6 Financing Gaps, Competitiveness and Capabilities: Why Bretton Woods needs a Radical Rethink

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The international financial institutions (IFIs) of the Bretton Woods System (BWS), namely the International Monetary Fund (IMF) and the World Bank (the Bank henceforth) were meant to overcome collective action problems among countries and help solve market failures in financing on a global scale (at least outside the 'Iron Curtain'). The system worked for a while and contributed to the rapid global growth in the post-World War Two period. But then it unwound spectacularly in 1971 when President Richard Nixon ended the pegging of the US Dollar (USD) to gold spurred on by West German, Swiss and French redemptions of dollars for gold. Partly as a consequence, the 1970s and 1980s were decades of global stagnation, high inflation and high unemployment in the developed economies while many developing economies languished even more. The world economy started looking rosier from the 1990s as capital started flowing to developing economies, and trade expanded under the aegis of the World Trade Organization. Earlier in the 1980s a few economies like South Korea, Taiwan, Malaysia and Thailand had 'emerged', by the end of the 1990s China was emerging as the world's economic powerhouse and the Indian sub-continent was also displaying steady growth rates of GDP. China's manufacturing growth helped boost demand for African and Latin American commodities and its purchases of US treasury bills financed the growing budget deficits of the US and helped keep the Yuan low against the USD. This new system of global payments began to be described by analysts as Bretton Woods 2 (BW2) where exchange rates were managed by some emerging economies to uphold their export-oriented economies and the USD was once again the reserve currency of choice, this time informally as opposed to the formal mechanism of the BWS, allowing the United States to easily finance its current account deficit. This system is not without its critics who feel the US deficit position is unsustainable. (Eichengreen 2004; Goldstein and Lardy 2005; Roubini and Sester 2005). This though is not why the current IMS is unsustainable.

This chapter posits that the real reason for this unsustainability is the failure of BW2 to address the critical problem that also led to the failure of the original BWS —the permanence of payments surpluses and deficits in many countries. The new BW2 system might reflect the continuing dominance of the United States as the global superpower but there has been a significant change in power structure with the emergence of China as an economic powerhouse with substantial and persistent USD surpluses. The financing situation however still remains unchanged with the US running a permanent deficit balanced largely by China's payments surplus. In the case of the original BWS surpluses and deficits were not meant to be permanent. The IMS was supposed to provide solutions where deficits countries could move back into surplus and surplus countries using their reserves were to help countries in deficit. By the late 1960s however the United States was in permanent deficit and other countries had to maintain surpluses to balance the world economy and the unravelling of the original BWS was in part linked to this problem.

As we outlined earlier according to the current discourse the real problem is how to reduce US deficits and how to get China to reduce its surplus. While this adjustment is necessary according to a large body of literature (Goldstein and Lardy 2005; Roubini and Sester 2005) the necessity is not an immediate one given that the US is not about to lose its reserve currency status very soon. The critical issue that this chapter outlines is that the global payments system, whether the initial Bretton Woods system or the so-called Bretton Woods Two has not addressed the most important problem underpinning the payments deficits of developing countries. This is the problem of financing the development of organizational and technical capabilities in emerging enterprises and sectors, so that the competitiveness required for addressing trade imbalances can be acquired. This specific problem should not be confused with the broader issue of 'capacity development' that can encompass investments in institutions, human capabilities and so on. While these latter aspects of development are also important we are concerned with a more specific capability because without the development of this capability, developing countries in particular are unable to engage in the global trading system in a sustainable way. Capability development refers to the processes through which firms learn to organize modern production methods in order to achieve international competitiveness. This in turn requires financing the process of learning. Learning is only successful if the financing comes with credible conditions and the disciplining mechanisms and the governance agencies that oversee the financing cannot be significantly distorted by rent-seeking interests (Khan 2013). The development of globally competitive sectors and in particular the development of a broad-based employment generating manufacturing sector is essential for sustaining development in labour-surplus developing economies. The absence of a global financial architecture that can provide the financing for developing these capabilities has contributed to the instability of the global payments system. A later section in the chapter outlines the framework of capability development in greater detail.

Persistent deficits constrain the financing abilities of developing countries and we argue financing capability development is the basis for achieving capital accumulation. We believe that industrial development and in particular the development of a broad-based employment generating manufacturing sector is essential for sustaining development in labour-surplus developing economies who least have access to financing. Hence any new global system must address this gap in financing and despite the huge amounts disbursed by both Bretton Woods institutions, the IMF and the Bank the financing they provide has yet to cater to capability development or the development of broad-based manufacturing in developing countries. For too long a time the Bank moved away from project financing to lending for governance or bureaucratic reform and the IMF focused on conditional lending that only took into account ‘macroeconomic stability’(or the balance between inflation and employment and size of the budget deficit). Even though both the bank and the IMF have recently made changes to their lending policies they are still far from addressing the financing needs we point to. The problem is compounded by the fact that the global power balances that led to the creation of the BWS have changed substantially making it even more difficult for a new financing paradigm to be created. Hence a radical shift is required in the task of creating a new global financing system that will adequately address the needs of developing countries.

Developing countries also often lack credibility as debtors given the vulnerable state of their economies. OECD countries on the other hand have credible states with large productive tax bases and hence do not face much difficulty in persuading surplus emerging countries like China to finance their debt. This is why the US finds such favour among lenders, helped in no small amount by the fact that it is also the world's leading economic and military power. Developing countries on the other hand have weaker state capacity as they are still negotiating the fraught process of transitioning from pre-capitalist to capitalist economies. Their tax base is smaller and therefore they have lower credibility in attracting the long term lending that is so necessary for development financing. Financing that is today readily available for OECD countries needs to find its way to Bangladesh or Chad and BW2 has no tools to achieve this on a significant scale. Yet global stability in the longer term is dependent on the sustainable growth of developing economies. If there is a global crisis looming it is the crisis of underdevelopment brought on by a dearth of financing opportunities in the very countries where potential growth is very high. Instead the capital that does find its way to developing countries is 'hot money' or short-term capital flows that is volatile and dependent solely on capricious sentiment and the availability of liquid financial instruments. The critical issue of international political economy that is explored in this chapter is how the current world economic order can solve this gap in financing for capability development. The chapter discusses the need to implement new institutions that can design and implement financial instruments that suit the needs of developing economies. The next section explores the origins of the Bretton Woods global payments system, the immediate imperatives behind it and how far was it able to solve the problem of capability building.

The beginnings of the IMS

The United Nations Monetary and Finance Conference held at Bretton Woods in 1944, more popularly known as the Bretton Woods conference, brought together 730 delegates from 44 governments. These were as disparate as the United States, Liberia, Bolivia, British India, Mexico, the USSR, Iceland, Poland, the United Kingdom and China among many others. Some were imperial powers, some colonies or in varying degrees co-opted by larger countries and a few were countries trying to build their polities and economies independent of larger powers. The Conference was also being held within the theatre of the Second World War and therefore under circumstances that were far from ideal. The Conference became a stage for the changing dynamics of the international political economy with British imperial power on the wane, American power on the ascendance and colonies, especially Asian ones, getting restive about their dependent status.

Despite this, what this Conference achieved was a relative harmonization of interests among these disparate countries in terms of setting up two seminal institutions that were to help finance and where necessary refinance development over both the short term and the long term. The IMF was set up to provide short-term financial assistance for countries that were facing Balance of Payments (BoP) crises and the Bank, initially called the International Bank for Reconstruction and Development (IBRD) would provide long-term financing to countries. The IMF was the cornerstone of the negotiations and its chief responsibility was to provide liquidity to countries that needed it (Cohen 1982). This provision was predicated on the understanding that the economic crisis of the inter-war years was a result of freely floating exchange rates that held countries hostage to external pressures and limited their role in currency management, much to their detriment. A fixed exchange rate that would still allow countries enough room to intervene in currency markets was therefore necessary. But maintaining or 'defending' a fixed rate regime also requires adequate liquidity in the form of foreign exchange to deal with short term imbalances and flexibility within countries to adjust their prices and productivities so that deficits, in particular, are not permanent. The IMF was envisioned as the institutional answer to help countries gain access to this liquidity. In the case of a large payments deficit, a country can experience a sudden shock to its economy if it has to adjust rapidly. This disequilibrium made access to liquidity important and this was the role of the IMF.

The Main debates

Not surprisingly recently discovered transcripts found by an economist in the uncatalogued section of the library at the United States Treasury reveal that the most contentious debates at the conference took place around the IMF and its role (Schuler and Rosenberg 2013). Interestingly not all of the important debates were on the 'dollar-sterling' issue that many historians have earmarked as the overriding concern at the conference (Ruggie 1982; Gardner 1985). While the conflicting British and American positions on the issue of the reserve currency and adjustment mechanisms (discussed later in the section) in the world economy certainly took centre stage, the transcripts throws light on some other important debates that saw developing countries take on the developed ones and at least in some cases achieve important concessions. Recent work by Heillener has also provided robust evidence of the involvement of developing countries in the Conference not just as spectators (Heillener 2014). One of the most critical debates was on the nature of the IMF's functions. Was it going to concentrate on economic development of both developed and developing countries—in the sense of focusing on full employment for the former and aiding in the development process for the latter—or would its mandate be the narrower one of smoothing over temporary BoP crises? This debate summed up the widely diverging policy imperatives for developing and developed countries. For the latter economic development and strategies for industrialization and 'catching up' were far more important than developed country imperatives of full employment and social welfare and in the end it was the latter interest that won, given the balance of power in the world. Hence at this stage financing for capability development wasn't even part of the discourse on development which in the large part remained restricted to addressing BoP crises. Given the economic context of the inter-war period even this was a significant achievement but the system still did not go as far as it should, and could have gone, given that if the United States had wanted to this agenda could have been pushed.

The other keenly discussed issue according to the transcripts were centred on how the IMF would deal with the "debt legacy" (Heillener 2014). Colonies like Egypt and India were demanding that they be allowed to use the Sterling credits the British provided in return for goods exported to them by their colonies during the Second World War that they were at that point unable to use because of exchange controls imposed on them by the British. This would have made the IMF responsible for a direct legacy of the Second World War, a role the United States, United Kingdom and France were opposed to. Among other issues, and one that seems anodyne now—the composition of the current account—saw lines drawn between developed and developing countries. The question of quotas and how they were to be paid for was also a hotly contested one that divided the delegates. The reason to highlight these seemingly small victories is they were conceded at a time when the world was deeply divided and the developing countries had little agency. There are lessons to be drawn here in terms of what can be achieved today given that with the changed power structures the developing world can negotiate harder to design a global financial architecture that is more inclusive and equitable.

At the time however what defined the BWS was the competing recommendations of the British and American delegations on what the international monetary architecture would look like. This chapter will not go into the intricacies of the differences as there is more than ample literature on the subject (Cohen 1982; Cooper 1984; Mikesell 1994; Pauly 1996; Skidelsky 2005). The British delegation led by John Maynard Keynes mooted the idea of an International Clearing Union (ICU) which would have the authority to create a new currency (bancor) that would act as a reserve currency. Overdraft facilities to the tune of $ 26 billion would also be provided to countries with a BoP deficit so that they could borrow without fulfilling strict conditionalities. The system would work like a conventional banking system where surpluses would be lent out to countries with a deficit just like deposits in a bank are lent out as loans. The proposal also put forward corrective measures that were to be taken both by creditor and debtor countries when conventionally the burden of adjustment fell on the debtor.

Counterfactuals have little place in historical analysis and there is no telling what might have happened if Keynes' plan had been implemented, but there is little doubt that Keynes's plan was more sound than the American one presented by Harry Dexter White, a technocrat at the US Treasury and not a very senior one at that. However White became the prime mover at Bretton Woods because he was negotiating from a position of strength as the US representative. The plan by White did not include the ICU and the overdraft facility was finally whittled down to $ 8.8 billion. The proposal of the creditor taking on liabilities was also struck down as the United States was clearly the largest creditor at the time and was replaced by a watered down 'scarce currency clause' as a compromise with the British.1 Most significantly the bancor was one of the first proposals to be dismissed during

1 The clause said that if the IMF ran out of stocks of a country's currency, this could be declared a 'scarce currency'. Members could then discriminate against the country's goods in their trade policies. This was because in 1944 the dollar was expected to become scarce but this did not happen because of the Marshall Plan.

negotiations prior to the conference and the USD was to emerge as the reserve currency. This was later to become the undoing of the BWS as presciently highlighted by Triffin (Triffin 1960). Yet it was the White plan, though it remained broadly Keynesian, which came to be adopted at the Conference. However as the next few paragraphs show some of the debates highlighted earlier in the section were keenly debated between developing and developed countries.

The Agency of Developing Countries

While the stage seemed to have been shared the most by White and Keynes their interactions, not always cordial, have been well documented (Schuler and Rosenberg 2013; Steil 2013) a look at the composition of the Conference is instructive about how developing countries played a role. The Conference was organized into three commissions and each commission had a number of committees. For instance Commission One which was dealing with the IMF and was chaired by White had four main committees, eight ad hoc-committees and a Special Committee on "Unsettled Problems" among others. Commission Two was headed by Keynes and responsible for charting the course of the IBRD or the Bank. However it is clear from the transcripts that Commission One was the heart of the Conference and Keynes did attend many meetings of that Commission too. Commission Three on "other means of financial cooperation" was headed by Eduardo Suarez of Mexico and was largely a forum to make recommendations on topics that could not be made a part of the two main Commissions. Its most significant recommendation was the dissolution of the International Bank of Settlements which however survives well to this day.2 (Schuler and Rosenberg 2013).

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2 It was thought at the time of the Conference that the Bank was a conduit that helped Germany steal Allied assets. Its dissolution was stayed because its two most vocal critics Morgenthau and White exited the Treasury soon after the Conference was concluded.

In each of these Commissions and Committees voices from developing countries deliberated quite loudly including from still-colonized countries like Egypt and India. It would appear from the transcripts that China and India were among the harder negotiators. The role of the IMF in economic development was keenly debated and India and Australia wanted the remit of the IMF to be broader. While this was not taken on board concessions were nonetheless made and changes were made to the draft of the Bank agreement to lay greater emphasis on concerns of late development (though the term 'late developers' was not widely used then) (Schuler and Rosenberg 2013). Latin American countries were the key players in the negotiations that led to a greater emphasis on economic development given that they shared a long history of engagement with the United States through the latter's 'Good Neighbour' policy that Roosevelt had initiated. This had established financial relationships with the United States that Latin American countries drew from at Bretton Woods (Heillener 2014).

The other issues debated for developing countries was that of voting rights and quotas and deliberations on components of the current account. Little success was achieved in the former case but a more significant success was achieved by countries like China, Greece and India—all of whom received a significant share of income from remittances—to include them in the current account. Given that the BWS did not allow convertibility on the capital account, placing remittances in that account would have made such a crucial source of income off-limits for the current account of these countries (Schuler and Rosenberg 2013).

On the issue of the management of post-war debt countries like India and Egypt bargained hard with the threat of India leaving the Sterling area looming large if British debts to India were written off (Tomlinson 1985; Reserve Bank of India 1998). However in this instance the two countries were not able to reach a satisfactory conclusion due to opposition from the United Kingdom and France which ran a Franc zone similar to the Sterling area and the

United States that did not want to antagonize two key allies (Schuler and Rosenberg 2013). While the UK made some pronouncements to placate Egypt and India it was well after the conference in the 1950s that the UK reached some sort of settlement on the sterling balances with India (Reserve Bank of India 1998).

A quick look at the composition of committees also complements the above analysis and provides an idea that developing countries were not completely devoid of agency at the conference. Three out of the four main committees of Commission One were headed by delegates from developing countries (Committee Two was headed by Pavel Maletin the deputy finance minister of the USSR). Committee One discussing "Purposes, Policies, and Quotas of the Fund," was chaired by the Chinese (though he was a member of the Chinese National People's Party or the Kuomintang) diplomat and historian Tingfu Tsiang. He later served as Taiwan's permanent representative at the UN. This committee decided among other things that quotas would be re-evaluated after five years. Committee Three on "Organization and Management of the Fund," was headed by Artur de Souza Costa, Brazil's finance minister and was responsible for the provisions on supermajorties and calls to the IMF board of governors mentioned above. Committee Four on "Form and Status of the Fund," was chaired by Manuel Llosa a Peruvian legislator and deliberated on aspects of the IMF "on paper" (Schuler and Rosenberg 2013).

The autobiography of Chintamani Deshmukh a key member of the Indian delegation at the conference and who later went on to become the governor of India's central bank reveals an interesting sideshow where the Indian delegation threatened to leave the conference because it was being provided with too small a quota. The threat worked and in the end India was provided a quota that ensured it remained a permanent member of the executive board of the IMF for 25 years (Deshmukh 1996). It also reveals that Keynes' ideas were not popular among many British colonies largely because of his insistence on the United Kingdom's debt being forgiven which would have meant a loss for countries holding Sterling balances. Unfortunately Deshmukh does not provide details of what the nature of the negotiations were that led to this success but one can only imagine neither the Americans nor the British wanted a participant with as large a territory and population as India's to leave the Conference at a time when the former two countries needed to build a sound consensus around their ideas of the international financial system. However the developing countries were not able to wrest any concessions in terms of industrial development even though the Bank was created to help countries like India and Egypt. In its first couple of decades of operation the Bank did undertake extensive project lending but it did not come with any institutional mechanism that would involve disciplining to prevent rent seeking and ensure successful implementation, a mechanism that this chapter posits needs to be an important part of any new financing system.

Even this limited success on the part of the developing countries at the conference was of course a marked departure from the manner in which the League of Nations operated. If anything the League, an attempt by European powers after the First World War to regulate international economic affairs, is used as an example of how not to construct international consensus and there is some truth in this discourse. However as Eichengreen writes the construction of an international monetary order is a historical process and the older order does find itself reflected in the new in some way (Eichengreen 2005). The League's biggest achievement came in 1927 when the International Economic Conference was held in Geneva in 1927. 194 delegates and 157 experts attended along with the United States and the USSR. Key issues discussed were trade and the issue of granting 'most favoured nation' status, a matter of World Trade Organization deliberations even today, and the cartelization of large industries. As Pauly writes the real success of the League is the legacy of "multilateral economic surveillance" that the IMF and the Bank also carried forward. (Pauly1996). There were senior members of the League's Economic and Financial Organization and the Economic Intelligence Service (EIS) of the League like Per Jacobsson of Sweden, JM Fleming and Louis Rasminsky, both British and from the EIS and Jacque Polak from Netherlands also of the EIS who served in the IMF in its initial years. Hence there was a modicum of continuation in both policies and personalities in the early IMF. The architects of the BWS also learnt from the one cardinal mistake of the League: that the automaticity principle in the international economic order didn't hold. This was the belief that markets would create order on their own without monitoring while the League would act as a 'temporary buffer' between markets and its members (Pauly 1996).

This principle was set aside during the Bretton Woods negotiations by consensus but in many instances the United States used the Conference to put forward its agenda and succeeded given its status. In that sense the trade-offs the United States was willing to make were the least costly ones. As Ikenberry highlights while the United States did use its hegemonic power it did not also want to be seen as being coercive, especially with its European allies and this limited its post war agenda (Ikenberry 1992). The normative aspect of the US agenda is girded by the fact that coercion would lead to unproductive results for the United States. The United States also needed the IMF and the Bank to ensure countries in the developing world did not become a part of the Communist bloc. Hence the financial order that emerged after the Conference was a result of both liberal and realist interests. While US hegemony did carry the negotiations forward this was only made possible through the "breakpoint" that had been reached during the war (Ikenberry 1992). It was imperative to find a solution to the problems facing the world order in the years around 1945 and this provided the opportunity to fuse world interests, in whatever limited but as yet unprecedented manner, at the Conference.

In terms of institutional economic analysis the Second World War proved to be an exogenous shock for the international order that provided the incentives to overcome collective action problems of coordinating the interests of the various representatives. This was based on the realization that everyone should follow similar rules in their own self-interest rather than engage in the type of free riding and ultimately self-defeating behaviour that results in each country trying to devalue currencies to gain an advantage. Without this shock, coordination problems and free riding incentives would have led to similar problems that the League faced and which ultimately led to its demise. In the mid-1940s the global distribution of power was also such that it allowed the United States to define the distribution of benefits (as a result of the creation of the IMF and the Bank) in its favour almost unchallenged. This was a global "political settlement" which made the distribution of global power compatible with the definition of institutional rules with a specific distribution of global benefits (Khan 2010). As a result, the BWS was relatively quickly and successfully implemented by the 1950s. Countries adhered to the formal rules of the newly created system for a while because they saw the benefits compared to the previous system and did not perceive they had the bargaining power to achieve anything better. This made for a strong and sustainable institutional order as long as the underlying distribution of power across countries was stable. The "rules of the game" (North 1981) were compatible with the global distribution of power in the new financial order. The post-war power structure or political settlement was thus an important independent variable that influenced the creation of the new system. However as US deficits grew from the late 1950s they also grew larger than its gold stock and confidence in the dollar was gradually undermined as Triffin had foreshadowed (Triffin 1960). The needs of other European countries were no longer being fulfilled by the system. US deficits were growing due to increased social welfare spending but mainly due to the war in Vietnam. The Europeans and Japanese were concerned about this seemingly excessive ability of the

United States to finance its liabilities and began questioning the credibility of the dollar by making far too frequent demands on the gold holdings of the United States than the system formally demanded, given that the system had invested the responsibility of economic stability to the United States. As a result the equilibrium in the "political settlement" between the distribution of power and distribution of benefits was slowly getting undone leading to its dissolution in 1971.3

Despite the 'fatal flaws' discussed above and inherent in the system there can be little doubt that the results of the Conference led to unprecedented results for the world economy. World output grew at an annual rate of just below 5 percent and world industrial production at 5.6 percent every year at least till the mid 1960s. Due to the provision of a closed capital account short term, 'hot money' flows were absent and capital flows were largely long-term in the form of FDI. The combination of capital account controls and space for domestic policy making worked to redress some of the contradictions of external and internal balance. Inflation was low and per capita income was at its highest since 1879 (Schwartz 2000). The Bank was actively involved in financing projects linked to economic development like power projects or transportation. The Marshall Plan did play a complementary role in this but the policy architecture that the Plan made use of was still under the policy framework of the BWS. The BWS did have a positive effect on at least some developing economies especially Latin America and East Asia but this was not to be enough because the crucial financing gap

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3 A recent history of the Conference pins the US-centric outcome at the Conference that came at the expense of Britain on White and his Soviet sympathies. Of course White's pro-Soviet sympathies and interactions with the USSR are no secret for historians of Bretton Woods but a new book, *The Battle of Bretton Woods: John Maynard Keynes, Harry Dexter White, and the Making of a New World Order* (2013) by Benn Steil observes that White's secret association with the USSR and his admiration of its economic programme was responsible for the loss of British positions in Bretton Woods. As Steil writes, "What even his closest colleagues were generally unaware of, however, was that White's vision involved a much closer American relationship with a new, rising European power (meaning the USSR), and that he was willing to use extraordinary means to promote it." (Pg 5). White incidentally died of a heart attack at 55, arguably before his time, in 1948 soon after testifying that he was not a Communist after having resigned his position as US representative to the IMF in 1947.

of building credibility remained. Yet the concessions wrested by developing countries surely foreshadow what might be possible if a similar negotiating table is set to redraw the contemporary global financial architecture.

The Need for a Bretton Woods Three?

The moot point that remains is that both in the original BWS and the current BW2, the problem of financing economic development in developing countries has yet to be addressed. After the collapse of the BWS in 1971 the IMF still maintained its role as a provider of liquidity and even started getting more involved in the economies of developing countries through programmes like Structural Adjustment Policies and Poverty Reduction Strategy Papers. Enough criticism has been levelled against these policies (Marshall et, al. 2001; Stewart and Wang 2003; Stiglitz 2004) but we will restate that in the IFIs' efforts to provide macroeconomic stability' the key principle of capability development was never addressed. Capability development remains the heart of the problem of development and is a supply side issue that needs to be urgently addressed in developing economies. Capability development refers to a) developing know-how in organizational capabilities, literally how to organize modern production at all levels but particularly within firms, and b) financing the period of low returns or even loss-making when an organization is going through this learning process (Khan 2013). It is widely known that developing countries fail to achieve competitiveness even when they import the appropriate machinery and have the appropriate skills because their firms and other organizations lack the organizational capability to produce efficiently. Capability development is an extension of Arrow's 'learning-by-doing' analysis but we also know that when financing is available for economies and firms to improve their organizational capabilities, they have to put in a *high level of effort* that needs to be monitored in order for them to develop the relevant organizational capabilities (Khan 2013).

Otherwise the financing fails and the firms become bankrupt and the country has to be bailed out. The global failure to develop institutional mechanisms for financing capability development is one of the central constraints to the development of global financing arrangements that can drive development.

While technology for mature industries is relatively freely available for developing countries, they are usually unable to develop the requisite organizational capabilities to achieve competitiveness even with their advantage of low wages. This is because their organizations and firms do not yet have the internal routines and processes to organize production well enough to achieve competitiveness (Khan 2013). Of course this would not be true of all developing countries. Their institutional and political success in developing organizational capabilities varies widely as this broad group includes relatively successful countries like China (the outlier in this group), intermediate countries like Malaysia, Indonesia, South Africa and India as well as many countries in Sub-Saharan Africa and elsewhere where organizational capabilities are less developed. The learning-by-doing we refer to is most fundamental for the latter group but is also necessary in many sectors even in the more successful ones. India for instance has a very sophisticated auto and auto components industry but lacks a semi-conductor sector despite having a skilled pool of engineers and attempting to develop these capabilities for many years. Learning-by-doing necessarily needs a sustained but short period of 'loss financing' as organizations build up their capabilities. And as with all financing arrangements it also needs the effort put into the learning process to be monitored. Monitoring has to go hand in hand with effort in order for the financing to be used effectively and not get captured (Khan 2013). The current world economic order however neither has the financial instruments for financing firms in developing countries and nor does it have any institutional framework for monitoring effort in learning appropriately even if financing were available. At a more fundamental level policy priorities are not even directed at helping governments develop such instruments. While capital flows, especially short term ones are highly mobile, technological capabilities are not (Cimoli et, al. 2008). This is precisely the reason why economies need financing to acquire technological capabilities. This is the type of radical developmental thinking that the framework of a Bretton Woods Three should aim to incorporate.

Conclusion

The question then is what a desirable global payments system would look like for developing countries and whether such a system is politically feasible given the power and interests of the dominant players in the world system. The financing that remains available to them is either short term through the capital market often with high rates of interest or from the IMF and the Bank that do not lend with capability development in mind. The global imbalances in payments indicate massive surpluses at the global level that do not find productive avenues of investment precisely because many of the countries with the largest surpluses lack the capabilities to use these productively. These surpluses are directed into US Treasury bonds that are actually destabilizing and cause asset imbalances because advanced countries cannot generate high rates of real growth given their already high levels of per capita incomes. *Hence what is required is an international bank where surplus countries can buy bonds issued by a global institution like a revamped IFI and that institution can direct funds for capability development to poor countries where growth prospects are by definition high.* This way investors can potentially get good returns and developing countries can grow. Critically this requires new thinking about the criteria for managing global financing flows and the institutional mechanisms for monitoring effort and performance in investments for capability development.

The change in voting rules in 2009 at the IMF did little to effectively change the rules of the game. In fact Kregel builds on Minsky's theory of financial fragility and describes a large part of the lending by international agencies as a 'Ponzi scheme' where over-indebted countries borrow to pay off debts 4 (Kregel 2004). There is an obvious and critical need for strong global institutions that can penetrate developing country economies and provide credible lending with institutional developments that can sustain effective investments in capability development. The G 20 has not been able to provide the leadership required and the G 77 has a nominal presence and lacks a strong consensus on the way forward. The IMF and the Bank in their current form cannot perform this function. The discourse of "foreign expertise and local futility" that one of the Bank's foremost economists, Albert Hirschman, railed against during his stint in Colombia in the 1950s (as detailed by his biographer) still exists in a compounded manner within the IMF and the Bank (Adelman 2013). Perversely ruling coalitions in developing countries often use this to their benefit to capture some of the rents from policy lending by the IFIs by following their policies on paper when they know these are unlikely to deliver any developmental benefits. The cynicism on all sides in the global aid and policy business can unleash a vicious cycle of adverse growth outcomes, growing debt burdens and periodic write-offs. Of course Hirschmanian-style experimenting is too uncertain in the current context as developing countries need faster results! Hirschman argued that countries learn how to solve problems by experimenting and learning from their mistakes. This is hard to disagree with but experimenting along lines that are unlikely to be enforceable in particular political settlements is liable to be very wasteful and will not be accepted by international financial organizations providing the funds. The political context of the experimentation was not part of Hirschman's framework. Experiments have to be based

4 According to Minsky there are three kinds of loan financing: hedge, speculative and ponzi financing. Hedge financing is when creditors are able to pay back both principle and interest, speculative is when regular interest payments have to be made but the future is uncertain and there is a risk of default, and ponzi is when creditors have to borrow to even pay back the interest.

on credible institutions in the country that can limit the waste from failed experiments by a) not attempting types of financing that cannot be policed in that political context and b) ensuring that institutions exist that can credibly impose conditions for particular types of financing that ensure high levels of effort in learning. This will be a hugely contentious issue even before the various sides take to the negotiating table. Least developed countries will want concessions that other developing countries will oppose and developing countries have different sectoral and technological interests that may be conflicting. Developed economies, on the other hand will need an assurance of returns to their financial flows to developing countries and the assurance that institutions exist to ensure losses are detected early and thereby limited and gains are declared and shared. The challenge is to identify and agree the governance structures that could make such a global financial structure work. This might sound impossible but the creation of the Bank and the IMF would have equally been deemed impossible in the Inter-War years. The radical shift that we referred to in the introduction is the only way forward.

It is an irony of the current IMS that countries that have solved the problem of financing capability development have done so largely by using protective and interventionist mechanisms that operated outside the global financial system. These instruments have become progressively more difficult to imitate because of changes in the global trade architecture, especially through the WTO and because most countries do not have the internal political settlements that allowed a few countries to operate these financing systems. South Korea in the 60s and 70s and China since Deng Xiaoping for instance used subsidies and import protection, along with currency intervention in the case of China to develop capability. Most developing countries do not have the internal political settlements that would allow them to replicate these strategies. In an increasingly open trading framework, and given the inability of most developing countries to provide indirect financing to their emerging sectors to develop competitiveness, the world needs global financial institutions that are radically different in their design. A sustainable world system requires multilateral institutions with the appropriate institutional capabilities to effectively provide the financial flows that could fill this glaring gap. Creating such a global financial system would be a radical m, and it is a challenge that is necessary to address. The earlier attempt, the BWS, was not the best that could have been achieved. It did however lay the foundations for world economic growth and there are lessons that need to be learnt from it. It was also an attempt at multilateral institution-building that was radical for its time. If we are to achieve a more sustainable global order, it has to be built on a global financial system that allows the rapid development of new productive capabilities across countries, communities and regions and that would indeed be a dramatic break with the past.

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