The Disastrous Consequences of a World Without Balance
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Our world is as prone to financial crisis as ever. Officials from the International Monetary Fund and the World Bank should remind themselves of that as they prepare for their annual meetings next week.

With the collapse of Argentina, and Brazil and Turkey appearing, at various times, to be near the brink, the past 12 months have once again underlined our failure to tackle basic problems. But it is not just the countries in, or near, crisis that are disillusioned. Throughout Latin America, where liberalisation, privatisation and stabilisation - controlling inflation - have proceeded apace, countries are still waiting for the promised rewards. Growth in the 1990s was just over half of what it was in the pre-reform decades, while increased labour market flexibility has brought lower wages but not lower unemployment.

It is true that progress has been made. For example, the IMF has reconsidered its stance on capital market liberalisation. It is also rethinking the use of bail-outs, which have proved largely unsuccessful, and is talking more about poverty and participation than before. But a number of fundamental problems remain.

First, there is a basic instability with the current system, which focuses on countries with trade deficits. By definition, the sum of the trade deficits must equal the surpluses; if some countries, such as Japan and China, insist on having a surplus, in the aggregate the rest must be in deficit. If one country reduces its deficit - as normally happens after a crisis - it simply appears somewhere else in the global system. The system has behaved perhaps better than might be expected because the US has acted as the deficit-of-last-resort. But for how much longer can the richest country continue to borrow from the rest? How long will the appetite of the rest of the world for American bonds and equities continue?

Second, it is much harder for poor countries to bear the risks of exchange rate and interest rate fluctuations than it is for rich ones, but they are forced to bear those risks. The consequences of this imbalance are often disastrous. Debt burdens that look moderate become unbearable after big devaluations. This year Moldova, already desperately poor, will spend about 75 per cent of its government's income on debt repayments. Markets have failed to develop appropriate mechanisms for risk distribution; the international economic institutions should at least begin to discuss undertaking this role.

Given the large number of countries with unsustainable debt, there is a need for giving better advice on risk management. And since every loan has both a borrower and a lender, and the lenders are supposedly more sophisticated at risk management than the poor borrowers, much of the fault must lie at the foot of the lenders.

Third, the experience in Argentina has shown that we have also failed to learn how to manage crises when they occur. Sure, Argentina bears some share of the blame; but even if it had done everything the IMF recommended, and there had been no corruption, there is little reason to believe that it would have avoided the crisis, or that the crisis would have been less profound. Assume Argentina had been "good" and had received an IMF loan. Would foreign investors have started to pour into a country that was still in depression? It is hardly likely.

We need policies designed to reactivate the real economy, which means creating markets for Argentina's goods and providing credit to its companies. A World Bank study shows that what drove the Mexican recovery was trade with the US, financed by American importers, more than the IMF bail-out. East Asia's recovery was spurred by Japan's Miyazawa initiative, which provided billions in trade credit. We have had nothing like this to offer Argentina. Fourth, trade agreements need to be made fairer. Among the principal successes of the United Nations summit on poverty last March was the US's commitment to increase aid. But that also showed how paltry aid has been so far. There was another achievement of that meeting: it made clear that finance issues could not be separated from other aspects of the economy.

Exports provide revenue and jobs but trade negotiations have been asymmetric: the north has not done enough to open its markets to the south. Larger US agriculture subsidies have made things even worse. Finance ministers should lean on their trade colleagues to make the Doha round of trade negotiations truly a development round.

Fifth, trade should be used as an instrument of economic stability. In the past, countries facing an economic downturn or an onslaught of imports have raised tariffs to protect themselves. These beggar-thy-neighbour policies exacerbated the Great Depression. Would a positive trade policy of temporarily opening up markets to countries in crisis not be better? Additional sales of Argentine wine, beef and wheat would help to resuscitate the country's economy more than the billions of dollars of high finance.

Sixth, September 11 and the war on terrorism have again raised the question of transparency in the financial sector. The enervating effects of secret bank accounts on the developing world have yet to be tackled head on. They are central in facilitating the corruption, tax evasion and drug money laundering that weaken so many developing countries. The question of transparency also applies to the international economic institutions, where there are growing concerns over governance structures. Changing the arrangements will prove slow and tortuous, but greater transparency meanwhile would help.

Finally, there will be some discussion at the World Bank/IMF meetings of government bankruptcy and the IMF's proposal for a sovereign debt restructuring mechanism. But there is a concern about the central role that the IMF would like to assume. Can a single creditor play a central role in the bankruptcy process - other than as one among several creditors? Clearly, it cannot be the bankruptcy judge. But that makes clear that a discussion of bankruptcy reform, in an institution in which the creditors dominate, would be like delegating bankruptcy reform in the US to the financial institutions. No democracy would find this acceptable.

Globalisation, including global financial flows, is of concern to ordinary people, not just to finance ministers and central bank governors. Yet their voices are not being heard. Rethinking the global economic architecture to ensure that they are is the most important challenge facing the global community today. I hope that this too will be on the agenda at the IMF/World Bank meetings.