

THE TRENDS OF THE REFORM OF INTERNATIONAL MONETARY SYSTEM IN THE GLOBALIZED FINANCIAL WORLD MARKET: FROM THE PERSPECTIVES OF DEVELOPING COUNTRIES

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Resumen

The international monetary and financial crisis that began in Thailand on July 2, 1997 spread over rapidly other emerging market economies in East Asia and transition economies, and even to some of the industrialized countries. In terms of both its scope and its impact, the world economy is experiencing the most serious monetary and financial crisis since the breakdown of Bretton Woods System in the early 1970s. These influences were much more global than the other crises world economy has seen in the past two or three decades.

Clasificación JEL: N15; E44; F33

Recibido: 10 de mayo de 2001.

Enviado a dictamen: 14 de mayo de 2001.

Aceptado: 3 de julio de 2001.

International Monetary Fund (IMF) Managing Director, Michel Camdessus characterized this crisis as “the first financial crisis of the twenty-first century”. In his words:

“Mexico’s crisis has been described as the first financial crisis of the twenty-first century, meaning the first major financial crisis to hit an emerging market economy in the new world of globalized financial markets. And this says a lot about its significance. –Furthermore, financial globalization has increased the speed with which disturbances in one country can be transmitted to others. So financial globalization, though both a product of and a contributor to the economic progress of our time, has heightened the challenges of preventing and resolving financial crises.” [Camdessus, M., 1995].

The crisis has demonstrated with particular severity on this occasion, that the stable real economic development is far more important for developing countries and emerging market countries than their financial liberalization and deregulation to foreign capital flows (including short-term capital flows). Financial liberalization has contributed to severe financial turmoil and economic losses to several developing countries and emerging market economies that have integrated into the globalized financial world. The East Asian financial crisis has also demonstrated a fundamental problem in the capitalist world economy that the existing international financial institutions, particularly the IMF, are inadequate to deal with “today’s high-tech financial crises” [De Gregorio, J., *et. al.*, 1999] and not sufficiently to anticipate them. Accordingly, this systemic shortcomings and the associated threat of recurring financial crises in the future have underscored the urgent need for a comprehensive reform of the international financial system.

A number of proposals have been made since the East Asian crisis in these areas by governments, international organizations such as the IMF, private researchers,

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market participants, and academic circle. [De Gregorio, J., *et. al.*, 1999] [Kaizer, Karl, *et. al.*, 2000], [Savona, Paolo, 2000], [Eichengreen y Sussman, 2000], [Griffitt-Jones, S., 1999] First of all, the paper begins to inquire into the major features of the reforms of the international financial system which proposed by the IMF, the G-7, and U.S., secondly, investigate the real nature of “Towards a new international financial architecture” presented by the Executive Committee on Economic and Social Affairs of the United Nations on January 21st, 1999. Finally, it ends with a brief discussion of what developing countries could do at the globalized financial world to establish defense mechanisms against international financial crises and contagion. Since the impacts of recent financial crises have been particularly severe in developing countries and their effects on the real economy are far larger than in industrialized developed countries.

Broad international consensus with the reform of international monetary system among the IMF and the G-7

Broad international agreements have been reached on a number of crucial measures to ensure a more stable international financial system among the IMF and major developed countries. Major contents and features are as follows:

Greater transparency and enhanced accountability

The IMF helps foster better decision-making and economic performance by further improving transparency in the policies and practices of member countries. Also, the IMF intends to improve the effectiveness of surveillance and Fund-supported programs and to enhance public dialogue on member countries. The IMF recognized that the East Asian crisis made clear the importance of transparency on the part of the international financial institutions themselves and that increased transparency could help prevent the buildup of countries’ financial and macro-economic imbalance. Furthermore, the admitted accountability is important for all institutions [Economic Report of the President, 1999: 269-270].

Several initiatives have been launched to improve the transparency of the IMF.

- 1) The active encouragement of the release of Public Information Notices (PINs) following Article IV consultations.
- 2) The establishment of a presumption to release Letters of Intent (LOIs), Memoranda of Economic and Financial Policies (MEFPPS).
- 3) The release of staff assessments of members; Poverty Reduction Strategy Papers (PRSPs); it is envisaged that the country-owned PRSPs will also be published.
- 4) The release of the Chairman’s; Statement following Executive Board discussions on the Use of Fund Resources (UFR).
- 5) Expanded public access to the IMF’s archives.
- 6) The public release of key policy documents in a wide range of areas combined, in some instances, with requests for public comments.
- 7) The publication of regular information on the IMF’s Liquidity position and on member’s accounts with the IMF on the web site.
- 8) The publication of the IMF’s quarterly financial transactions plan (formerly called the operational budget).
- 9) The pilot program for the voluntary public release of Article IV staff reports. [Report, 2000: Appendix I].

Strengthening financial system

Recent financial crises in a number of countries and cross border contagion have demonstrated the need to strengthen countries’ economic fundamentals and financial systems and, in particular, to improve abilities to identify financial sector risks and vulnerabilities at an early stage. To carry out this work most effectively, this work should be carried out in conjunction with the World Bank [G-7 Financial Ministers Report, 1999], [IMF, 2000]. The IMF has intensified its work on the following sectors:



- 1) The joint IMF-World Bank *Financial Sector Assessment Program (FSAP)* was introduced on a one-year pilot basis during 1999. The FSAP is designed to help countries reduce vulnerabilities within their financial sectors and to assist in determining priorities for longer term financial sector development.
- 2) Within the IMF, Financial Sector Stability Assessments (FSSAs), which are designed to provide a sharper focus on vulnerabilities identified during the FSAP, are prepared on the basis of the FSAP reports for each country.
- 3) The Executive Boards of the IMF and World Bank recently considered a progress report on the FSAP. On the basis of the experience gained so far with the pilot, it has been agreed to continue the Program [IMF, 2000: Box 3].
- 4) Work on strengthening financial systems has also progressed in other forum, for example the Basel Committee, which has continued work to flesh out the new capital adequacy framework. On the other hand, the Financial Stability Forum (FSF) Working Group on Highly Leveraged Institutions and Offshore Financial Centres have presented their final reports and recommendations [IMF, 2000: Appendix II].

Capital account liberalization and capital controls

The Executive Board has emphasized the substantial benefits of capital account liberalization, but stressed the need to carefully manage and sequence liberalization in order to minimize risks.¹ While there remain differences of view on the merits of capital controls, it is generally agreed that controls cannot substitute for sound

¹ The economic Report of the President puts much emphasis on the benefits of free capital mobility. "The United States and most other leading industrial countries, for example, do well without capital controls. First, with unrestricted capital mobility, the market is free to allocate saving to the best investment opportunities,—. Second, firms and other borrowers in high-growth countries can obtain funds more cheaply abroad in the absence of controls than if they had to finance their investments at home. Third, free capital mobility allows investors and households to diversify risk. Fourth, the scrutiny of global investors can provide an important discipline on policymakers." (*Economic Report*, 1999: 281-282).

macroeconomic policies, although they may provide a breathing space for corrective action.

Since the emerging markets economies crisis, the surveillance of capital account development has been given greater prominence in Article IV consultations. Special attentions is being given to risks posed by the potential reversal of capital inflows, the impact of selective capital account liberalization and the rapid accumulation of foreign-currency denominated debt [IMF, 2000].

- 1) The Executive Board reached agreement on broad principles including the need for a case-by-case approach in assessing the use and effectiveness of capital controls.
- 2) FSF published report on capital flows emphasized the need to monitor risks and avoid distortions that could encourage buildup of unwarranted external exposure for enhanced risk management by public and banking sectors and for improved data and transparency.
- 3) Against this background, FSF suggested that capital controls (on inflows) with a prudential element can be considered in some instances, provided macro framework is sound.
- 4) As next step, IMF Executive Board intends to discuss in 2000 the linkage between capital account liberalization and financial stability, and how stability can be safeguarded in a liberalized capital account regime and in the process of liberalization [IMF, 2000: Appendix I].

The establishment of appropriate exchange rate regimes

The choice of an appropriate exchange rate regime has become ever more important as an increasing number of countries have become more closely integrated in world capital markets in an environment of widespread liberalization and expansion of capital movements. IMF Executive Board has reexamined the issue of appropriate exchange rate regimes, emphasizing that sound exchange rate policies are central to the effective operation of the international monetary system. It has stressed the need



for the IMF to continue to exercise firm surveillance over the exchange rate of most member countries, particularly of advanced and emerging markets economies, and to provide candid advice to members on their choice of exchange rate regimes.

The main conclusions of the Executive Board concerning exchange rate regimes:

- 1) No single exchange rate regime is appropriate for all countries or in all circumstances. The existing system of flexible exchange rates among the three major currencies (dollar, yen and euro) is likely continued to prevail. Other countries would, therefore, need to adapt to a global environment of exchange rate variability.
- 2) In recent years, several emerging market countries have adopted a flexible exchange rate regime. The requirements for maintaining a peg when capital is internationally mobile are exacting.
- 3) Large exchange rate fluctuations in small or medium-sized open economies may have significant economic costs.
- 4) If credible supporting policies and institutions are in place, a peg could still be viable for the smaller, more open economies, especially those less open to short-term capital flows or with a dominant trade partner.
- 5) The IMF should continue to respect the exchange rate regime choices of members, but its surveillance and programs must seek to ensure that countries' policies and circumstances are consistent with their exchange rate regimes.²

² Economic Report of the President said that financial market openness, monetary policy independence, and exchange rate stability are sometimes called the "impossible trinity" (*Economic Report 1999*: p. 288) [Cologne, 1999].

IMF reform

In view of the rapid changes occurring in the global financial landscape, and in particular the increasing importance of private global capital markets, the G-7 believes it is essential that the international community continues to examine the role and functioning of the IMF and other international financial institutions.

At their spring meeting with Central Bank Governors in April 2000, they laid out the following key principles:

- 1) The IMF should play the central role in promoting macroeconomic and financial stability as an important precondition for sustainable global growth.
- 2) The IMF is a universal institution that must work in partnership with all its member countries.
- 3) To be effective, the IMF and its activities must be transparent to the public, accountable to its members and responsive to the lessons of experience and external and independent evaluation.
- 4) Preventing crisis and establishing a solid foundation for sustainable growth should be at the core of the IMF's work. So, surveillance of economic and financial conditions and policies in member countries and the implementation of internationally agreed codes and standards are primary tools for accomplishing these aims.
- 5) IMF's financial operations should continue to adapt to reflect the realities of global capital markets and they should encourage countries to take preventive measures to reduce vulnerabilities and provide temporary and appropriately conditioned support for balance of payments adjustment.
- 6) IMF lending should not distort the assessment of risk and return in international investment to this end, the IMF should take appropriate steps to ensure the private sector for both in forestalling and resolving crises.

³ For a number of the specific proposals toward reform of Financial Ministers of the G-7 countries, see pp. 7-22 in *Report*, 2000.

While the World Bank is the central institution for poverty reduction, supporting macroeconomic stability in the poorest countries through the Poverty Reduction and Growth Facility is the responsibility of the IMF.³

Involving the private sector in forestalling and resolving crises

The IMF and the G-7 (Report of the G-7 Finance Ministers to the Cologne Economic Summit) confirmed that the involvement of the private sector to forestall and resolve financial crises, and prevention remains the first line of defense against crises. Recent crises have emphasized that consistent macroeconomic and exchange rate policies, sound debt management, effective prudential supervision of financial systems are all critical elements of a policy framework designed to manage vulnerabilities and thereby reduce the frequency and severity of crises. At the same time, policies designed to improve the environment for private sector decision making can also contribute to reducing international financial vulnerability and instability.

The Executive Board see merit in continuing to work toward an operational framework for securing private sector involvement, building on the principles and framework articulated by the G-7 Finance Ministers in their report to the Cologne Economic Summit [IMF, 2000], [G-7 Financial Ministers Report, 1999]. Specific proposals required are as follows:

- 1) Allow the IMF to lend into *sovereign arrears* to private bondholders to support adjustment measures during debt negotiations. The Executive Board modified the 1989 policy to allow the IMF to lend into arrears to private bondholders during negotiations and implemented in Ukraine and Russia in June/July 1999.
- 2) Allow the IMF to lend into *nonsovereign arrears* arising from the imposition of exchange controls, to support adjustment measures during debt negotiations. The Board extended further the 1989 policy to lend into nonsovereign arrears during negotiations.

- 3) Encourage countries to consider changes in the *terms of foreign sovereign bond* contracts to speed the negotiation process in times of difficulties, as appropriate. Directors supported the proposal. Many Directors suggested that industrial countries introduce such terms in their own bond issues.

- 4) Consider measures to raise the cost of *short-term cross-border capital flows*. Specifically, make capital requirements a function of the type of funding; have the monetary authority charge banks directly for the existence of sovereign guarantees; and on the lending side, assign higher risk weightings to interbank lines under the Basle Capital Accord. Most Directors saw the merit. The Executive Board has urged consideration of these proposals on a fast track of early implementation of proposals that can gather international support.

Encourage countries to arrange *commercial contingent credit lines*. The Executive Board generally supported with appropriate pricing, but noted that creditors may withdraw other credit lines when contingent lines are drawn, and that care was needed in design. Argentina, Indonesia, and Mexico have arranged such lines to September 1999 [IMF, 2000: Appendix I], [IMF, April 1999][G-7 Financial Ministers Report, July, 2000].

The evolving of IMF financial facilities

The Executive Board has initiated a fundamental review of the design and operation of the IMF's non-concessional financing facilities to determine whether and how they need to be modified to meet members' needs in a changing world economy. This review is a part of the broader debate on the architecture of the international financial system in view of the profound changes in recent years and touches on issues that go to the core of the IMF's role in that system. Specific proposals required are as followed:

- 1) Increase the IMF quotas, bring into force the New Arrangements to Borrow (NAB), and allow for the special one-time allocation of Special Drawing Rights (SDRS).



The increase in IMF quotas and the NAB have become effective following 11th General Review of Quotas.

- 2) Secure full financing for the interim Poverty Reduction and Growth Facility (PRGF) and IMF's participation in Heavily Indebted Poor Countries (HIPC) initiative. In December 1999, the Executive Board took decisions to allow bilateral contributors and the IMF to make contributions to PRGF-HIPC Trust.
- 3) Assess consistency of IMF's existing facilities with IMF's role in today's global economy. In preliminary discussions, broad consensus that no changes to the SRF (Supplemental Reserve Facility) will be pursued at this stage, but that the design of the CCL (Contingent Credit Lines) should be reconsidered. A variety of views on the EFF (Extended Fund Facility), but agreement that strict judgements are needed on eligibility.

Simplify structure of IMF facilities to enhance transparency to members and to the public. The Board has decided to eliminate Currency Stabilization Funds (CSF), commercial bank Debt and Debt Service Reduction (DDSR), the contingency element of the Compensatory and Contingency Financing Facility (CCFF), and the Buffer Stock Financing Facility (BSFF) [IMF, 2000: Appendix I] [IMF, April 1999] [G-7 Financial Ministers Report, July 2000] [G-7 Financial Ministers Report, 1999: 286-287].

Some problems on the consensus for the reform of international monetary system

A number of proposals for the reform of international monetary system have been made since the East Asian financial crisis by international institutions, governments, and private researchers. The international broad consensus in these areas by the IMF and the G-7 members were almost 7 areas as mentioned above. Of course, there have been considerable differences among the G-7 countries regarding the nature and direction of reforms. Strange to say, both major industrial and developing countries are doubt of whether the broad consensus can be successful in predicting and preventing future financial crises at the globalized financial markets.

Transparency and information

Following the Mexican and East Asia crises, the IMF has emphasized the importance for better transparency and information. The central element of the IMF's own initiatives in this area is the Special Data Dissemination Standard (SDDS), which was established in April 1996 to guide member countries in the public dissemination of economic and financial information in the context of seeking to international financial markets. At the same time, it was hoped that the new, more stringent rules associated with the SDDS would serve as an early warning system to prevent future financial crises. However, ultimately the rules did not make such a contribution in the case of the East Asian financial crisis.

While the SDDS are capable of providing additional, more timely and reliable information to investors and policymakers, emphasis on inadequate information is the major reason for failure to forecast the Asian financial turmoil appears exaggerated. The financial turmoil has pointed to weaknesses in available information appropriate to governments' ability to manage capital flows and external debt. In some cases, the existing data systems provide inadequate indications about the scale and nature of the exposure of Asian banks to other countries in the region, and about the country of ultimate risk in international inter-bank lending.

It should be noted that quicker access to macroeconomic and financial information may also be a source of financial instability and general dissemination of certain up-to-date data is capable actually of increasing the volatility of capital flows [UNCTAD, 1998: 95-96]. As Paul R. Krugman said "—international markets are imperfectly, competitive, characterized by imperfect information, and in some cases demonstrably inefficient" [Krugman, 1989] available imperfect information for imperfect capital and banking markets can not prevent and forestall the financial crises perfectly.

The Euro-Currency Committee at the Bank for International Settlement (BIS) has drawn up a framework for the regular collection of statistics on over-the-counter



derivatives markets on the basis of reporting by leading market participants. Such efforts to improve transparency, particularly in relation to derivatives, and HLIS, such as hedge funds, are widely welcomed. This sector, however, constantly evolving and there is a concern that regulatory reporting will never be able to keep pace with this complex and dynamic markets. It seems important for many central banks of member countries (naturally, including developing countries) and the BIS to improve registration of derivatives and hedge funds by making it obligatory [Griffith-Jones, 1999], but I think it seems impossible to make it obligatory in most case. Consequently, crucial information on international financial markets available to policy makers, especially in developing countries is clearly unsatisfactory, above all before and during financial crises.

Even more a lot of argument is the transparency of the IMF itself. Greater transparency mechanism have been introduced in the form of Public Information Notices (PINs) following Article IV consultations. There are, however, crucial difficulties in acquiring full transparency of the IMF since member countries are undesirable to disclose of their confidential information they provide to the IMF [Akyuz, 2000].

Global surveillance

The IMF surveillance has to adapt continuously to new global world, especially to the rapidly evolving and growing world financial markets. The basic objective of surveillance must be defined in terms of the IMF's responsibility for the promotion of external sustainability of its member countries. Primary interests of surveillance are issues related to the sustainability of a country's balance of payment, its overall macroeconomic developments and policies (monetary, fiscal and exchange rate policies), and issues bearing on vulnerability to financial crises (especially, financial sector issues, the current account balance, and capital account flow and stocks). The Executive Board emphasized that surveillance must be informed by timely, comprehensive and accurate data, and called for more real assessments of data inferiority. One of specific proposals was an early warning system (EWS), which develops and tests empirical models that may help to predict balance of payments crises

[IMF, April 1999]. However, the IMF surveillance has not been successful in predicting and preventing East Asian financial crisis.

This failure reflects only partial adaptation of existing procedures to the problems posed by large autonomous private capital flows. But perhaps more fundamentally it is due to the unbalanced nature of these procedures, which give too little recognition to the disproportionately large global impact of the monetary and exchange rate policies of the United States and a few other OECD countries.

International financial crises in emerging markets economies are not always home-grown, but they often connected with great changes in exchange and interest rate in the core countries. However, IMF surveillance does not include ways of dealing with unilateral impulses resulting from changes in their policies [UNCTAD, 1998: 93-94].

The need for strengthening IMF surveillance has 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".⁴ Accordingly, the IMF will need to pay greater attention on external influences produced by monetary and exchange rate policies of the major industrial developed countries, and also its recommendations should include the systemic control over capital flows.⁵

Controls of capital account

The continuing events of financial turmoil in developed industrial countries suggest that regulatory and supervisory reform and surveillance are unlikely to provide safety protection in this area. If this situation is true of countries with supreme reporting, regulation and supervision, it is

⁴ See Interim Committee Communiqué of April 16th, 1998.

⁵ Paul Bowles argues, "the need for the systemic regulation of international capital flows and for mechanisms to address macroeconomic imbalances caused by swings in the currencies of the core countries has been given relatively little weight in comparison" [New Political Economy, 2000: 442].



likely to apply naturally to most developing countries without them. Therefore, capital controls are increasingly regarded as necessary for greater stability to them.

The key characteristic of the economic globalization trend in recent years has been a rapid increase of international financial activity. For example, the daily volume of transaction in the world's major foreign exchange markets reached almost \$ 1 trillion by the early 1990s, this figure close on forty times the daily value of international trade [Goldstein, *et. al.*, 1993:1]. And net capital inflows to developing countries have risen by more than twenty-fold in nominal terms since 1970. However, these increases would appear to be response to financial instability of private capital flows, especially short-term bank loans and much portfolio investment.

Capital account liberalization has contributed to severe financial turmoil and economic losses to some developing countries that have deeply integrated into the global financial markets. The developing countries had been drawn into the process of financial liberalization partly due to prominence of advocates of market-oriented or "neo-liberal" thought in these countries and to "advice" given by international financial institutions, especially the IMF. Freedom of capital movements was not a principle of the IMF's original Articles of Agreement.

However, gradual relaxation of initial limitations on the IMF's involvement in the liberalization of capital account transactions has been evident in a number of decisions since the late 1970s. "The Fund has become a major proponent of capital account liberalization, and the G-7 governments are currently seeking to change the Articles to make this a central part of its mandate" [Bullard, *et. al.*, 1998: 133]. At the September 1997 Hong Kong annual meeting of the IMF and World Bank, the Interim Committee gave the IMF a mandate to alter its Articles, by which it would have additional "dictatorship" over the capital account as well as over the current account of members' balance of payments.⁶

⁶ The bailout package presented by the IMF to the Government of the Republic of Korea contained conditions relating to the liberalization of capital transactions. [Yoshikawa, 2000].

However, financial crisis in East Asia has dramatically demonstrated the negative effects caused by volatile short-term capital flows and the grave dangers that accompany capital account liberalization in some developing countries. The latest financial crisis has showed the argument of the orthodox thought that liberalization of global finance would bring mainly benefits, especially, in case of foreign direct investment which is not only stable but also brings technological know-how and lowers the cost of capital for creditworthy firms. However, when large surges of short-term capital to developing countries took place, it led to real estate bubble and sudden sharp reversals caused acute depreciation which multiplied the burden of servicing foreign debt. At UNCTAD X, Yilmaz Akyuz (Head of the UNCTAD Macroeconomic and Development Policies Branch) argued as follows: " It is true that control and regulation over such flows may reduce some of the benefits of participating in global markets. 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" [Akyuz, 2000].

Exchange rate regimes

Recent arguments on exchange rate regimes in developing countries have concentrated on the problem of connections between exchange rate policies and financial fragility in East Asia, and of monetary authorities' response to selecting for the stable exchange rate regime. The flexible exchange rates⁷ would imply appreciation in nominal

⁷ Details of flexible exchange rate arrangements are as follows: Flexibility limited vis-à-vis single currency, the value of the currency is maintained within certain margins of the peg. Some Middle Eastern countries adopt this system. Flexibility limited: cooperative arrangements, this system is a cross between a peg and a float and this applies to countries in the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS). EMS currencies are pegged to one another, but otherwise float. More flexible: managed float: The central bank sets the rate, but sometimes varies it frequently and adjustments are judgmental, usually based on a range of indicators, such as foreign exchange reserves, the real effective exchange rate, and developments in black markets for foreign exchange. More flexible: independent float: Rates are market-determined. Most developed countries have floats, but the number of developing countries included in this category has been increasing in recent years. Cf. Wilbert O. Bascom, *The Economics of Financial Reform in Developing Countries*, Mac-Millan, 1994, p. 57.



exchange rates during periods of large capital inflows and depreciation during periods of outflows. The important rationale is that the flexible exchange rates might discourage speculative attacks and highly reversible capital inflows, and also allows the monetary authorities a greater degree of independence as they become relatively free from preoccupation with stability of the exchange rate.

However, there are number of arguments in favor of a stable exchange rate, but a fixed or a stable exchange rate regime is substantially vulnerable to speculative attacks in the case of an expectation of devaluation in the market.

Monetary authorities or governments should intervene in the foreign exchange market to defend the exchange rate. However, this intervention is bound on the upper side by the stock of international reserves, and moreover, rising domestic interest rates to prevent devaluation impose substantial costs on the economy, which include an increase in public debt burden and a dampening impact on the level of economic activities in general.

Some one argues that crisis like the Asian one might be avoided by the establishment of currency board (those of Argentina and Hong Kong, China) involving exchange rates rigidly pegged to some major currency. Under such a regime, first, there is an absolute commitment to supply or compensate monetary liabilities of the monetary authority at a fixed rate. Second, these are the only terms on which such liabilities are exchanged. The purest currency board can not extend credit to the government, the banking system or other borrowers, and interest rates are market-determined, the monetary base being rigidly linked to the country's foreign exchange reserves [UNCTAD, 1998:105-106].

However, speculative attacks against a currency can occur in a currency board regime just as in other exchange rate system. A currency board can not guarantee that domestic interest rates remain at the level of the country which the currency is pegged. Good example is the experience of Argentina during the Mexican crisis and that of Hong Kong (China) during the Asian crisis. In the both cases,

interest rates had to raised dramatically, and the pegs could be maintained only at the expense of sharp declines in output (- 6%). Accordingly, it appears that the costs of maintaining pegs by a currency board were no less than those incurred by countries experiencing currency crises.⁸

Thus, under free mobility of capital, there are strong doubts in developing countries that either of flexible exchange rate or pegged exchange rate regimes will protect against financial crises and currency instability. As UNCTAD argues, no regime of exchange rates will guarantee stable and competitive rate, nor will it steady growth with financial stability. Accordingly, there now appears to be growing consensus that nominal flexible exchange rate in developing countries to regulate or control over destabilizing capital flows remains the most reasonable option for them [UNCTAD, 1999:130]. Moreover, states in developing countries inevitably are in the face of serious contradiction of objectives such as aiming simultaneously at a stable exchange rate, financial sector liberalization and independence in monetary policy—the so-called “impossible trinity” [Islam, 1999:64].

Plan for A New International Financial Architecture of United Nations

In January 21st, 1999, “ Towards a new international financial architecture” [ECLAC, 1999] was published as the report of collaborative and coordinated effort by the Executive Committee on Economic and Social Affairs.⁹

⁸ Cf. By some IMF occasional paper , most pegged exchange rate regimes of developing countries are short lived. “In 1975, 87% of developing countries had some type of pegged exchange rate, while only 10% had flexible rates (the remaining 3% being account for by the ‘ limited flexibility’ category) ; by 1985, the proportions were 71% and 25%, respectively; and by 1996, the proportions were 45% and 52%.” By a Staff Team led by Barry Eichengreen and Paul Masson with Hugh Bredenkamp, Barry Johnaston, Javier Hamann, Esteban Jadresic, and Inci Otker, Exit Strategies Policy Options for Countries Seeking Greater Exchange Rate Flesibility, IMF, Occasional Paper 168, 1998. p. 5.

⁹ The membership of the Committee comprises Department of Economic and Social Affairs (DESA), Economic Commission for Europe (ECE), Economic and Social Commission for Asia and the Pacific (ESCAP), Economic Commission for Latin America and the Caribbean (ECLAC), Economic Commission for



This report presents the unified position of United Nations Secretariat in the economic, social and related fields on one of the most urgent issues at present. The report focuses mainly on prevention and management of financial crises, and is also the first in a series of policy-oriented reports the Executive Committee intends to produce over the coming months.

In this report, the Committee argues that international financial system is an organic whole and requires comprehensive approach. Thus, reform must include a number of interrelated aspects of international liquidity management, global uniformity of macroeconomic policies and financial regulation, areas essential to the prevention and management of financial crises, and finance for development and the resolution of outstanding external debt issues.

It should be emphasized that the existing international monetary system is badly equipped to prevent current financial crises and only partly provided to manage them. Therefore, reforms in this area must be addressed with a sense of urgency in six areas. Firstly, the report underscores that these reforms interrelate with each other, and that reliance on any one or a few of these proposals would not generate a balanced world system in terms of its ability to both prevent and manage international crises. Secondly, it emphasizes that any reform of the international financial system ought to be based on a broad and democratic discussion, involving all group of developing countries, transition economies, and advanced industrial countries.[ECLAC, 1999: 17].

Africa (ECA), Economic and Social Commission for Western Asia (ESCWA), United Nations Conference on Trade and Development (UNCTAD), United Nations Environment Programme (UNEP), United Nations Centre for Human Settlements (HABITAT), United Nations Office for Drug Control and Crime Prevention (ODCCP), Office of the United Nations High Commissioner for Human Rights (OHCHR), United Nations Development Programme (UNDP), United Nations University (UNU), International Research and Training Institute for the Advancement of Women (INSTRAW), United Nations Institute for Training and Research (UNITAR), and United Nations Research Institute for Social Development (UNRISD).

Improving the consistency of macroeconomic policies at the global level

The report maintains that the current crisis has made evident to enhance the coherence of macroeconomic policies in industrial countries, in order to avoid both inflationary and deflationary effects not only at their domestic economies, but also at the world level. Therefore, the design of international institutions and policies must include, first of all, clear incentives for governments in the industrial world to maintain full employment and to avoid inflation. It emphasizes that “in order to achieve this objective, a more effective surveillance of national policies by the IMF and regional and sub-regional institutions is necessary. This surveillance must have broad objectives and a preventive character, acting to warn of impending unemployment and growth retardation, as well as of inflationary pressures reflected in the evolution of domestic prices of goods, services and assets or in the deterioration of external balances.” [ECLAC, 1999:18].

Proposals of the report include granting greater policy powers to the IMF Interim Committee and broadening the G-7 to include representatives of the developing and transition countries. We must appraise the latter proposal broadening the G-7 to include delegates of many kind of the developing countries and transition countries. While the nature of the relative power relations of these organs should be debated, proposals emphasize the need to strengthen the Economic and Social Council to provide political leadership and promote broad consensus on international economic issues. In order to ensure proper balance between their multiple objectives, macroeconomic policies of central banks should be subject to public scrutiny. For the same reasons the IMF should be also subject to public scrutiny on similar grounds.

The provision of adequate international liquidity in times of crisis

The management of international liquidity is crucial for preventing and avoiding contagion from financial crises and lessening their adverse economic effects. However,



at present, the IMF has not enough funds¹⁰, the conditionality attached to the use of its funds is not always appropriate to the problems faced by countries experiencing financial crisis, and it has very limited capacity to stop contagion.

From the viewpoint mentioned above, report proposes that the IMF should be enlarged in order to enable it to enhance the stability of the international financial system through three channels.

- 1) Effective and swift mechanisms should be devised to increase its access to official funds in times of crisis.
- 2) It could be granted authorization to borrow directly from financial markets under those circumstances, and
- 3) Perhaps most importantly, SDRs could be created when several member countries face financial difficulties.

Moreover, the report criticizes the IMF conditionality, which it imposes upon its borrowers, for violating the sovereignty of borrowers:

- 1) The IMF should restrict itself to the macroeconomic issues that fell within the purview of conditionality in the past.
- 2) Conditionality should not include issues related to economic and social development strategies and institutions should be decided by legitimate national authorities, based on broad social consensus.
- 3) Conditionality should not cover areas within the purview of other international institution, such as the World Trade Organization (WTO). For example, with regard to the Fund currently has no mandate with respect to capital account convertibility, convertibility should not become a requirement for access to Fund resources, either.

¹⁰ The primary source of financing of the IMF is quotas, and in January 1999, a quota increase of 45% became effective, bringing total quotas to roughly SDR 210 billion (about \$283 billion). <http://www.imf.org/external/np/exr/facts/quotas.htm>.

4) Conditionality should not be used to force the adoption of a specific exchange rate regime by any country. What should be made clear to national authorities is that the exchange rate regime they adopt should be consistent with fiscal and monetary policies, which vary according to the regime chosen, and that it may require complementary measures.

5) In order to avoid overkill, the IMF should adopt general practices that allow for automatic reduction of the restrictiveness of an adjustment agreed upon with a borrowing country [ECLAC, 1999:19-22].

International codes of conduct, improved information, and enhanced financial supervision and regulation

A basic consensus relates to the need for international codes of conduct in the fiscal, monetary and financial areas, for principles of sound corporate governance, for improved accounting standards, for greater availability and transparency of information regarding economic and financial data and policies, and for enhanced financial supervision and regulation. The report argues that they should include international standards to combat money and asset laundering as well as corruption and tax evasion.

It emphasizes that the role of financial regulation and supervision in risk management and crisis prevention are crucial elements in the global financial world. Moreover, it stresses central element of a new international financial architecture is the development of regulatory and supervisory mechanisms that will better correspond to today's globalized private capital and credit markets.

It recommends that an important proposal in the area of financial regulation and supervision creates a world financial authority—or a standing committee for global financial regulation—in charge of setting the necessary international standards for financial regulation and supervision and of supervising their adoption at the national level. Such an institution could evolve from relevant ones, such as the Bank for International Settlements (BIS), the International Organization of Securities Commissions



(IOSCO), and would require significant expansion of the membership of these organizations.

At present, minimum prudential standards must be designed not only to cover bank transactions but also, to the new actors in financial markets, such as hedge funds and mutual funds. Hence, it stresses that the Core Principles for Effective Banking Supervision of the Basle Committee on Banking Supervision should be worked out more fully to prevent systemic risk at the international level and to control various risks at the country level. Furthermore, in the case of industrial countries, it welcomes the G-7 declaration of 30 October 1998 on the need to examine the implications arising from the operations of hedge funds and offshore institutions and to encourage off-shore centres to comply with internationally agreed standards. On the other hand, in the case of developing and transition countries, the implementation of the Core Principles should go along with a significant effort to improve domestic regulation and supervision of banks and other financial intermediaries.

Lastly, it emphasizes that transparency in information and improved regulation and supervision are certainly important, but they are alone by no means a fail-safe instrument for preventing financial crises, for practices in them tend always to fall behind constant financial innovations. Moreover, the report argues for the principle of transparency of information also to be applied to international institutions [ECLAC, 1999: 23-26].

The preservation of the autonomy of developing and transition economies with regard to capital account issues

The current financial crisis in the global financial markets has shown that abrupt or premature liberalization of capital account is inappropriate for developing and transition economies. Without strong domestic financial systems, regulation and supervision, it has proved quite difficult for developing and transition economies that liberalize the capital account to adapt to volatile international capital flows.

Under the current financial crisis, not only the magnitude of capital flows but also its **composition** particularly, including portfolio and short-term capital flows, plays an essential role in generating external vulnerability.

Therefore, the report maintains that under these conditions, developing and transition economies should retain the right to impose controls on inflows, particularly in times of capital surges, and on outflows during severe crises. These controls could include reserve requirements on short-term inflows, various taxes on capital inflows intended to discourage them, and minimum stay or liquidity requirements for investment banks and mutual funds that wish to invest in the country. They could also include complementary prudential regulations on domestic financial institutions, such as higher reserve or liquidity requirements on short-term deposits. Then, it argues that such capital regulations should be regarded as permanent, rather than temporary devices, as long as international financial markets remain volatile and domestic economic structures are weak.

The report insists on, finally, that considerations regarding the autonomy of developing and transition economies to manage the capital account should therefore be incorporated in the current discussions on broadening IMF mandates to include capital account convertibility. It must be clear that any ambitious liberalization of the capital account of these countries would also require equally ambitious reforms in other areas of the international financial architecture [ECLAC, 1999: 27-28].

Incorporating internationally sanctioned standstill provisions into international lending and adequate sharing of adjustment

A standstill on debt servicing is an efficient alternative to violent capital flight, once a country faces severe international financial crises. Article VIII of the Articles of the Agreement of the IMF (General Obligations of Members, Section 6. Consultation between members regarding existing international agreements) could provide a legitimate basis for the application of debt standstills. Through capital flight, domestically the economic and



social costs of adjustment increase, and externally the probability that creditors as a group may be repaid decreases.

Moreover, rescue packages by international financial institutions generate significant problems of moral hazard and poor sectors of society that did not share in the capital inflows must be imposed a significant burden in adjustment costs. The adjustment costs should be distributed more equitably. To avoid moral hazard on the part of borrowers, it may be advisable that the IMF sanctions standstills.

The report emphasizes that one way out of these difficulties would be to allow the introduction of standstills on external debt and capital convertibility as maintained above, and then to bring the borrowers and lenders together to reschedule debt. Through these “bailing-in” operations, authorities in the countries facing crises surmount their difficulties.

To ensure that this mechanism operates properly, the report proposes two essential rules:

- 1) There should be internationally agreed “collective action clauses” in international lending. Therefore, it welcomes the support given by the G-7¹¹ to the introduction of such clauses. Their generalized introduction is crucial to avoid “free riding”.
- 2) Debt renegotiations should take place within a specified time limit, beyond which either the IMF or the independent council would have the authority to determine the conditions of the debt rescheduling. Repeated debt renegotiations have been one of the most troublesome features of the international financial markets in recent decades and underlying causes of slow growth in some developing and transition economies [ECLAC, 1999: 29-30].

¹¹ In G-7 Financial Ministers Report, 1999: 42, it proposes that “we have agreed on the importance of stronger efforts to encourage progress in broadening the use of collective action clauses in sovereign debt contracts, along with other provisions that facilitate creditor coordination and discourage disruptive legal action”.

Design of a network of regional and sub-regional organizations to support the management of monetary and financial issues

As proposal for the reform of the international financial architecture, the report underscores stronger regional and subregional financial institutions rather than a few international financial organizations. Having been illustrated with the experiences of Western Europe, especially from the Payment Union to European Union and the Euro today, regional financial organizations and arrangements can play an essential stabilizing role. Moreover, these regional and sub-regional development banks can also play crucial role in a new international financial architecture, both in financial crisis management and in finance for development.

It maintains that they could also play a crucial role as complements to the IMF funding, and thus, on both the demand and the supply sides, they could reduce the need for the IMF support.

At present, most regional financial institutions are small, and thus have limited effectiveness, but an investment in their development would certainly succeed in the long run. The report argues that regional institutions and peer review could also play a central role in surveillance, both of macroeconomic policies and of domestic financial regulation and supervision. Such surveillance and peer review could be more acceptable to countries than that of single, powerful existing international institution, such as the IMF. Finally, it puts emphasis on the fact that regional financial institutions would contribute towards a more balanced globalization [ECLAC, 1999: 31-32].

As report admits, new financing facilities and standstill provisions are not substitutes for better regulation and supervision of financial institutions. Rather, measures as maintained above, along with domestic measures to deal with short-term capital movements, are mutually complementary. Rules regarding internationally sanctioned standstills are also no substitute for the establishment of the IMF facility to deal with contagion.



In conclusion, the Executive Committee argues that the final objective of redesigning the international monetary and financial system is to make use of the potential of private international financial capital flows to the service of stability and growth in the world economy. In order to pursue this objective effectively, it is important that the various components of the architecture be addressed at the same time. Reliance on any one or even a few of these proposals would hardly bring about the changes needed to both prevent and manage crises or lead to greater equity in power relations. There is an evident need for a comprehensive and timely approach, in order to generate a more balanced and hence enduring globalization process, and to ensure that it contributes effectively to sustainable human development [ECLAC, 1999: 34-35].

This report, "Towards a new international financial architecture", is the product of the Executive Committee on Economic and Social Affairs, as well as it seems to be greatly influenced by Jose Antonio Ocampo, Executive Secretary of United Nations the Economic Commission for Latin America and the Caribbean. Different from the major features of the reforms of the international financial architecture by the IMF, G-7, and U.S. as remarked above, this report might be appreciated to consider the difficulties of developing and transition economies facing international financial turmoil. That is to say:

- 1) The report proposes to include granting greater policy powers to the IMF Interim Committee and broadening the G-7 to include representatives of the developing and transition countries.
- 2) IMF conditionality should restrict itself to the macro-economic issues, and also not include issues related to economic and social development strategies and institutions.
- 3) Considerations regarding the autonomy of developing and transition economies to manage the capital account should be incorporated in the current discussions on broadening the IMF mandates to include capital account convertibility.

On the other hand, the report appreciates regional and sub-regional institutions to be able to play an essential

role as complements to the IMF funding and surveillance activities, as well as in surveillance of domestic financial regulation and supervision. However, it must be said that the report fails to recognize the real nature of the IMF that is the major industrialized countries' surrogate, as well as pushes forward the policies of neoliberal globalization.

The G-7, in particular under U.S. leadership, has proposed a lot of reforms to strengthen the international financial system on the general principle that a "market-based" or "marketfriendly" system provides the best prospects for a sound global economy [Economic Report of the President, 2000: 229]. For them, what is needed are improved monitoring and surveillance of international capital flows, more transparency in the operations of major institutional players, such as hedge funds and mutual funds, strengthening of financial regulatory regimes of the borrowing countries and contingency financing to prevent market contagion in the future.¹² Within the U.S. there are also sharp discord on the role of the IMF in a reformed system. Some favor the IMF becoming an international "lender of last resort" [Fisher, 1999], others, such as the Joint Economic Committee of the U.S. Congress, are opposed to this and argue that such a role can be played by the U.S. Federal Reserve [Fisher, 1999].

The G-7 and especially U.S. main interests are in accordance with opposing international regulation of capital movements and short-term capital controls in borrowing countries. Therefore, U.S. substantial interests are the major beneficiary of the present set of international arrangements.

On the other hand, the voice of the developing countries has been relatively silent on the problems of international finance. Ministers of G-24 underscore the necessity of comprehensive reforms of the international monetary and financial systems, geared to prevent costly crises and to manage them effectively. In this regard, Ministers repeat

¹² "Treasury Secretary Robert E. Rubin remarks on reform of the international financial architecture to the School of Advanced International Studies", Treasury News, Office of Public Affairs, Washington D.C., April 1999.

their call for the establishment of a task force with participation from industrial countries and representatives from a wide range of developing countries, engaging in an complete examination of issues related to the reform of the international monetary and financial system [G-24 Communiqué, April 1999]. However, G-24 has not indicated the kind of reforms it devises.

**The reform of international monetary system:
from the perspectives of the South**

The East Asian financial crisis and its quick contagion to Russia, Brazil and Argentina have given rise to a general consensus on the need to redesign the international financial architecture for both industrial countries and developing countries. An orderly formulated position on the system reform from the developing countries' perspective has not been pronounced clearly. Moreover, the developing countries have never made clear and collective proposals for the reform of international monetary and financial system from the standpoint of themselves. One of the reasons is that, like the major industrial countries, there are opposing interests and differences in circumstances that give rise to disagreement in perspective.

The crucial problem is that the current financial crises have become too severe to encourage a fundamental reform of the international monetary system by major countries, including emerging markets economies and developing countries. However, the danger is that, in such a fundamental reform, "the interests of the South will once again be ignored as they were at Bretton Woods, while a new set of arrangements are negotiated among the USA, the EU and Japan" [Girvan, 1999: 417].

While considerable adverse effects from international financial crisis affected member countries, especially a number of developing countries suffered from them remarkably. Therefore, under these adverse financial circumstances, reform proposals to encourage the sustainable and independent development of developing countries have been put forward from various circles [UNDP, 1992: 74-82], [UNDP, 1994: 84-85], [Browne, 1996],

[Danaher, 1994], [Girvan, 1999], [Ocampo, July 1999], [Ocampo, October 1999]. However, developing country states have not always been supportive of proposed measures of reform. In a sense, they have been ambiguous about the reform of the system, because, in many cases, they want to retain their policy autonomy at national or global level.¹³ Given these problems among various groups of developing countries and conflicts of interest, it is meaningfully to me to inquire into the reform problems of international monetary system against financial instability and contagion from the perspective of developing countries.

*The policy autonomy of developing countries
against capital account liberalization*

In contrast with trade liberalization, capital account liberalization may be disruptive for developing countries without sound domestic financial system. Indeed, financial liberalization has often followed by financial crises as Argentina and Chile in the late 1970s and early 1980s. However, a number of developing countries, especially emerging markets economies have been unwilling to impose controls on capital inflows during the boom phase of the financial cycle. They suppose that capital liberalization should stimulate economic growth and improve welfare through the effective allocation of productive resources around the world.

Over the past decades, the IMF has promoted the capital account liberalization. This clearly reflects the position, neo-liberal policies, of United States government. South Korea is a typical example of this problem. South Korea was required to liberalize its capital account as a precondition of OECD membership. In October 1994 in Madrid, the IMF's Interim Committee adopted a special Madrid Declaration. It went on to welcome " the growing trend

¹³ Yilmaz Akyuz expounds on this problems as follow: a large majority of developing countries opposed such measures 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. [Akyuz, 2000: 4].



toward currency convertibility”, and it encouraged “member countries to remove impediments to the free flow of capital” [IMF, October 1994: 320]. That year end, Mexico plunged into crucial peso crisis, followed in early 1995 with the US \$50 billion rescue packages, a contagion crisis in Argentina and a second rescue packages.

In practice, many positive effects of capital liberalization are extremely uncertain. Rodrik argues that there is “no evidence that countries without capital controls would have grown faster, invested more or experienced lower inflation”. [Rodrik, 1998: 61] In spite of these arguments, the IMF rescue packages stipulate that recipient countries must carry out reforms in their financial markets to make it more open and introduce stronger “rules of game”. Under these environments, now it is generally agreed that such liberalization should be gradual, should emphasize longer-term flows and be extremely cautious with shorter term and volatile capital, such as short-term credits and portfolio flows, and should be preceded by the strong financial regulation and supervision, [Ocampo, July 1999: 23] therefore:

- 1) Capital account liberalization has contributed to severe financial turmoil and huge economic losses to several developing countries that have been integrated into the globalized financial markets. Hence, they must maintain the autonomy to manage capital account as to be argued by United Nations Task Force. [ECLAC, 1999: 27-28] Controls on capital flows must be imposed for two reasons, first, as a macroeconomic measure to reinforce monetary and fiscal policies, and second, to attain long-term national development objectives that ensure residents’ capital is domestically invested and that certain type of activities are reserved for residents.
- 2) The IMF should not developing countries facing crisis compel to liberalize their capital account as one of necessary preconditions for bailout packages. Some study of capital account liberalization highlighted various warning against capital account liberalization in developing countries and identified several preconditions for establishing capital account convertibility. [Mathieson, *et. al*, March 1993:30-33].

- 3) The developing countries should not remove their capital controls until a sound domestic financial system is established. In the light of the current Asian crisis and the current international financial turmoil, developing countries need to have capital controls to protect themselves against international financial turbulence. UNCTAD thus concludes that, for the foreseeable future, developing countries should be permitted to introduce capital control measures rather than obliged to further liberalize capital flows.¹⁴

Freedom to choose the exchange rate regime

Recent debate on exchange rate policies in developing countries, especially emerging markets economies, has concentrated on the connection between exchange rate regimes and financial crises. The current financial and monetary crisis in East Asia has often associated with pegged exchange rate regime. What has been more clearly is that pegged exchange rates are often an invitation to financial crises. Accordingly, developing countries are increasingly being advised to choose of the two extremes; either to float freely or to lock in their exchange rates with one of the major currencies, often the United States dollar or the French franc, through such arrangements as currency boards, or even simply adopting the dollar as their national currency [UNCTAD, 1999: 128].

However, under complete free movement of capital, there are strong doubts that either of these two extremes is likely to provide better protection against currency volatility and financial crises than nominal pegs. There is a clear that, contrary to some assumptions, developing countries with flexible exchange rates are no less vulnerable to financial crises than those with pegged or fixed exchange rates. At present, there is variety of exchange rate arrangements. [Bascom, 1994: 56-57] These arrangements may be generalized as follows: currency

¹⁴ In the conference of the Group of 77, Fidel Castro proposed a minimum 1 percent tax—in the excess of one trillion dollars every year—on speculative financial transactions, which would permit the creation of a large indispensable fund to promote real, sustainable, and comprehensible development in the third world. Cf. Fidel Castro, “Address to the South Summit”. [UNCTAD, 2000: 153] Monthly Review, July/August.

pegged to single currency or currency composite, limited flexibility, managed float, and independent float. Most developing countries have adopted single or composite currency pegs, but contrary to some perceptions, currency pegs have not achieved their primary purpose of preventing exchange rate volatility as explained in the current Asian crisis.

As described in TDR, under free capital mobility no exchange rate regime will guarantee stable and competitive rates nor will it combine steady growth and financial stability. Thus, it seems most plausible option for the most developing countries to manage nominal exchange rates in a flexible manner in combination with effective regulation and control over destabilizing capital flows.¹⁵

As is generally known, most developing and transition countries come to the IMF as “a lender of last resort” when their balance of payments deficits reach crisis levels. The IMF, in return, “recommends” changes in their macroeconomic policies to correct the deficits as part of conditionality. Developing countries have made a strong protest against the notion that adoption of a particular exchange rate regime should be part of the IMF conditionality for access to the Fund resources. The freedom of the IMF member countries to choose their exchange rate arrangement are formally authorized in the Second Amendment to the IMF’s Articles of Agreement in 1978. It has diminished the role of the IMF as one of the managers of the post Bretton Woods System. Hence, the IMF has not had an official view on its member countries’ exchange rate regime.¹⁶ The existing Articles of Agreement

emphasize the need for member countries to direct their economic and financial policies at facilitating the achievement of the IMF’s overall objectives.

IMF conditionality

The IMF has acted as “the mean cop” [Scipes, 1999:1] for the international financial world for a long time, but its role in the current East Asian crisis has brought it new notoriety. Traditionally, the IMF conditionality includes a requirement that domestic credit expansion may not exceed the growth of production, that budget deficit may not exceed a certain percentage of the GNP, that the rules of the General Agreement on Tariffs and Trade must be strictly observed, and that either liberalization of capital mobility or interests of investors may be protected. It has been explained clearly in current Asian financial crisis that conditionality benefits multinational corporations, especially who are largely based in the United States. As the result, hundreds of thousands of jobs have been lost, and standards of living have plunged into despair drastically, and the prices of imported goods and services have increased. On the other hand, multinational corporations have been able to purchase goods and services, raw materials and local major corporations more cheaply than before the outbreak of the financial crisis.

From the beginning of the IMF, its conditionality has long been controversy, division, and debate, all of which continue now. Recently this issue has become increasingly bothersome:

- 1) The scope of conditionality has been gradually expanded, to include not only realm of other international organizations, such as the World Trade Organization (WTO)¹⁷ and development banks, but also on domestic

¹⁵ John Grieve Smith argues as follow: “The creation of a more stable exchange rate mechanism and finding means of curbing speculative capital movements and currency transactions need to go hand in hand.”, “A new Bretton Woods Reforming the global financial system”, in Jonathan Michie and John Grieve Smith eds., *Global Instability the political economy of world economic governance*. Routledge, 1999, p.241. [UNCTAD, 1999: 130], [UNCTAD, 1998: 105].

¹⁶ An Independent and Accountable IMF admits that the IMF should recommend exchange rate flexibility on three main considerations. Cf. Jose De Gregorio *et al.*, *An Independent and Accountable IMF Geneva Reports on the World Economy* 1 pp. 32-3.

¹⁷ In December 1997, the WTO concluded its financial services agreement which basically commits member countries to scheduled accelerated liberalisation of the trade in financial services. This agreement would primarily benefit the US and Europe. Cf. Jomo K.S. “Introduction: Financial Governance, Liberalisation and Crises in East Asia” [Jomo, 1998:19].



economic and social development strategies and institutions as the United Nations Task Force has criticized above.

- 2) Whereas the legitimacy of conditionality is indisputable when domestic policies are the source of macroeconomic disequilibria that lead to financial crisis, it is unable to understand how the same principles (“old medicines for a new disease”) applies when crises are generated by contagion effects. There has been considerable doubt as to whether the IMF actually recognized the real causes of the current financial and currency crisis in East Asia. Nevertheless East Asian countries facing financial crisis have been running fiscal surpluses in recent years, the IMF has forced all countries to cut public expenditure and increase their budgetary surpluses.
- 3) Evidence of overkill in some IMF programs has accumulated and has led to mounting criticisms on the specific macroeconomic analysis implicit in the programs [Ocampo, July 1999:22]; [Ocampo, October 1999:29-30]. For example, one of the criticisms of the IMF programs for the Asian crisis countries concerns the very high interest rates that the programs demand. The IMF recommended the Asian countries to raise sharply their interest rates in order to defend their exchange rates during the financial crisis. However, the high interest rates of one country would seriously depress the economic conditions of others, and vice versa.

The IMF conditionality came under fire not only the recipient countries, but also some of industrial countries’ politicians and financiers. In this respect some principles should be advanced:

- 1) Conditionality should be restricted to the macroeconomic policies. It should be used when expansionary policies are clearly associated with the generation of macroeconomic imbalances, or when a country needs to draw Fund resources above and beyond some automatic level of low-conditionality facilities. Then, reforms of domestic prudential financial regulation and supervision as a part of conditionality may be required, but there are limits to what reforms in these areas can do and in the absence of adequate funding in times of crisis, market discipline may generate a strong deflationary bias in macroeconomic policy.
- 2) It must be emphasized that low conditionality facilities, such as Compensatory and Contingency Financing Facility, should be available in adequate quantities when the causes of the imbalance are international financial contagion.
- 3) More stringent credit terms should not be used as a complement to conditionality.
- 4) Automatic rules should be agreed upon when signing an agreement with the IMF, under which the restrictiveness of the adjustment programme would be eased should evidence of “overkill “ become clear. However, the negotiation process of such easing was too cumbersome and it came with a significant lag, when the contractionary effects of adjustment programme had surpassed by significant amounts.
- 5) Regular official evaluation of IMF program, either by an autonomous division of the Fund or by outside analysts, should be introduced and major conclusions of these evaluations should be explicitly incorporated into the Fund regular practice [Ocampo, July 1999:22-23]; [Ocampo, October 1999:30].

The conditionality that the IMF has imposed on the developing countries in return for the loans includes removing restrictions on foreign investments, reorienting their economies toward exports, reducing wages, reducing government spending on health, education, and welfare, reducing tariffs, and other trade restrictions on imports, devaluing their local currencies against in particular the U.S. dollar, privatizing state enterprises and public utilities, and opening their economies to the export producers, and importers. By condition on the implementation of these policies, the IMF can structure both the external and internal economic policies of the developing countries that receive loan from it. Thus, the present economies of most developing countries are being regulated by the IMF and are becoming integral parts of a



global economy, that is dominated by international financial institutions, major capitalist countries and large multinational corporations, as unequal partner.

The roles of regional and sub-regional financial and development institutions

On October 1994, ministers of the Group of Twenty-Four underscored that “the appropriate forms of interaction between the Bretton Woods institutions and the regional financial and monetary institutions “(the Press Communique’ of the Group of Twenty-Four, October 1994) should be included adequately in the proposed reform of international financial architecture . There have been many proposals for regional and sub-regional financial institutions from various circles.

The latest idea of an Asian Monetary Fund was advanced by the Japanese government soon after the burst of East Asian financial crisis as the Miyazawa Initiative.¹⁸ In Latin America and the Caribbean, the Inter-American Development Bank (IDB) far prevails over the World Bank in development finance to the region. The Andean Development Bank, sub-regional institution in this area, prevails also over the IDB in financing to the Andean region countries in recent years. The Latin American Reserve Fund has played constructive role in balance of payments support to the Andean countries over the past two decades [Ocampo, July 1999:26-27]; [Ocampo, October 1999:33-36]; [UNCTAD, 1998:106-107].

There are several arguments in support of a strong role for these institutions in the new financial order. First of all, for smaller developing countries, the access to a

¹⁸ Japanese government proposed to establish the Miyazawa Initiative capitalized total US \$100 billion and designed to respond quickly to international financial capital markets in the region. Japan had good reasons for laying its huge money upon the table: Japanese banks are heavily exposed to Thailand, South Korea, Indonesia, and Malaysia. It is in their interests to stabilize volatile currency markets. However, Japan was forced to back down in the face of violent opposition from the U.S. Department of Treasury. It reaffirmed the central role of the IMF in the Asian rescue packages. Washington feared a loss of political and economic influence in the region, since the Miyazawa Initiative, if implemented, would obviously have dominated the region [Cohen, 2000: 99-101].

broader menu of alternatives to manage a financial crisis or to finance development is relatively important. Owing to their small size, their negotiation power with respect to large organizations like the IMF would be limited, so their most important defense is competition in the provision of financial services from these institutions. Second, regional institutions can serve as regional buffers as the European Union’s experiences indicate. Regional reserve funds can also play a useful role in the developing countries and could even provide full support to the small and medium-size countries within these regions. Third, an organized system of peer reviews or a more sophisticated mechanism of regional and sub-regional surveillance can play more positive role than mutual surveillance designed by the IMF.

In future, the regional and sub-regional financial institutions could play an essential stabilizing role and also an important role both in crisis management and in finance for development not to supplement the IMF funds. However, it is important to argue that they should be independent of the IMF and World Bank as advocates of neoliberal globalization policies, and that encourage developing countries to promote sustainable and independent development. Moreover, these institutions should be accompanied by a reform of its voting structure and decision-making procedures to bring about greater participation by developing countries.

Appropriate and democratic reform of international financial institutions

In order to achieve brilliant prospects in the 21st century, developing countries should get the space and opportunity to strengthen their economies and to develop their social infrastructure. For this to happen, they should have more rights of participation in decision-making processes in major international institutions, such as the IMF and World Bank. The certain governments of major industrial developed countries —and the United States in particular— exercise unequal influence over the decision-making processes taken by the IMF. It has pursued policies that serve the Wall Street and the U.S. Treasury rather than the world economy as a whole, especially developing



countries. General critics assert that the IMF is too responsive to its principal shareholders, that is, the G-7, the interests of which do not necessarily accord with those of developing countries.

The business of the IMF, including approval of stand-by agreement and surveillance etc., is set by the Executive Board of 24 Executive Directors. The Board is responsible for exercising the powers delegated to it by the Board of Governors: 182 finance ministers or governors of central banks. According to the Articles of Agreement (XII.5. c), the Board decisions are taken by a majority or super-majority.¹⁹ The voting power of the United States amounts to 17.56% of the total number of votes and its large voting share in the Board enable it to exercise a overwhelming influence over decision-making in the IMF. Therefore, there is a need to reform the decision-making processes in order to give developing countries their right to adequate participant, because they form the majority of membership in the IMF.

As the most democratic and universal organization, United Nations and its agencies should reaffirm their development policies and strengthen their programmes and strategies according to democratic principles. The attitudes of major industrialized countries that have degraded their commitment to the UN system should be reversed and affirm its essential and necessary role in advocating social and development dimension in the process of rapidly globalized financial world. The developing countries should require that this dimension must be kept alive and strengthened clearly.²⁰

¹⁹ There are two cases: the 70 percent majority and the 85 percent majority [Gold, 1977: 57-61].

²⁰ S.Amin emphasizes “reconstructing the UN system in order to make it the locus of political and economic negotiations to organize the articulation of commercial and financial interdependence between the major regions of the world” [Amin, 1995:50]. Also, Iris Young argues that instead of closure of the IMF and the World Bank, reasonable goal is reform of the UN, the best existing starting point for building global democratic institutions [Bond, 2000:133-134].

Policy cooperation among developing countries in the financial globalization

In the current East Asian financial crisis, it became increasingly clear to establish collective regional defense mechanisms against systemic volatility and contagion among developing countries. In this regard, after the breakdown of the Bretton Woods system, the experiences of Europe with the monetary and financial cooperation and ERM teaches us useful lessons. Regional monetary and financial policy coordination among developing countries could be more easily viable.

Exchange rate arrangements, macroeconomic policy coordination, regional surveillance, common rules and regulations over capital flows, and regional mechanisms for the provision of international liquidity among them must be urgently established to cope with the current financial crises. Especially, the initial priority areas, including regulation over highly leveraged institutions, offshore centers, and curbing volatility of short-term capital flows are extremely important.

In this respect, however, experts in the IMF and the World Bank have argued that regional monetary and financial cooperation which involves only developing countries is not likely to be very effective, and that unless such efforts include global capitalist countries, the United States, the European union, and Japan, it is not likely to succeed in the long run. In terms of policy toward developing countries, the IMF and the World Bank take the view that “one size fits all” [Farrel, 1994:297], that is, their policy prescriptions do not want regional or subregional forms of economic cooperation to take place that are independent of the major industrial countries of transnational corporations. As remarked above, the United States and the IMF strongly objected to the idea of the Asian Monetary Fund, arguing that it would threaten the stability of the existing international financial system by weakening the IMF’s voice in promoting structural adjustments in crisis countries and by increasing the moral hazard problem.

Let me conclude with a few remarks. Major industrial countries are unwilling to reform of the existing international monetary system fundamentally, since the



present system being based on neo-liberal view is optimal for them and it constitutes free markets in operation sufficiently. Moreover, they show a reluctance to accommodate the concerns of developing countries regarding international financial reform. The IMF and the World Bank that basically base on neo-liberal globalization policies go hand in hand with advance of poverty and social polarization in the world through structural adjustment policies. On the other hand, the current financial crisis in developing countries, especially in emerging markets economies, highlighted clearly the limits of national regulations for averting speculative attacks on their currency and stock markets on the globalized world economy. At present the developing countries as a whole lacked suitable defense mechanism for deflecting from speculative attacks on currency and stock markets. Consequently, they were highly exposed themselves to a sudden defeat of international investors confidence and the grave real economic costs combined with this process. On the globalized financial world markets, it is increasingly evident that cooperation among developing countries may prove to be a crucial instrument for countervailing against greater financial and monetary volatility stemming from the liberalization of capital account. Developing countries must cooperate and unite with each other at a very high global level in order to confront with neoliberal globalization and realize their sustainable and independent economic development.

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