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" THE DEBATE ON THE INTERNATIONAL FINANCIAL ARCHITECTURE: REFORMING THE REFORMERS"

Background Paper for Special Session IV on Global Financial Issues*

prepared by

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THE DEBATE ON THE INTERNATIONAL FINANCIAL ARCHITECTURE: REFORMING THE REFORMERS

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DISCUSSION PAPERS

THE DEBATE ON THE INTERNATIONAL FINANCIAL ARCHITECTURE: REFORMING THE REFORMERS

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THE DEBATE ON THE INTERNATIONAL FINANCIAL ARCHITECTURE: REFORMING THE REFORMERS

Yilmaz Akyüz *

This paper briefly surveys the progress made in various areas of reform of the international financial architecture since the outbreak of the East Asian crisis, and explains the principal technical and political obstacles encountered in carrying out fundamental changes capable of dealing with global and systemic instability. It ends with a brief discussion of what developing countries could do at the global, national or regional level to establish defence mechanisms against financial instability and contagion.

Introduction

After the recent bouts of turbulence and instability in international currency and financial markets – including the 1992/93 EMU crisis – large gyrations in the exchange rate of the dollar,[1] and the emerging market crises in Mexico, East Asia, Russia and Brazil, a consensus seemed to emerge that instability was global and systemic, national efforts would not be sufficient to deal with the problem, and there was a need to overhaul and indeed reconstruct the global financial architecture. The ensuing debate has concentrated mainly on the following areas:

(i) standards and transparency;
(ii) financial regulation and supervision;
(iii) management of the capital account;
(iv) exchange rate regimes;

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* UNCTAD, Geneva. An earlier version of this paper was presented at a meeting of the Global Development Network (GDN.99), "Bridging Knowledge and Policy", Bonn, Germany, 5B8 December 1999. For a more detailed discussion of many of the issues taken up here, see Akyüz and Cornford (1999).

[1] The dollar swung from 79 yen in the spring of 1995 to about 150 yen in 1997, coming back to some 100 yen at the end of the decade. During the past year it showed substantial gyrations against the yen, sometimes changing by 15B20 per cent within weeks.

(v) surveillance of national policies;

(vi) provision of international liquidity; and

(vii) orderly debt workouts.

Measures under these headings can help to prevent or manage financial crises, and sometimes serve both objectives simultaneously. Clearly, reforms in these areas generally imply significant changes in the operating procedures and governance of the Bretton Woods institutions (BWIs), notably the IMF. Indeed, these issues are often addressed in the context of the reform of these institutions, as in the case of the recent Meltzer Commission Report presented to the United States Congress.

A number of proposals have been made since the Asian crisis in these areas by governments, international organizations, private researchers and market participants. Some of these proposals have been discussed in international institutions such as the IMF, BIS and the newly-established Financial Stability Forum. A close look at a recent IMF report reviewing the progress so far made shows that many of the proposals and actions considered in these fora have concentrated on marginal reform and incremental change rather than on the big ideas that emerged in the wake of the East Asian financial crisis.[2] More specifically, attention has focused on standards and transparency, and, to a lesser extent, financial regulation and supervision while efforts have been piecemeal or absent in the more important areas addressing systemic instability and its consequences. With stronger-than-expected recovery in East Asia, the containment of the damage in Russia and Brazil, and rebound of Western stock markets, emphasis has increasingly shifted towards costly self-defence mechanisms and greater financial discipline in debtor countries. Developing countries are urged to adopt measures such as tight national prudential regulations to manage debt, higher stocks of international reserves and contingent credit lines as a safeguard against speculative attacks, and tight monetary and fiscal policies to secure market confidence, while maintaining open capital account and convertibility. Big ideas for appropriate institutional arrangements at the international level for global regulation of capital flows, timely provision of adequate international liquidity with appropriate conditions, and internationally sanctioned arrangements for orderly debt workouts have not found favour among the powerful. Some "very big ideas" did not even make to the agenda of the international community as they were presumably found to be too radical to deserve official attention. These include:

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[2] For a summary of the proposals discussed and actions so far taken in the IMF, see IMF (1999a).

(i) A proposal by George Soros to establish an International Credit Insurance Corporation, designed to reduce the likelihood of excessive credit expansion;

(ii) A proposal by Henry Kaufman to establish a Board of Overseers of Major International Institutions and Markets with wide-ranging powers for setting standards and for the oversight and regulation of commercial banking, securities business and insurance;

(iii) A similar proposal for the creation of a global mega-agency for financial regulation and supervision or World Financial Authority with responsibility for setting regulatory standards for all financial enterprises, off-shore as well as on-shore entities;

(iv) The proposal to establish a genuine international lender-of-last-resort with discretion to create its own liquidity;

(v) The proposal to create an international bankruptcy court in order to apply an international version of chapter 11 of the United States Bankruptcy Code for orderly debt workouts;

(vi) The proposal to manage the exchange rates of the G3 currencies through arrangements such as target zones, supported by George Soros and Paul Volcker;

(vii) The Tobin tax to curb short-term volatility of capital movements and exchange rates.

There are certainly conceptual and technical difficulties in designing reasonably effective global mechanisms for the prevention and management of financial instability and crises. Such difficulties are also encountered in designing national financial safety nets, and explain why it is impossible to establish fail-safe systems. At the international level there is the additional problem that any system of control and intervention would need to be reconciled with national sovereignty, diversity and conflicting interests. For all these reasons it is not realistic to expect replication of national financial safety systems at the international level involving global regulation, supervision and insurance mechanisms, an international lender-of-last resort and international bankruptcy procedures.

However, political constraints and conflict of interest, rather than conceptual and technical problems, appear to be the main reason why the international community have not been able to achieve even a modest real progress in setting up effective global arrangements for the prevention and management of financial crises. However, political disagreements are not only between industrial and developing countries. There have also been considerable differences among the G7 members regarding the nature and direction of reforms. A number of proposals made by some G7 countries for regulation, control and intervention in the financial and currency markets have not enjoyed consensus, in large part because of the opposition of the United States.

By contrast agreement among G7 has been much easier to attain in areas aiming at disciplining the debtor developing countries.

It seems that a rules-based global financial system with explicit responsibilities of creditors and debtors, and well-defined roles for public and private sectors is opposed by major industrial powers which continue to favour a case-by-case approach because, *inter alia*, such an approach gives them considerable discretionary power due to their leverage in international financial institutions. However, it is not clear if such a system would be desirable from the point of view of smaller countries, particularly developing countries. For, it is not realistic to envisage that a rules-based global financial system could be established on the basis of a distribution of power markedly different from that of existing multilateral financial institutions. It would likely reflect the interest of larger and richer countries, rather than redressing the imbalance between international debtors and creditors. Such biases against developing countries exist even in the so-called rules-based trading system[3] where the North-South relation is a great deal more symmetrical than in the sphere of finance where developing countries are almost invariably debtors and industrial countries creditors.

Indeed, developing country governments have not always been supportive of proposed measures for reform. In a sense they have been ambivalent about the reform of the system, even though, because of their greater vulnerability, this is an issue deserving top priority for them. In many cases, this is motivated by their desire to retain policy autonomy. But they have also opposed measures, at national or global level, that would have the effect of lowering the volume of capital inflows and/or raising their cost even when such measures could be expected to be effective in reducing instability and the frequency of crises in emerging markets:

(i) A large majority of developing countries have been unwilling to impose control on capital inflows during the boom phase of the financial cycle with the objective of moderating them and deterring short-term arbitrage flows.

(ii) Emerging markets are generally unwilling to introduce bond covenants and collective action clauses, and have been asking industrial countries to take the lead in this respect.

(iii) Again developing countries are generally opposed to differentiation among sovereign risks in the Basle capital requirements for international bank lending, a measure now being proposed as part of the new framework by the Basle Committee (Cornford, 2000).

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[3] For a discussion of the asymmetries and biases against developing countries in the international trading system see UNCTAD (1999).

Given these differences among various groups of countries and conflicts of interest, it should come as no surprise that so far very little progress has been made in the reform of the global financial architecture. In what follows I will briefly go through the main areas of reform to discuss the state of play and the difficulties encountered in the reform process.

I. PROGRESS IN VARIOUS AREAS OF REFORM

A. Standards and transparency

It was generally agreed in the wake of the Asian crisis that prevention and better management of financial crises required greater transparency and disclosure of information regarding the activities of the public sector, financial markets and institutions and international financial institutions, particularly the IMF. This was thought to be necessary for markets to make prudent lending and investment decisions, for governments to implement effective measures for regulation and supervision of financial institutions and activities, and for the IMF to improve its surveillance. While many observers argued that greater availability of information would not by itself be sufficient to prevent financial crises, it was nevertheless generally agreed that disclosure and transparency were necessary ingredients of an improved financial architecture.

Action in the international community has so far concentrated on setting standards for and improving the timeliness and quality of information concerning key macroeconomic variables, and transparency of public sector activities including fiscal, monetary and financial policies. Less progress has been made regarding the financial reporting of banks and other financial firms, and almost none in the case of highly leveraged institutions and offshore markets.

While the *laissez-faire* ideology has played some role in the slow progress regarding the transparency of financial institutions, there are also serious conceptual and structural problems. It is generally agreed that public disclosure of information submitted to supervisors could in some circumstances enhance rather than diminish instability. Nor is it clear what constitutes relevant information, since there is considerable variation among industrial countries in both the quantity and form of publicly disclosed information. Furthermore, the increased speed at which financial firms can now alter their balance sheet and off-balance sheet positions renders financial statements out of date almost before they can be prepared.

Even more contentious is the transparency of the IMF itself. New mechanisms have been introduced in the form of PINs following Article IV consultations and a pilot programme for voluntary release of Article IV staff reports. However, there are difficulties in attaining full transparency of the IMF since governments often find objectionable the disclosure of confidential information they provide to the Fund. Moreover, owing to the political sensitivities involved as well as the questions regarding its track record in macroeconomic and financial diagnosis, temptations to turn the Fund into a fully-fledged credit rating agency are rightly resisted. Within these limits, however, there is scope to improve the transparency of the IMF. Its prescriptions could be subjected to independent review, for instance by a commission constituted by the United Nations.

B. Financial regulation and supervision

The official position here is to formulate global standards to be applied by national authorities, rather than to establish a global regulatory agency. In order to ensure that such standards be adopted and implemented by developing countries, IMF surveillance has now been extended to financial sector issues. However, it is generally agreed that the IMF itself should not become a global standard-setting authority in financial regulation and supervision, and that the BIS should not become a policeman of the international financial system.

Developments in the past few years have shown that the standards of the Basle Capital Accord are increasingly divorced from the credit risks actually faced by many banks, and are distorting incentives for banks regarding the capital maintained for a given level of risk. Moreover, while the short-term exposure of international banks has been a major feature of recent external debt crises, the Basle Capital Accord attributes a low risk weight for the purpose of calculation of capital requirements on interbank claims. Again, in the case of the majority of countries the same capital charge is assessed against a loan to a sovereign with an investment-grade rating as to one with a junk-bond rating. These have led to pressure for regulatory changes which would have the consequence of raising the cost to banks of such lending so that they better reflect its risks.

The new capital rules proposed in June 1999 include, *inter alia*, provision for risk weights for exposure to sovereign entities based on external assessment by rating agencies.[4] However, such an approach is highly contentious for two reasons. First, past record suggests that private rating agencies cannot be trusted

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[4] For an up to date account of the Basle Committee's proposals for revised standards see Cornford (2000).

for the assessment of country risk. Secondly, as noted above, such an approach is generally resisted by developing countries on grounds that the introduction of differentiated sovereign risk weights would lead for many of them to an increase in spreads and reduce the volume of lending.

There seems to be consensus that tightened regulation and supervision should be extended to highly leveraged institutions (HLIs – of which the most important examples are hedge funds) ones as well as to off-shore centres (subjects closely related since HLIs are often incorporated in off-shore centres). In the case of HLIs, this consensus reflects partly the realization, since the narrowly averted collapse of Long Term Capital Management in 1998, that such funds can be a source of systemic threat to financial stability, so that the traditional argument for subjecting them to only tight supervision based on their restriction to wealthy investors capable of protecting their interests no longer suffices. Moreover, the consensus is also a response to evidence assembled by certain Asian governments concerning the contribution of such institutions on occasion to the accentuation of volatility in the markets for currencies and other assets. However, so far little progress has been made in these areas. These issues are on the agenda of the Financial Stability Forum. Indirect control of HLI (e.g. through their creditors on the basis of enhanced transparency) appears to be the preferred option. The extent to which such institutions may eventually be subjected to direct control will depend on the effectiveness of reforms so far proposed.

C. Management of the capital account

The continuing incidence of financial instability and crises in industrial countries suggests that regulatory and supervisory reform and transparency are unlikely to provide fail-safe protection in this area. And if this statement is true even of countries with state-of-the-art financial reporting, regulation and supervision, it is likely to apply a fortiori to most developing economies. Thus, capital controls are increasingly seen as essential for greater stability.

There is a broad agreement that the boom-bust cycle in private capital flows needs to be moderated, and this can be attained by controlling short-term, liquid capital inflows through market-based measures such as such as taxes or reserve requirements. Controls on inflows would also reduce the likelihood of a rapid exit. Nevertheless, as the Malaysian experience indicates, should a crisis occur, temporary controls on outflows, which constitute an essential complement of debt-standstills (see below), can also be very effective.

Given that developing countries have no international commitment regarding the capital account, the position of international financial institutions on such matters may be thought to have little practical

consequence. However, without an unqualified recognition by the IMF of the need for control over short-term capital flows, developing countries would generally be unwilling to apply such measures for fear of undermining market confidence and reducing their overall access to international finance. Indeed, only a few countries have so far resorted to such measures during the boom phase. Moreover, in order to effectively carry out its bilateral surveillance, IMF recommendations should include capital controls, particularly to countries where the financial system is not robust enough to intermediate short-term inflows without leading to a build up of excessive currency risk and fragility. While retaining autonomy with respect to capital account policies remains essential for developing countries (as often reaffirmed in G24 communiqués), an official sanctioning of controls over certain types of capital flows would considerably strengthen their hand in managing their capital accounts.

However, there has been no agreement in the IMF Board on the use of capital controls. Some major shareholders still consider even moderate forms of control as exceptional and temporary, rather than essential components of capital account regimes in emerging markets. They seem to believe that sound macroeconomic policies and improved prudential regulations would do the trick. Thus, the IMF Progress Report states that the "Executive Board reached agreement on broad principles but differences remain on operational questions about the use and effectiveness of capital controls", and they put "stronger emphasis than was previously placed on the need for a case by case approach and on the adoption of prudential policies to manage the risks from international capital flows" (IMF, 1999a).

D. Exchange rate regimes

Recent debate on exchange rate policies in developing countries has concentrated on the question of connections between exchange rate regimes and financial crises. Pegged or fixed exchange rates have fallen out of favour on grounds that financial and currency crises in emerging markets have often been associated with such regimes. Accordingly, developing countries are increasingly advised to choose one of the two extremes; either to float freely, or to lock in their exchange rates to one of the major currencies, often the United States dollar, through such arrangements as currency boards, or even simply to adopt the dollar as their national currency.[5]

However, there are strong doubts that, under free mobility of capital, either of these extremes will provide better protection against currency instability and financial crisis than nominal pegs. Moreover, there

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[5] For a discussion of these alternatives see Eichengreen (1999: 103-109).

is a danger that neither will allow the exchange rate to be tailored to the requirements of trade and competitiveness. Contrary to some perceptions, countries with flexible exchange rates are no less vulnerable to financial crises than those with pegged or fixed exchange rates. Differences among pegged, floating and fixed regimes lie less in their capacity to prevent damage to the real economy and more in the way damage is inflicted: for instance, in real terms Argentina and Hong Kong (China) – both economies with currency boards – have suffered as much and even more than their neighbours experiencing sharps declines in their currencies. There now appears to be a growing consensus that better management of exchange rates in developing countries requires targeting real exchange rates in combination with the control and regulation of destabilizing capital flows. This is often seen to offer a viable alternative to free floating or to a complete ceding of monetary authority to a foreign Central Bank.[6]

Developing countries have resisted the notion that adoption of a particular exchange rate regime should be part of the IMF conditionality for access to international liquidity. In any case, the IMF has not always kept to the newly emerging consensus among the mainstream economists to avoid pegged exchange rates. For instance, the Fund has been supporting an exchange-based stabilization programme in Turkey, put in place at the end of 1999, with a preannounced exchange rate to provide an anchor to inflationary expectations.

But perhaps more fundamentally, it is open to question whether emerging markets can attain exchange rate stability simply by adopting appropriate macroeconomic policies and exchange rate regimes when the currencies of the major industrial countries are subject to large gyrations. Indeed, many observers (including Paul Volcker and George Soros) have suggested that the global economy will not achieve greater systemic stability without some reform of the G3 exchange rate regime, and that emerging markets remain vulnerable to currency crises as long as major reserve currencies remain highly unstable. However, various proposals for exchange rate coordination, including target zones for G3 currencies (an idea briefly supported by Germany), have so far been opposed by the United States.

E. Surveillance of national policies

A crucial area of reform is the IMF surveillance over the policies of creditors as well debtors. In view of the growing size and integration of financial markets, every major financial crisis now has global ramifications. Consequently, preventing a crisis is a concern not only for the country immediately affected but

[6] For a detailed discussion of this issue see UNCTAD (1999, chapter VI).

also for other countries. This is why global surveillance of national policies is called for. So far, however, IMF surveillance has not been successful in preventing international financial crises. This reflects, in part, belated, and so far only partial, adaptation of existing procedures to the problems posed by the large private capital flows, and is closely related to serious shortcomings in the existing governance of the IMF.

Traditionally bilateral surveillance has concentrated on macroeconomic policies, paying little attention to sustainability of capital inflows and financial sector weaknesses associated with surges in such inflows. After the Mexican crisis, IMF surveillance was extended to include the sustainability of private capital flows,[7] but this did not prevent the East Asian crisis. The need for strengthening IMF surveillance has again been recognized by the Interim Committee in April 1998 which agreed that the Fund "should intensify its surveillance of financial sector issues and capital flows".[8] Clearly, to succeed, IMF will need to pay greater attention to unsustainable exchange-rate and payment developments and, as already noted, its recommendations should include control over capital inflows. However, this would mean a major departure from the current official approach to capital account management.

But perhaps more fundamentally the failure of IMF surveillance in preventing international financial crises is due to the unbalanced nature of these procedures, which give too little recognition to the disproportionately large global impact of monetary policies in major industrial countries. Financial crises in emerging markets are not always home-grown; they are often connected with major shifts in exchange and interest rates in the major industrial countries. This was true not only for the debt crisis of the 1980s, but also for more recent booms and busts in capital flows to Latin America and East Asia.

Certainly, given the degree of global interdependence, a stable system of exchange rates and payments positions calls for a minimum degree of coherence among the macroeconomic policies of major industrial countries. But the existing modalities of IMF surveillance do not include ways of attaining such coherence or dealing with unidirectional impulses resulting from changes in the monetary and exchange-rate policies of the United States and other major OECD countries. Countries elsewhere in the world economy lack mechanisms under the existing system of global economic governance for redress or dispute settlement regarding these impulses. In this respect governance in macroeconomic and financial policies lags behind that for international trade, where such mechanisms are part of the WTO regime. But if such a function is to be performed effectively by multilateral financial institutions, it would be necessary to reform not only the surveillance

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[7] IMF Executive Board Decision No. 10950-(95/37) of 10 April 1995.

[8] Interim Committee *Communiqué* of 16 April 1998.

procedures, but also the governance of these institutions, including its voting structure and decision-making procedures, to give greater weight to the views of developing countries. However, so far the only significant reform in this respect has been to rename the Interim Committee (International Monetary and Financial Committee) and to reaffirm that after 25 years of existence it is no longer interim but permanent!

F. Provision of international liquidity

With the increased frequency of crisis in emerging markets, a consensus has emerged on the need to provide contingency financing to countries experiencing payments difficulties linked to the capital account, in addition to the traditional role of the Fund to provide current account financing. However, the modalities regarding the provision of liquidity, its adequacy, the conditions attached to it, and its funding remain extremely ad hoc and inadequate to address the problems associated with systemic instability.

Provision of liquidity to pre-empt large currency swings has not been the international policy response to currency crises in developing countries. Rather assistance coordinated by the IMF has usually come after the collapse of the currency, in the form of bailouts designed to meet the demands of creditors, to maintain capital-account convertibility, and to prevent default, thereby creating moral hazard for international lenders and investors, and putting the burden on debtors. Moreover, availability of such financing has been associated with policy conditionality that went at times beyond macroeconomic adjustment, interfering "unnecessarily with the proper jurisdiction of sovereign government" (Feldstein, 1998: 26). Finally, provision of funds needed for bailouts often depended on ad hoc arrangements with the IMF's large shareholders, which as creditors often have important interests to protect.

Efforts to eliminate these shortcomings in the provision of liquidity have been unsatisfactory. The IMF has taken several steps to strengthen its capacity to provide financing in crises, including the Supplemental Reserve Facility established in response to the deepening of the East Asian crisis, and more recently the creation of the Contingency Credit Line to provide a precautionary line of defence against financial contagion. However, none of these facilities have resulted in additional money, relying on the existing resources of the Fund. A proposal has been made to allow the Fund to issue reversible SDRs to itself for use in the provision of international liquidity (Ezekiel, 1998; UN, 1999; Ahluwalia, 1999). But this would require an amendment of the Articles of Agreement and would face opposition from some major industrial countries.

The terms of access to such facilities continue to face a number of problems. Clearly, lending in unlimited amounts and without conditions except for penalty rates would require much tightened global

supervision over borrowers to ensure their solvency, an unlikely development. While automatic access would ensure a timely response to market pressures, it could also create moral hazard and considerable risk for the IMF. By contrast, conditional withdrawal of funds would reduce the risk of moral hazard, but negotiations could cause long delays, perhaps leading to deepening of the crisis. It could also lead to irrational and unnecessarily tough conditionality since the countries facing attacks on their currencies would be too weak to resist such conditions.

Pre-qualification is proposed as a way of avoiding these problems.[9] In such an arrangement, countries meeting certain *ex ante* conditions would be eligible for lender-of-last-resort financing, with eligibility being determined during Article IV consultations. However, it would still be necessary constantly to monitor the fulfilment of the terms of the financing, adjusting them as necessary in response to changes in conditions. In these respects difficulties may emerge in relations between the Fund and the member concerned.

Such problems are exemplified by the recent Brazilian agreement with the IMF. The Brazilian package might be described as the first experiment with the provision of international lender-of-last-resort financing to an emerging market: it was intended to protect the economy against contagion, subject to a stringent fiscal adjustment and a gradual depreciation of the *real* throughout 1999. After a political struggle the Brazilian Government succeeded in passing the legislation needed to meet the fiscal target. But when the attack started, the currency was allowed to collapse, and the Fund required additional and more stringent conditions regarding the fiscal balance in order to release the second tranche of the package.

G. Orderly debt workouts

The international community faces a major dilemma in formulating policies towards international capital flows. In the absence of capital controls, financial crises are likely to be increasingly frequent, severe and extensive. When a crisis occurs, defaults are inevitable in the absence of bailouts. But bailouts are becoming increasingly problematic. Not only do they create moral hazard, but more importantly, the funds required have been getting larger and are now reaching the limits of political acceptability. This is the main reason why the international community has been engaged in finding ways to "involve" or to "bail-in" the private sector in the resolution of currency and debt crises. However, in this area too no agreement has been reached, in large part because of the resistance of some major countries to involuntary mechanisms.

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[9] This was first proposed by Fischer (1999) and more recently by the Meltzer Commission Report.

A way out of the dilemma would be recourse to the principles of orderly debt workouts along the lines of Chapter 11 of the US Bankruptcy Code, first raised by UNCTAD in the 1986 *Trade and Development Report* (*TDR*) in the context of the debt crisis of the 1980s, and further elaborated in *TDR 1998*. These procedures are especially relevant to international currency and debt crises resulting from liquidity problems because they are designed primarily to address financial restructuring rather than liquidation. They allow a temporary standstill on debt servicing in recognition of the fact that an asset grab race by the creditors is detrimental to the debtor as well as to the creditors as a group. They provide the debtor with access to working capital needed to carry out its operations while granting seniority status to new debt. Finally they involve reorganization of assets and liabilities of the debtor, including extension of maturities, and, where needed, debt-equity conversion and debt write-off.

Naturally, the application of bankruptcy procedures to cross-border debt involves a number of complex issues. However, the principles are straightforward and can be applied without establishing full-fledged international bankruptcy procedures. The most contentious issue is the standstill mechanism since IMF now lends into arrears and it is heavily involved in debt work-outs. Clearly, to have the desired effect on currency stability, debt standstills should be accompanied by temporary exchange controls over all capital-account transactions by residents and non-residents alike. According to one proposal, standstills would need to be sanctioned by the IMF. Canada has proposed an Emergency Standstill Clause to be mandated by IMF members.[10] There could also be other arrangements including pre-qualification for unilateral standstill decision by the countries concerned, or empowering an independent panel to sanction such decisions similarly to the way in which WTO safeguard provisions allow countries to take emergency actions.

As noted by the IMF Progress Report, there has been no agreement over empowering IMF to impose stays on creditor litigation: "Some Directors thought that amending Article VIII, Section 2(b) warranted further consideration; others did not see the need for, or feasibility of, such action" (IMF, 1999). A number of G7 countries, including Canada and United Kingdom, proposed to establish a rules-based system for crisis resolution, with explicit rules on the respective roles of the public and private sectors. However, private financial institutions have been opposed to an involuntary mechanism of standstill or rollover. The United States continues to defend a case-by-case approach for the reasons already mentioned.

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[10] Department of Finance, "Canada's Six-point Plan to Restore Confidence and Sustain Growth", September 1998.

This lack of agreement has also meant placing greater emphasis on voluntary mechanisms (Group of 22, 1998, section 4.4; IMF, 1999b). The dilemma here is that the need for mandatory provisions has arisen precisely because voluntary approaches have not worked in stemming debt runs. On the other hand, while a number of proposals have been made to introduce mechanisms to provide automatic triggers, such as comprehensive bond covenants, automatic debt roll-over options or collective action clauses designed to enable debtors to suspend payments, these are unlikely to be introduced voluntarily and would need an international mandate.[11] Indeed, developing countries fear that such clauses would reduce their access to financial markets, thus insisting that they first be introduced in sovereign bonds of industrial countries, an objective which may require an international mandate.

II. CONCLUSIONS

Discussions above suggest that, despite a proliferation of meetings and communiqués as well as a multiplication of groups and fora, there remains a reluctance to accommodate the concerns of developing countries regarding international financial reform. Thus in the current political environment, the maximum feasible strategy for developing countries in their search for an effective reform at the global level would seem to be to press for internationally-agreed arrangements for debt standstills and lending into arrears to help them to better deal with financial crises when they occur. However, until systemic instability and risks are adequately dealt with through global action, the task of preventing such crises falls on governments in developing countries, at the national and regional level.

There can be little doubt that the developing countries now enjoy much less policy autonomy than any time in the post-war period. This loss of autonomy has three origins. First, systemic pressures have increased on governments as a result of liberalization and integration of markets. This is most visible in the case of financial markets. As a result of the greater exit option enjoyed by capital, governments policies have now become hostage to financial markets, and the kind of discipline that these markets impose on governments is not always conducive to rapid growth and development. Second, policies in developing countries are also subject to pressures from major industrial powers and multilateral institutions. Finally, a number of policy

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[11] Concerning these difficulties see Eichengreen (1999): 66B69. For universal debt roll-over options, see Buiter and Silbert (1999).

instruments are no longer available to some developing countries as a result of their international commitments as part of their membership to such blocks as the OECD or NAFTA.

Nevertheless, there is much greater scope for domestic policies for regulating and controlling capital flows than has been exploited in many developing countries. There is no global agreement that forces the developing countries to open up their financial markets. There is indeed considerable variation within the South in the extent to which policy autonomy has been used in the domain of finance. For instance, while India and China have pursued a much more gradual and cautious approach to international capital flows, many countries in Latin America have rapidly opened up their capital account and financial sector. Again, a comparison between the policies adopted by Malaysia and the others in response to the East Asian financial crisis shows that policy options even under crisis conditions are not as narrow as generally assumed. If developing countries are to avoid costly financial crises, it is essential that their autonomy in managing capital flows and choosing whatever capital account regime they deem appropriate should not be constrained by international agreements on capital-account convertibility or trade in financial services, and that they should effectively exploit the room they have for these purposes.

There is also much that could be done at the regional level, particularly among like-minded governments who are prepared to establish collective regional defence mechanisms against systemic instability and contagion. In this respect, the experience of Europe with the monetary and financial cooperation and the ERM, introduced in response to the breakdown of the Bretton Woods system, holds useful lessons. Regional monetary and financial cooperation among developing countries, including exchange rate arrangements, macroeconomic policy coordination, regional surveillance, common rules and regulations over capital flows, and regional mechanisms for the provision of international liquidity, could be a viable and more easily attainable alternative to global mechanisms designed to attain greater stability.

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