essential idea.

At the end of their chapter Stijn and Geoffrey discuss the important issue of the organisation of less powerful actors. The less powerful actors, that is, the developing countries, will only have influence if they organise themselves as a group of interest. Therefore, regionalism is essential. There are very interesting developments going on, particularly within the WTO where we have seen organised coalitions of developing countries, including that of ACP developing countries, in the negotiations. Another example is the New Partnership for Africa’s Development (NEPAD). The coming together of African countries that led to NEPAD has made them a stronger coalition. So in the end, the solution to some of the problems that Stijn and Geoffrey pose has to come from the developing countries. Rather than accepting the current rules of the game, developing countries will have to play the game by identifying their collective interests and then go with them to the international organisations and, hopefully, also to the markets and say: These are the interests that we want to defend. The current inter-

national system will only be workable if it is based on stronger regionalism. A stronger regionalism is the only way to balance the huge asymmetries in power that we have in the system – that is the centre-periphery part of Stijn and Geoffrey's chapter.

Competition Between International Institutions

Turning to the role of the IMF in low-income countries, I clearly see the crucial role that the IMF has to play in macroeconomic issues. I am not sure that loosening the dividing line between the IMF and the development banks or between the IMF and development cooperation is a good idea, for the IMF or for development cooperation. I would prefer to keep a clear dividing line, thinking about the national level, where the development functions of central banks were taken away from them and given to specialised development banks.

With regard to the signaling or gatekeeper function of the IMF, my personal judgement is that a world of competitive evaluations is better. We should not rely on one single individual judgement of one single institution, because, among other reasons, we all have made mistakes in the past. Competition in ideas and judgements is a good way to avoid making too many mistakes. We have not talked much about this, but I really think that a world order based on various institutions is better. The competition in the provision of services is actually good, not bad. It is good to have competition between regional and sub-regional development banks and among the bilateral donor community. Similarly, it is good to have various regional monetary funds. Europe has done a good job in taking the monetary problems of Europe out of the IMF. If we have an Asian Monetary Fund and a Latin American Monetary Fund and an African Monetary Fund, the system would be more balanced.

Maybe the future IMF should be more like the European Central Bank or the US Federal Reserve System, and not remain the centralised institution it currently is. That is probably the direction to think about. In the area of development banking, the world has moved in that direction and it should probably go further in that direction, including establishing, in particular, development banks totally owned by developing countries. There are a few cases around that have been successful, why not have more of those? The same may be true for the traditional functions of the IMF; this would make them more balanced.

Ownership

Another important issue is ownership. We continue to discuss the meaning of the concept of “ownership”, which is somewhat unclear. We have to find an operational definition of ownership, we have to have a better idea of what that means. The evaluations of the Poverty Reduction Strategy Papers (PRSP) by both the World Bank and the IMF have tried to assess to what extent PRSPs have contributed to ownership. I have found those two evaluations particularly useful to understanding the problems that are going on. Going back to my previous point, ownership will start by evaluations being really done by countries – not by the IMF or the donors, or the World Bank, or the NGOs, but by country teams. That should be the framework for any evaluation.

This is very closely tied to the issue that capacity building is the best measure of ownership. When you have strong capacity at the national level, and programmes are really done by countries because of strong capacity, you have real ownership of the programmes. Then the international community can give its points of view but such discussions would then take place around a programme that is designed by the countries. Until now, it has too often been the case that programmes do not present the view of the government, and this is part of the distortion generated by the international system.

Diversity of Views and the Streamlining of Conditionality

I feel very strongly about the need to respect the diversity of views. Particularly about growth, poverty reduction and the needed fiscal space there continues to be huge diversions of opinions, even increasingly among professionals. Last year at the Latin American Economists Association meeting, I was struck when in the final panel where I participated, a group of well-known economists reached the consensus that, after all, we did not know what determines growth. That is a huge recognition of the deficiency of professionals. I find it a good recognition. I certainly prefer it to the arrogance of those who pretend they have all the answers. We know much less than we think we do. The economic profession is not a very hard science. It is full of ideological prejudices, on all sides of the debate, all sides. Diversity of views is essential.

I am always struck by the intellectual environments that you see in

different parts of the world. When you go to developing countries, you see a real diversity of views on many things. In New York, in the UN, it is more or less the same: there is a wide variety of views. Washington, however, seems a bit less diverse.

It would be good to leave some things to the judgement of no one else than the countries themselves, particularly on very contentious issues. This is why I think the streamlining of conditionality should really be implemented. The principle of streamlining of conditionality was approved by the Fund, some three years ago. It is a good principle, except that it is left to the Fund's judgement what are the structural conditions that are relevant for the macro economy. My point of view is that still too many structural conditions are included in IMF programmes and, moreover, I think that the word "structural" is used in a confusing way for that purpose. We have to recognise that we have had stable macroeconomic regimes under very different structural conditions: high interventionist states with very good macro balances and very neo-liberal states with a lot of macro imbalances.

The basic problem is that there is a huge confusion in the use of the term "structural" in most of the literature. For instance, I would probably agree with the Fund that having some structural fiscal balance, or a structurally stable financial system, is a good thing. But does this imply that you have to have privatisation? Maybe yes, maybe no. In some countries, privatisations may help establish fiscal balances, but that does not mean that privatised regimes are always better. It may be the case, it may not be the case. After all, it should be left to the democracies, not to institutions at the international level. If a country wants to have a more privatised regime, that is the country's choice. If it wants to have more public sector, that is the country's choice. I do not think we should be judging internationally how large states should be. That is not for international institutions to decide, that should be left to the judgement of nation-states.

Rating of Countries by Quality of Institutions

This brings me to the very contentious issue of judging the quality of institutions of a country on the basis of the so-called Millennium Challenge Account (MCA) and the Country Policy and Institutional Assessment (CPIA). Even though I share the basic concern about institution-building, because transparency and combating corruption are important, and even though I support the basic political principles

behind it, this way of doing it is unlikely to produce good results. These two approaches are likely to be seen as impositions of views that are based on highly imperfect information. Trying to build institutions through ranking countries and using that ranking for aid allocation purposes will lead to a loss of legitimacy rather than an improvement in the way of working. So I think that these MCA and CPIA practices should be discontinued.

I again use the word “ownership”. Ownership here is the critical issue. I do not think that external rating and tying support to the rating of institutions is going to improve the institutions in a country. First of all, two major mistakes, two major things will happen. The first one is that the judgement will be resisted at some point. There will be countries that say: this is not due functioning. But the second thing is that even a country that has received a positive rating, at some point is likely to break the rule and then you have to reclassify this country or make an exception. I really think – and I use a peculiar case – the best idea is to leave the judgement of institutions to developing countries themselves, or to a grouping of developing countries that encourage the implementation of principles they have agreed upon. For example, NEPAD may be a much better place than IMF conditionality to build ownership of better institutions. And the UN convention against corruption is probably a better mechanism, as are many other international processes that are going on. They are better ways to manage some of these institutional issues.

Let me give you another example: the case of democracy in Latin America, which I know very well. The Rio Group, which basically is a grouping of Latin American countries without Cuba, took this issue of helping weak democracies maintain a democratic regime as a conscious effort over the last 10 to 15 years. They took the initiative themselves. So every time you see a problem in a country – a possibility of breaking a democratic rule – what happens is that all the countries try to help the weak country to maintain its democracy. That is much better. I tell you that this was never done through the Organisation of American States (OAS), where the US is powerful. Canada is seen in Latin America and the Caribbean as a more reliable partner than the US. The US has always been seen as too powerful in the game. And of course, the US is seen as having supported some non-democratic regimes in the past. So it is much better to leave it to the countries themselves and try to support this through other, more indirect, means.

Millennium Development Goals

Finally, the issue of the MDG framework. This framework has been a very good one for the political discussions. It has contributed to policymaking in the Bretton Woods institutions. However, there is still a tendency in the Bretton Woods institutions to think of the Fund and the Bank as the centre of the earth. In practice, it would be better for them to build stronger networks, not only with the UN organisations, but also with the regional development banks and the bilateral donors. Such networking should go beyond the practice established at the national level, where the dialogue has improved but nonetheless continues to be distant in many cases. At both the national and the global levels, we have done a lot to improve the dialogue. The Monterrey process was a major advance in terms of dialogue, but we have to strengthen it much more in the future.