New Financial Architecture as a Global Public Good

Professor Stephany Griffith-Jones

*Paper prepared for Inge Kaul at UNDP. I am very grateful to Inge Kaul, Amar Bhattacharya, John Langmore, Ricardo Gottschalk and Arnab Acharya for valuable comments and stimulating discussions. I particularly appreciated Inge Kaul's detailed and insightful suggestions.
### Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Introduction</td>
<td>3</td>
</tr>
<tr>
<td>II. Required new architecture and progress so far</td>
<td>5</td>
</tr>
<tr>
<td>A. A new global and regional architecture required to achieve financial stability</td>
<td></td>
</tr>
<tr>
<td>B. What progress on international financial reform?</td>
<td></td>
</tr>
<tr>
<td>III. The politics of the international reform process</td>
<td>10</td>
</tr>
<tr>
<td>A. The broad context</td>
<td></td>
</tr>
<tr>
<td>B. The actors in the reform process and their objectives</td>
<td></td>
</tr>
<tr>
<td>IV. Suggestions for measures to accelerate and deepen international financial reform</td>
<td>18</td>
</tr>
<tr>
<td>Annex 1 Proposal for increasing developing country participation in global financial governance</td>
<td>23</td>
</tr>
<tr>
<td>Bibliography</td>
<td>27</td>
</tr>
</tbody>
</table>
Introduction

International financial stability and efficiency is a very important global public good, especially significant for poor people in developing and emerging countries. Financial stability and efficiency can make an important contribution to development; lack of financial stability - both nationally and internationally - can be an important obstacle to growth, development and poverty reduction. As Wyplosz (1999) points out, financial instability is a global public bad because it spreads across countries; collective public international action is required to overcome it. As we will argue in this paper, there is at present an under provisioning of the international public good of financial stability, which is particularly - but clearly not only - damaging for developing countries. Poor people in developing countries are particularly unfairly and badly hit by financial and currency crises, for three main reasons: a) they are unfairly hit, because they are normally innocent bystanders, who suffer effects of crises, which they played no role in causing. b) they are particularly badly hit because they often bear a disproportionate burden of the cost of crises, and c) last, but certainly not least, the welfare costs for the poor are much higher because their income losses imply falls from incomes which are already very low; indeed they may mean - as in Indonesia in 1998 - that many people fall below the poverty line. Financial efficiency can also make an important contribution to development; however, it is important that financial efficiency is not defined only in its own terms (e.g. via growth of financial assets or reduction of financial inter-mediation costs), even though these variables may play a positive role, but that the key criterion for measuring financial efficiency is its contribution to growth and development; in that context, measures to develop financial institutions and deepen markets, can play an important role.

It should however, be stressed that providing the global public good of financial stability and efficiency is not just in the interest of developing countries and the poor. Quite the contrary! Stable growth in developing countries provides growing markets for developed country exporters and increasing profitable opportunities for developed country investors. Greater prosperity in these countries also reduces potential political instability there and greater pressure for migration to developed economies, both of which could have negative effects for the latter.

More broadly, avoidance of currency crises in developing and transition economies significantly reduces the risk of them spilling over to developed economies, and thus to the global economy; this risk materialised briefly during September 1998, when in the aftermath of the Russian crisis, and LTCM, US credit markets very briefly dried up. Thus, crises prevention and better crises management for emerging markets is an important way to better safeguard global financial stability, which is clearly an important global public good, as well as helping sustain growth in developing countries, the latter also having very positive externalities for the developed economies.

In this sense, the perspective of developing countries, which we outline below - to meaningfully reform the international financial architecture, so it significantly improves both international financial stability and efficiency - is actually in the interests of the global economy. There is an interesting parallel with the situation that emerged at Bretton Woods, where Keynes - by defending the interests of debtor nations such as the UK - was defending also the interests of a more prosperous and
stable global economy. Similarly, if, international measures are taken to help safeguard financial stability and growth in developing countries, these measures will improve the global public goods of stability and prosperity.

This global public good can be de-composed into two parts: a) the avoidance as well as better management of currency and financial crises, which as recent experience has shown are very costly for developing countries and for poor people; indeed, deep and frequent crises in developing countries could undermine achieving the UN target to halve poverty by 2015, and b) the provision of sufficient long-term and sufficient stable capital flows to different categories of developing countries (including low-income ones), so these flows can complement domestic savings, as well as transfer technology and management know-how.

Given the large number, frequency, severity and high development as well as financial cost of recent crises, much emphasis in recent writing has been on combating the global public bad of financial instability. Wyplosz (1999) and others have clearly argued that financial instability is a potential public bad that spreads across countries through negative externalities and that collective action problems have led so far to an under provision of the international public good of financial stability. Instability originates nationally to a certain extent; that is why the provision of the public good of financial stability has to start at the national level. However, this is not enough, due to international spillovers, market failures that are particularly large at the international level and races to the bottom (see, again, Wyplosz, op.cit for an excellent analysis).

There is a growing literature that shows the strong negative link between financial instability and macro-economic volatility on the one hand and growth, investment and poverty reduction on the other hand. The need to overcome the negative impact of this global public bad of financial instability has led since 1998 to an active debate - and some, though very limited action - on international financial reform (see Griffith-Jones 1999). Less emphasis, and even less action, has been placed on the second task described above, that is the provision of sufficient long term capital flows (both private and public), to different categories of developing countries, and especially the poorest. (For a review of these latter issues, see for example Griffith-Jones, Ocampo with Cailloux, 1999).

From the perspective both of developing countries, and of the global economy, it is crucial to: a) make concrete and significant progress in the implementation of a new international financial architecture; this new architecture (drawing on the extensive discussion which has already taken place) would facilitate the provision of the global public good of global financial stability, which is deeply under-provided, and b) develop a conceptual framework, and implement mechanisms, to help attract sufficient long-term capital flows to both middle-income and low-income countries.

To summarise, financial stability clearly has the properties of a global public good. Under-provision of global financial stability has high growth and development costs. There are different ways in which financial stability can be - and is being - achieved. Some ways generate a higher growth and/or a more equitable distribution of benefits than others. The present international financial architecture, and many of the recent

---

proposals, tend to benefit more large, private financial actors and, more broadly, developed economies than developing countries. This fact implies that adjustment burdens are unduly shifted to developing countries; such adjustment is often incredibly demanding - and sometimes almost impossible - given the volatile nature of today's financial markets. Therefore, it would be in the interests of all to put in place a financial architecture that better fits the needs and interests of all actors, is better implemented and therefore actually enhances the stability and efficiency of the present financial system. As a consequence, a fairer international architecture would also be a more efficient one.

In what follows (section II) we will examine relatively briefly the mechanisms and institutions that would need to be in place to produce the global public good of financial stability with special emphasis on the regional and global dimensions. We would then look at what progress has been made so far. Then in section III, we will examine the political process involving the discussion of international financial reform. Special emphasis will be placed on outlining the key actors involved, their broad aims in this process as well as their more specific objectives, on concrete changes in the global financial architecture. A key point that will emerge is that while there is quite strong consensus on the broad aims of international financial reform, (which is positive and needs to be built on) there is far less agreement on specific key reform actions. Section IV will conclude with suggestions, especially but not only for developing countries, on actions that could help significantly accelerate, and deepen the process of international financial reform, in ways that could achieve the twin aims of stability and efficiency.

II Required new architecture and progress so far

A. A NEW GLOBAL AND REGIONAL ARCHITECTURE REQUIRED TO ACHIEVE FINANCIAL STABILITY

Developed and developing countries both face a difficult challenge, which is to create a global financial system that supports - and does not undermine - growth and development in the dramatically changed context of the 21st Century, characterised by large, but extremely volatile and highly concentrated private capital flows, as well as relatively small international public financial institutions. There is not a totally clear cut blueprint for what such a international financial architecture should look like; however a clear vision of key elements in this architecture has emerged both from the international discussion since 1998, and from parallels drawn from the institutional mechanisms developed nationally as domestic credit and capital markets grew.

There is a need at the global level for four functions to be met: a) appropriate transparency and regulation of international financial loan and capital markets, b) provision of sufficient international official liquidity in distress or crises conditions, c) accepted mechanisms for standstill and orderly debt work-outs, at the international level and d) appropriate mechanisms for development finance. The first mechanism would help prevent crises, which are developmentally, socially and financially very costly. The second and third mechanisms would help manage crises better to make them less costly, especially to poor people in developing countries.
The fourth mechanism, linked to development finance, helps channel public flows to countries (especially low-income ones) that do not have sufficient access to private flows, to sectors where social returns are high, and higher than private returns such as in activities with very high national externalities; it should help finance global public goods, such as disease prevention and environment protection; it should help catalyze private flows to countries and sectors where insufficient flows are going and finally it should - in times of crises - channel public flows in a counter-cyclical way, to help increase fiscal spending on social protection schemes, crucial to protect the poor in times of distress. Meeting all these functions adequately (some of them new ones) would require an increase in total multilateral lending.

These institutional mechanisms at the global level need to be complemented at the regional level, for at least three reasons (also see Ocampo, 2000). The first is growth of intra-regional trade and capital flows, which increases macroeconomic linkages; as a result certain functions can be better carried out at least partly at a regional level, these can include surveillance and consultation of macroeconomic policies, as well as mutual surveillance for national prudential regulation of the financial system. One advantage of regional surveillance is that asymmetries of information are smaller at a regional level, due to regional knowledge. Secondly, contagion of crises often starts within regions; therefore a complement to global mechanisms, particularly for liquidity provision, can be provided by regional mechanisms which can provide a first line of defence; such a mechanism is currently beginning to be implemented within Northeast Asia, and has existed for several decades within the European Union. Thirdly, for smaller countries, the access to a broader alternative set of institutions for crisis management, including regional ones, may be particularly valuable as they have relatively less influence and bargaining power with global institutions. More generally, the creation and strengthening of regional developing country mechanisms and institutions will also help increase developing countries’ ability to negotiate for a fuller global financial architecture.

However significant regional arrangements may become, it is important to stress that they should be perceived as a complement and not a substitute for global institutions (such as the IMF, World Bank and the BIS). These are particularly important in a world where finance and markets are increasingly globalised.

As our key concern here is global financial stability, we are stressing global and regional dimensions of the international financial architecture. Furthermore, as developed further below, up to now most action has taken place precisely in these national aspects (of recipient countries) and very limited progress has been made on the truly international aspects of the required architecture. The latter dimension is crucial as to an important extent crises are caused by failures in private global financial markets, which need to be tackled at an international level. However, naturally these measures have to be complemented by improvement of national macroeconomic and financial policies in the recipient countries, which we do not have space to discuss here.

Clearly measures taken at the national level are important, as the provision of the public good of financial stability must start at a national level; these include measures to reducing both macro-economic and micro-economic vulnerability (the latter especially in the financial sector), as well as deepening financial markets.
Furthermore, national and international measures to strengthen financial stability are mutually reinforcing.

B. WHAT PROGRESS ON INTERNATIONAL FINANCIAL REFORM?

The recent wave of currency and banking crises that began in East Asia, then spread to many other emerging markets - and even threatened briefly to spill over to the US in the wake of Russia and LTCM – generated a broad consensus that fundamental reforms were required in the international financial system. Existing institutions and arrangements were widely seen as inadequate for dealing with very large and extremely volatile capital flows, in which an important part of the volatility was caused by large imperfections in the financial markets themselves.

Over three years after the Asian crisis, it is a good time to evaluate progress achieved on reforming the international financial system. Some progress has been made, but it is clearly insufficient. For example, IMF lending facilities for both crisis prevention and management have been quite usefully expanded and adapted and the Fund’s total resources were increased.

Important institutional innovations have been introduced, such as the creation of the Financial Stability Forum (FSF), to identify vulnerabilities and sources of systemic risk, to fill gaps in regulations and to develop consistent financial regulations across all types of financial institutions. As capital and credit markets become increasingly integrated both amongst each other and between countries, it is essential for regulation to be efficient that the domain of the regulator is the same as the domain of the market that is regulated. Given that regulation is still national and sectoral, an institution like the FSF is valuable to help coordinate regulation globally and across sectors. The creation of the G-20, a body to discuss international financial reform - that includes both developed and developing countries - is also a positive development.

Developing countries have been asked to take a number of important measures to make their countries less vulnerable to crises; these include both more prudent macroeconomic policies and the introduction of a large number of codes and standards. As regards introducing standards, though this is very positive, there are however concerns in developing countries that the number of standards (at more than 60) is too large; and that standards are too uniform, in the assumption that ‘one size fits all’. Senior policymakers from developing countries have called for greater selectivity and flexibility in the standards they are asked to implement. A more inclusive process is also necessary, whereby developing countries could participate in the development of these standards and codes, which at present they are asked to implement without having involvement in their design. (For more detailed discussion of developing and transition countries perspectives on standards, see Griffith-Jones et al, 2001)

Even though there has been quite significant progress on reform of the financial architecture, it has suffered from two serious problems. Firstly, it has been insufficient, given the magnitude of the changes required to create an international financial system along the lines required, outlined above in section II. A. The mechanisms that existed
previously and the adaptations made after the crises clearly do not fully meet the new requirements. There is also a concern about the risk of reversal in progress on international financial reform, should positions like that reflected in the Meltzer Report (which argued for a drastic cut-back in the scale and functions of the international financial institutions) exert influence on G-7 positions; such a reversal of progress achieved so far would be deeply counter-productive, particularly from the perspective of developing countries and development.

Secondly, progress made has been asymmetrical in three key aspects, in which a more balanced approach is urgently needed. A first asymmetry in the reform process is that, as mentioned, far more progress has been made on important measures taken by developing countries. However, far less progress is being made on equally important and complementary international measures. As many leading economists (such as Stiglitz, Sachs, Rodrik, Bhagwati, Wyplosz and others) have stressed, crises-such as in Asia-were not just caused by country problems but also by imperfections in international capital markets, such as herding, that lead to rapid surges and reversals of massive private flows. To deal with the problems in the international financial markets, it is essential that international measures both for crisis prevention and management are also taken.

Thus, standards in the area of transparency are being pressed upon developing countries to improve information for markets without corresponding obligations for disclosure by financial institutions, including highly leveraged ones, such as hedge funds, who have no reporting obligation. Better information on financial markets would be of great value to policy-makers, especially in developing countries. Transparency should not be a one way street. Furthermore, while valuable progress is being made on attempting to improve regulation of domestic financial systems in developing countries, there is painfully slow progress in filling important gaps in international regulation, of institutions such as mutual funds or hedge funds, or of modifying regulations, as of banks, where current regulations may have contributed-rather than prevented-greater short-termism of flows. In fact, current proposals for reforms of the Basle capital adequacy requirements, increasing reliance on banks own models would augment - rather than decrease - pro-cyclicality of international bank lending and could significantly increase cost, as well as decrease level of bank lending to developing countries (see Griffith-Jones and Spratt, 2001).

As regards more prudent macro-economic policies, developing countries have become far more cautious, which is positive. However, these countries are being urged - and are following voluntarily - policies that imply national self-insurance against crises. These self-insurance policies include for example maintaining very high levels of international reserves or having deflationary biases in macro-economic policies so as to build stronger defences against crises and stronger credibility with international financial markets. These national self-insurance policies are necessary largely because an appropriate international financial architecture is not in place to deal with volatility in international capital markets. That is, because the global public good of financial stability is under-provided at a global level, second-best self-insurance policies, that developing countries are forced to adopt for crises avoidance, are unnecessarily costly, especially in terms of foregone growth and poverty reduction. This is a crucial reason why the global public good of constructing a global financial architecture should be provided, to open more space for macro-economic and other policies, that can
encourage higher and more sustained growth, which through higher investment and employment, will imply more rapid and consistent poverty reduction.

Passing from crisis prevention to crisis management, it seems important that the IMF’s own resources are large enough to meet the financing needs of a systemic crisis involving several economies simultaneously, while also retaining sufficient liquidity to meet normal demands on the Fund’s resources. Michel Camdessus and others— including the influential US Council of Foreign Affairs — as well as several representatives from developing countries have suggested that this expansion of official emergency financing could be funded in part by temporary and self-liquidating issues of SDRs. Such a mechanism would not add to total world liquidity, except in a temporary manner during a crisis situation — when it would be compensating for reductions or reversal of private flows. This proposal deserves serious analysis and consideration and there seems to be considerable merit in the G-24’s call for a study of this matter and discussion at the autumn 2001 meeting of the IMFC. A somewhat more modest, but also important change that could be taken to facilitate rapid liquidity creation in times of developing country crises, linked by contagion, is a further modification of the IMF's Contingency Credit Line; this would imply introducing automatic disbursement of this facility once a crisis happens, for countries that have previously been very favourably evaluated in their regular Article IV consultations (these could be more frequent, for example twice a year, instead of once a year). This would imply that a large number of countries would qualify for the CCL (though few would use it), which would eliminate the current stigma on its use. More speedy progress on standstill and orderly debt work-outs is also urgent (for a very good discussion, see UNCTAD Trade and Development Report 2001).

A second source of asymmetry in the reform process that needs to be urgently overcome is the insufficient participation of developing countries in the key fora and institutions. As regards the international financial institutions (especially the IMF, World Bank and BIS) more representative governance needs to be discussed in parallel with a redefinition of their functions. It is particularly urgent that developing countries (which are now only represented in a very limited way in the FSF Working parties) are fully represented in the Financial Stability Forum itself, as the issues discussed there have very profound effects on their economies and as their insights can make an important contribution to the Forum’s valuable work. As already mentioned, it is also very important that developing countries are represented on standard-setting bodies, like the Basle Committees, particularly as they will then be asked to implement the standards there defined.

To avoid bodies like the Financial Stability Forum or the Basle Committee becoming unwieldy, a small number of developing countries could be chosen on a regional basis, appointed for a fairly short period and then rotated. It would also be valuable if developing countries could be represented on funds granting them technical assistance; indeed, it is very positive that the suggested new UK DFID Fund proposes to have developing country representatives on its Board. (For a detailed proposal on increasing developing country participation in international financial governance, please see Annex 1). The inclusion of major developing countries in the G-20 is clearly a welcome step, but it might be of value to include also some smaller developing nations, to reflect their specific concerns. Above all, it would also be helpful if the agenda of the G-20 could be broadened, to include more explicitly the key issues of
international financial reform and that the G-20 became a genuine institution for
decision-making, rather than one where G-7 countries inform developing countries on
how they should implement decisions taken in developed country fora.

A third asymmetry that has emerged in recent discussions on reform of the system is
that we have all placed excessive focus on crisis prevention and management, mainly
for middle-income countries. Important as this is, it may have led us to neglect the
equally – if not more important – issues of appropriate liquidity and development
finance for low income countries. As regards liquidity, it is important that existing
IMF facilities for low-income countries – such as the Compensatory Financing Facility
and the Poverty Reduction and Growth Facility – should be made more flexible, in
case the present level of oil prices are sustained or if other terms of trade shocks affect
such countries. More generally, the role of the IMF in providing liquidity to low-
income countries is crucial. As regards development finance, low income countries
need sufficient multilateral lending and official flows, as well as speedy debt relief. It
is a source of concern that multilateral lending to low-income countries, especially via
IDA, has recently fallen sharply. Furthermore, in a world of rapidly increasing private
flows, it is important that low-income countries, donors and international organisations
collaborate to help attract more significant private flows to them. Mobilizing sufficient
and stable development finance, both private and official to low-income countries is an
essential pre-condition to help ensure growth and poverty reduction in the poorest
countries.

III The politics of the international reform process

A. THE BROAD CONTEXT

The need for constructing a new international financial architecture, that will both
increase stability and efficiency in the global financial system, is crucial for
development, with potentially very high pay-offs, both for those concerned with
development and poverty reduction, as well as those concerned with making
globalisation and the market economy really successful.

There are perhaps three major challenges for constructing such an architecture, which
will need to be overcome. The first is the need for an appropriate clear and forward-
looking vision. We are in unchartered territory with many uncertainties and there is no
detailed agreed-upon blueprint for a new international financial system, though
thinking and debate in recent years have brought forward many valuable building
blocks. Policy-makers, both in developed, developing and international institutions -
as well as market actors, academics and NGOs need to continue to engage in research
and analysis; however, most importantly they need to converge towards a common
vision. In this task, it is important that different actors build "more on what unites
them - in terms of their joint global interests and the common goal of convergence-
than by what divides them" (South Centre 2001).

The second challenge is that there is no global government. There are, however
international institutions in the financial field (mainly the IMF, BIS, World Bank and
others), which form the kernel of global financial governance, and which rather
partially perform the functions of international regulation, liquidity, orderly debt
workout and standstill as well as development finance required. There is at present clearly little appetite for deepening the functions of these international institutions, either through new international treaties or even modification of existing agreements e.g. the IMF Articles of Agreement. There is far less interest in creating new international institutions. However, more progress is being made through new "soft international law", where national authorities (usually from G-7 or G-10 only) agree amongst themselves certain standards, implement them in their countries, and then these agreements become international standards, that are broadly implemented in developing countries, often pushed by IMF and/or World Bank conditionality or by market pressure. This "soft law" approach has been quite effective in spreading some regulatory measures, but is clearly insufficient for other fields. The "soft law" approach is also problematic for developing countries if, as is the case for example in the Basle Committee, it is G-10 regulators who agree a standard (for example the new Capital Adequacy Accord) and then developing countries are pressed by IFIs and indirectly by markets to implement them, even though they did not participate in their design. This has led many developing countries representatives to argue that there should be "no standardisation without representation." Indeed, it is very problematic that very important aspects of the world economy, including the provision of many global public goods - such as that of financial stability - is run by "clubs" with limited membership, such as the G-7, G-10 and the FSF.

A third problem is that the most powerful governments (the G-7) have not fully thrown their weight consistently behind the reform exercise, though they were enthusiastic about it in the wake of the September 1998 events, including the very brief credit crunch in the US. This may partly be because the most powerful actors in those countries (e.g. financial markets or parts of them) do not see it in their interest to support or promote major changes in the international financial architecture; it may also be because those who would benefit most from such changes in developed countries (e.g. shareholders, managers and workers of companies that trade and invest long term in developing economies, as well as those in developed economies who more widely benefit from global financial stability), are not properly represented in the key decision-making levels of the developed economies. As a result, the impulse for major international financial reforms, that would benefit not only developing countries, but that would also have major positive effects on the global economy, may have to come from developing countries themselves. Strengthening the voice and influence of developing countries in the reform of the international financial system, so that the global public good of financial stability is better provided would thus be not only more equitable, but also more efficient than current outcomes, where global stability and efficiency may partly be sacrificed due to the excessive power of narrow interest groups.

However, developing countries participation in the discussion and especially in the decision-making is weakened by: a) their relatively limited power (as reflected in their exclusion or limited participation in key bodies, see below), b) their limited ability to generate strong coalitions amongst themselves, with clear and focussed proposals to present to the developed countries, which they all jointly support and c) the dispersion of developing country technical efforts amongst a large number of different fora, none of which have enough aggregate weight to be the genuine partner for dialogue with the

---

2 I thank Gerry Helleiner for suggesting this phrase.
G-7. These different developing country fora and initiatives - valuable as they are - do not co-ordinate sufficiently among themselves. Far greater co-ordination, would seem a priority need, to try to generate a strong, technical partner for dialogue and bargaining with the developed countries.

As regards developing countries' ability to generate strong coalitions (point b above), to support a joint common platform, this is a key issue that needs to be addressed. At present, developing countries often tend to group themselves in international discussions (such as the Commonwealth Finance Ministers Meeting or the discussion at the UN Finance for Development) according to their common features and dominant aims; thus, highly indebted low-income countries tend to focus almost exclusively in their presentations on increased aid and debt relief, whereas middle-income countries tend to focus almost exclusively on issues in the financial architecture of direct interest to them, (e.g. more IMF liquidity in times of capital account led crises). Very rarely do countries from one category support the aims of the other category. Furthermore, the more successful of the middle-income countries seem, to a certain extent, to wish to detach themselves from developing country groupings, or bargaining positions; on the contrary, they seem to prefer direct interaction with developed countries (e.g. in fora like the OECD, if they join).

It would seem very important for developing countries, however, to make a significant effort at coalition building, and to jointly support a common platform, which would include items of interest, both to low-income and middle-income countries; indeed, the very concept of new financial architecture needs to be broadened to integrate explicitly the provision of sufficient official lending, aid and debt relief for the poor countries as well as the design of measures to help them attract more private flows to the poor countries (see Griffith-Jones, Ocampo with Cailloux, op cit 1999). Furthermore, as we have argued above, such a common developing country platform involves so many clear positive sum elements with developed economies, so it would be beneficial to all involved.

B. THE ACTORS IN THE REFORM PROCESS AND THEIR OBJECTIVES

There is a very wide range of actors involved (or whose interests are directly or indirectly affected by) in the discussions on reform of the international financial system. This is one of the key differences between the current situation, and that of Bretton Woods, where the US and the UK (especially the former) dominated the scene, and could more easily reach agreements.

However, there is one very positive element, which is perhaps not sufficiently highlighted. All the key actors involved share one common objective, which is, that they are in favour of - and benefit from - sustained growth in developing countries. As shown in Table 1 below, for some actors this is a more dominant and central objective; for others, e.g. financial markets, or developed country governments, this is a more secondary objective. But the crucial point is that they all share the same objective, and that therefore in broad terms they should be willing to engage in positive sum debates and measures, such as reforming the international financial architecture, to help sustain such growth. Similarly, most of the key actors share the goal of international
financial stability; however, some segments of the financial markets, e.g. hedge funds, actually benefit from a certain amount of volatility and instability, though not from extreme instability.

Returning to the actors involved in the process of international reform, the key ones are a) developed (especially G-7) governments, b) developing country governments, and c) international banks and capital markets. As regards governments (both developed and developing), it is their Ministries of Finance and Central Banks, that are mainly involved.

There is also a set of other actors, who are interested and/or affected by the process of international reform, and who can exercise some positive though more limited influence on it. These include the non-financial part of governments (e.g. Development Cooperation Ministries of developed countries), various UN agencies, NGOs (especially but not only Northern ones), the people of developed and developing countries (represented for example by political parties, parliaments, trade unions), and non-financial corporations, especially multinational ones.

To make the analysis more manageable, we will focus at this stage on the first category of actors. However, it seems important to stress that the second category of actors includes potentially important allies of developing country governments in their search for a better international financial system.

As regards the key actors, we try to summarise their objectives in Table 1

<table>
<thead>
<tr>
<th>Actor</th>
<th>Dominant objectives</th>
<th>Other objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed country governments (1)</td>
<td>Growth in their own (developed) economies</td>
<td>Growing in developing countries</td>
</tr>
<tr>
<td></td>
<td>Profits for their financial sectors. Global financial stability. No large bail-outs (2)</td>
<td>No crises</td>
</tr>
<tr>
<td>Developing country governments (1)</td>
<td>Growth in their (developing economies). Global financial stability. Stable and sufficient flows</td>
<td>Growth in developed countries</td>
</tr>
<tr>
<td>Banking and Financial Markets</td>
<td>Maximise short-term profits</td>
<td>Global financial stability (3). Growth in developed and developing economies</td>
</tr>
</tbody>
</table>

(1) As pointed out in text above, it is mainly Fin. Ministries and Central Banks that participate in the important discussions on financial architecture.

(2) This objective has emerged more recently and seems to be particularly stressed by the new US Administration.

3 International financial institutions (such as the IMF, World Bank and the BIS) are clearly also very active in international reform; however, we do not include them here explicitly as they are intergovernmental bodies, through which governments take collective action.
Though most financial actors share this goal in a relatively weak way, some e.g. hedge funds, actually benefit from a certain amount of volatility.

We can see clearly from Table 1 that growth in developing economies is an objective for all the key actors and a dominant objective, for two of the key actors; developing country governments and international financial institutions. Both developed country governments and international banks and financial markets have a strong (though somewhat more secondary) preference for sustained growth in developing countries. Furthermore, most - though not all - of the key actors have global financial stability as an objective.

It is therefore necessary in discussions and negotiations to build on these common objectives, and on the consequent need to provide the global public good of an appropriate financial architecture, that can both support sufficient flows to developing countries and avoid costly crises.

If there is this strong commonality of these broad objectives, why has more progress not been made? An important part of the answer seems to be that there is, at present, far less agreement amongst the different actors on specific measures to be taken for building a new financial architecture. One important example relates to opening of developing countries’ capital accounts. International financial markets and banks who are extremely powerful, have as their main aim short-term profit; (see Table 1); to achieve that aim, they have a strong preference for capital accounts that are as open as possible, which gives them total freedom to go in and out of countries, in as short a span of time as possible. Indeed, as pointed out above, some financial actors, like hedge funds, actually benefit from increases in exchange rate volatilities, as this provides them with profitable opportunities. For them, devaluation and currency crises may provide particularly profitable opportunities; such actors will be particularly against any measure to restrict capital account openness or to regulate them. Other financial actors also prefer totally open capital accounts - but do not profit or may even risk major losses - if currency crises occur. On the whole, developed country governments in their quest for totally free capital accounts back their financial sectors, because these markets are so powerful, because finance has a high share of the countries' GDP, and because of ideological preferences for open economies and totally free markets. Developing countries, on the other hand, would benefit more from a more gradual and sequenced opening of their capital accounts, and one which favours more long-term flows as well as being far more prudent on liberalising short-term and easily reversible flows, to help avoid costly crises.

More generally, there are differences in objectives and in positions on the specific key measures that would need to be taken to create a new financial architecture (see Table 2). As we can see in Table 2, in fact, most of the significant measures that would need to be taken have not actually happened.

---

4 It should, however, be emphasised that in the wake of so many crises recently, the attitude both of developed country Governments and IFIs has mellowed somewhat on the subject of capital account liberalisation.
Table 2
Attitudes of different actors to specific changes in IFA

<table>
<thead>
<tr>
<th>Changes in IFA</th>
<th>Markets</th>
<th>Developed Gov</th>
<th>Developing Gov</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>Codes &amp; Standards</td>
<td>Vaguely, yes</td>
<td>Yes</td>
<td>Some opposed or reluctant, or have reservations</td>
<td>Happens</td>
</tr>
<tr>
<td>Sufficient international official liquidity</td>
<td>Yes</td>
<td>Not large</td>
<td>Yes</td>
<td>Not happens (1)</td>
</tr>
<tr>
<td>Increased development finance</td>
<td>Vaguely, yes</td>
<td>Very reluctant</td>
<td>Yes</td>
<td>Not happens</td>
</tr>
<tr>
<td>Sufficient &amp; appropriate international regulation</td>
<td>No</td>
<td>Lukewarm</td>
<td>Lukewarm, linked to representation</td>
<td>Not happens</td>
</tr>
<tr>
<td>Standstill and orderly debt work-outs</td>
<td>No</td>
<td>Yes, some quite keen</td>
<td>Vary, not too keen</td>
<td>Not happens</td>
</tr>
<tr>
<td>Increased developing country participation</td>
<td>Indifferent</td>
<td>Very reluctant</td>
<td>Yes</td>
<td>Not happens</td>
</tr>
</tbody>
</table>

As discussed above and below, there has been an increase in IMF resources and creation of new facilities after the Asian crisis. However, there is clearly not sufficient, quickly and easily disbursable liquidity should crises occur and spread via contagion.

Thus, the creation of mechanisms for sufficient international liquidity in terms of crises, via adaptations of the Fund’s Contingency Credit Line - unused at the time of writing - or via temporary and self-liquidating issues of SDRs, have not been implemented (see again Table 2). This is in spite of the fact that private markets and developing country governments would clearly support such broader measures. However, developed country governments - which have the majority in the Executive Board of the IMF - are opposed; in particular, the US government - which has veto power on the IMF Board opposes such a measure.

As regards increased development finance (see again Table 2), developing countries are clearly in favour (especially low income ones). Markets are vaguely in favour, as development finance may for example help develop and strengthen developing countries banking systems, or stock markets, which will make investing in those markets more profitable. However, several of the main developed country governments oppose this expansion, indeed, the Meltzer Report prepared for the US Congress in 2000 even argued for a fairly significant reduction in development lending. As a result, there has been no increase in development finance, and there is even risk of some scaling down, which would be highly negative. Again, it is developed country governments who decide the level of multilateral lending in the Boards of the multilateral and regional banks.

As regards sufficient and appropriate international regulation, especially in source countries, proposals focussed on issues especially relevant to developing countries

---

5 It should however be mentioned that some relatively modest modifications of the CCL were introduced in September 2000, reportedly due to pressure from developing country Directors (especially Latin American ones) in the Fund Board; however apparently - at the same time - developing countries accepted increases in the cost of certain Fund facilities, partly as a quid pro quo (interview material). This provides an example of successful intra-issue bargaining by developing countries, even though the results were modest. More importantly, previously during and after the East Asian crises, a new IMF Facility (the Supplemental Reserve Facility or SRF) was created and has been quite successfully used during crises, like the Brazilian one, and Fund resources were relatively significantly expanded, which increased the potential scale of Fund lending.
come mainly from academics (both in developed and developing countries) and UN agencies. Some developing countries' governments support such regulatory changes and see them as potentially valuable however, their expertise on these highly technical issues is clearly limited by their lack of participation in the key bodies that determine international regulatory policy; indeed, as one emerging market policy-maker described it, they are at the receiving end of regulatory changes. Furthermore, they may be unwilling to suggest regulatory changes that would be designed by bodies where they do not participate, and which therefore could be designed in ways that could have some negative effects on their economies. Developed country governments and regulators are lukewarm to such changes, though some individuals - including senior ones - are very sympathetic. Indeed, the focus of the recent proposals, e.g. on modifying the Basle Capital Accord - are on broader systemic issues, and give only marginal attention to measures that are directly relevant to emerging markets; furthermore, developed country regulators focus in this new Accord on issues that will increase efficiency of banks, and are willing even to accept increases in pro-cyclicality of flows as a cost even though such pro-cyclicality is particularly harmful for developing countries; equally seriously, the proposed new Basle Capital Accord could seriously reduce levels and prohibitively increase the cost of new international bank lending to most developing countries, which could have very negative effects on their development prospects (see Griffith-Jones and Spratt, 2001). Furthermore, desirable changes from a developing country perspective have not yet happened, an example is the non-creation of counter-cyclical elements in international bank regulation - which would be valuable to developing countries, as it would discourage excessive surges of capital flows and lessen the likelihood and depth of crises.

In relation to the creation of a rule-based framework for orderly debt work-outs and involuntary standstills, there has been much discussion, and many papers have been written - including by bodies like the G-10 and the IMF - but very little action. This is even though some developed governments (especially European ones) are quite keen for progress in this area, and they are backed in this position by staff members in the IMF and the World Bank. Opposition is naturally particularly strong in markets, due to fears that such a framework would increase ease with which developing countries could postpone or reduce debt servicing or other capital outflows. Interestingly, developing countries (especially Latin American ones and Russia) tend to oppose a rule-based framework for debt work-outs and involuntary standstills, as they fear that such a framework could discourage new private flows and increase their cost in normal times, and could even initially accelerate outflows in times of crises, as creditors and investors feared that standstills or orderly debt work-outs could be implemented. As a result, very little concrete progress has been made on a broad framework, even though some more limited progress has been made on encouraging, supporting and facilitating developing countries' use of collective action clauses in bonds.

Finally, as regards increased developing country participation in global governance (see again Table 2), there has been practically no progress. Even though the creation of the G-20 is welcome, it seems this is mainly an informative and not a decision-making body. It is a source of particular concern that new international fora are

---

6 However, some market participants seem interested in elements of such a framework, as they rightly perceive that it could not just protect developing countries, but also help overcome collective action problems, and thus benefit both lenders and borrowers.
created, like the Financial Stability Forum, where developing countries do not participate at all. Clearly their participation is desirable, but it seems to be opposed in practice by most developed governments; countries like Canada, Holland and the Scandinavian countries tend to be far more sympathetic to such changes as are foreign and development cooperation ministries. Furthermore, the Commonwealth Finance Ministers Meeting in September 2000 - which includes the UK, Canada, Australia and New Zealand, as well as many developing countries - explicitly endorsed developing country participation. However, it seems that the Treasuries and Central Banks of some of the main developed countries, and especially their civil servants are opposed to such participation.  

The only measure (see Table 2) that is being carried out - albeit with limitations - is implementation of Codes and Standards. This relates to the fact that developed country governments are for their implementation, markets are lukewarm and only developing governments are reluctant, or have important reservations about the process of implementation of standards, its speed, scale, relevance etc. (See again Griffith-Jones et al, 2001, for developing country views).

If developed governments or markets are against certain measures, such as, for example, sufficient international liquidity, sufficient development finance or increased developing country participation, (as discussed above and as reflected in Table 2), then these do not happen. Till now, the influence of developing countries has been limited by a number of factors, of which a particularly important one is that the main changes that need to take place in the international financial architecture require provision of resources (e.g. sufficient liquidity or development finance) or actions (e.g. on regulation) that basically need to be taken by developed country governments. Therefore, the challenge for developing countries is to convince, as well as effectively bargain for, developed countries' governments to take such actions.

To summarise, all actors are interested in the global public good of financial stability. So, they have a shared interest to see that good emerge. Furthermore, no market or country can produce the good alone. A summation process is required; all markets and governments have to make changes. For such collaboration to take place, it is necessary that all involved see a clear net benefit. Therefore it would be desirable to achieve a positive sum grand bargain (along lines suggested below), where all involved would make important gains, but make some concessions; this could lead to

---

As regards the specific issue of some participation of developing countries in the Financial Stability Forum (FSF), in September 2000, the Finance Minister of one of the leading G-7 countries clearly invited them to participate in a speech at an important international gathering. However after the Minister left, his officials tried to play this down and refused to include this invitation in the final statement of this meeting. It was only after several major developing countries insisted that the invitation made by the Finance Minister be reflected in the final statement of this meeting. It was only after several major developing countries insisted that the invitation made by the Finance Minister be reflected in the final statement, and particularly when they were backed by a developed country - in this case Canada - that the desirability of developing countries joining the FSF was put in the final statement. Unfortunately, at the time of writing, this measure has not yet been implemented, even though the Chairman of the FSF, Andrew Crockett, has also publicly endorsed the need of developing country participation in the FSF. This episode seems to illustrate two broad points: firstly, it seems to be the case that often civil servants - both national and international - may be more conservative than senior figures (e.g. Finance Ministers, Chairman of the FSF, Managing Director of the IMF). This would imply the importance of political dialogue at the highest level. There may also be a tension between political decision and implementation (which may sometimes, but not always reflect the difference between rhetoric and practical action). For all these reasons, it is crucial that representatives of developing countries accurately prepare technical positions, not only negotiate them carefully, but also follow-up on their implementation.
IV  Suggestions for measures to accelerate and deepen international financial reform

To ensure that measures to accelerate and deepen international financial reform really begin to be taken, developing countries would need to develop a consistent strategy to persuade developed counties' governments - as well as bargain for - actions to be taken. The UN process of Finance for Development, if effectively used, could provide a key milestone. If this were not successful, other fora-such as the IMFC, the Group of 20 or others - should be used. A number of pre-conditions would have to be met.

Developing country governments - and those in favour of development - should present the need for a new financial architecture as providing one of the key pillars for sustained economic growth, development and poverty reduction in their countries, within a context of a well managed global market economy. Such sustained growth in their economies would also contribute to higher global growth, and thus benefit all global actors involved. Higher growth in the South would imply larger and growing markets for developed country exporters, better and more profitable opportunities for developed country investors and lenders, and less pressure for low skilled migration from developing to developed economies. It seems important that developing countries' representatives should spell out all the positive interactions in developing and developed countries alike, that reforms of the international financial architecture could generate, as well as the dangerous risks if such changes are not implemented. The fact that systemic financial stability is a global public good, whose current under-provision is harmful to both developed and developing countries needs to be particularly and clearly emphasised. Indeed it is important that the positions of developing countries be guided by a vision of the possible and the desirable, that emphasises the common global public goods, that jointly developed and developing countries can achieve. Indeed, a successful pursuit of a new international financial system requires "leadership, vision and faith that our future is not merely the work of destiny but ours to shape" (Kaul, Grunberg and Stern, 1999).

Secondly, developing countries have to make a significant effort to develop strong common positions on matters of international financial reform. Clearly this is a challenging task as there is differentiation among categories of developing countries in their levels and patterns of development, and - more specifically - in their main needs and priorities as regards a new financial architecture. However, a coherent, common developing country platform is essential for increasing their influence on the possibility of a genuine reform. The objective basis for such a common platform exists in large commonalities of needs and interests.

Thirdly, to elaborate these common positions in the international financial field, developing countries need to both focus their efforts and develop common technical capacities. Two crucial tasks need to be tackled, both institutionally and technically. Firstly, developing countries should agree joint clear positions on the main areas of international financial architecture, outlined above, which include: provision of sufficient international liquidity and development finance, sufficient international
regulation of private capital flows, standstills and orderly debt work-outs and increased participation of developing countries in the process. This could be done via existing institutional mechanisms such as the G-24 or the G-77. Alternatively, a new high Level Panel of developing country politicians and experts from developing countries, could be established for this purpose, to provide an integrated vision of reform of the international financial system, from a developing country perspective (as suggested by South Centre 2001, op cit). Secondly, there should be systematic support on a regular basis for developing countries (e.g. for their representatives in the IMF and World Bank Board), in reacting to proposed changes, as well as for taking their own initiatives, in specific international financial changes, based on their broad common vision and platform (e.g. on changes in international financial facilities, their conditionality, etc). Because a major overhaul of the international financial system (à la Bretton Woods) seems unfortunately highly unlikely in the short term, changes in the international financial system are much more likely to take place in an incremental way. Therefore, this second approach is extremely important. It would be valuable if a special programme was created, within the context of the "Global Participation Fund" suggested in Kaul et al, op cit, self-administered by developing countries. This could provide much needed additional support to developing country representatives in key international bodies (e.g. IMF), who are often overwhelmed by country work related to the countries they represent and have insufficient time and resources to analyse broader international issues. Such a fund could have a core technical secretariat, but would draw on a virtual network of think-tank and other experts for its work. It would prepare brief, focussed papers, that would either help react to new proposals made by developed countries, or make alternative specific proposals. Particularly in reacting to proposals, this would have to be a quick response facility, as there is normally a very short period between distribution of papers and their discussion, e.g. in the IMF and World Bank. Such a support fund would not just be of a great value for developing countries, but would actually be very useful for developed countries, in that it could improve the quality of developing countries' position and dialogue.

Also, developing countries' governments need to have an active dialogue on international financial reform, not just with financial authorities in the developed countries, in the markets and in the IFIs (who clearly are the key actors in the reform process), but with other actors in the developed world. These other actors may be more positively inclined towards genuine international financial reform. In the North, these clearly include Development Cooperation Ministries (strongly committed to growth, development and poverty reduction and therefore supportive of changes that will make them more likely) as well as Trade and Industry Ministries (in search of new trade opportunities), as well as representatives of non-financial global companies, also keen on an environment of stable and rapid growth in developing countries. A dialogue of developing countries with Northern political parties - and especially parliamentarians, who are democratically elected representatives of their peoples - in key developed countries seems very important, particularly as many of them seem likely to be quite sympathetic both to developing country positions, and to the pursuit of global financial stability, as an objective that is also of central value to their own countries. Indeed, such a dialogue may be particularly valuable with European countries where in most of the key countries, Social Democratic governments are in power, who potentially could be supportive of the IFA changes discussed above.
NGOs and UN agencies could more effectively support developing country positions if these were articulated very clearly and if there was a regular dialogue. Northern NGOs are particularly important, as they are often very influential with developed country governments, media and IFIs, and as their main aims are development and poverty reduction. However, a problem is that their critiques are sometimes too broad, radical and - above all - not properly focussed on clear technical proposals about necessary changes or reforms. Their actions have been, however very effective when they have focussed on a fairly specific issue and made clear proposals; one well known example is the clear influence of Jubilee 2000 and other NGOs on acceleration of HIPIC debt relief; another example is the clear impact of Swiss NGOs in securing significant Swiss government debt relief for low-income countries in the 1980's; a third example was action by UK NGOs (based on a precise technical proposal) that persuaded the UK government to change taxation on banks to encourage commercial debt relief to developing countries in the late 1980's. Issues relating to IFA are more complex than debt, and special efforts need to be deployed to integrate with NGOs. Bodies representing developing countries, academics or others, should invest quite important efforts in dialogue with actors like NGOs to ensure that they understand developing country positions on IFA, and they articulate clear and concrete reform proposals; such an effort could have quite significant pay-offs in terms of potential impact.

Dissemination and discussion with key actors within developing countries (e.g. political parties, parliamentarians) of financial reform proposals could be valuable in itself, and especially effective in bargaining terms, if it led to a concrete dialogue on these issues of such actors with their counterparts in developed countries (e.g. world meeting of political parties and of groupings like Parliamentarians for Global Action).

Fourthly, developing countries should develop far more - where feasible - regional institutions and mechanisms, that would complement global institutions. As pointed out above, these are particularly relevant in areas such as surveillance (e.g. of financial regulation), coordination of macro-economic policies and in regional mechanisms for liquidity provision, especially in times of crisis. Such regional liquidity mechanisms especially in Asia, could be very significant, given the very high level of foreign exchange reserves in that region; they could also be important, though less so given lower levels of reserves, in the Latin American region. The development of regional mechanisms would not only be valuable in themselves; it would also strengthen the bargaining position of developing countries for a better global financial architecture. For this, it is important that regional mechanisms are developed and clearly presented as complementing - and not competing with - global institutions and mechanisms. Indeed regional mechanisms should be built so as to strengthen global institutions, and not weaken them. Though developing countries’ governments can do much towards creating a new financial architecture by appealing to joint interests and goals with developed countries, by forging common positions amongst themselves, by increasing their technical capacity, by searching for broad support of their positions, and by

---

8 At the time, the author prepared a brief proposal, (based on an in-depth study) for changing UK tax exemptions, from the moment of banks' provisioning against losses due to potential non-payment, to the moment when the bank actually gave debt relief; this increased strongly banks incentives to give debt relief, rather than provision against possible losses. This brief proposal was sent by a coalition of the main UK NGOs to all UK parliamentarians. As a result, the then UK Finance Minister introduced a change in the tax treatment in line with this proposal. (Based on author's own personal experience)
taking regional initiatives, they also will have to do some strong and effective bargaining to achieve their aims.

What bargaining chips do developing countries have for this purpose? In fact, they may have more than appears at first sight. For example, as an aggregate developing countries have very high levels of foreign exchange reserves (with Asia having at least $1.000 billion of reserves, and Latin America also having a considerable, though smaller, amount). Such high level of reserves - especially to the extent they are partially pooled into regional funds which is far more efficient than each individual developing country holding very high levels of reserves, as this is very expensive - could reduce their exclusive dependence on global financial institutions, especially in times of crises. Furthermore, high levels of reserves held by developing countries offer new bargaining possibilities, as their governments became large depositors and investors in developed country banks and institutions like the BIS; also the scale of their reserves implies that by their investment decisions, e.g. on currency mix-developing governments can exert some influence on developed countries' exchange rates.

Developing countries' markets - including their financial ones - are of great interest to developed country investors, lenders and exporters. The extent to which developing countries strengthen and regulate their financial system, as well as liberalise their capital account, are not just of great interest to their own companies and people, but also of much interest and value to international companies and banks in developed economies. Therefore, some type of positive sum grand bargain could be thought of. Developing countries could say they would become far more keen to implement initiatives that are of interest particularly to developed economies, such as Codes and Standards of best practices (e.g. on financial regulation) and opening to a fuller liberalisation of their capital accounts, if, and only if, developed countries start reforming the global financial system, in ways that would facilitate more and more stable capital flows to developing countries, and that would make costly crises in these countries less likely. Whilst such a reformed international financial system would not exist, they would clearly be less able and less willing to open their capital accounts fully, as the potential risks of doing so could outweigh the benefits. Similarly, developing countries could argue that implementing Codes and Standards of financial regulation by developing countries (which have been determined mainly by developed country bodies) should be explicitly linked to some regulation of developed countries' financial markets to help avoid excessive surges of potentially reversible capital flows to developing countries, to mechanisms that encourage long-term flows, and especially to development of international liquidity mechanisms - with low or no ex-post conditionality - that would significantly protect individual developing countries from crises, and stop them spreading to other countries.

Thus, developing countries that followed good macro-economic policies and were significantly improving their financial regulation policies (as certified for example in their annual Article IV IMF consultations) could have practically automatic access to sufficient IMF lending, if hit by a crises, whose origin was not of its own making, but was due to unexpected changes in perceptions of international lenders on investors or due to large terms of trade shocks. Low income countries that followed good macro-economic policies, improved financial regulation, and took other measures, would
have sufficient access not just to international liquidity, but also to development finance.

Such a bargain would provide incentives for developed countries to make necessary international changes, as they would know that these would ensure the changes they desired to take place in developing countries, and vice versa. Collective action problems could be overcome, if genuine progress was made simultaneously by developed and developing countries. Most importantly, the result would be of great value, not just to developing countries, but also to developed ones.

Developing countries could draw here interesting lessons from both the bargaining tactics used and the vision presented by Keynes in negotiations that lead at Bretton Woods, to the creation of the post-war international financial order. (See Skidelsky, 2001). As regards bargaining tactics, Keynes presented two clear alternatives: an "ideal" scheme, with key international elements - such as a large IMF - and a "second best" case, wherein the UK would reluctantly follow a far more closed approach - in trade and the capital account - if the international financial system was not properly developed; there was, he argued no middle way (though in practice he made some important concessions later). Suitably adapted to the features of the early 21st Century, world economy, developing countries can argue that the same two clear options remain: a) an appropriate international financial system, that would support development and make crises far less likely and less costly, not just for them but particularly for the global economy. Developing countries could contribute to this new IFA by implementing standards, good macro-policies and by liberalising their capital accord fully, OR b) an incomplete and lopsided international financial system that could not guarantee supporting developing country aims, and where they would reluctantly therefore not be able to open fully their capital accounts, adapt their financial systems to the requirements of developing countries, etc, as they would regretfully have to defend their autonomy of policy-making to protect their interests in a "second best" international financial system. Developing countries could also draw lessons from Keynes preparation of a clear vision of the key elements, which would need to be included in a "first-best" international financial system, but also by showing how such a superior system would benefit all actors involved; this system would be superior both because it would support more stable growth in developing countries - of benefit to many actors in the developed world - but perhaps more importantly, because it would increase financial stability globally. As pointed out in the introduction, there is here a clear parallel with Keynes’ position at Bretton Woods, who in defending the interests of the relative weaker, debtor countries like the UK, was at the same time defending global prosperity. Last but not least, just as Keynes appealed to then US internationalism and liberalism to help overcome opposition to his proposals, developing countries should appeal to current US ideals of supporting and deepening the market economy globally; for this purpose, they should stress how a "first-best" international financial system, that would facilitate growth and prosperity for them, would clearly increase their own commitment to this global market economy.
Annex 1

Proposal for increasing developing country participation in global financial governance

There are three areas where increasing developing country participation in global financial governance is urgent. The three areas are: 1) incorporating developing country participation in the Financial Stability Forum where at present they do not participate at all, even though they are invited to the working groups, 2) increasing participation of developing countries in the BIS (where there has been some, but clearly insufficient increase in participation) and in the Basle Committees (where there is no formal participation, though there has been increased consultation) and 3) enhanced participation of developing and transition countries in the IMF Board. This greater developing country participation would not only be clearly beneficial for developing countries themselves, whose voice would be stronger; it would also benefit the international institutions both by enhancing their legitimacy and also by getting valuable insights from developing countries; it would also benefit the developed countries, as they would ensure greater commitment from developing countries to free and open markets.

1. The Financial Stability Forum

In the wake of the Asian financial crisis, the Financial Stability Forum was created with three main purposes: 1) the identification of vulnerabilities in national and international financial systems and sources of systemic risk, 2) ensure that international rules and standards of best practice are developed, and gaps are identified and filled and 3) arrangements to ensure that consistency in rules across all types of financial institutions is improved.

The creation of the Financial Stability Forum is a very valuable step towards co-ordination of various bodies and actors to improve global stability. However, it is highly problematic that at present developing countries are not at all represented in the Forum itself.

Indeed, FSF membership is limited to three representatives from each G-7 country (one from the finance ministry, one from the central bank and one from the regulatory agency) one representative each from Holland, Australia, Hong Kong and Singapore (the latter two because they are a major financial centre). The IMF and the World Bank have two representatives each, as has the Basle Committee on Banking, IOSCO, and IAIS. The BIS, the OECD and the two other Basle Committees have one representative on the FSF. With the chairman, Mr Crockett, this implies a total size of 40 members at present.

At present the FSF does not include any representation from developing countries, even though many of these are major recipients of international private flows and all major crises in recent years have been in these countries. The FSF therefore is at present, a bit of a "Hamlet without the prince." There are therefore clear reasons why developing countries should be included. Furthermore, when the FSF was established by the G-7, they stated that "while the FSF initially would be limited to G-7 countries, it is envisaged that other national authorities, including from emerging market countries, will join the process at some stage."
There is a strong case to argue that the time has come for ensuring that this developing country participation takes place. Several G-7 countries are known to be sympathetic. Indeed, the Commonwealth Finance Ministers Meeting (in September 2000), which includes the UK, Canada, Australia and New Zealand, explicitly endorsed developing country participation. The Chairman of the FSF has also publicly expressed sympathy for developing countries’ inclusion.

A specific formula could be proposed to include developing countries in the FSF. If six developing countries were included, the membership of the FSF would rise from 40 to 46, which is slightly more than 10 percent. Developing country representatives, for example from countries with large levels of private capital inflows in proportion to their GDP, could be chosen on a regional basis: there could be two Asian, two Western Hemisphere and two African. This would ensure that the perspectives of poorer countries would also be represented. These representatives could be appointed for a fairly short period (for example two years) and then rotated. This type of representation by developing countries operates in other contexts e.g. in the Boards of the Bretton Woods institutions.

The FSF is a very important initiative. Adding a small representation of developing countries to it would: a) increase its legitimacy, b) increase developing countries’ commitments to its aims and c) add valuable insights and perspectives to its decision-making process. This would be achieved without a major increase of its membership.

2. The Bank for International Settlements (BIS) and the BIS Committees

The Bank for International Settlements is an increasingly important institution, as it has been increasingly active in the pursuit of its mandate to promote international co-operation on monetary and financial issues, with the pursuit of international financial stability at the heart of its activities. Initially the BIS activity focussed very much on financial stability in the major industrial countries, but has increasingly widened its activities to include developing countries; indeed the BIS has played an important role in both crises prevention and management, especially in the former.

Meeting in Basle, under the umbrella of the BIS - but not part of it - are three important Basle Committees. They are the Basle Committee on Banking Supervision (which produced the influential Basle Capital Accord), the Committee on the Global Financial System and the Committee on Payment and Settlements System.

The BIS was before 1996 constituted by the G-10 and Switzerland, as well as other developed countries, plus two developing countries, South Africa and Turkey. In 1996, several large developing countries were invited to join; they were Brazil, India, China, Korea, Saudi Arabia, Hong Kong, Mexico, Russia and Singapore. This is very welcome. However, there are at present no developing countries on the BIS Board of Directors (though there are no restrictions in the BIS statutes for this happening). There are very important monthly two-day meetings of G-10 governors; developing country governors are invited only to one session during the two days.

The Basle Committees define regulatory and other standards, that are increasingly implemented world-wide and that are increasingly becoming part of the IMF and World Bank surveillance of developing countries. However, the membership of these committees is still purely G-10, even though they do increasingly consult with developing and transition
countries. Though they do consult, decisions are still being made by a purely G-10 group, decisions which then are implemented either via "soft law" and increasingly via IMF and World Bank surveillance (and possible future conditionality) by large numbers of developing countries.

It seems important and urgent to a) increase the number and types of developing countries who are members of the BIS; in the long term, this could even include universal membership, with weighted and rotating participation on the BIS Board. In the meantime, further increase of developing country participation in the BIS membership would be desirable, b) ensure participation of developing countries in the Board of the BIS and c) ensure greater and more formalised participation of developing countries in crucial meetings at the BIS, for example the monthly meetings of Central Bank Governors.

As regards the Basle Committees, which are currently made up of G-10 countries and Switzerland, these could be initially expanded to include one developing country representative for each region [Latin America, Asia and Africa]. These representatives could be appointed for a two year period and then the countries rotated. This would not excessively expand the size of the committees, and would allow crucial developing country participation.

It would seem important to achieve progress on several of these fronts, on the BIS and the Basle Committees simultaneously; this is not a particularly radical proposal, but just implies a fairly significant acceleration of recent trends.

Indeed, in some of these areas it may be easy to achieve agreement, as the BIS Senior Management and Board may well agree with some of these proposals. The problem may be of effective implementation. It may therefore be desirable to establish a small liaison group, for example between the BIS and a group representing developing countries, e.g. G-24 or G-77, who helps make concrete suggestions for creating mechanisms to ensure greater developing country participation in the BIS and the Basle Committees, along the lines suggested.

3. Enhanced participation of developing and transition countries in the IMF Board

As is well known, the IMF is and will continue to be a key actor in the international financial architecture.

Although the IMF is an international organisation, its members do not have equal voting power. The distribution of voting power in the IMF Board plays a key role in IMF governance.

The voting power of an IMF member has two components. Each member has 250 basic votes simply by virtue of its membership; this is a symbolic recognition of the principle of the legal equality of states. Each member also has one additional vote for every 100,000 SDRs of its quota. Because the number of basic votes has not been changed with successive quota increases, the ratio of basic votes to total votes fell from just over 11 per cent of the voting power of the 45 countries that participated at the 1944 Bretton Woods Conference, to less than 3 per cent in the 1990’s, even though the total number of countries has at least tripled.

---

9 This section has been jointly prepared with Ariel Buira, former Deputy Governor of the Banco de Mexico and IMF Executive Director. I also thank Bishaka MuKerjee for very useful suggestions.
This is one of the important factors that has diminished the value of the initial principle of the legal equality of states, and has implied a rather low participation of developing countries in decision-making at the IMF.

The concentration of voting power in the hands of the major industrial countries ensure they have a determining influence on IMF policies. Furthermore, one country - the US - or in other cases a few major industrial countries, have actual veto power on a number of crucial decisions, such as the size of the IMF, policies on access to IMF resources, its scale and the rate of charge. As regards seats on the IMF Board, several small European countries are represented (e.g. Belgium, Netherlands and Switzerland each has a chair, even though they also represent other developing and transition countries). On the other hand, developing countries have a relative small presence (for example all of Sub-Saharan Africa has only two chairs, and Asia as well as Latin America only have three chairs). Small developing countries from the same region are also scattered (e.g. Central America) through different chairs, even though they often have similar problems and features.

A number of measures could be taken to improve both the distribution of quotas in general and to enhance the role of developing countries in the governance of the IMF.

As regards the latter aim, to increase the role of developing countries and to make a more significant contribution to the principle of the legal equality of states, in the governance of the IMF it seems crucial to increase the ratio of basic votes to total votes in determining members' vote. Since this ratio was initially 11 per cent of voting power, when there were 45 countries, we suggest this ratio should be increased to 33% to reflect the fact that there are now over 150 countries that are IMF members. Should this figure be deemed too high by the major developed countries, compromise could be reached of an intermediate percentage - of 22% intermediate between the ratio of basic votes and the ratio of 33% that would reflect the large increase in IMF membership. This would be compatible with any formula for the quota distribution that will start being discussed, e.g. with the recommendations of the Cooper Report on Quota Review quoted above.

---

10 An important recent document that addresses these first issues is the Report to the IMF Executive Board of the Quota Formula Review Group. April 18, 2000, also known as the Cooper Report, due to the name of its chairman.
Bibliography


South Centre (2001) "Multilateral Funding for Middle Income Countries". Financing Development. Key Issues for the South, series no. 37, South Centre, Geneva.