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A Historical Perspective on the International Monetary System

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We are celebrating the sixtieth anniversary of the United Nations Monetary and Economic Conference at Bretton Woods, New Hampshire. I should start by saying that Bretton Woods now carries a rather mixed connotation: some see it as a triumph of international cooperation and consensus building, while others judge it to be the source of a mistaken (restrictive) approach to international capital account movements.[1] It may of course have been both at the same time. Ten years ago, the positive elements were still emphasized rather more than the negative; today, perhaps largely as a result of widespread disillusion with instabilities produced by fixed exchange rate regimes, most commentators place their emphasis the other way round. Indeed in an influential book with Luigi Zingales, Raghuram Rajan, who subsequently became the International Monetary Fund's (IMF) chief economist, described Bretton Woods as a rather unhealthy compromise, which created in many countries an insulated *relationship capitalism* (that might be described as *crony capitalism*) in which: "Productive firms that were not in political favor could not get finance. Capital controls also took away a significant source of budgetary discipline on governments, thus giving them leeway for constant intervention in the economy."[2]

In fact, Bretton Woods at the time was conspicuously incomplete: it was supposed to consist of three pillars, only two of which actually became reality, the International Monetary Fund and the World Bank. They were supposed to give concessions on the monetary side to the rest of the world, while the United States imposed trade liberalization through the third pillar, the International Trade

[1] I have presented both versions: the former in International Monetary Cooperation Since Bretton Woods, 1995, the latter (with Michael Bordo) in Haberler versus Nurkse: The Case for Floating Exchange Rates as an Alternative to Bretton Woods (2002), pp. 161–182.

[2] Raghuram G. Rajan and Luigi Zingales, Saving Capitalism from the Capitalists: Unleashing the Power of Financial Markets to Create Wealth and Spread Opportunity, 2003, p. 243.

Organization. But ITO was left until after the end of the World War, and was consequently stillborn.

1. Rules and the International Monetary System

The world economy after the Second World War was rebuilt on the basis of systems of rules and complex institution-building, but only for some areas.[3] One way of thinking about the economic story is to regard rule-building in two critical areas as moving in different directions. During the interwar period, international discussions on international cooperation foundered because trade negotiators believed that while tariff reduction and quota elimination might be desirable, there was no point in discussions until a stable monetary system had been created. Without stable monetary order, the use of trade measures to stem the export of pernicious deflation could be justified as a desirable second-best measure. On the other hand, the monetary discussions foundered because of reluctance to make agreements while the vicious spiral of trade protection was still underway. During the Second World War, the U.S.A. made it clear that it was not prepared to negotiate on trade liberalization that it saw as necessary to postwar peace, and as a result, all the diplomacy concentrated on a framework of monetary rules (at Bretton Woods).

The rule-based monetary order disintegrated in stages between 1968 and 1973. The functions of the IMF, the major institution charged with policing the rules of Bretton Woods, changed very dramatically. Its major task turned out to be plugging market failures left by the newly invigorated capital markets: in practice a great deal of attempt at crisis prevention and a great deal of experience in crisis resolution.

A consensus gradually emerged for U.S. administrations that attempts at international monetary coordination were pointless and counter-productive: like the Bretton Woods order, they restrained monetary policy in a sub-optimal way and led to undesired outcomes. Thus, the experience of the 1978 Bonn summit, or the 1985–87 negotiations and semi-agreements about appropriate exchange rates were generally viewed as discrediting the idea of negotiating about exchange rates. The mantra of all administrations since the 1980s is that exchange rates are set by the market.

On a global level, the rule-based system disintegrated, though there was a regional counter-movement in Europe. The moves to closer European monetary integration, with the elaboration of a system of rules at first very reminiscent of

[3] The classic account of the postwar order is by Richard Gardner, Sterling-Dollar Diplomacy; the Origins and the Prospects of our International Economic Order, 1969. See now G. John Ikenberry, After Victory: Institutions, Strategic Restraint, and the Rebuilding of Order after Major Wars, 2001.

Bretton Woods, actually took place at moments of disillusion about the global scenario. Thus, the European Monetary System was established in 1979, in the aftermath of the abortive Bonn summit; after the Plaza, the Europeans moved to agreed on principles for currency intervention for the European Monetary System (EMS) with the Basle-Nyborg agreement in 1987; and the final impetus to monetary union was given by the non-synchronous experience of recession in the U.S.A. and Europe in the early 1990s.

The postwar period produced a great expansion of trade that is fundamental to the story of increased prosperity. Trade became institutionally more regulated. The General Agreement on Tariffs and Trade (GATT) generalized bilateral agreements, then produced general tariff reductions in the 1960s Kennedy round, and then became fully institutionalized as the WTO in 1996. Many observers are surprised by the apparent willingness of the U.S.A. to accept rules in this area at each stage of the development of a rule-based order. The story of trade opening can be read as a suspense drama, with a new twist to the narrative on almost every page. The GATT was a compromise. It achieved its biggest successes in the 1960s, largely at the cost of reducing its extent so as to exclude some of the most contentious trade items – textiles and agricultural products. By the 1970s, after the collapse of the Bretton Woods par value system, most writers agreed that the GATT was moribund. The Tokyo round was protracted and spotty. In the mid-1980s, the leading experts concluded that the GATT was *in a state of breakdown*. The ministerial meeting of 1982 had failed. The Uruguay round looked doomed to failure as the United States and the European Community became locked in a politically complex struggle over agricultural pricing and subsidies. Even in 1993, on the eve of the final agreement of this Round, a major text produced by a GATT official had as its theme "the weakening of a multilateral approach to trade relations", "the creeping demise of GATT", and the fact that "the GATT's decline results from the accumulated actions of governments." [4] But then came the astonishing extension of multilateral principles to intellectual property, trade-related investment, and the creation of a more complete conflict resolutions procedure and the institutionalization of multilateralism in the World Trade Organization. At that time, the commentators were skeptically insisting that the United States would ignore the new institution, and instead continue a unilateral exercise of power through the application of Super 301. But when the first ruling came against the U.S.A., the U.S.A. accepted it. In 1998, everyone gave reasons why the financial services agreement could not be realized. Then, apparently unpredictably, at the last moment it came about. The U.S. steel tariffs would destroy the World Trade Organization (WTO), but then the U.S.A. gave in. Rules still ruled.

[4] Patrick Low, Trading Free: The GATT and U.S. Trade Policy, 1995, p. 247.

How can we explain this development toward rules in trade and away in the monetary domain? In the 19th century era of globalization, there were no mechanisms for agreeing international rules on either trade or money: this was a decision for nation-states. There were plenty of other international agreements: on weights, standards, postal systems, the treatment of prisoners of war, the International Red Cross. The one attempt to provide a common monetary standard, the International Monetary Conference summoned by Napoleon III in 1867, was a miserable failure.

In the earlier age of worries about globalization at the turn of the 19th century, a backlash began. The nation-state appeared as a protective carapace against the ills flowing from global integration, and in the end evolved restrictions on migration and high levels of trade protection. When national protection became the major priority of most countries, in the 1920s and 1930s, the world became both poorer and less safe. There was a vicious cycle, in which external forces were blamed for loss and disaster, and high levels of trade protection destroyed national prosperity.

It was in response to this failure that the need for international agreement on a framework of rules for international integration became apparent. Rules on trade were designed to lock in solutions to Olsonian collective action problems: to the tendency of powerfully articulated particular interests (for protection) to assert their primacy over a much less forcefully developed sense of a general good lying in trade opening.

Monetary questions by contrast are much less vulnerable to capture by particularistic rent-seeking interests. The monetary rules of Bretton Woods were not devised to solve collective action issues *within* countries, but rather to deal with coordination problems *between* countries. They followed from the articulation of conflicting national strategies: in particular, the fixed exchange rate regime was generally explained by the need to prevent nations indulging in competitive *beggar thy neighbor* devaluations of the kind that had occurred in some instances in the 1930s (notably in Japan after 1931).

Most countries have avoided the interwar sort of backlash in the second half of the 20th century, although their citizens had the same angst. The changing of employment patterns is a constant accompaniment of growth. In the early 1970s and again in the 1980s U.S. workers and producers were upset about the loss of jobs to Japan. Some of the most skilled jobs, in automobiles, were lost; household appliances like TVs were no longer made in the United States. On each occasion, the administration tried to respond to the job loss worries not by trade restrictions, but by exchange rate alterations that would make the U.S. products more competitive, in other words by a kind of echo of 1930s style solutions: first the end of the gold convertibility of the dollar in 1971, and then in 1985 the Plaza agreement to depreciate the dollar. Monetary and exchange rate policy initiatives offered a way of absorbing adjustment pain. The focus of trade discontent was

shifted to the monetary arena in a way that helped to undermine the legitimacy of institutional ways of regulating the international financial system.

The use of monetary policy and exchange rate adjustment to deescalate trade conflict is harder today, since many of the countries whose products are entering the United States either formally or informally peg their own currencies to the dollar. (Japan, notably, is classified by the IMF as having an *independent float* but in practice has a vision of where its exchange rate should be.) In practice, over half of the world's population and over half of the world economy is more or less informally associated in a sort of Bretton Woods system, but without the rules for behavior and adjustment of the original order.[5]

Governments still feel that they need some response in an attempt to *feel the pain*, and to show that they are doing something. Like the Bush administration they adopt tariffs that may then be over-ruled by the WTO. In this way they do nothing very harmful, but point out to the electorate that their hands are tied by international agreements and institutions. But this sort of action itself then produces a new kind of backlash, against the international institutions.

Trade problems were in fact in the post-1945 world routinely dealt with by shifting the emphasis to the monetary arena. The world has developed its institutional arrangements in the setting of globalization by making them harder in the trade arena and softer in the monetary one. In the future the offloading of adjustment problems to monetary policy will be more difficult (because of widespread Asian exchange rate pegging) and the trade system will be in consequence more vulnerable.

2. International Capital Flows

The key element of the Bretton Woods system, which allowed the formulation of the rules, was the widespread consensus on the desirability of controlling and restricting the movement of capital. Conversely, the major development which is usually held to require movement to a floating rate system is the development of large international capital flows. Since the 1990s, these have become more extensive, but also more various: they are no longer limited to bank credits mostly to public sector borrowers, but involved portfolio investment and FDI. From the standpoint of capital flows, the world can be split into three groups: at the ends of the spectrum, there are on the one side well developed industrial economies, and on the other poor economies, in which capital inflows play no substantial role. In between, there is a group of countries with rapid growth and good prospects for the

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[5] Especially Michael P. Dooley, David Folkerts-Landau, Peter Garber, An Essay on the Revived Bretton Woods System*,* 2003. The lessons are drawn in Martin Wolf. Why the Fed is Forced to Fuel a Global Boom. 2004. See also the recent critique of Barry Eichengreen. Global Imbalances and the Lessons of Bretton Woods. 2004.

future, but a limited capacity to borrow (what Reinhart and Rogoff have diagnosed as *debt intolerance*) and no ability to develop long term markets in their own currencies.[6] These economies are vulnerable to crises of confidence.

Deep capital markets and well-developed financial institutions are generally recognized as a prerequisite for opening to international capital flows. But it is clear that many countries with strong chances of impressive economic growth do not have such institutions, and are consequently very vulnerable to financial crises as capital flows are abruptly reversed. Indeed in the wake of the 1997–98 Asia crisis, there is almost a new consensus on emerging markets that the price that is paid for premature capital account liberalization is too high.

This view may be too cautious: some very successful economies grew dynamically, but with repeated interruption by severe financial turbulence. This was the case with the United States in the later 19th century, where there existed a very dynamic instability, but also of Korea since the early 1960s. Repeated crises, in the mid-1970s, in 1982, and then again in 1997–98, were accompanied by reform, a reorientation of economic policy priorities, and a new type of growth. Chile's path to reform and economic opening was also marked a major crisis in 1982–83.

But there are two caveats: first, widespread contagion is obviously damaging on the world level and has at some moments, notably 1982 and 1998, threatened the global financial system. Secondly, even in an isolated national context, financial crises can be deeply destabilizing, especially in conditions where there is inadequate political stability. As a consequence, the policy debate has shifted from a narrower concern with purely financial measures to a much broader concern with institutional and political capacity: measures of corruption, the relation of the central government to provincial authorities, capacity for enforcement, transparency of the financial and economic system. The consequence is that it is useful to think of mechanisms to enhance stability of *emerging markets* – where markets and political institutions are not yet very deep.

3. Conditionality and the International Monetary System

The substitution of international mechanisms as credibility or commitment devices in place of absent deep domestic markets may offer a role for the IMF, but it is a very difficult and problematic one.[7] Conditionality can be described as a way of lending not only money but credibility through effective policy reform. Keynes's original vision for Bretton Woods did not need this, since there were no capital flows; and he wanted in consequence an entirely automatic Fund, in which

[6] Carmen M. Reinhart, Kenneth S. Rogoff, Miguel A. Savastano, Debt Intolerance, 2003.

[7] See Ashoka Mody and Diego Saravia, Catalyzing Capital Flows: Do IMF-Supported Programs Work as Commitment Devices?, 2003.

financial resources would simply be made available as in a sort of blind credit cooperative. But Keynes was over-ruled on this.

At first, the idea of policy reform was relatively simple, but it has become increasingly wide and complex. The problems involved in the linking of lending with conditionality and policy reform are not unique to the IMF's operations. They are inherent in any attempt to subject lending to conditionality. The League of Nations programs for Hungary and Austria in 1922 and 1923, for instance, raised exactly the same issue, and the criticisms of them as excessively harsh and intrusive on national sovereignty precisely prefigure later debates. The external control imposed on politically fragile states emerging out of the postwar breakup of the multinational Habsburg Empire was so extensive and tough that it constituted a deterrent to embarking on similar programs in other states. Instead, countries attempting to stabilize their currencies in the mid-1920s turned to the less *political* capital markets, with the result that, as a general principle, the League's conditionality was counterproductive. A reaction against the experience of the League made some of the architects of the Bretton Woods system, particularly John Maynard Keynes, desire a more automatic Fund. But the principle of conditionality – Keynes called it in a memorable phrase *being grandmotherly* – soon reasserted itself in the lending of the new institution.

For the IMF, conditionality became an increasingly sensitive issue in the 1960s and, above all, in the 1970s for the following reasons. First, because quotas were not raised in line with the dramatic expansion of world trade, higher levels of lending in relation to quotas were required, with consequently increased conditionality. At this time, there was a very strict view that conditionality should be proportional to the extent of quota borrowing, with every tougher measures required as quotas were exceeded. Second, the expansion of capital markets, which had been completely unanticipated at the time of the Bretton Woods conference of 1944, offered an alternative source of capital. The result was that conditionality applied only to some debtor countries, and the concept of countries *graduating from* the IMF became increasingly popular. Here, however, the skittishness of markets soon produced some unpleasant surprises. Before the outbreak of the 1982 debt crisis, many finance ministers and bankers had considerable confidence that the IMF was irrelevant to all except the poorest countries. Similar beliefs gripped the markets before the 1997 outbreak of the Asian crisis. Third, conditionality became more complex in order to avoid unintended consequences in programs. Previously, for instance, because of the pressure exerted by powerful political and civil service lobbies, fiscal conditions had often led to big cuts in government investment but very little reduction in government consumption. As a result, economic prospects worsened. Programs therefore began to specify elements in public spending – public sector pay guidelines, investment levels, and the like. Such an expansion of activities inevitably brought the IMF into the political domain.

The big capital account crises of the 1990s involved much larger amounts of support relative to previous crises. Mexico in 1995 drew 688% of its quota, Korea 1939% in 1997–98, Argentina 800% in 2001, and Turkey 1330% in 2002. Before the 1990s, there had been an inclination to give too little in order to give incentives to program countries to make adjustment and reforms. When the emphasis shifted to reassuring nervous markets in a capital account crisis, the priorities were reversed, and stabilizing the expectations of the markets would involve the assurance of so much support that speculators could not take a position against a country or currency and hope to succeed. This function had an analogy to the role of central banks in national economies as lenders of last resort, an analogy that was controversially drawn by the IMF's First Managing Director Stanley Fischer. The parallel is sometime made to the Colin Powell doctrine about military intervention: that it only makes sense if conducted with massive force.

The aftermath of the big bailouts in the 1990s is acutely controversial. The immediate criticism, which was probably overstated, was that it produced a moral hazard problem. In the view of Milton Friedman, for instance, the 1995 Mexican program produced the Asian crisis of 1997 because investors assumed a Fund guarantee. This may have been some part of investors' calculations, but they were fundamentally impressed by the idea of an *East Asian miracle* that they should buy into. There is an analogy with the development of the stock market boom in industrial countries the late 1990s: some of it may have been driven by the idea that central banks (and in particular the Federal Reserve System) would support a certain level of the market, but mostly it was driven by a vision of a New Economy.

The real problem came from the size of the rescue operations, the strain that these brought for the IMF's resources, the fact that as a result such operations could not be envisaged for a large number of countries simultaneously. In particular in 1998, after the Russian crisis the realistic belief that the Fund was near to the end of its resources increased fears of a generally contagious crisis. The conflict between a aim of massive response and the limited financial capacity of the IMF brought an element of intellectual incoherence to the whole approach, that was particularly visible in the stance of the United States. Paul O'Neill as Treasury Secretary repeatedly attacked the idea of *big bailouts* in principle, but then went on to advocate them very forcefully in particular cases, often in the face of resistance from other G-7 countries who wanted to interpret them as political opportunism.

In the 1990s, this view of the IMF and its role changed dramatically. In large part, this was a consequence of reflections on the collapse of communism and on the links between political and economic reform. In the 1980s, many political scientists believed that economic reform was more easily achieved by authoritarian regimes. The experience of Central Europe, in particular, completely reversed the general understanding of the link between economic liberalization and political democratization. In the new picture, only a country whose government was

sustained by a deep reserve of legitimacy would be able to bear the pains associated with adjustment.

This change had repercussions for the concept of conditionality. If there was less room for a benevolent authority in imposing economic reform, this would also mean questioning the traditional role assigned to the IMF. Instead, the issue of *ownership* became central.

The collapse of the centrally planned economies or (in the case of China) their movement toward the market was the last stage in creating a new consensus about economic policy, frequently but misleadingly referred to (in a phrase coined by John Williamson) as the *Washington consensus*. The consequence has been an increasing homogeneity of political outlook, as well as of the economic order. Indeed, one key insight is that the two are linked: that economic efficiency depends on a functioning civil society, on the rule of law, and on respect for private property.

The post-cold war world has quite different politics. There is no longer a lineup of East versus West, in which pro-Western regimes automatically obtain support, regardless of their levels of efficiency and competence and probity. Rather, the international community is adopting a much more interventionist stance in which the logic that associates economic and political change is taken more seriously. The result has been the forcing of a much quicker pace of economic reform in some countries (for example, Egypt, which until the early 1990s largely resisted attempts to liberalize); the disintegration of the political order in others (the collapse and defeat of Mobutu's Zaïre); and the descent into the status of international pariah for others. The striking change in this area is that there is no longer an acceptance of domestic political inefficiency, corruption, or oppression.

The most visible product of the new political environment of the 1990s is the concern of the Bretton Woods institutions with *governance*. In August 1997, a new set of guidelines promulgated by the IMF's Executive Board instructed the staff that, in policy advice, the IMF "has assisted its member countries in creating systems that limit the scope for ad hoc decision making, for rent seeking, for undesirable preferential treatment of individuals or organizations." The IMF suggested that "it is legitimate to seek information about the political situation in member countries as an essential element in judging the prospects for policy implementation." At the same time, these guidelines also preserved the nonpolitical vision of Bretton Woods, requiring the IMF's judgments not to be influenced "by the nature of the political regime of a country." In particular, recognizing an obvious danger, they specify that "the IMF should not act on behalf of a member country in influencing another country's political orientation or behavior."

The IMF's interest in governance was already reflected in a number of very high profile decisions in 1996–97. Conditionality has come to the fore in each of four completely new areas. First, military spending had never been a topic of explicit discussion by the IMF in the era of the cold war. For instance, in the early 1980s, in

the context of a discussion of a large IMF program with India, the Deputy Managing Director (DMD) stated that the discussion of military spending had to be avoided, in that this was an issue which touched on the core of sovereignty. Since 1993, however, it has been discussed in the IMF's *World Economic Outlook* reports as a major problem of misallocation of resources. In a number of cases, notably those of Pakistan and Romania, it became a central element in IMF discussions. Second, corruption is explicitly addressed: in Africa, but also in Indonesia. Third, so also is democracy addressed, although there is no reference to democracy in the IMF's Articles of Agreement (unlike those of the European Bank for Reconstruction and Development). Fourth, especially in response to the Asian crisis, a critique developed of a feature that had previously been regarded as a linchpin of Asia's economic success – the concept of *trust*, or of strong *informal networks* – and that was now relabeled and condemned as *crony capitalism*. This criticism was linked to the attack on corruption, and *a stable and transparent regulatory environment for private sector activity* was laid out as the solution.

There had been some consideration of human rights issues in the past: in Poland, whose membership application was held up in the 1980s after the imposition of martial law and the internment of political dissenters; or, more discreetly and subtly, in South Africa in the 1980s, where apartheid was attacked as an inefficient labor practice. But the scale of the discussion of political issues in the mid- and late 1990s is novel. To take an example: there was no discussion of political issues in Article IV consultations with Indonesia until June 1997, when these issues suddenly appear and are addressed quite directly as a need for political reform. The extension of the IMF into these areas is an immediate result of the new consensus about economic practice and of a new world political order that it has helped to produce. But it reflects something more profound – a realization increasingly shared throughout the world that the world economy, and world institutions, can be a better guarantee of rights and of prosperity than some governments, which may be corrupt, rent-seeking, and militaristic. Economic reform and the removal of corrupt governments are preconditions both for the effective operation of markets and for greater social justice. Indeed, these two results, far from being contradictory as some critics imagine, are complementary.

The new approach may produce greater global prosperity and stability. By helping to provide markets with better information, ensuring greater transparency, and limiting the irrational destructiveness of financial crises, the IMF can help markets operate more efficiently. But questions arise concerning the degree to which the IMF can be *evenhanded* in its treatment of all its members.

First, one of the most fundamental issues is the political counterpart to the criticism expressed by Paul Volcker, former Chairman of the U.S. Federal Reserve System, of IMF economic programs: "When the Fund consults with a poor and weak country, the country gets in line. When it consults with a big and strong country, the Fund gets in line. When the big countries are in conflict, the Fund gets

out of the line of fire." Addressing the issues of military expenditure, corruption, and undemocratic practices is easier for international institutions in the cases of small countries, or even politically isolated countries. But it is likely to be hard and controversial in large states with substantial military and economic potential – for instance, China or Russia. Discussion of such issues inevitably plays a major role in domestic politics. In Russia, this kind of criticism of international institutions has made most effectively by liberal opposition politicians such as notably Grigory Yavlinksy. They explain the problems and failures of Russian reform programs by unwillingness of the international community to go far enough in attacking corruption and in imposing reform from the outside. In other cases, conditionality will be interpreted as a blatant attempt to impose Western values in the hope of restraining or even crippling potential competitors (a criticism frequently voiced, for example, by Mahathir Mohamad, the former Prime Minister of Malaysia).

Second, the IMF’s financial capacity is limited. The amount of money involved means that only a very few big crises can be dealt with at a time. This was the near panic fear of 1998. We are clearly not yet out of the woods on this issue. Indeed it is possible to imagine in the future a program with China that could not be dealt with by an institution of the present size of the IMF. With that, the institution would be back to the dilemma of interwar institutions, such as the League of Nations or the Bank for International Settlements that attempted policy advice and stabilization but simply did not have the resources in the face of market panic.

Third, there is also the question of the IMF's institutional capacity for implementation. Some recent programs and statements also go into such issues of economic organization as the dismantling of cartels, the improvement of accounting practices, and banking supervision. On the one hand, it is easy to see the macroeconomic effects of the organizational or structural flaws criticized by the IMF. On the other hand, correcting them takes the IMF into completely new areas in which it has no previous experience. It is clearly experienced in fiscal affairs and in advising on central bank policy, but not in wide-ranging reforms of the financial sector or in accountancy. The detailed reorganization of corporate balance sheets in order to ensure greater transparency – which is incidentally also a problem in many industrial countries – is a less appropriate task for international institutions than for private sector consultants and accountants. The gains, after all, will directly benefit the companies undertaking the reforms.

Fourth, and most fundamentally, this process of adding new expectations could create a dangerous momentum of its own. Part of the discussion of the late 1990s in the U.S. Congress on an IMF quota increase involved the issue of whether to integrate environmental and labor standards into IMF programs. Congressional conservatives wanted to add clauses restricting the use of public funding (that might be held to derive from IMF loans) for abortion. Many of the IMF's member countries rightly feel that economic reform programs must be responsive to social and humanitarian concerns. But the amplitude of such an agenda may produce an

expectations trap. The more the IMF is seen to extend its mandate, the more it will be expected to undertake, and, inevitably, the greater the challenge it will face in trying to live up to the demands. This is largely what happened in the 1990s: with financial globalization, the IMF seemed to be on the one hand more powerful, and on the other hand less capable of influencing events.

The IMF after 1998 clearly recognized the need to resist institutional overstretch: to ensure that its mandate is limited, clearly defined, and subject to realistic assessment of results. The review of conditionality in 2002 tried to adopt a more flexible approach, and to play up the element of country *ownership*, i.e. political responsibility for the formulation of effective policy response. But it is important to recognize that the mission creep of the 1990s was not simply the result of a bureaucratic power drive, but reflected a real difficulty in designing appropriate and credible institutions in a world in which capital moved more freely.

4. Conclusion

The problems raised by the new mobility of capital, that Bretton Woods had intended to constrain, are not capable of being simply dealt with by the adoption of a new framework of rules or laws. In that sense, Bretton Woods cannot really be reinvented; and the analogy with the trade area, which is appropriately the domain of international law-making, is not correct. But the problems are certainly real, and demand a considerable extent of institution building. This is a complex process, and not always easily done from the outside or on a global scale. Above all, it requires the elaboration of generally applicable rules if it is to be legitimate, rather than case by case interventions, which may foster discontent and resentment. Let me conclude on an Austrian note. Thinking back to the circumstances of 1944, a work which John Maynard Keynes read on his way to Atlantic City and Bretton Woods contains some useful advice. In *The Road to Serfdom*, F.A. Hayek wrote:

"Though there are no doubt many people who honestly believe that if they were allowed to handle the job they would be able to settle all these problems justly and impartially, and who would be genuinely surprised to find suspicion and hatred turning against them, they would probably be the first to apply force when those whom they mean to benefit prove recalcitrant, and to show themselves quite ruthless in coercing people in what is supposed to be their own interests. What these dangerous idealists do not see is that where the assumption of a moral responsibility involves that one's own moral views should by force be made to prevail over those dominant in other communities, the assumption of such responsibility may place one in a position in which it becomes impossible to act morally. To impose such an impossible moral task on the victorious nations is a certain way morally to corrupt and discredit them." (p. 169)

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