

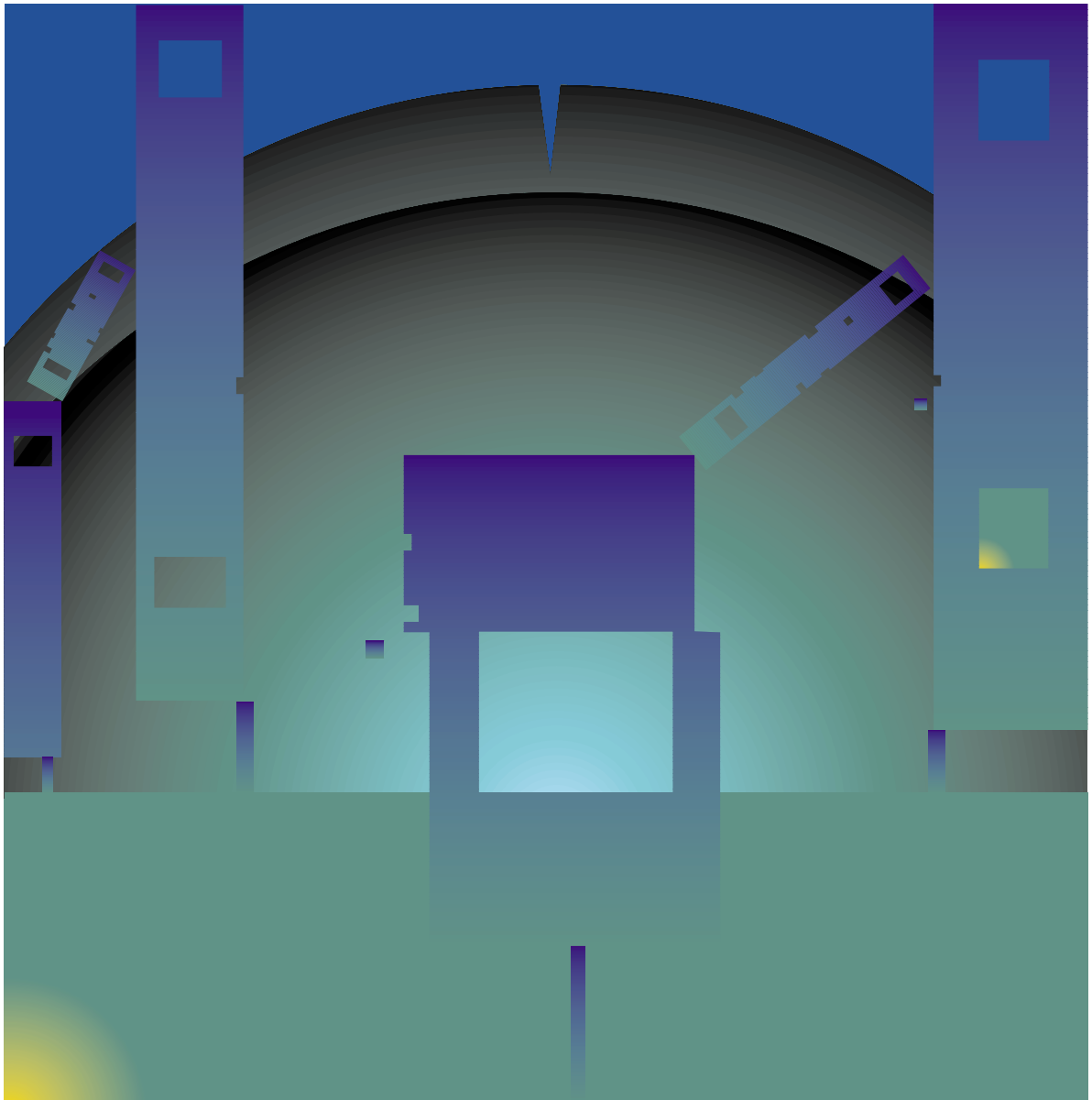
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OVERVIEW



UNITED NATIONS



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A quarter is a long time in economics. At the annual meetings of the Fund and Bank in Prague last September the mood was upbeat. The world economy had shrugged off a series of financial shocks in emerging markets, the United States economy was continuing to forge ahead, driven by the “new economy”, Europe was at last showing signs of a robust recovery and Japan was beginning to emerge from a prolonged recession. Growth figures were being marked upwards. The only cloud on the horizon was rising oil prices.

The mood is different today. There are concerns about just how far and how fast the United States economy will slow down and whether traditional macroeconomic instruments can manage a rapid recovery; how vulnerable the dollar is; whether the nascent recovery in Japan will once again be nipped in the bud; whether the European locomotive can pick up sufficient speed to keep the world economy on track, and if not what a global downturn might mean for the still fragile recovery in Asia. On a more optimistic note, the oil cloud on the horizon has dissipated; prices had already peaked at the time of the Prague meetings. Conventional economic analysis is not, it seems, adapting very well to the gyrations of a globalizing world.

The UNCTAD secretariat has for some time been warning that excessive financial liberalization is creating a world of systemic instability and recurrent crises. A common response has been to blame such crises on misguided policies and crony investment practices in emerging markets. Whether similar accusations will surface as financial excesses and wasteful investments are exposed in the United States by economic slowdown remains to be seen, but they would be no more helpful than they were in the aftermath of the Asian crisis. Markets can and do get it wrong, and for developing and developed countries alike. The onus is still on policy makers to find preventive measures and appropriate remedies.

Certainly that task is difficult in a highly integrated world economy. But multilateral financial rules and institutions were established precisely to prevent a repetition of the inter-war economic chaos linked to persistent payments and currency disorders and excessive reliance on short-term capital flows. Sadly, since the break-up of the Bretton Woods system the world has been ill-prepared to deal with the re-emergence of such problems. Talk of far-reaching reform of the international financial architecture after the Asian crisis has proved to be no more than that. However, if a strong wind does pick up from the North, the consequences for the world economy will be much more chilling than those of the wind that blew in from the South. It is to be hoped that this threat will suffice to breathe new life into the reform efforts.

Global economic downturn and prospects

The performance of the world economy in 2000 was the best in over a decade. In every region growth edged upwards, with recoveries in Latin America and the transition economies that were stronger than expected. Moreover, this performance was achieved against the backdrop of sharply rising oil prices. While positive impulses from the previous year, notably the large liquidity injection to stave off the Y2K bug and to support the introduction of the euro, helped maintain the momentum, it was the continued strength of the United States economy that underpinned the 4 per cent growth in global output. To some observers, the combination of deregulated markets and new information technologies was putting pay to old-fashioned ideas about how economies worked, and many were looking forward eagerly to an unprecedented era of global prosperity.

Things changed dramatically over the last quarter of 2000 and into the new year. The United States economy began to slow sharply and the landing could well be harder than optimists had expected. The unwinding of its high-tech boom has produced a drop in investment spending, which has been aggravated by weaker consumer confidence and the threat of sizeable job losses in new and old economic sectors alike. The Federal Reserve reacted swiftly by cutting interest rates twice in January, with further cuts expected. The question that remains is whether the United States economy is experiencing the kind of cyclical downturn which will respond positively to such moves, and so ensure a quick rebound from two or three quarters of flat or negative growth back to a potential growth rate above 3 per cent. If the answer is in the negative, is the United States in for a longer period of disinvestment and debt restructuring with resemblances to those which occurred in Japan and parts of Europe in the early 1990s?

Expectations remain quite high that a short Keynesian downturn in the United States can be corrected by appropriate monetary and fiscal action. Some indicators at the beginning of the year provided grounds for guarded optimism: oil prices had dropped from their earlier peak; equity prices appeared to be stabilizing; and the trade balance had started to improve. The quick and decisive action taken by the Federal Reserve is also encouraging. The tax cuts that are under consideration, if appropriately timed and targeted, could further stabilize the situation.

But, even if the steady policy hand of recent years is maintained, there are doubts that traditional macroeconomic policies will carry the day, given the high level of private indebtedness, the surfeit of investment during the technology boom, and uncertainties surrounding the dollar. While the public sector prepares to pay off its outstanding debt, the private sector has attained record debt levels. As households see their income growth decline, they will have to borrow more in order to maintain current spending, at precisely the time when it is becoming more difficult for them to keep up with payments on their outstanding debt. At the same time, much of the high-tech Schumpeterian investment sustained by the venture capital boom and the stock market bubble may be destroyed with a return to normal financing conditions. If households and the business sector were to simultaneously limit their spending to current earnings, there could be a significant decline in GDP.

The fact that such a long period of expansion has no recent precedent should make for cautious assessment of the current slowdown. However, on balance, the various conflicting pressures point to an uncertain future; any abrupt shifts in sentiment or policy could still make for a deeper downturn than many are expecting and prejudice a swift recovery.

In view of its pivotal role in bolstering global demand in recent years, the prospects for the United States economy are a matter of worldwide concern. The increasing integration of the global economy certainly means that both real and financial shocks are transmitted much more rapidly across regions, countries and sectors. At the same time, because of the intertwining of finance and production, such shocks can have unexpected consequences, as has been demonstrated by the financial crises which began in Asia in 1997.

Whatever the immediate future holds in store for the United States, the long-term fate of the global economy cannot be left to be determined by policies and events in a single country. In the context of growing interdependence, all the major industrial economies need to harmonize their forces, if the gains from globalization are to be widely distributed and, in particular, to reach down to developing countries. Accordingly, “business as usual” is not the right mantra for policy makers anywhere.

Growth in Europe in 2000 broke through the 3 per cent barrier for the first time in over a decade, but leading indicators point to a slowdown in 2001. Now that budget deficits have been brought under control, the current account is healthy and there are few signs of inflationary pressure, the way is clear for a shift to expansionary macroeconomic policy. With interest rates falling in the United States and the prospect of a recovery of the euro which should further ease the pressure on monetary policy, Europe seems well placed to take on global economic responsibilities and boost global demand, thus offsetting the effects of slowdown in the United States. However, the EU appears reluctant to test the limits of its potential growth, as the United States did in the second half of the 1990s. Yet such action is also necessary in order to overcome its persistent and high unemployment. The European Central Bank maintains that it sees no signs of the potential growth rate in the euro area rising above a modest 2.0–2.5 per cent, implying that it sees no immediate scope for relaxing monetary policy without inflationary consequences. This stance may need to be reconsidered if, as seems likely, the EU is hit harder by a slowdown in the United States than might be suggested by its limited trade ties with that country.

Japan is unlikely to fill the breach, given its fragile recovery and the importance to it of the United States market. Its nascent expansion, which looked healthy in the first half of 2000, was built on rising net exports, but negative growth was resumed in the third quarter of the year. A lower dollar and weaker demand in the United States market place the burden of recovery on strong domestic demand. But since domestic investment is still closely tied to exports, and unemployment is again edging upwards, it is not at all clear from where the impulse will come.

Governments in Japan have repeatedly responded to sluggish growth with more active fiscal measures, but now that public debt is at an unprecedentedly high level pressure for fiscal consolidation is starting to impact on macroeconomic policy. Considerable uncertainty also surrounds the future direction of monetary policy; the Central Bank no longer seems willing to hold itself to a zero interest-rate policy, which it views as an impediment to financial structuring. With liquidity and fiscal traps snapping shut and export prospects darkening, recovery may once more be cut off just as it gathers momentum.

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Much still depends on the readings and actions of policy makers in Washington and it is premature to give the global economy a clean bill of health. Even if Europe in 2001 were to match the earlier United States growth performance, that would not have the same effect on the developing world, since

it has a lower propensity to import from those countries. The downside risks for developing countries are thus considerable.

Trade flows are one channel for contagion from a United States slowdown. The danger is apparent from the Asian experience, when slower growth in high-tech exports played an important role in the build-up of external fragility and the impact of the subsequent financial shock was amplified through intraregional trade. Just as significantly, strong export growth has played a key role in the Asian recovery. In 2000 the growth of United States imports reached double-digit figures for the third year running. The benefits to developing countries and transition economies were particularly marked, their total export volumes being estimated to have risen by over 10 and 15 per cent, respectively. A further factor in their favour was an improvement in their terms of trade on account of sustained oil price rises. The prospects for this year are much less favourable.

Financial and currency markets are another channel for contagion. Falling United States interest rates will certainly benefit countries with large stocks of dollar debt. Capital flows could also be redirected to emerging markets as smaller profits in the United States discourage inflows of capital seeking to join in the high-tech revolution and falling interest rates dampen short-term arbitrage inflows. However, it is equally possible that the United States slowdown will accentuate the bearish sentiment in global financial markets, raising the liquidity premium on dollar assets and the risk spread on emerging-market borrowing, thereby wiping out the benefits of lower United States interest rates. In that event, capital flows to developing countries would scarcely exceed their disappointing levels of 2000.

The presence of different channels of transmission suggests that the United States slowdown will be felt very differently in different regions of the developing world. East Asia was the fastest-growing region last year. After strong recoveries in 1999 in most of the economies damaged by the financial turmoil of 1997–1998, growth accelerated further in 2000. Exports to the United States, which amount to more than 20 per cent of GDP in Malaysia, 10 per cent in Thailand, and 7 per cent in the Republic of Korea, played a key role, especially exports from high-tech sectors. The current combination of declining sales in the United States and falling semiconductor prices has resulted in terms-of-trade losses and declining export earnings for all these countries. Growth is consequently expected to fall throughout the region this year. Intraregional trade linkages could once again amplify the negative impact of these shocks, triggering a further round of destabilizing exchange rate swings across the region. Moreover, the economies are slowing down at a time when financial and corporate restructuring is running into difficulties in a number of countries.

The economy of China is also sensitive to developments in the United States, which absorbs over 20 per cent of its exports. While robust growth last year gives grounds for hope that China can weather the downturn in the United States as well as it did the Asian crisis, the task of striking the right policy balance is being complicated by protracted, and as yet unfinished, negotiations over accession to WTO. The prospect of Chinese accession in the near future is also a matter of concern among some of the smaller labour-intensive exporters in Asia, who fear losing competitiveness at the very time when their export prospects are blackened by weakening import demand in the United States.

The impact of a United States slowdown on Latin America is more difficult to gauge. Recovery in that region was stronger than expected in 2000, when growth reached close to 4 per cent, after stagnation in the previous year. However, the aggregate picture hides much variation among countries. Mexico, which accounts for one fifth of regional output, witnessed growth of around 7 per cent, reflecting its close economic ties to the United States (which takes some 85–90 per cent of Mexican exports), as well as the rise in the export prices of its oil. It seems unlikely that the Mexican economy will be able to escape the consequences of the slowdown in the United States, although lower interest rates could be helpful. In addition, there is concern, shared with some other Central American and Caribbean countries, over the prospect of greater competition from China after its accession to WTO.

The impact on the rest of Latin America is likely to be different. In view of the weaker trade links with the United States and the heavy dependence on capital inflows, improved external financial conditions may more than offset the effect on their exports of reduced demand in the United States. In the absence of a significant increase in risk spreads, lower interest rates in that country should mean reduced borrowing costs and debt servicing, easing the pressure on balances of payments and budgets. Furthermore, for countries which have opted for a currency board or outright dollarization a weaker dollar improves competitiveness vis-à-vis third parties. Argentina may turn out to be a big winner on both counts, emerging from the vicious circle of stagnation and deflationary adjustment to the external shocks of 1998–1999. Brazil should also benefit from improved financial conditions, though to a lesser extent.

Despite some grounds for optimism, the real danger facing Latin America is one of diminished expectations. Policy makers throughout the region appear content to target growth in the 3–4 per cent range, well below what is required to promote graduation to the next level of development. Moreover, with more countries choosing dollarization, dependence on conditions and policy decisions in the United States is increasing. A deeper downturn there, bringing with it a new round of financial uncertainty and reassessment of risks, could well wipe out the potential benefits of a weaker dollar and lower interest rates and, together with a slowdown in exports, could produce a further setback to growth prospects.

As regards Africa, there is a certain degree of asymmetry in the impact of fluctuations in global economic activity. Because of supply-side rigidities, African LDCs that rely on exports of only one or two primary commodities cannot take full advantage of global expansion by increasing their export volumes, while they often bear the full brunt of commodity price declines. Prices of many of the commodities exported from Africa were falling in the 1990s. The rise in oil prices benefited some countries in 1999, and again in 2000, but for others, particularly the many that depend on oil imports, the consequence was a further widening of the resource gap.

Thus, despite the strong growth in the world economy in 2000, Africa's growth rate rose only modestly, to 3.5 per cent, which is below the rate reached before the Asian financial crisis and well below what is needed to tackle the problems of rising poverty and declining health. Even before the slowdown in the United States, growth forecasts were being revised downwards because of the continued sluggishness of some of the larger economies, severe weather conditions and disruptions caused by civil and political unrest.

In these circumstances, any global shock could be particularly damaging for African countries. Not surprisingly, aid and debt relief remain high on their political agendas. The region should benefit from bilateral debt reduction accorded by some industrialized countries to the poorest economies, as well as from recent European and United States initiatives to open up their markets to the poorest economies in Africa. However, with progress on the HIPC Initiative still much too slow, and a growing acknowledgement that the financial benefits are much smaller than expected, there is an urgent need for a bolder approach to multilateral debt relief.

The transition economies benefited considerably from favourable trading conditions in 2000. For the first time since the Berlin Wall fell, GDP increased in all countries. Growth in the Russian Federation rose sharply, thanks to strong demand for its primary exports, particularly oil. Elsewhere, it was the industrial sector that underpinned improvements, notably those of Eastern European countries, which benefited from strong export growth of manufactures to the EU. Even so, the fact that the recovery is from a low base, and occurred in favourable global demand conditions, means that a slowdown in the world economy will be felt by many of the transition economies and that any further recovery will have to come largely from a stimulus originating in domestic demand.

The downturn in the United States, unresolved structural difficulties and sluggish growth in Japan, and undue emphasis that monetary policy continues to place on inflation in Europe have the consequence that the major industrial countries will be converging towards a slower pace of economic activity. Despite decisive policy action, rapid recovery in the United States economy is jeopardized by the financial excesses associated with its unprecedented period of expansion. Furthermore, an orderly transition to a world where all the leading economies are pulling in the same direction is further complicated by the uncertainty surrounding exchange rate adjustments to the trade imbalances which have built up over the past few years. A rapid weakening of the dollar would not only compromise the ability of monetary policy in the United States to respond vigorously to a deepening of the downturn, but could also expose financial fragilities elsewhere. For all these reasons the downturn and instability in the world economy could be more pronounced than under normal cyclical conditions. Consequently, cooperation among, and responsible action by, all major players in the world economy becomes all the more necessary.

Reforming the international financial architecture

Between the myopia of global markets and the myth of global government, multilateral rules and institutions can help reduce market volatility and prevent mutually incompatible policy responses to economic shocks. For the architects of the post-war multilateral system who gathered at Bretton Woods, history had taught that financial markets were a particularly fecund source of instability and shocks, and that control over international capital flows was a precondition for currency stability, the revival of trade and economic growth and the achievement of full employment.

The breakdown of the Bretton Woods system in the early 1970s initiated a period of financial and economic uncertainty and instability that shares at least some of the characteristics of the inter-war period. Various initiatives have been pursued in different forums in the hope of finding a system of governance compatible with flexible exchange rates and large-scale private capital flows. The history of these initiatives can point to some successes but has, by and large, proved unsatisfactory, in part because they have been premised on keeping separate the problems facing developed and developing countries within the multilateral financial arrangements.

When the Asian financial crisis erupted, it seemed that all that would change. The virulence of the economic forces unleashed after the collapse of the Thai baht in July 1997, and among countries with track records of good governance and macroeconomic discipline, seemed to confirm the systemic nature and global reach of currency and financial crises. But despite the initial emphasis of some policy makers in the leading industrial economies on the need for systemic reform, moves in that direction have subsequently stalled. Instead of establishing institutions and mechanisms at the international level to reduce the likelihood of such crises and better manage them when they do occur, there has been a very one-sided emphasis on reforming domestic institutions and policies in developing countries.

Efforts in the past few years have focused on measures designed to discipline debtors and provide costly self-defence mechanisms. Countries have been urged to better manage risk by adopting strict financial standards, improving transparency, adopting appropriate exchange rate regimes, carrying large amounts of reserves, and making voluntary arrangements with private creditors to involve them in crisis resolution. While some of these reforms undoubtedly have their merits, they presume that the cause of crises rests primarily with policy and institutional weaknesses in the debtor countries and accordingly place the onus of responsibility for reform firmly on their shoulders. By contrast, little attention is given to the role played by institutions and policies in creditor countries in triggering international financial crises.

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Proposals for new international institutions explicitly designed to regulate and stabilize international capital flows have been summarily dismissed by critics as the work of mavericks lacking in political sense and technical judgement. The preferred line of reform has sought to establish various codes and standards to help strengthen domestic financial systems in debtor countries, enhance their macroeconomic and financial policy formulation, and improve the collection and disclosure of information. The Bretton Woods institutions, the Basel-based bodies and the Financial Stability Forum have already made a series of proposals along these lines.

Such measures can bring self-evident benefits, but they can be properly assessed only as part of an evolutionary process of stabilizing global financial markets. Of more immediate concern to developing countries is the fact that what has been proposed so far under the heading of codes and standards embodies the view that the main problems lie in countries receiving capital flows, but entails neither a fundamental change in policies and practices in the source countries nor improvement in the transparency and regulation of currently unregulated cross-border financial operations. And despite the emphasis on their voluntary adoption, there is the danger that incentives and sanctions linked to standard-setting will become features of IMF surveillance and conditionality, compliance with which would place a further heavy burden on the administrative capacities of many countries.

Because much of the impetus to improve codes and standards assumes their introduction into a stable and predictable global financial system, such measures offer little in the way of immediate protection for developing countries against supply-driven fluctuations in international capital flows, which are strongly influenced by policies and monetary conditions in the major industrial countries. Almost all major crises in emerging markets have been connected with shifts in exchange rates and monetary policy in those countries. The root of this problem lies, in large part, in the failure to establish a stable system of exchange rates after the breakdown of the Bretton Woods arrangements. The expectation then was that floating among the main reserve currencies would automatically bring about orderly balance-of-payments adjustments, increased exchange-rate stability and greater macroeconomic policy autonomy. This has not happened. But while the damage inflicted by disorderly exchange-rate behaviour has been limited for the G-3 economies this has not been the case for debtor developing countries, which depend more heavily on trade and whose borrowing profile exposes them to greater currency risk.

Despite the broad consensus that the Bretton Woods institutions should get back to what they do best, the discussion on reforming the international financial and monetary system has so far avoided serious mention of how the Fund might help rebuild a stable exchange rate system among the G-3 currencies. Proposals for securing greater stability through coordinated intervention and macroeconomic policy action, including formally established target zones, have been brushed aside, and discussions have concentrated on the pros and cons for developing countries of fixed or floating exchange-rate regimes and the macroeconomic policies consistent with one or other of these “corner

solutions". This ignores the mounting evidence that developing countries cannot unilaterally ensure appropriate alignment and stability of their exchange rates as long as major reserve currencies are subject to frequent gyrations and misalignments and international capital flows to large swings beyond the control of recipient countries.

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With little progress on how best to prevent financial crises, attention has increasingly turned to how best to limit their damage through faster and more effective responses once they do occur. So far, large bailout packages have been the preferred option, in most creditor and debtor countries alike, but they are becoming increasingly problematic. Not only do they create moral hazard for lenders but also they shift the burden of the crisis firmly onto taxpayers in debtor countries. Moreover, the approach is running into political opposition in creditor countries as crises become more frequent and extensive and the funds required get larger.

Thus, ways and means have been sought to redress the balance of burden-sharing between official and private creditors, as well as between debtors and creditors, by involving private creditors in crisis management and resolution. The issue is a contentious one. While the international community has come to recognize that market discipline will only work if creditors bear the consequences of the risks they take, it has been unable to reach agreement on how to bring this about.

For some time now the UNCTAD secretariat has been advocating a temporary standstill on debt payments during crisis situations to prevent asset grabbing by creditors, combined with lending into arrears to ensure that debtors have access to working capital. Although such procedures do not need full-fledged international bankruptcy procedures, they do need effective mandatory backing at the international level. Such backing has met with strong opposition from some of the major economic powers and market participants, who favour voluntary arrangements between debtors and creditors. Governments in some debtor countries have also been reluctant to back this proposal for fear of impairing their access to international capital markets. However, voluntary arrangements, while potentially helpful in debt restructuring, are unlikely to halt asset grab races. Again, the evidence from recent settlements suggests that without statutory protection for debtors the balance of power will continue to weigh heavily in favour of creditors.

A credible strategy for involving the private sector in crisis management and resolution should combine mandatory temporary standstills with strict limits on access to Fund resources. A first step in this direction would be the design of explicit guidelines under the IMF's Articles of Agreement allowing a stay on creditor litigation in order to provide statutory protection for debtors imposing temporary standstills. On the other hand, since the main objective of large-scale crisis or contingency lending would be to keep debtors current on their obligations to creditors, it would be difficult to ensure private sector involvement without limiting access to IMF financing. There is indeed growing agreement on the need to limit crisis lending. In setting such limits, it must be recognized that current IMF quotas have lagged far behind the growth of global output, trade and financial flows, and may not provide appropriate yardsticks to evaluate the desirable limits to normal access. However, the current approach still appears to favour large-scale packages for countries considered to present systemic risks, while other countries would face access limits and be encouraged to default in order to involve their private lenders in the resolution of their financial difficulties.

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The above are not the only changes needed in the mandates and policies of the Bretton Woods institutions. Over the past two decades, the unwillingness of the advanced countries to defer to IMF on contentious monetary and financial matters which directly affect their own interests has meant that the Fund's surveillance of the policies of the most important players in the global system has lost any real purpose. Instead, there has been an intensification of surveillance of developing countries, which has now been extended to include financial sector issues, consistent with the diagnosis that the main flaws are to be found in debtor countries.

One result has been the expansion of conditionalities attached to IMF lending to countries facing actual or potential crisis. This has given rise to serious concerns about undermining sovereign responsibility, even as the effectiveness of IMF surveillance is increasingly questioned. These concerns increased in the aftermath of the East Asian crisis, when excessive conditionalities led to policy responses which intensified the crisis. As a result, there have been calls, including within the International Monetary and Financial Committee, for the streamlining and refocusing of surveillance in line with the Fund's core competence in macroeconomic policy and related reforms. However, the recent financial difficulties in Turkey and Argentina illustrate the reluctance to break with the past practice of attaching wide-ranging policy recommendations to any IMF-negotiated loan package.

With swings in exchange rates and monetary policies in the major industrial economies acting as a catalyst for crises elsewhere in the world economy, a priority of the reform process must be strengthening surveillance mechanisms to achieve a minimum degree of coherence among the macroeconomic policies of those countries. In view of the asymmetries in existing practices, one way forward might be to link surveillance procedures to a mechanism analogous to that used for settling disputes in international trade, where disagreements over the impact of macroeconomic and financial policies could be taken up and their resolution sought.

More radical reform proposals put forward so far have sought to build on the consensus that the Fund should provide international liquidity not only to countries facing current-account difficulties but also to those facing capital-account crises. According to the Meltzer Commission, the time has come to make the Fund an international lender of last resort for any economy able to meet a series of *ex ante* conditions for solvency. This proposal raises two major concerns. On the one hand, it is likely to result in much larger packages than existing crisis lending, with attendant moral hazard problems for lenders and no incentive for bailing in the private sector. On the other hand, a radical shift in IMF lending to short-term capital-account financing would deny access to multilateral financing to all those developing countries considered systemically unimportant. These proposals place inordinate faith in market forces both to resolve financial crises and to provide finance for development.

One of the original objectives of IMF was to provide short-term financing to countries facing current-account problems due to temporary shocks and disturbances so as to ensure an orderly adjustment process. Experience continues to show that financial markets often fail to meet such needs, as they tend to be pro-cyclical. Given the increased instability of the external trading and financial environment of developing countries, an effective reform of the Bretton Woods institutions should seek to improve, not eliminate, counter-cyclical and emergency financing for trade and other current transactions.

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There are certainly a number of conceptual and technical difficulties in designing reasonably effective global mechanisms for achieving currency and financial stability. Such difficulties are familiar from the design of national systems. At the international level, there are additional political problems associated with striking the right balance between multilateral disciplines and national sovereignty.

Indeed, political constraints and conflicts appear to be the main reason why the international community has not been able to achieve significant progress in setting up effective global arrangements for the prevention and management of financial crises. In particular, the process has been driven by the interests of the major creditor countries, which hold most of the power in the multilateral financial institutions, as well as in bodies set up more recently with the explicit intention of reforming the international financial architecture. As a result, many of the issues of crucial importance to developing countries have been excluded from the reform agenda.

If reforms to the existing financial structures are to be credible, they must provide for much greater collective influence from developing countries and embody a genuine spirit of cooperation among all countries. This will require a major reformulation of the reform agenda. It will also require careful examination of the representation in the existing multilateral financial institutions and of their decision-making practices.

But it is equally important that developing countries themselves reach a consensus on how they want the reform process to move forward. While this consensus is lacking on several issues of the reform agenda, there are many commonly shared objectives, including: more balanced and symmetrical treatment of debtors and creditors regarding standards, codes, transparency and regulation; more stable exchange rates; more symmetrical surveillance; less intrusive conditionality; and above all, multilateral institutions and processes that are more democratic and participatory. Effective reform of the international monetary and financial system will ultimately depend on the willingness of developing countries to organize their efforts around such common objectives, and on acceptance by developed countries that accommodating these objectives will be an essential part of building a more inclusive system of global economic governance.

In the absence of collective arrangements for a stable international financial system, developing countries should avoid commitments which restrict their policy autonomy with respect to dealing with financial instability. Interest is now growing in regional arrangements to provide collective defence mechanisms against systemic failures and instability, and regional currencies are increasingly seen as viable alternatives to dollarization. The European experience has also been held up as a model for regional arrangements, including in areas such as intraregional currency bands, intervention mechanisms, regimes for capital movements, payments support and regional lender-of-last-resort facilities. Such arrangements among developing countries probably require the inclusion of a major reserve-currency country willing and able to assume a key role for this purpose. In this respect, recent initiatives in Asia, involving developing countries and Japan, could constitute an important step towards closer regional monetary integration.

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