ADVANCE COPY

A RE-EXAMINATION OF THE ARCHITECTURE OF THE INTERNATIONAL ECONOMIC SYSTEM IN A GLOBAL SETTING: ISSUES AND PROPOSALS

No. 181
October 2005

A RE-EXAMINATION OF THE ARCHITECTURE OF THE INTERNATIONAL ECONOMIC SYSTEM IN A GLOBAL SETTING: ISSUES AND PROPOSALS

Dr. Michael Sakbani

No. 181
October 2005

***Acknowledgement**: The author is grateful to an anonymous reviewer from Thunderbird University and to Richard Kozul-Wright for editorial comments. The views expressed and remaining errors are his responsibility.*

UNCTAD/OSG/DP/2006/1

***JEL classification**: E, F, G, O*

Contents

Page

Abbreviations .... *iv*

Abstract 1

INTRODUCTION 1

I. THE PROBLEMATIQUE OF THE GLOBAL ECONOMIC SYSTEM 3

A. The different facets of globalization and their manifestations 3

B. The problems and challenges of globalization 5

C. Investment, transfer of technology and global business 7

D. The interfacing of the national and international orders 9

II. THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEMS 9

A. The governance and regulation of the capital and monetary flows 11

B. The management of financial crises: the bank of last resort 14

C. The foreign exchange system 17

D. The reform of the IMF 19

1. Governance of the IMF 19

2. Surveillance and conditionality 21

REFERENCES 23

ABBREVIATIONS

IMF	International Monetary Fund; the Fund (used interchangeably)
IBRD	International Bank for Reconstruction and Development; World Bank and the Bank (used interchangeably)
ITO	International Trade Organization (proposed but not created)
GATT	General Agreement on Tariffs and Trade
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization
TRIMs	Trade-related Investment Measures
TRIPS	Trade-related Aspects of International Property Rights
OECD	Organisation for Economic Co-operation and Development
WHO	World Health Organization
BIS	Bank for International Settlements
ASEAN	Association of South-East Asian Nations
EU	European Union
EMU	European Monetary Union
EMS	European Monetary System
IMS	International Monetary System
IFS	International Financial System
IRS	International Reserve System
SDR	Special Drawing Rights on the IMF second window, established in 1968
C20	A Committee of 10 developed and 10 developing countries that mirrored the constituencies of the IMF, established in 1972 by the Governors of the IMF to look into the reform of the International Monetary System
G7	Group of Seven major developed countries
G77	The group of Seventy Seven developing countries which was formed in 1964 in the United Nations General Assembly. It was instrumental in passing the GA resolution establishing UNCTAD in the same year.
G24	Group of Twenty-four, created by the G77 to follow closely IMF matters
FDIC	Federal Deposit Insurance Corporation, created in the United States as part of the banking reforms of the Roosevelt Administration in the 1930s
TNC	Transnational corporations
FDI	Foreign direct investment (long term investments in real assets)
PF	Portfolio investments

A RE–EXAMINATION OF THE ARCHITECTURE OF THE INTERNATIONAL ECONOMIC SYSTEM IN A GLOBAL SETTING: ISSUES AND PROPOSALS

*Dr. Michael Sakbani**

Abstract

The globalization of the world economy poses major challenges to the prevailing international economic system. The recent trade-investment system raises the issues of the marginalization of countries, firms, and agents if they are not capable to compete with large successful entities. The system engenders conflicts of interest in its interfacing with sovereign domains. In numerous cases such as employment and mutual trade benefits, it can produce zero sum outcomes. Consequently, significant segments of public opinion in many countries have mobilized against it. In the monetary and financial area, the system has from 1945 evolved on a piecemeal and ad hoc basis. In recent years, it has not been able to predict, prevent or effectively deal with financial crisis. It demonstrates a lacuna in global financial governance especially with respect to enforcing its rules on the major countries and bringing the private sector therein. The central institution, the IMF, is shown to be in need of basic reforms involving forging a global vision, reconsidering and updating conditionality, further democratization of political governance, and revamping the exchange rates and surveillance functions.

INTRODUCTION

The prevailing international economic arrangements are an amalgam of facts, rules and modalities created one at a time rather than as a holistic system of cohesive design. The monetary part is a transformation of the old Bretton Woods system, which came into actual collapse in August 1971, but was rescued by successive fixes from 1972 onward. It remains based on the United States dollar, and centred around the IMF[1] whose mission and philosophy have evolved at a politically controlled pace. The monetary and financial systems are covered institutionally by the IMF in monetary matters and by the World Bank in finance matters. Moreover, the World Bank, while an important source of development funds for the poor countries and an instrument for bringing their policies under the scrutiny of the dominant members, shares its role, de facto, with the private sector, which is, de jure, not a part of the official system and is in the business of profit making.

The trade part of these arrangements, issuing essentially from the GATT, was redesigned in its scope and its law by the WTO agreement. However, it has maintained numerous features of the old GATT; it is still based on the exercise of full sovereignty in granting or not granting concessions; it remains essentially one based on liberal trade access, on non–discrimination in treatment via the application of the most favoured nation clause; and it is now based on equal treatment of countries regardless of their trading capacities. There is yet no sub-system for dealing directly and explicitly with investments and the transfer of technology.

---

* The author is a former UNCTAD Director of Economic Cooperation, Proverty Alleviation and Special Programmes and Adjunct Professor of Finance and Economics in Thunderbird Europe and Webster University in Geneva. He continues to work as consultant to the United Nations, the European Union and Swiss private banks.

[1] See glossary of abbreviations. p. *iv*.

The overarching theme of this paper is that some parts of the international system have become, under globalization, rather obsolete and sometimes mutually inconsistent. The system has shown itself incapable of anticipating or preventing financial crisis in a global economy. There is also a glaring asymmetry in the treatment of source and recipient countries. Alternatives and reform ideas are suggested with full cognisance of their political feasibility and analytic soundness.

The conclusions of this paper are as follows:

- The globalization process cuts into the sovereign control of Nation States and to a certain extent erodes their fiscal base, while imposing costly burdens and obligations upon them to husband and develop their productive capacities and preserve their respective social compacts. It also reduces their scope of policy choice.

- The system has an obvious need for international governance, but its major Nation States do not accept the implied limits on their sovereignties.

- Globalization confers considerable benefits upon the participants, but it pays no attention to developing production, technological and commercial capacities. Thus, it may lead to the marginalization of some States, firms and individuals.

- The WTO system, which is based on equal treatment and unfettered sovereign granting of concessions, in effect provides level playing field only to participants with equal trading capacities or with equal value of concessions. Some aspects of this system disallow, for example, environmental and industrial policies, thereby infringing upon domestic Nation State decision making and putting in question the objectives and purposes of domestic policies wherever they have international effects.

- The short run incidence of trade globalization might be harmful to employment in the job losing countries, with the result of placing globalization in domestic political contention.

- The globalization of financial flows and investments might enhance allocative efficiency, but it skews further equity and fairness in the use of international savings and might undermine macroeconomic discipline.

- The private sector is not brought into the system in a meaningful way, especially in the areas of