India and Bretton Woods II

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The G-20 meeting in Washington on 15 November is an opportunity for India to help shape the new global economic architecture in line with its strategic interests. India should propose short-term crisis response actions and suggest a clear medium-term agenda. On the former, India needs to support globally coordinated actions to help limit the economic downturn, including a political commitment by all countries to keep markets open.

The medium-term agenda would have, first, reforming the financial architecture, including by strengthening the International Monetary Fund's capacity to respond to crises and enhancing its legitimacy through radical governance reform to give greater say to the emerging powers. Second, securing openness of the trading system, which would require going beyond completing the current Doha agenda in two ways: deepening rules in existing areas (especially services) and developing rules in new areas (to deal with undervalued exchange rates, cartelisation of oil markets, investment restrictions and environmental protectionism). Third, reforming governance of the meta-process for global decision-making, including through the creation of a more representative membership than the G-7.

We are grateful to Ralph Bryant, C Fred Bergsten, Josh Felman, Morris Goldstein, Vijay Kelkar, Deena Khatkhate, Pratap Bhanu Mehta, Nandan Nilekani and Ted Truman for helpful discussions and comments. These views are those of the authors and do not necessarily represent the views of the institutions they are affiliated with.

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Fareed Zakaria, editor of *Newsweek* and foreign policy pundit, has asserted that the Indian state is too weak to harness power to purpose, national or international. The proposed Bretton Woods II summit that the European Union (EU) and United States (US) have summoned offers an opportunity for India to prove the sceptics wrong. This summit is an opportunity for Indian leaders and intellectuals to step up and help shape the new global economic architecture.

It may well be that this whole enterprise will be one of obligatory, crisis-induced platitudes and piety, leading to nothing. But it is still important for India to begin developing and articulating its vision and objectives for Bretton Woods II (BW II).

1 Why Should India Engage?

India has always favoured multilateralism. But it was a defensive multilateralism stemming from the ideology of economic self-sufficiency. The underlying objective of Indian participation was the zealous safeguarding of India's sovereignty: in Strobe Talbot's description, India was a "sovereignty hawk". Whether in regard to conditionality associated with borrowing from the World Bank and the International Monetary Fund (IMF) or trade rules in the General Agreement on Tariffs and Trade/World Trade Organisation (GATT/WTO), India has tried its best to minimise having to do what it would otherwise not want to do. In the trading system, for example, India took upon itself the role of leader of the Group of 77 developing countries that lobbied hard and strong through the 1960s, 1970s, 1980s, and even some of the 1990s, to preserve the right to protect its economy through tariffs and quotas. Even India's liberalisation was to be undertaken at its own pace rather than be dictated by trading partners.

For reasons described below, India will continue to have a strong stake in multilateralism. But new developments, including India's growth and global integration, will require moving away from the defensive multilateralism to one that is more consistent with its new economic interests.

1.1 India's Continued Stake in Multilateralism

For a number of reasons, India will need the multilateral economic system and cannot manage economic relations on an exclusively bilateral, unilateral, or regional basis.

India Will Not Be an Economic Superpower: Meghnad Desai put a dampener on India's global aspirations when he recently prophesied that "China will be a great power, but India will just be a great democracy". Indians chafe at this prognostication. But is it right?

Acquiring Great Power status seems to have three prerequisites – economic size, comprising a large and dynamic economy both in its domestic and international dimensions, military might (including an arsenal of nuclear weapons), and some form of "soft" power. Where does India stand now and where will it be in the future, say in 2025?

Table 1: Size and Prosperity 2005 and 2025 (Est)
(trillion for GDP and billions for GDP per capita)

	GDP ($)	GDP (PPP dollars)	GDP Per Capita ($)	GDP Per Capita (PPP dollars)
2005				
US	12.4	12.4	41.7	41.7
China	2.2	5.3	1.7	4.1
Japan	4.5	3.9	35.6	30.3
Germany	2.8	2.5	33.8	30.5
India	0.8	2.3	0.7	2.1
UK	1.9	2.2	37.3	31.6
Russia	0.8	1.7	5.3	11.9
Brazil	0.9	1.6	4.8	8.6
2025				
China	10.5	24.9	6.7	15.8
US	22.4	22.4	75.3	75.3
India	4.0	12.0	2.7	8.2
Japan	5.9	5.0	46.1	39.2
Brazil	2.6	4.6	11.6	20.8
Germany	4.1	3.7	50.3	45.3
Russia	1.5	3.4	10.6	23.6
UK	2.8	3.3	55.4	46.9

Source: Subramanian (2008).

With the approval of the US-India nuclear deal, India's possession of nuclear weapons has now been internationally legitimised. Various dimensions of soft power help India's image and standing internationally. These include a vibrant, pluralistic democracy – the legacy of Mahatma Gandhi, Nehru and other early Indian leaders, and growing cultural influence ranging from Salman Rushdie and other writers to Bollywood's film exports.

The rapid growth in the Indian economy since the early 1980s (about 6% per year), and the further acceleration over the last five years (about 8.6% per year) have served to rescue India from the languid Hindu-growth pace into one of economic dynamism. Despite the slow pace of policy reform and external shocks, economic dynamism is likely to endure. The central tendency of estimates of medium-term growth for India is still about 6-7% per capita growth.

Even at these growth rates, however, India may not attain the economic heft sufficient to guarantee entry into the ranks of the Great Powers. As Table 1 shows, at plausible growth rates, India will, by 2025, be a distant third behind China and the United States in terms of GDP (measured in PPP dollars) and a distant fifth behind the US, China, Japan and Germany in terms of GDP measured in dollars.

As far as the international dimension of economic size is concerned, while India has made rapid strides, it remains a relatively small trader, ranking in the third decile in terms of global trade in goods and services list (Table 2, p 64), and occupying a similar position on the foreign direct investment (FDI) list. And even if the torrid pace of recent Indian trade growth is maintained, it would still lag considerably behind a number of countries – US China, Germany, Japan, France and the United Kingdom (UK) – in 2025.

The bottom line is that on the crude economic prerequisites of size, India will not be in the top three or even top five countries. *Great Economic Power* status will remain elusive.

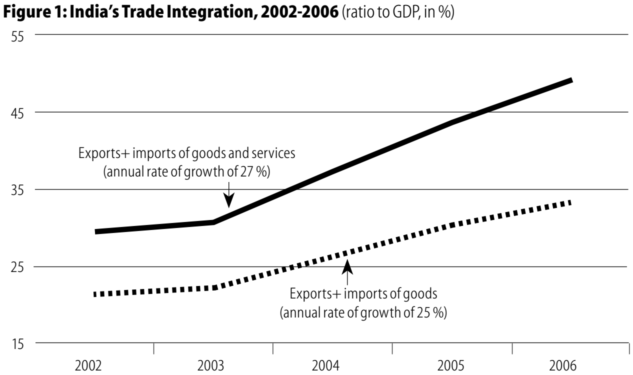
At the same time, India is too large and too independent to enter into deeper forms of economic integration with any of the major powers. Thus, regional or bilateral arrangements will never be an exclusive option as it has become for many of the Latin American or eastern European countries.

India will therefore inhabit the murky middle. It will not be an economic superpower over the foreseeable future that is able to manage economic relations on an exclusively unilateral, bilateral or regional basis. Nor will it be willing to give up its sovereignty as part of regional or bilateral arrangements.

Multilateralism Remains Preferred Strategy for Engagement with Large Powers: China's emergence creates opportunities but also poses challenge. Growing trade links between India and China illustrate this duality. China has, within a very short period, become India's largest source of foreign goods, accounting for about 12% of all Indian imports, up from 3.8% in 2000 (see Table 1 in Subramanian (2008)). China is still not the largest market for Indian exports (it ranks third) but here too recent growth (of over 36% a year for the last five years) has been the most dynamic compared with exports to other markets.

This trade is highly beneficial to both countries but it also carries with it the potential for some conflict in trading relations. For example, a few years ago, there were howls of protest in India against allegedly "dumped" imports from China. In the event, the issue lost salience but it can easily resurface. Recently, the implications of China's exchange rate for competitiveness created concerns for India as did China's acquisition of extensive stakes in natural resources in Africa. India will, of course, engage with China, even on economic issues, on a number of fronts, bilateral and regional. But, at least as a forum of last resort the multilateral option needs to be available and open. The one virtue of the multilateral forum as a means of engaging China is the possibility of leveraging the US and EU in those instances where India's interests coincide with them and diverge with the interests and positions of China.

Figure 1: India's Trade Integration, 2002-2006 (ratio to GDP, in %)



Source: World Development Indicators, World Bank.

By the same token, another reason for ensuring the strength of current multilateral institutions is that they will continue to be important in dealing with the other major economic partners – the EU and US. Sure, the recent nuclear agreement was a largely bilateral effort between India and the US. It is also true that India is negotiating a free trade agreement with the EU. But India is unlikely to enter into deep integration agreements with these countries. And on some issues such as the environment, India's interests may be closer to China's than those of the US and EU.

1.2 India's Growing Stake in Global Openness

India is growing rapidly and also integrating rapidly with the world economy. On the policy side, tariffs and other import restrictions have come down sharply (Figure 1, p 63); FDI has been liberalised, and policy constraints on the inflow of other forms of foreign capital have been significantly eased (IMF 2008). This liberalisation has created an economic stake for foreigners and foreign business in India.

These policy changes have been reflected in actual flows of goods and services. India's ratio of trade to GDP has risen sharply in the last few years. More dramatically, net capital inflows of GDP have surged and at end-2007 were close to 13% of GDP, substantially greater than net flows into China.

Indian growth has come to rely increasingly on its exports of goods, services, capital and skills. Moreover, the pattern of growth has been unusual, what we would describe as the *Precocious India* phenomenon. In manufacturing, it has been producing and exporting an unusually high degree of skilled-intensive goods (see Kochhar et al 2006). At the same time, India's exports of services have been growing rapidly, at an annual average rate of 34% between 2002 and 2006. Even allowing for some natural slowdown, exports of services could easily reach $400-500 billion over the next 10 years and account for about 20% of GDP. The IT-sector could continue to define the zeitgeist of the Indian economy for some time (Kapur 2002).

Table 2: World's Top Traders of Goods and Services, Today and 2025 (in US $ billion)

	2004		2025 (Proj)[1]
United States	2972	China	11765
Germany	1957	Germany	12183
China	1262	Russian Federation	10804
United Kingdom	1184	United States	9381
Japan	1136	India	7147
France	1056	Singapore	6094
Italy	862	Korea, Republic	5763
Netherlands	771	United Kingdom	4960
Canada	714	Spain	4739
Hong Kong, China	616	Italy	4715
Belgium	585	France	4668
Spain	578	Netherlands	4516
Korea, Republic	570	Japan	4111
Singapore	466	Poland	3798
Mexico	418	Belgium	3645
Russian Federation	334	Saudi Arabia	3395
Switzerland	305	Hong Kong, China	3178
Sweden	293	Ireland	2628
Austria	286	Canada	2148
Ireland	278	Thailand	1972
India	266	Austria	1902
Malaysia	262	Mexico	1538
Australia	260	Switzerland	1498
Thailand	221	Malaysia	1414
Denmark	210	Sweden	1381
Poland	195	Australia	1344
Saudi Arabia	194	Denmark	1303

1 Assuming growth rate for the period 1999-2004 is maintained. For China, projected growth rate is half that for 1999-2004 period.
Source: Subramanian (2008).

Second, in an unprecedented development, India is becoming an exporter of managerial and entrepreneurial capital, i e, an exporter of FDI. Figure 2 (p 65) illustrates this phenomenon most starkly. In 2007, while China was a much larger importer of FDI (now by a factor of about 3 – $75 billion for China versus $25 billion for India), India was a larger exporter of FDI. In dollar terms its outward FDI is almost as great as China's ($14 versus $18 billion) but as a share of GDP it is substantially greater.

In the last two years, Indian companies have made a series of high profile acquisitions of foreign companies (see Ramamurthi and Singh 2008). Unlike in the Chinese or Russian case, virtually all the Indian FDI has been outside the natural resource sector and a lot of this FDI has been uphill, going to the richest industrial countries rather than to poor resource-rich countries. Moreover, Indian exports of FDI have been impressively diverse in scope – in steel, IT, electronics, pharmaceuticals, consumer products, hotels, automotives, and even wind energy. Figure 3 (p 65) plots exports of FDI by a select group of countries to the OECD (this is a measure of what we call uphill flows). Strikingly, India is the second-highest exporter of FDI to rich countries and is doing so at a much earlier stage of development.

All these developments suggest that open foreign, and in particular industrial country, markets – for India's goods, services, and capital – will be essential for its growth.

2 How Should India Engage?

India should ensure that the BWII process has not only a short-term agenda that is devoted to responding immediately to the international financial crisis, but also a medium-term process where the important but less urgent issues relating to agenda and governance structures are addressed.[1]

2.1 Short-term Crisis Response

Since the most important thing in the short run is to limit the global economic downturn, at the 15 November summit, India should (see the note by Morris Goldstein at http://www.petersoninstitute.org/realtime/?p=146 for details):

- support/call for a globally coordinated (among the G-20) macroeconomic stimulus.
- back recent liquidity support being made available by the IMF and the US Federal Reserve (and perhaps even call for support, especially the latter, to be extended in time and across countries);
- call for coordinated currency intervention to prevent any strong and sustained rise in the US dollar (India at this stage has an interest in preventing a sharp dollar rise because of the flip-side pressure on the rupee and, as we discuss below, the risks of protectionism it creates in the US down the road).

Most importantly, India should call for a clear political commitment by all countries to keep markets open and not to impose protectionist measures.

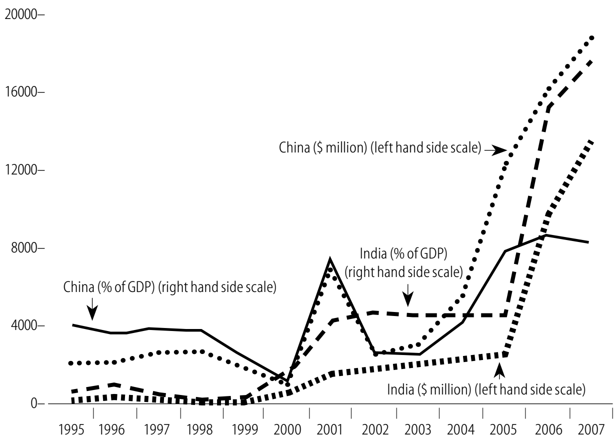
2.2 Medium-term Issues

Given the ongoing financial crisis, it is likely that the international community will focus on short-term crisis management and issues related to the international financial architecture. That is as it should be. But the crisis should also be seen as an opportunity to address a broader agenda of issues that crave multilateral cooperation (the summary of all our proposals is in Table 3, p 67).

(a) Finance and the IMF: On the financial side, the major issues for India are the size of the IMF and its governance. The current crisis makes clear that for the IMF to be effective, it must have the financial resources to be able to respond to financial crises. With capital flows exploding (a trend that is likely to continue unless countries erect serious barriers to these flows), the IMF will need more resources.

The strategic choice for India is between a big, and hence strengthened, IMF, and once that, once the crisis is past, reverts to being relatively small and of diminished relevance.

Figure 2: FDI Outflows 2007



Source: *World Investment Report* (2008), UNCTAD.

From a narrow perspective, and given the relatively small probability of India needing recourse to crisis financing in the future, it could be argued that India has no stake either way. The arguments for a bigger IMF stem from a broader strategic view.

First, a larger IMF offers some insurance value, however small, of directly protecting against future financial crises. Second, the IMF can play useful systemic roles. For example, in crises like the current one, effective IMF intervention can help limit global spillovers, which will have greater value for India as it progressively integrates internationally. The IMF can also serve as guardian of the international financial system through analysis and surveillance more broadly, for example, of misaligned exchange rates. Third, a weakened IMF will inevitably lead to efforts to create alternative financial arrangements, regionally or otherwise. A likely alternative is financial arrangements within Asia. Would it suit India better to participate in these regional arrangements under these circumstances or to strengthen the IMF with China and East Asia, anchored in it?

The size of the IMF and its governance are intimately related. On the one hand, if governance structures within the IMF are not radically altered, there will be little incentive for China and other Asian economies to want to create a bigger IMF. On the other, the crisis and the need for a bigger IMF with greater resources actually create an incentive for the US and EU to be more open to reforming governance because countries such as China now have the resources to contribute to increasing the IMF's size.

It would be in India's interests to call for a fundamental re-think of the IMF, emphasising the following principles:

First, the IMF's mission should be flexible in that its mandate should be broad enough to address all types of economic and financial crises and it should be able to access a large pool of resources to address these crises. In practice, this would translate into India expressing a preference for expanding IMF resources.

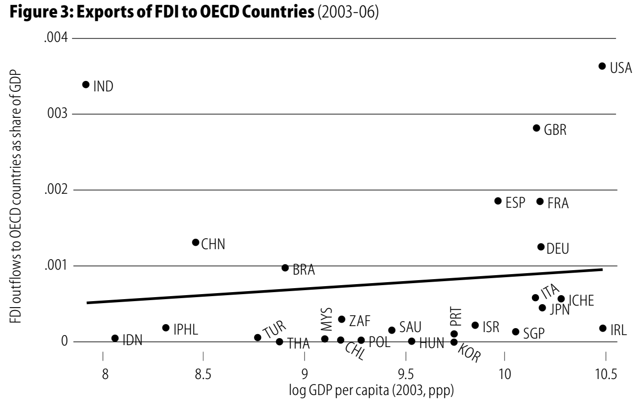
On governance, the new architecture should reflect new economic realities. Voice and participation should reflect the economic power of the large and rapidly growing countries. The industrial countries (G-7) need to cede and share power. This effort must go beyond narrow quota reform and aim to create a genuine sense that new powers have an important role in the system. In a truly ambitious and cooperative framework for the future, it is not obvious why, for example, the US and EU should retain veto rights in the IMF. In the Appendix 1 (p 70), we discuss illustrative proposals for determining the size of the IMF's aggregate resources as well as their allocation among countries. Under these proposals, India would see its quota share rise.[2]

A related aspect of governance is, of course, the selection process for the heads of the BW institutions. Here, India should continue to support the need for a clear, transparent, and principles-based process for selection. Merit and not nationality must be the key principle guiding the selection of the managing director of the IMF. This idea has been gathering support for some time and is being resisted by the major powers.

(b) International Financial Regulation: As India allows more foreign financial institutions to establish domestically and as its own institutions venture abroad, it has an increased stake in international regulatory cooperation. Such cooperation would define standards of prudential regulation and for policies during financial crises.

Discussions on regulatory architecture will need to address the fact that finance is global while regulation remains predominantly national. For example, it is becoming clear that any reconfiguring of the financial system in the US and UK will involve limiting leverage. Policymakers are likely to favour higher capital adequacy and also specific debt limits not just for traditional banks but for a widening array of non-banking financial actors. These

Figure 3: Exports of FDI to OECD Countries (2003-06)



Source: Mattoo and Subramanian (2008a).

standards tend to become de facto international standards and have an important influence on national policies.

Another aspect of international financial regulations that is, and likely to become more important for India relates to the rules on resolution of banking crises involving banks with cross-border operations. Branches of Indian banks are proliferating overseas and in the event of a crisis, it is still very unclear how they will be treated by their host country regulators as part of crisis resolution efforts. India should therefore push for clear multilateral rules in this regard to ensure equitable burden sharing between taxpayers and shareholders in different countries in rescue operations.

Figure 4: Restrictions on Services and Goods Trade

Line indicates the mean value.

Source: Gootiz and Mattoo (2008).

These efforts at developing and applying international standards will require coordination among institutions such as the IMF, Basel Committee on Banking Supervision and the Financial Stability Forum (FSF) which deal with financial regulation. Many countries such as India are not currently members of these latter fora and should therefore press for expanding membership. India needs to be an active participant in discussions shaping the future regulatory architecture.

(c) Maintaining Global Openness: As discussed above, India has an enormous stake in ensuring that global markets remain open. Until very recently, India could have been sanguine about the prospects of markets remaining open. But the likely deep and prolonged recession in the US and EU and the strengthening dollar[3] could act on pre-existing anxieties about globalisation (stagnant median wages and increasing inequality) and lead to a resurgence of protectionist pressures.[4] Some intellectuals have begun to question whether keeping markets open is always desirable and sustainable. Opinion polls suggest that public support for free trade has dropped sharply.

A Democratic administration in the US combined with a Democratic Congress may be subject to significant pressures. Extensive government support for the financial sector will encourage others to line up for government help. And while conventional trade barriers may not be erected, there is a lot of scope for favouring domestic producers through subsidies, barriers disguised as regulations and invoked for environmental and other reasons. India can no longer take for granted the openness of foreign markets.

The problem for India is that its emphasis on openness will lack force because it has earned a reputation for being a reluctant policy reformer and a difficult negotiating partner (e g, in the Doha negotiations). And this perception, especially of the general stance of India's policies, has some basis despite the significant liberalisation it has recently undertaken. Figure 4 plots the trade policies of a group of countries in goods (x-axis) and services (y-axis). Points to the north and east correspond to restrictive policies. India stands out as a complete outlier in being the most protected in goods and services. The point is that India cannot maintain this asymmetry of trade policies and be a champion of openness worldwide.

At this stage, India has two options to secure openness abroad as well as more open markets at home.

The less ambitious option would be to play a more constructive role in the swift completion of the Doha round of the WTO. Playing this role would address the perception that India is a foot-dragger in trade negotiations. Moreover, completing the Doha round on the terms that were broadly on offer earlier this year when the talks collapsed would not entail significant economic policy changes and hence any serious dislocations. Essentially, India would have to give up the right to protect in the future in agriculture (a right that it would not entirely give up because the wedge between India's tariff bindings and actual tariffs would still be considerable).

Even a successful Doha would, however, have only a limited effect in heading off protectionist pressures in the US and EU, and would not lead to any significant liberalisation at home. As a more effective way to forestall these pressures, India could call for much more ambitious new trade negotiations with a more consequential agenda. For such a call to be credible, India would have to signal a willingness and commitment not merely to give up the right to increase protection but to significantly open up its markets to foreign trade and investment. A more consequential agenda would involve deepening trade rules in existing areas, and negotiating rules in new areas.

The deepening of the old agenda would include: in manufacturing, strengthening rules on contingent protection (for example anti-dumping actions);[5] in agriculture, seeking deeper cuts in import protection and subsidies as well as disciplines on export restrictions; and in services, obtaining more secure access for cross-border exports of business and other services, greater scope for the movement of at least skilled service providers, and stronger disciplines against regulatory barriers to trade.

Rules in new areas would include: disciplines on sustained and policy-induced undervalued exchange rates; pro-competitive regulation of the cartelisation of oil markets; stronger rules to guard against investment protectionism; and disciplines to ensure that environmental concerns are not invoked to impose trade restrictions (elaborated in Mattoo and Subramanian 2008b).

On exchange rates, what is needed is a rule in the WTO proscribing sustained and policy-induced undervalued exchange rates, which are in effect a combination of export subsidies and tariffs, each of which is currently disciplined by the WTO. We envisage a more effective delineation of responsibility, with the IMF continuing to play a technical role in assessing when a country's exchange rate was undervalued, and the WTO assuming the enforcement role.

It is one of the striking omissions of the trading system that there are no multilateral rules on collusive government restrictions affecting the most important globally traded commodity – oil. Collusive government action in oil markets is against the spirit of open multilateral trade. Multilateral rules would ideally target collusive action designed to charge monopoly prices without precluding action to stabilise prices or conserve natural resources. The preferred course of action, drawing upon precedents in the WTO, would be to bring together the producers (The Organisation of Petroleum Exporting Countries (OPEC)) and the consuming countries (represented, for example, in an expanded International Energy Agency (IEA)) to design the necessary arrangements.

The growing international presence of Indian multinationals creates an interest for India to forestall investment protectionism. At the same time, its openness to foreign inflows implies that it shares widespread concerns about investment by foreign government – controlled entities (sovereign wealth funds (SWFS)). A mutually beneficial bargain between capital exporters and importers is possible and the WTO may be an appropriate forum as it already regulates private and government investments in key services sectors. On the one hand, capital importing countries would commit not to imposing undue restrictions on foreign investments, including by SWFS. In return, SWFS would commit to certain standards of behaviour (transparency, arms-length relationship with governments, and pursuit of purely commercial objectives), building on the recent voluntary code of conduct for SWFS negotiated under the auspices of the IMF.

As concern for climate change grows, there is increasing talk of using trade as an instrument for furthering environmental objectives. The most prominent climate bills in the US Congress (Lieberman-Warner and its predecessor from senators Bingaman and Warner) all envisage some form of trade restrictive action against imports from countries that are not deemed to take "comparable action" to that of the US. The EU too has been contemplating similar action.[6] The international community – representing environmental and trade interests – will have an opportunity to determine the trade-climate change regime next year. These negotiations should take place without the threat of trade sanctions, which will only vitiate the atmosphere for cooperation, especially because major developing countries feel that industrial countries have been primarily responsible for the climate change problem. Furthermore, if the negotiations are successful in getting all countries to agree on a path of carbon emission, the need for trade restrictive actions on competitive grounds will also be largely rendered moot.

Table 3: Summary of Proposals

Policy Area	India's Objective	Proposals on Substance	Proposals on Governance
Finance	Systemic stability through:		
	Credible mechanism for crisis response	Expansion in IMF resources, related to gross international capital flows, and adequate to deal with systemic crises. Actual size could evolve over time. Extra resources will require increased contributions from all countries. Could also come from credit lines extended by new powers (China, India, etc).	Eliminate effective veto of the US and EU in the IMF; Allocate quotas on the basis of variables that reflect ability to contribute and economic status rather than potential financial need; quotas and voting rights should evolve automatically. Use GDP at purchasing power parity (and population) as measure of economic status. End monopoly of US and EU on jobs of heads of the Bank and Fund; change to a transparent, principled, and merit-based procedure.
	Effective regulation	Elaborate new prudential norms and mechanisms for burden sharing during crises Signal willingness to complete Doha.	Expand membership of Financial Stability Forum (FSF) and Basel Committee on Banking Supervision to include new economic powers.
Trade, Investment	Sustain openness	Because Doha will not fully secure openness in all areas of India's interest, propose a more consequential agenda that involves deepening multilateral rules in existing areas and extending them to new areas. Deepening of traditional agenda would include: – in manufacturing, strengthening rules on contingent protection (for example, anti-dumping actions); – in agriculture, seeking deeper cuts in import protection and subsidies as well as disciplines on export restrictions; and in services, obtaining more secure access for cross-border exports of business and other services, greater scope for the movement of at least skilled service providers, and stronger disciplines against regulatory barriers to trade. New agenda would include: Disciplines on sustained and policy-induced undervalued exchange rates; Pro-competitive regulation of the cartelisation of oil markets; Stronger rules to guard against investment protectionism; Disciplines to ensure that the environment is not invoked to impose trade restrictions	Over-democratisation of the governance of the WTO is inhibiting progress, in particular by conferring veto powers on small and poor countries whose interests are only imperfectly aligned with those of an open and efficient trading system. Depart where necessary from the Uruguay round model of a single undertaking where all parties negotiate on all issues, and are equally bound by any resulting rules. Instead subsets of WTO members should be able to negotiate among themselves, and as appropriate extend the benefits to all other members- i e, negotiations should allow greater scope for variable geometry. Collaboration between IMF and WTO, with IMF providing technical inputs into the WTO's enforcement procedures Collaboration between oil producers (OPEC) and oil consumers (IEA, with an expanded membership), to jointly reconcile goals of competitive access, price stabilisation and conservation of natural resources. Collaboration between WTO, IMF, OECD and other concerned organisations to reconcile capital exporters desire for secure access to foreign markets, and capital importers concerns about investments by government-related entities. Cooperation between WTO and climate change negotiating process to ensure that the threat of trade sanctions does not vitiate the attempt to secure an equitable agreement on climate change and to preclude the use of trade measures on environmental and competitiveness grounds.
Meta-process	Increased say in major decisions on global economic governance	Enlarge the G-7 to become a more representative decision-making body Make sure that this enlarged body becomes permanent, albeit with membership that evolves to reflect economic status. Ensure meta-process takes stock of progress on the ongoing agenda, and decide on which issues need to be addressed and how.	Illustrative proposal for selection of enlarged group: Achieve representational legitimacy by ensuring that all (eight) regions are represented, and effectiveness by requiring that only some countries within each group get a seat at the table. This proposal would lead to an MP-15 (meta-process 15) comprising 15 countries: the US, Brazil, Mexico, Germany, UK, France, Russia, South Africa, Nigeria, Iran, Saudi Arabia, Egypt, India, China, and Japan.

The WTO too faces governance challenges, stemming in particular from the situation of the small and poor countries. This challenge has arisen because of the conjunction of two elements. On the one hand, because of the Uruguay Round's Single Undertaking, small and poor countries have acquired a significant say and legal influence in WTO decision-making. On the other hand, their interests are only imperfectly aligned with those of the system. It is not necessary, and may not even be desirable, that future efforts follow the Uruguay round model of a single undertaking where all parties negotiate on all issues, and are equally bound by any resulting rules. It was this over-reach of the Uruguay round that may have encumbered its successor with a constant and ultimately unsuccessful striving for a set of rules that would be uniformly applicable to an increasingly diverse membership.

The fast-moving nature of the issues we have identified will require flexibility and speed of response. Some of these issues can only be effectively negotiated by a subset of the most concerned countries. In some cases the benefits of agreed rules could then be extended to all WTO members (as in the WTO's information technology agreement). But this most favoured nation (MFN) obligation must not inhibit cooperation between smaller groups of countries in new areas. For example, advances in GATT/WTO rules on government procurement, subsidies, standards, and antidumping (i e, the Tokyo Round Codes) were facilitated by allowing participants to deny the benefits of the deeper obligations they assumed to nonparticipants. The key point is that negotiations should allow greater scope for variable geometry.

(d) Governance of Institutions and Meta-process: In the context of BWII, governance can relate to individual institutions and crucially also to a meta-process that transcends these institutions. The nature of governance differs across, say, the IMF (and the related financial institutions) and the WTO. In the former, governance reflects an antiquated structure that harks back to the receded economic realities of the post-second world war era. Here the effort must aim to create a genuine sense that new powers are part of the system and that the system is as much for them as anyone else. In contrast, as discussed earlier, the governance problem in the WTO is over-democratisation and the impediments that creates for further liberalisation and rule-making. In each case, we have made suggestions for governance reform. We now turn to the governance of the meta-process.

The original BW institutions were created by a meta-process: the Bretton Woods conference in 1944. It was a one-off event, albeit stretched out over three years (1941-44), where a few people wrote the rules of the game for the international economic architecture. If the rules of the economic architecture are going to be re-fashioned, there would similarly need to be a new meta-process. Such a process is also necessary because of the cross-cutting nature of some of the issues and the fact that decisions involving systemic change must be taken at the highest political level.

In practice, of course, the world currently does have a meta-process – the G-7. But its legitimacy – largely because of its narrow membership – is increasingly being questioned. For the first BWII summit in Washington DC, US President Bush has invited the G-20, conferring some quasi-legitimacy on this group. It is a signal of the need for and acceptance of a more representative meta-process.

Recently, World Bank President Robert Zoellick has called for the creation of a G-14, comprising the existing G-7 and adding Brazil, Russia, India, China, Mexico, South Africa, and Saudi Arabia. Neither the G-14 nor the G-20 may be the ideal groups. Their composition is not based on some clear underlying principle. One reason for any governance structure to be rules-based is that it allows for organic change in the group as circumstances evolve instead of keeping membership fixed.

In deciding on the composition of the meta-process, it seems important to combine or respect two principles of legitimacy: representativeness and effectiveness. Any meta-group has to be broad enough that all distinct groups countries feel they have a voice; and yet not too broad as to become unwieldy and ineffectual (a criticism for example of the WTO negotiating process). We spell out in Appendix 2 (p 70), as a purely illustrative exercise, the composition of a meta-process that meets these requirements and leads to an MP-15 (meta-process 15) comprising 15 countries: This group would comprise: the US, Brazil, Mexico, Germany, UK, France, Russia, South Africa, Nigeria, Iran, Saudi Arabia, Egypt, India, China, and Japan.

Regardless of the specific membership, the convening of a larger group should not be a temporary, crisis-induced nod to representativeness. Rather, India must ensure that the new meta-process, composed either of the G-20 or some variant, is made permanent and institutionalised. This could be achieved by insisting that BW II be not just a one-off summit but a medium-term process with a clear, well-defined agenda, along the lines discussed above.

What would the meta-process do? This group would meet, as we envision it, periodically at heads of state level to take stock of progress on the ongoing agenda, and decide on which issues need to be addressed and how.

The following three examples illustrate the role that the meta-process could play. Our proposal on regulating undervalued exchange rates was based on cooperation between the IMF and WTO. The rationale for WTO involvement is that there are both large trade and distributional consequences of undervalued exchange rates, and that the WTO's enforcement mechanism is credible and effective. The WTO would not be involved in exchange rate management, and our proposals do not entail the WTO displacing the IMF; rather, they would harness the comparative advantage of the two institutions, with the IMF providing the essential technical expertise in the WTO enforcement process. The meta-process that we envisage could play an important role in facilitating and guiding cooperation between the two institutions on exchange rates.

Or take the case of oil market cartelisation. Successful attempts at addressing this problem will require a degree of cooperation between oil producers (OPEC) and oil consumers. In such a case, there should be scope for bringing together the producer cartel (OPEC) and the consuming countries (represented, for example, by an IEA albeit with wider membership). The meta-process can play an important role in bringing these institutions together.

Finally, the need for consistency and cooperation between trade and environmental rules is becoming evident as the Copenhagen process on climate change negotiations gets under way and as countries start crafting national rules. The meta-process can play a coordinating role between these negotiations and the WTO to ensure the success of these negotiations and also to prevent the proliferation of trade restrictions on environmental grounds. (One collateral benefit of our proposal for the composition of the meta-process is that it includes all the world's major polluters and could hence form the core of the Copenhagen discussions on climate change next year.)

3 Concluding Remarks

One of the few plausible hypotheses about the political economy of reform (Williamson 1993) both nationally and internationally is that there is a greater tendency for reforms to be implemented during or in the immediate aftermath of crises. The magnitude of the current crisis offers a unique opportunity to revisit the fundamental issues relating to the BW architecture. While it is true that long-term reform needs preparation and hence time, this has to be traded off against the declining fervour for reform as the crisis and its memory fades.

From India's perspective, engaging in the BW II process may create a positive spillover beyond the economic benefit. This crisis affords the opportunity, in Prime Minister Manmohan Singh's words, to better align the global polity with the global economy. Achieving the restructuring of economic governance takes India one step closer to seeking legitimacy for restructuring of international governance on security, which for India is a key strategic objective.

Finally, this crisis affords an opportunity for India to punch a little bit above its weight because of its intellectual capital. In the original BW conference, the UK, a clearly declining power, still managed to shape the system to suit its interests because of the input and influence of Keynes and his colleagues. The following ditty captures this influence:

In Washington Lord Halifax
Once whispered to Lord Keynes,
"It's true they have all the money-bags
But we have all the brains."

Today, there is a vacuum in terms of cogent voices from the emerging world, and precocious India, with its unusual endowment of skilled capital, seems to be better equipped than other countries to fill this vacuum.

NOTES

1 In discussing the vision for BWII, we will focus mostly on the trade and financial aspects of reform and not on development finance. This choice is dictated by our view that India will have progressively less stake and interest in development finance as the economy continues to grow rapidly.

2 See also the papers by Ralph Bryant of the Brookings Institution, Ted Truman of the Peterson Institute, and Vijay Kelkar who come to a similar conclusion on these issues.

3 The US is at the epicentre of the financial crisis and yet the dollar has recently strengthened again, after a six-year decline, especially against the Chinese currency. And the large currency declines today – between 30 and 50% in Brazil, Mexico, Korea, and India – will translate into a large set of hyper-competitive trading partners for the US, resulting in loud and insistent calls for protection.

4 Over the last three decades, the most serious outbreak of protectionism in the US happened in the 1980s, when it imposed voluntary export restraints on autos, steel, textiles and many other goods on mainly Japan and other trading partners. It was also a period that saw a sharp rise in anti-dumping and countervailing duties on imports to the US. Protection resulted because the rise in the dollar, driven by the Fed chairman Paul Volcker's sky-high interest rates to counter inflation and president Reagan's budget deficits, severely undermined the international competitive position of manufacturing. Despite the robust recovery of the overall economy after 1982, protectionist pressures became so great that leading congressmen opined that "the Smoot Hawley tariff itself could now pass the Congress by overwhelming majorities" if it ever came to a vote.

5 Historically, such protection tends to increase during economic downturns.

6 The call for restrictive action is heard particularly from producers in energy-intensive sectors in the US (ferrous metals, non-ferrous metals, chemicals, paper and non-metallic mineral products) and is aimed at imports from China and India where environmental standards are especially low.

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Appendix 1: Illustrative Proposal for Determining IMF Quotas and Resources

The current quota formula at the IMF suffers, as Vijay Kelkar has noted, from a classic Tinbergian problem of too many objectives and too few instruments. The quota is used for three purposes: to determine a country's contribution; to assign its voting power; and to benchmark its future level of financing ("access") should it run into trouble.

There are many problems with the current approach (see the excellent series of papers by Bryant (2008a and 2008b); papers in the edited volume by Truman (2005), especially by Truman and Lachman; and by Kelkar et al 2005). But one problem these articles do not note is that it is problematic to have quotas determined by a country's future financing needs. In principle, a country's need will depend on its circumstances during a crisis and its policy responses. The link between need and quotas can be tenuous. Moreover, in practice, especially in the capital market crises of the late 1990s and today, actual IMF financing has been well in excess of quotas and has varied significantly across countries because the magnitude and nature of crisis have been different.

So, our first suggestion would be that the quota formula should not have any variables reflecting a country's potential need for finance (a collateral advantage of this approach is to avoid endless and pointless discussions over which flows better capture need, whether flows should be scaled or not; and whether intra-EU flows should count as part of trade).

The next question is whether the determination of contributions and voting rights should be also decoupled. The argument against such decoupling is the basic and appealing principle that a country's influence should be related to its financial contribution.

So, what then should determine a country's quota? Like Bryant (2004) and Kelkar et al (2005), we believe that quotas should be determined by two factors: a country's ability to contribute and its relative economic status in the world. We would propose that the former be proxied by GDP at market exchange rates. While the latter could be proxied by either GDP at PPP exchange rates alone or some combination of PPP GDP and population, the latter being strongly advocated by Bryant (2008a).

There are two ways of proceeding. One option that would retain the veto shares for the US and EU would be the following. The US and EU would each get the 15% share needed to retain the veto.* This would release about 13-14% of voting rights which could be allocated to those – such as small and poor countries – who might be penalised by any otherwise reasonable formula.

Alternatively, if a genuinely cooperative framework were contemplated, radical governance reform, including the elimination of the veto power of the US and EU should be up for discussion. This variant would actually make the simple application of the formula proposed above difficult because, short of arbitrary and forced contortions, no combination of the proposed variables and weighting schemes would satisfy some widely accepted ex ante requirements: a substantial decline in the share of the EU; an increase in the share of emerging markets; an increase in the share of small countries, especially in sub-Saharan Africa, and no serious decline in the share of some existing large creditors such as Saudi Arabia. In such a case, it might become necessary to increase the basic votes that each country gets (currently 250 per country which in the aggregate amounts to about 2-3% of total voting rights), so that smaller countries obtain more voting rights than would follow from the application of the quota formula.

Thus far, we have discussed only the allocation of quotas between countries. But how would the aggregate size of the pie – i e, the IMF's aggregate resources – be decided?

The essential principles that should guide the size of the pie, drawing from the lessons of the Asian financial crisis and the current one, are that aggregate resources should be related to and evolve with some measure of gross capital flows, and be adequate to deal with systemic crisis (i e, to cater to the contingency that many countries simultaneously need financial assistance).

* One question would be whether the 15% veto should apply to the European Union or the Euro area countries.

Appendix 2: Illustrative Proposal for Composition of Meta-Process

While recent proposals on creating new Gs and indeed the current composition of the G-20 have merit, they suffer from the problem of being arbitrary and not being based on some underlying principle. One reason for any governance structure to be rules-based is that it allows for organic change in the group as circumstances evolve instead of keeping membership fixed.

In deciding on the composition of the meta-process, it seems important to combine or respect two principles of legitimacy: representativeness and effectiveness. Any meta-group has to be broad enough that all distinct groups countries feel they have a voice; and yet not too broad as to become unwieldy and ineffectual (a criticism for example of the WTO negotiating process).

One possibility is based on the premise that all regions of the world need to be represented, to have a voice. The world appears to be divided into regions, reflected not least in the proliferation of efforts to form regional economic and political arrangements. A natural division based on, and adapting, the World Bank's classification, would be: North America, Latin America and Caribbean, Western Europe, Eastern and Central Asia, Middle East and North Africa, Sub-Saharan Africa, South Asia and East Asia, Pacific and Oceania.

Clearly, only a few countries can represent each region to keep the process effective. Our criteria for who represents each group would be simple: each group would be represented by as many countries (in descending order of economic size) as is necessary to ensure that 50% of the region's GDP (measured at purchasing power parity) is represented. One exception to the rule would be the following: if certain regions have economic and political regional arrangements, they could pursuant to them, replace the criterion of economic size and chose the countries they wish to represent the region. There would be a limit that no region can be represented by more than three countries.

Under this proposal, our meta-process would comprise 15 countries, representing all the regions of the world. Thus, the MP-15 would be: the US, Brazil, Mexico, Germany, UK, France, Russia, South Africa, Nigeria, Iran, Saudi Arabia, Egypt, India, China, and Japan.

It is important to note one difference between the suggested approach and the existing G-7 or G-20. Countries in the latter groupings speak for themselves and not obliged to represent the interests of any other countries. By selecting countries to represent regions, our approach creates some obligation for the chosen countries to also stand for the interests of the region as a whole. This proposal would lead to groupings that would function like the constituency system in the Boards of the IMF and the World Bank. For example, in the IMF and the World Bank, there are 24 executive directors representing the 185 member countries.