
temas de coyuntura

International asymmetries
and the design of the
international financial system

José Antonio Ocampo



NACIONES UNIDAS



Santiago, Chile, April 2001

This document was prepared by José Antonio Ocampo, Executive Secretary of the Economic Commission for Latin America and the Caribbean (ECLAC). The author is grateful to Albert Berry, Stephany Griffith-Jones and Gerry Helleiner for comments to a previous draft of this paper.

The opinions expressed in this document are of the sole responsibility of the author and may not coincide with those of the Organization.

United Nations Publication
LC/L.1525-P
ISBN: 92-1-121300-2
Copyright © United Nations, April 2001. All rights reserved
Sales No. E.01.II.G.70
Printed in United Nations, Santiago, Chile

Applications for the right to reproduce this work are welcomed and should be sent to the Secretary of the Publications Board, United Nations Headquarters, New York, N.Y. 10017, United States. Member States and the governmental institutions may reproduce this work without prior authorization, but are requested to mention the source and inform the United Nations of such reproduction.

Contents

Abstract	5
Introduction	7
1. The basic problems	9
2. The role of international financial institutions	17
3. Six essential elements of a meaningful international financial reform	19
4. Conclusions	29
Bibliography	31
Issues published	35

Abstract

This paper argues that the design of the international financial system should take into consideration three different problems that the current system faces: financial market instability; basic macroeconomic and financial asymmetries that characterize the international economy; and the additional problems generated by the incomplete and asymmetric nature of the current globalization process. It proposes a useful analytic distinction between truly systemic issues, which focus on world economic stability, and center-periphery issues, which are closely associated with the correction of existing international financial asymmetries. Based on this distinction, the paper proposes a broad agenda focused on institutional aspects as well as on the services provided by international financial institutions (IFIs). The first group includes an adequate structure of representation of developing countries and governance structure of IFIs, an active role for regional financial arrangements, and a strong defense of national autonomy and ownership of policies. In terms of services provided by IFIs, it focuses on the systemic issues and on two center-periphery issues: the need to provide greater room for anti-cyclical policies in developing countries, and the need to compensate for the strong concentration of private capital flows.

Introduction

This paper argues that current controversies capture only in a very partial way the central issues associated with the design of the international financial system. Put succinctly, the basic assumption of a “level playing field” that underlies most discussions and proposals¹—i.e., that actors (e.g., nations) have an equal standing before the international financial system—is plainly mistaken. In broader terms, we argue that the changes in the international financial architecture must respond to three different problems that the current system faces: (1) financial market instability; (2) basic macroeconomic and financial asymmetries that are characteristic of the international economy which have mainly, though not exclusively, “center-periphery” (or North-South) dimensions; and (3) the additional problems generated by the incomplete and asymmetrical nature of the current globalization process. Viewed from the perspective of developing countries, the combination of market instability and basic asymmetries in the international order means that the current system poses either the threat of strong volatility and contagion effects, or that of marginalization from financial markets.

On the other hand, most current proposals tend to emphasize the need to strengthen national macroeconomic and financial policies in recipient countries—i.e., the national financial architecture—but are weak on the truly international aspects of the architecture required. It is true that inadequate policies are partly to be blamed for the problems that developing countries face, which are due to truly domestic problems (e.g., inappropriate macroeconomic policies or

¹ For a critical survey of recent proposals, see Akyüz (2000).

financial regulation) but also to pro-cyclical market pressure and international advice. However, market instability is clearly a broader phenomenon and is deeply rooted in the fundamental factors that determine financial volatility and contagion at the world level, including the great asymmetry between the sophistication of liberalized international financial markets and the institutions that regulate them. In such an environment, developing countries are particularly vulnerable to volatility and contagion and are expected to behave as “business cycle/policy takers”, transmitting internally the externally-generated boom-bust cycles of international finance. In this context, “self-insurance” (or “self-protection”) through domestic policies is certainly necessary but has limited returns and is costly in the absence of an inadequate international financial safety net.

The focus of discussion and proposals must thus be broadened to include the truly international aspects of the required architecture, in particular those that compensate for the asymmetries of the international financial system, as well as the structure of governance that characterizes existing institutions, the regional components of the financial architecture and national actions in the industrialized world that have global repercussions.

The first section of the paper looks at the three basic problems that the international financial system faces. This leads to a discussion on the roles of international financial institutions and the essential elements of a meaningful international financial reform. The paper closes with a short section of conclusions.

1. The basic problems

(a) Unstable financial markets

Although current-account, and in particular, terms-of-trade shocks continue to play an important part in the cyclical performance of developing countries, the central feature of the last quarter of the twentieth century was the dominant role played by capital-account shocks. Such shocks are part of a broader context of international financial instability, that is characterized by the frequency of financial and currency crises, which has also affected the industrialized world (IMF, 1998).

The instability of financial markets is deeply rooted in the way they function and in the market failures that characterize them.² They are associated, first of all, to basic asymmetries in information between lenders and borrowers, which are inherent to financial markets. Although they can be partly solved by fuller and more transparent information, even well-informed agents and sophisticated financial markets are extremely volatile. There are many reasons for this, but the most important is probably the fact that much of the relevant information is only made available with a significant lag, and that it depends on macroeconomic conditions that are not entirely known in advance. In a nutshell, markets are necessarily imperfect when time is involved, as the information necessary to correct such “market imperfection” will never be available. Opinions and expectations, rather than factual information, are thus the underlying forces behind the inter-temporal decisions that largely determine financial market performance.

² There is an extensive literature on this issue. See Stiglitz and Weiss (1981), Minsky (1986), Taylor (1998), Wyplosz (1999), Eatwell and Taylor (2000) and Persaud (2000), among others. For a historical account, see Kindleberger (1978).

Given the absence of information about the future and the cost of processing a large amount of current data to adopt specific decisions, either by an individual or a complex organization (e.g., a board of directors of a large financial or non-financial firm), simple information, and even rules of thumb may need to be used, and the tendency to conform to the “average opinion” prevailing in the market at the time might be very strong. The “contagion” of opinions and expectations, which generates alternative phases of euphoria and panic, is thus intrinsic to the functioning of financial markets. Moreover, the combination of the simple way in which opinions and expectations are created, technological developments and the sophistication of today’s markets means that they are likely to be more rather than less volatile. Thus, 24-hour trading and rapid information channels transmit changes in opinions rapidly. If many small and even large investors rely on the “information” provided by a few market agents (large investment banks or rating agencies), any change in their opinions and expectations is bound to have amplified repercussions. High leverage and unbundling of risks through derivative operations would increase the effects that variation in certain corners of the market would have on global financial performance. This implies that a variation of opinions by agents willing to take risks, or a breakdown in that specific corner of the market, would also have a considerable multiplier effect. Under these conditions, speculative behavior would have destabilizing rather than stabilizing effects, particularly at turning points in the boom-bust cycle. As a result of all these factors, as the Chairman of the Federal Reserve Board has argued, the “size of the breakdowns and required official finance to counter them is of a different order of magnitude than in the past” (Greenspan, 1998).

(b) International macroeconomic and financial asymmetries

Boom-bust cycles have different effects in different countries due to some basic asymmetries that characterize the world economy. These asymmetries have largely (though not exclusively) center-periphery dimensions. The first is basically macroeconomic. Broadly speaking, the center generates the global shocks (in terms of economic activity, financial flows, commodity prices and the instability of the exchange rates of major currencies), to which developing countries must respond and adjust. Such shocks include sharp fluctuations in capital flows to developing countries, partly as a response to the perceived opportunities and risks of investing in them. Moreover, owing to differences in diversification of the economies involved, both trade (e.g., terms-of-trade) and capital-account shocks tend to be larger in the periphery. Put succinctly, whereas the center economies –particularly the largest among them— are “business-cycle makers”, the developing countries (the “periphery”, in this framework) are “business-cycle takers”.

This asymmetry is closely associated to a second one, relating to the relative degrees of policy autonomy. Again, putting it succinctly, whereas the center has more policy autonomy and is thus “policy making” —certainly with significant variations among the different economies involved—, the periphery is essentially “policy taking”. This asymmetry is deeply rooted in macroeconomic factors as well as in large asymmetries in financial development. In macroeconomic terms, its most fundamental root is the fact that the center economies’ national currencies (now regional in the case of most members of the European Union) are also international currencies. This gives them greater degrees of freedom in terms of the use of national monetary policy to manage domestic business cycles, although certainly at the possible cost of exchange-rate fluctuations in the current world of floating exchange rates among major currencies. The degrees of freedom are obviously greater for the country that has the dominant international currency (the United States) and more limited for the rest of the industrialized economies. Through the impact of monetary policy on economic activity and exchange rates, the center economies generate externalities to the rest of the world that are not internalized by policy makers. These externalities are strongly felt in the developing world, which must adjust to them but lack the degrees of freedom that the ability to supply international currencies provides.

Viewed in historical terms, whereas the move away from the gold standard since the 1930s partially freed international-currency-issuing countries from adhering to the “rules of the game”, adherence to those rules continued to be essential to the periphery. The swing between “boom” and “depression economics” has been present all along in the non-international-currency-issuing countries. Its effects have certainly been more drastic in the last quarter of the twentieth century, owing to the coincidental occurrence of slower growth at the center and larger but more volatile international capital flows. Indeed, the latter lifted constraints on spending during booms, but only made them more intense during subsequent busts. Although access to multilateral financing in the post-war period may have helped to smooth out adjustment during crises, the counterpart of such financing has been, in any case, strict adherence to the “rules of the game”.

Moreover, in one important respect, the current system is inferior to the gold standard. In that system, the existence of a truly international standard implied that developing countries were not subject to the risks of exchange-rate fluctuations among major currencies. The sharp contrast between the international character of the world currencies and the largely national criteria for economic policies that determine their value is thus a source of vulnerability for the periphery.

Aside from asymmetries associated with international currencies, there is significant evidence that policies in the developing world can by no means be considered entirely “autonomous”. The most important issue in this regard is the fact that developing countries are expected to behave in ways that generate “credibility” to financial markets, which means that they are expected to adopt pro-cyclical (austerity) policies during crises. The fact that austerity policies have been in place during crises in turn generates economic and political-economy pressures to adopt pro-cyclical policies during booms as well. Non-financial agents and financial intermediaries then resist restrictions on their ability to spend or lend, whereas authorities are just happy to have some breathing space after a period of austerity. In other words, not only are the incentives to adjust absent during booms, but the drastic application of austerity rules during crises distorts the incentives that economic agents and authorities face throughout the business cycle (why should you also adjust during booms?).

Moreover, markets are indeed inherently pro-cyclical and generate strong pressure to spend during periods of financial euphoria, through the availability of financing, downward pressure on interest rates and capital gains associated to appreciation pressures in countries with large external liabilities. The contagion of optimism characteristic of this period leads all economic agents—including national authorities and international agencies—to underestimate the risks involved in pro-cyclical behavior and policies. The draconian “market discipline” characteristic of crises is thus weak during booms and leads countries frequently into broad divergence from long-term “fundamentals”—or, rather, from what are later considered by markets and international agencies to be such fundamentals. In turn, IMF surveillance has, in the past, tended to send weak warnings during booms and, in any case, such warnings are received with a lesser sense of urgency.

Furthermore, some readily accepted doctrines generate further pro-cyclical biases in developing country behavior and policies. In the recent past, the most common of these has been the push for countries to liberalize the domestic financial sector and the capital-account regime without taking into account the risks that such policies entail in the absence of adequate sequencing and speed. Financial liberalization is now broadly acknowledged to increase risks, and a more prudent approach has been followed recently. There is less acceptance, however, of the notion that even a well-sequenced liberalization permanently reduces the limited degrees that developing country authorities enjoy in a volatile financial environment. Moreover, the current doctrine that policy discretion in the developing world generates distortions (“policy failures”) that overshadow any possible market failures, implies that authorities should put in place “automatic pilots”. A particular case in point is the call to adopt polar exchange-rate regimes, either hard pegs or

totally flexible exchange rates. Although “automatic pilots” certainly reduce speculative capital flows associated with lack of credibility in economic policy, they are also synonymous of pro-cyclical—either monetary or exchange-rate—policies. Since most risks are accumulated during periods of boom, when market discipline is weak or absent, this will tend to increase rather than reduce the financial risks in which private agents incur throughout the business cycle. The pro-cyclical response that this policy approach entails may, in turn, increase rather than reduce risks, owing to its impact on economic activity (as reflected, for example, in the Argentine experience since the 1997 global shock). What is equally clear is that, to the extent that major capital-account cycles are generated in the center of the world economy, not all and certainly not the major shocks are necessarily associated to “credibility issues”.

The basic macroeconomic asymmetries between “business cycle/policy makers” and “business cycle/policy takers” have as counterparts basic asymmetries in financial markets. Four must be singled out: (a) the asymmetry between the size of developing countries’ domestic financial markets and the size of the speculative pressures they may face;³ (b) the nature of the currencies in which external debt is denominated, which generates significant currency mismatches between assets and liabilities and is closely associated with the inability to supply international currencies; (c) the significant difference in the maturities offered by domestic and international financial institutions, which gives rise to significant maturity mismatches for debtors who are unable to access international markets (e.g., small and medium-size firms) and currency mismatches for those that can; and (d) the thinness of domestic security markets, which reduces the liquidity and, thus, the development of long-term financial securities. Viewed as a whole, this means that domestic financial markets in the developing world are significantly more “incomplete” than international financial markets, indicating that some financial intermediation must necessarily be conducted through international markets. It also means that international financial integration is integration between unequal partners.⁴

The associated risks can only be partially covered (e.g., currency risks of large non-financial intermediaries)⁵ or partially corrected by domestic policy actions. Indeed, some of the policy actions that developing countries can adopt to prevent risks merely reflect (or reproduce) rather than correct the basic asymmetries in financial systems. For example, domestic financial risks in the developing world, particularly those associated with fluctuations of exchange and interest rates, have a large macroeconomic component. This could be managed by adopting prudential regulation of domestic financial activities that is stricter than minimum international (Basle) standards. However, this raises the cost of financial intermediation and probably restricts the development of new financial services, thus shifting financial asymmetries to another level, even increasing the incentives to use international financial intermediation. The same can be said of moving to a currency-board regime or giving up the national currency altogether. While these moves certainly reduce or eliminate currency risks, they may merely shift the underlying risks to a different area. Particularly, they could make economic activity more volatile, given the additional restrictions on the adoption of anti-cyclical policies. In a very real sense, developing countries face country rather than currency risks; the latter are, in a way, a mere manifestation of the former, but can certainly be made more complex by policy mismanagement (an overvalued exchange rate in an adjustable-peg system, or outright monetary and financial mismanagement in a flexible exchange-rate system).

³ See, on this, the very interesting remarks of the Council on Foreign Relations Task Force (1999), chapter III.

⁴ ECLAC (2000, ch. 8) and Studart (1996). Hausemann’s (2000) concept of “original sin” captures the second and third of these asymmetries.

⁵ The coverage provided by private financial agents is likely to be limited. The government or the central bank can also provide some of the coverage, thus helping to develop a market for such risk instruments. However, such coverage could just “socialize” the macroeconomic risks involved, potentially increasing the corresponding fiscal and quasi-fiscal costs.

The sharp distinction between “business cycle/policy takers” and “business cycle/policy makers” certainly goes a long way to summarize major features of the international economy. It should, nonetheless, be qualified in three important ways. First of all, as already noted, the degree of policy autonomy varies significantly among different industrialized countries, depending on their size and, even more importantly, on the different degree of acceptance of their currencies as international currencies, or as a standard for denominating debt instruments. Hence, the center should actually be visualized as a diversified collection of centers.

Secondly, to the extent that there are domestic policy alternatives, developing countries are not entirely “policy takers” (Ocampo, 2000). This does not, however, eliminate the basic assertion that current incentives in the world economy push them towards pro-cyclical policies. Moreover, if authorities do indeed adopt such policies, they help to amplify world business cycles —i.e., they serve as “business-cycle multipliers”.

Finally, developing countries have different sizes, trade and productive diversification, and degrees of access to international financial safety nets, depending on private assessments of their creditworthiness, international political and/or economic clout, and the corresponding access to private or official financing. The fact that private flows are sharply concentrated in a few middle-income “emerging” countries means that low-income countries face significant difficulties in accessing private capital markets, which makes them heavily dependent on the less dynamic sources of financial flows (official bilateral financing). Unstable access and outright rationing are thus alternative, interdependent mechanisms by which market failures in international finance affect the developing world. Indeed, unstable access can become outright rationing during crises. It also means that the sources of external shocks that different countries are likely to face vary: financial shocks are relatively more important for “emerging” economies, traditional trade shocks relatively more important for low-income countries.

A second basic differentiation divides the developing world between those countries that, at least in some episodes, may become systemically important and those that are not. Those that are systemically important can become true “business cycle makers”, but only to the extent that booms and crises in such economies do actually affect and are thus transmitted to the world economy through their repercussions on the center economies. Moreover, to the degree that systemically-important developing countries generate a special bias in the response of the international community, they enjoy more policy autonomy. This, in turn, implies that those countries that are not systemically significant or lack access to financial markets (the poorest and the smaller countries) may face a disproportionate need for pro-cyclical domestic policy responses to external shocks.

(c) An asymmetric globalization and the political economy of the reform process

The incomplete and even lopsided character of the current globalization process and the international policy agenda that accompanies it further complicate the asymmetries in the international economy. Four issues figure predominantly in the current agenda: free trade, intellectual property rights, investment protection, and financial and capital account liberalization. As we have noted, the latter has been subject to qualifications during the recent crises: it needs to be well sequenced, and emphasis needs to be given to longer-term flows and institutional development (strong prudential regulation and supervision). Moreover, in the area of trade, liberalization is, in turn, incomplete and asymmetric: “sensitive” items of strong interest to developing countries are subject to the highest protection in the industrialized countries.

On the other hand, other issues are conspicuously set aside in the current agenda: labor mobility (particularly low-skilled labor mobility); international rules on taxation, particularly on

capital (which is essential to guarantee adequate taxation of this highly mobile factor); the design of truly international competition rules and codes of conduct for multinational firms; and compensatory financing to guarantee inclusion of those countries and social groups that tend to be left behind in the globalization process, and thus guarantee an adequate distribution of the benefits of globalization.

This also reflects the most significant asymmetry of the current globalization process: the asymmetry between the rapid globalization of (some) markets and the conspicuous absence of an international social agenda. Indeed, the latter is largely confined to the definition of common international principles (through United Nations summits) and the still incipient rise of international legislation. The decline of Official Development Assistance (ODA) is the most remarkable demonstration of an inadequate commitment to a truly international social agenda, as is the growing conditionality of international financial support in general. Indeed, the paradoxical companion to declining ODA is the rise, in recent years, of “social conditionality”, particularly in relation to the Highly Indebted Poor Countries’ (HIPC) Initiative —undoubtedly the most conditioned international support program in postwar history— but also to International Monetary Fund (IMF) packages.

In broader terms, it is increasingly recognized that globalization has made the need to provide certain “global public goods” (political, social, economic and environmental) more apparent, as many previously “national” (and, further back in history, local) public goods are increasingly becoming global (Kaul, Grunberg and Stern, 1999). There is, however, an open contrast between the recognition of this fact and the inadequate funds allocated to the international institutions that are expected to provide such public goods.

These asymmetries obviously reflect certain basic political and political-economy characteristics of the world. The lopsidedness of the current globalization process and agenda undoubtedly reflects the asymmetric weight of major countries and large private firms. It also reflects, however, the disorganization of actors, particularly developing countries, in the international policy debate. This is associated not only with the weakening of the historical mechanisms of concerted action by developing countries (e.g., G-77), but also of the “policy competition” that globalization itself has generated: the great incentive that each country has to claim that it is more attractive for investment in an era of mobile capital and increasingly footloose production. Thus, the asymmetries in world power relations and the high cost of generating international coalitions to compensate for them have become even more important today. This means that the international agenda will probably continue to be biased towards the largest countries and best-organized coalitions, and it is unlikely that they will fully internalize the impact of their policies and agendas on the rest of the world.

A political and political-economy factor that creates further complications is obviously the reluctance of most countries, both industrialized and developing, to give up economic sovereignty to international organizations. Moreover, although open regionalism is a feature of globalization, and strong integration forces have been at work in many parts of the developing world (e.g., Latin America and Southeast Asia), this has not led to strong developing-country coalitions. Indeed, the European Union aside, countries are also unwilling to give up their sovereignty to regional institutions (and in the case of the European Union only in a limited sense). Under the strong market forces that characterize globalization, which tend to weaken nation-states, the unilateral national liberalization processes that have taken place simultaneously and the absence of a parallel development of international institutions, government regulations have weakened worldwide. Many analysts perceive this outcome as an advance, but it is also a source of significant distortions and risks. Increased financial instability is, in fact, a particular manifestation of the risks that have been generated by weakening regulation worldwide.

These political and political-economy factors have major implications for international financial reform. The most obvious are that only weak pressures for substantial reform appear to be present (Eichengreen, 1999), that any balanced negotiation process would be cumbersome, and that negotiation processes may underestimate or bypass altogether the interests of certain actors. Obviously, the most desirable alternative would be to design an adequate forum and a broad agenda, so as to properly represent the interests of those actors that would otherwise lack a strong voice.⁶

This also means that the international financial architecture will probably continue to rely essentially on a network of national institutions. The absence of truly international institutions also means that institutions that exist nationally will not be available at the global level (deposit or credit insurance) or will have inherent limitations (lending of last resort). In addition, classical “second best” arguments will be relevant owing to the incomplete nature of the current globalization process. Policy instruments that are not available at the national level should thus be left as open options at the international level for developing countries (e.g., the absence of labor mobility as a mechanism of adjustment may justify trade and capital-account regulations).

A final, crucial implication is that no international financial architecture will be neutral in terms of the equilibrium of international relations. It will be strongly argued in this paper that an international system that relies on one or a few international institutions will be less balanced than one that relies on a network of regional institutions, and that countries with very limited power in the international arena will be better off if they have access to a broader menu of alternatives to manage a potential crisis and a broader set of sources of development finance than if they are restricted to fewer options. The first part of this proposition indicates, in fact, that the strongest defense for weaker actors is competition in the supply of support to them. The second is that, in the absence of adequate international support, the “second-best” solution may be more rather than less national autonomy. National autonomy obviously has costs, as the greater menu of alternatives for managing crises must be traded off against the need to generate “credibility”, a factor that inclines developing countries to adopt the policy package they believe the market considers best practice. This is, indeed, a result of the “policy competition” to which we have alluded.

⁶ These are fundamental concerns of the United Nations Task Force (1999), the Group of 24 (1998), Helleiner (2000a) and Culpeper (2000).

2. The role of international financial institutions

The starting point of our analysis is the realization that markets work best when they are well regulated, when anti-cyclical policies are adopted to manage the pro-cyclical bias of markets, and when adequate social policies are in place that provide an adequate supply of human capital, social protection (of both a permanent and a cyclical nature) and inclusiveness. The latter is, in turn, closely associated with adequate social and political arrangements that give a “voice” to (empower) all social actors and maximize their participation in social and economic affairs.

Viewed in this broad framework, there are two interrelated demands for the services of international financial institutions (IFIs). The first demand is truly systemic in character and is associated to economic stability as a global public good. In this regard, these institutions should respond, first of all, to the need to correct “market failures”, particularly the volatility and contagion characteristics of international financial markets. Secondly, however, they must operate in a context in which national macroeconomic, regulatory and social-policy institutions are in place and, thus, in a context in which there is an important vacuum of governance associated to the absence of truly international institutions. Thus, their major task is the creation of adequate incentives and coordination mechanisms that will allow national authorities to internalize the externalities that they generate to other members of the international community.

The second demand comes from the recognition of the fact that the world economy (and polity) is not a level playing field but, on the contrary, is full of asymmetric features. The issues this raises are basically center-periphery in nature. They relate to the particular sensitivity of emerging economies to capital-account volatility, the rationing of private financing to low-income and many middle-income countries, the relative absence of macroeconomic policy autonomy that all developing countries face and the weaknesses of their social protection schemes. In these regards, IFIs should provide greater maneuvering room for anti-cyclical policies in the developing world and help to compensate for the concentration of private capital flows.

This differentiation between “systemic” and “center-periphery” issues goes a long way to clarify the confusions involved in some of the recent discussions on the matter. In particular, the controversy between advocates of “lenders of last resort” vs. those who emphasize the “moral hazard” that might be generated is certainly valid for systemic analysis, but additional factors must be taken into account when analyzing the center-periphery dimensions of this issue. The reduction of emergency financing or early resort to private-sector involvement in crises are likely to reinforce the asymmetric features of the world economy. In the words of George Soros, lending to developing countries will remain scarce and expensive, as “the system is tilted in favor of the center, namely the owners and providers of capital, and the economies at the periphery are at a disadvantage” (Soros, 1999, p. 141).

On the other hand, the emphasis on national architecture issues in developing countries —i.e., on “self-help” or “self-insurance”— that is typical of the current IMF approach will certainly help to reduce vulnerabilities and the intensity of crises in the developing world but does not address either the truly systemic or center-periphery issues. In the terms that we have used in the previous section, the major global effect of this approach will be to reduce the role of the periphery as a “business cycle multiplier”, but not the source of boom-bust cycles. Moreover, so long as it does not focus on the truly central issue of providing more maneuvering room for anti-cyclical policies in the developing world, it does not really compensate the basic asymmetries faced by the periphery.

The following section focuses on a broad agenda that is intended to respond to this dual demand on IFIs. We first look at three institutional issues: the structure of representation and governance of international institutions, the role of regional arrangements —an item frequently left aside in current discussions—, and national autonomy and “ownership” of policies. We then analyze the systemic and two basic “center-periphery” issues. The focus is on the central and controversial aspects of these issues, leaving aside the detailed consideration of some elements that have been the focus of previous work.⁷

It should be added from the onset that although the role of IFIs is crucial, it is also strictly limited. It is often argued, particularly in relation to development banks, that one of their essential roles is to provide global public goods.⁸ This is true of all international organization and is not unique to the actions of financial institutions; hence, this argument leads to an inadequate view of their activities, collusion of competencies with other international organizations, and overextension of conditionality. In the terms we used at the beginning of this section, it is clear that the major role of IFIs lies in the areas of regulation and the provision of room for anti-cyclical policies, but their role in social and political processes is limited, indeed secondary, to that of other international organizations (many United Nations bodies) and, particularly, to national policies and institutions. A proper view of IFIs is, indeed, one of the most crucial (and controversial) elements of the international financial architecture that is needed.

⁷ See Ocampo (1999, 2001) and Griffith-Jones and Ocampo (1999). See also United Nations Task Force (1999).

⁸ See, for example, Gilbert, Powell and Vines (1999) and frequent statements by the World Bank.

3. Six essential elements of a meaningful international financial reform

(a) Appropriate representation of developing countries and adequate forums and governance structures

Inadequate representation of developing countries in the governing bodies of IFIs and their limited or complete lack of representation in crucial forums are some of the most worrisome features of the current international financial order. The International Monetary and Financial Committee and the Development Committee, as well as the governing bodies of the International Monetary Fund and the World Bank, reflect a voting power in which developing countries, particularly medium-sized and smaller ones, are inadequately represented. Veto power in some crucial decisions (such as increases in IMF capital and the allocation of Special Drawing Rights) and the process of selection of the Managing Director and President are additional debatable features of these organizations which reflect, in the latter case, an informal power structure that is even more concentrated. Membership of developing countries in the Bank for International Settlements (BIS), though increasing, is still limited, and its governance structure is even further tilted in favor of the major industrialized countries (partly as a reflection of history). Given the central role played by BIS and IMF in the drafting of international codes and standards, these features are certainly problematic.

Even more worrisome is the dynamics of the various Gs (Culpeper, 2000), especially those that are designed as mechanisms of coordination of major industrialized countries, i.e., G-10 and G-7. The more recent creation of the Financial Stability Forum (FSF) as an offspring of G-7 and its leading role in the discussions on new regulatory rules and standards (similar to that of G-10 in the past) make this specific body particularly important. The invitation to some developing countries to join FSF working groups or their co-optation through broader ad-hoc groupings—such as G-20 recently—are clearly sub-optimal alternatives. Together with the problems outlined in the previous paragraph regarding IMF and BIS, this mechanism means that developing countries are not represented or are seriously underrepresented in crucial forums. The Governor of the People's Bank of China has expressed this point in strong terms: “The monopoly by a handful of developed countries on the rule-making in international financial field must be changed” (Dai, 2000).

The main body of its kind to be made up of developing countries, G-24, has played a very useful role in maintaining a degree of presence of developing countries in controversies relating to the international financial agenda, but its influence is limited.⁹ An equally worrisome feature on the developing-country side is the lack of wide discussion and consensus building on common interests regarding the international financial agenda, at the global level (e.g., eventually through G-77 or the non-aligned movement), at the regional level or even within constituencies in IMF or the World Bank. The dominance of finance ministries and central banks in these institutions is an indication of the fact that the most critical views on the functioning of IFIs within developing countries may not reach their governing bodies. NGOs and academia may have played a useful role in this regard, although they transmit mainly critical views expressed within the industrialized world.

The United Nations Economic and Social Council and the Trade and Development Board of the United Nations Conference on Trade and Development (UNCTAD) have a more balanced representation and clearly capture a broader (or, at least, alternative) set of views on international issues, but they are basically deliberative bodies. The interaction between these and the Bretton Woods institutions can thus be very productive. In this regard, the current United Nations finance for development process provides a useful starting point for a dialogue of this kind.¹⁰ Going beyond deliberative processes, giving United Nations governing bodies some decision making power in this field, including the possible creation of an economic security council, should continue to be part of the discussion agenda.

There is broad support for ensuring greater transparency of IFIs, although the possibility that wide dissemination of their analyses could hurt the role of these institutions as “confidential advisors” has been a concern of developing countries.¹¹ There is even broader support for stronger internal and external auditing of the activities of these institutions. In this regard, the internal auditing office of IMF, created in 2000, is a step forwards. These mechanisms cannot, however, replace external auditing and a broader discussion on the viewpoints of these institutions which should permeate discussions between these agencies, governments and civil society in the developing countries. An open exchange of views on policies is particularly important, given the absence of direct democratic accountability of these institutions (Stiglitz, 1999). United Nations organizations and deliberative bodies have and should continue to play an important role in this regard.

(b) The role of regional institutions

The role of regional institutions in the international financial system is one of the most prominent items missing from the mainstream discussion and agenda on international financial

⁹ This is also true of G-15, which has a broader political mandate.

¹⁰ See, in this regard, United Nations (2000).

¹¹ See, for example, G-24.

reform. It is absent from the main Northern reports¹² and from the views on financial reform which come from IMF (though the position of the new IMF Managing Director is more positive in this regard). The main manifestation of this gap in recent years was in the opposition to the creation of an Asian Monetary Fund in 1997, although this idea was revived in 2000 in the form of a swap arrangement between the ASEAN countries, China, Japan and Korea.

There are four basic arguments for a strong role for regional institutions in this area.¹³ The first is a classical risk-pooling argument. Regional and subregional development banks, even those made up entirely of developing countries, are likely to face lower risks than individual members. This creates the potential for profitable financial intermediation.¹⁴ Also, despite contagion, critical demands for funds do not coincide exactly in time, a fact that generates the possibility of a useful role for regional reserve funds or swap arrangements as a first line of defense during crises.¹⁵ If these mechanisms are effective, they can play a useful role in reducing contagion.

The second argument relates to the virtues of complementarity between world and regional institutions. Given the heterogeneity of the international community, world and regional institutions can play useful complementary roles. Thus, aside from those mechanisms that involve major industrial economies, macroeconomic policy coordination will work best in regional organizations. These organizations can also play a useful role in setting norms, in the adaptation of international norms to regional conditions (given different regulatory traditions), and in reducing learning costs and sharing experience with institutional development. They could also establish mechanisms to ensure surveillance of their regulatory systems and, eventually, regional currencies. The fact that, at least in the area of trade, globalization has been accompanied by strong regionalism, further points to the virtues of such complementarity.

The third is an argument for competition, particularly in the supply of services to smaller and medium-sized countries. World institutions are likely to serve best those actors who have some systemic influence. Smaller players do, in fact, face a very unfavorable power relation *vis-à-vis* large institutions. This creates a strong argument for a division of labor whereby regional institutions can and should play a stronger role in relation to small and medium-sized countries. Indeed, the best defense for smaller players is competition in the provision of services to them. Hence, the competition between world and regional organizations in the provision of development bank services, emergency financing or technical support is, undoubtedly, the best arrangement for small and medium-sized countries.

The last may be called the “federalist” argument. No matter what arrangements are adopted, the voice of small and medium-sized countries is unlikely to be strong in global institutions. This may lead, in turn, to a lack of commitment (“free rider” attitude) on the part of these countries. This can be remedied by the establishment of regional institutions in which their voice does matter, together with a sense that those institutions are truly part of a broader international order. Moreover, the sense of “ownership” of these institutions by developing countries creates a special relationship between them and member countries that helps to reduce the risks that regional and subregional development banks and reserve funds face, further encouraging the virtues of risk pooling.

These are strong arguments for giving a prominent role to regional institutions in the world order. The best example in this regard is, undoubtedly, the European Union. Indeed, these arguments point to the need to think of the virtues of providing global public goods in the area of finance (as well as in many others) through a network of either complementary or competitive

¹² See, for example, Council on Foreign Relations (1999), and Meltzer and others (2000).

¹³ For a broader discussion of these issues, see ECLAC (2001, ch. 2), Agosin (2000), Ocampo (1999, 2001) and Park and Wang (2000).

¹⁴ The experience of the Andean Development Corporation (*Corporación Andina de Fomento*) reflects this.

¹⁵ See, for example the experience of the Andean, now Latin American Reserve Fund (Agosin, 2000).

institutions. The International Monetary Fund of the future could be viewed, in this regard, as the apex of a network of regional and subregional reserve funds and swap arrangements (United Nations Task Force, 1999; Ocampo, 2001) —i.e., a structure more akin to that of the European Central Bank than its current centralized one. In turn, competition in the provision of development finance between the World Bank, the regional development banks and a growing set of regional and subregional banks entirely owned by developing countries is probably the best arrangement in this area, together with increased direct access by all developing countries to international private capital markets.

(c) National autonomy and “ownership” of policies

One of the most important conclusions reached in recent debates on international financial issues is that conditionality is ineffective or at least an inefficient means to attain objectives that the international community wishes to attach to financial support. So long as there is no true “ownership” of the policies involved —i.e., so long as they are not backed by strong domestic support—, they are unlikely to be sustained. This is strongly associated with the fact that “ownership” is essential to institution-building, which is generally recognized today as the clue to successful development policies. Indeed, the best standard of strong “ownership” is the most successful of all international support programs, the Marshall Plan. This, then, should be the standard that the international community should aim at. This is not to say that international support should not be tied to international objectives, but rather that conditionality is an ineffective means to achieve those objectives.

Beyond that, there is a different line of defense to strong “ownership”, which may be called the democratic argument. Indeed, there is no point in promoting democracy at the world level if national institutions do not have effective decision-making powers. Democratic processes will bring diversity to the international community, and that diversity should be seen as a positive outcome of international arrangements that rely on active democratic processes at the national level.

These two arguments have been the basis for the recent acceptance of “ownership” as a central feature of IMF and World Bank (Köhler and Wolfensohn, 2000) as well as ODA programs. It has also been accepted that IMF conditionality should be streamlined, to respond to criticisms from different sources. However, the fact that “ownership” still goes hand-in-hand with extensive use of conditionality is clearly problematic (Helleiner, 2000b). In a sense, even the process by which “ownership” is to be built at the national level in developing countries has become a subject of conditionality. Moreover, the view that there is a set of “correct” policies and reforms that should be adopted in the developing world is intrinsic to the functioning of major IFIs and underlies the extensive use of conditionality. Thus, the widespread discussion of alternative policy approaches, the actual choice in some countries of policies (or the rejection of reforms) that may run counter to the preferences of the IFIs, and the definition of rules that allow for international support in at least some of these cases will be the true test that “ownership” is being taken seriously.

A third argument in favor of more national autonomy has to do with the incomplete nature of international arrangements. There is indeed a clear “second best” argument associated with this fact that supports the choice of policies that may not be optimal in more complete arrangements. Thus, the absence of an incomplete international financial safety net means that capital-account regulations should be maintained as an area of national policy autonomy, just as inconvertibility was maintained as a prerogative of private financial institutions in the era of free banking, when institutional arrangements were still incomplete at the national level. It must be emphasized that this argument for autonomy is much broader than the defense of specific capital-account regulations, a controversial issue in the policy debate. For the same reason, the choice of the

exchange-rate regime should continue to be an area in which national autonomy should be maintained.

(d) The systemic issues

The basic systemic issues are coherent macroeconomic policies of major industrialized countries, adequate prudential regulation and supervision of financial activities, and adequate capacity to respond to financial crises in the industrialized world. In all these cases, national rather than international institutions play the central role today, with some coordination by G-7 and G-10, as well as BIS, a central aim of which has been to avoid regulatory arbitrage. Although the inadequacy of these arrangements in an increasingly globalized world has led to a call to form a world financial authority (Eatwell and Taylor, 2000) and a world central bank, the probability of moving in this direction is low. An important step in recent years has been the creation of the Financial Stability Forum.

In the macroeconomic area, the central issue should not be coordination in the traditional sense of the term —i.e., parallel movements in macroeconomic policies, such as those that characterized convergence towards monetary union in the euro area—, as different parts of the world economy may be subject to quite different inflationary or deflationary risks and may thus require different macroeconomic policies, but rather the coherence of what would largely continue to be national policies (regional in the case of the members of the European Central Bank). The major institutional issue is thus how to guarantee that the externalities that macroeconomic policies generate on other parts of the world economy are adequately internalized by policy makers in the industrialized world. From the point of view of developing countries, the risks associated with the movement in the exchange rates of major currencies are a major problem and, as noticed, reflect a paradoxical feature of current arrangements: the fact that the value of international monies is determined by national policies.

Given the lack of representation of developing countries in G-7 and the still insufficient membership of BIS, the International Monetary Fund should continue to play a central role in surveillance of the macroeconomic policies of industrial countries. The specific aim of such surveillance should be to ensure the consistency of policies so as to avoid both inflationary and deflationary pressures in the world economy as a whole, as well as the buildup of serious regional imbalances. Indeed, the International Monetary and Financial Committee and the IMF Board of Governors are the only institutions through which developing countries can have a voice *vis-à-vis* developed countries' macroeconomic policies, and they should act concertedly to make that voice heard. This also means that the focus of IMF on center-periphery issues, which has characterized the past quarter century, should be reversed. This institution should certainly continue to play a central role in regard to systemic issues.

In the regulatory area, several gaps have been identified in recent discussions. Some of them have been the focus of the Financial Stability Forum, particularly the inadequate regulation of highly-leveraged operations and institutions, and more broadly, the lag between regulatory practices and market developments. Proposals in this area emphasize indirect rather than direct regulation (Financial Stability Forum, 2000). A stronger focus on direct regulation is preferable. Among issues that have not been adequately addressed, the need to correct the pro-cyclical bias of regulatory policies should certainly receive prime attention.

From the point of view of developing countries, two troublesome features of current regulations should be emphasized. First, the growing emphasis in industrial countries on evaluating the financial institutions' internal risk-management practices, rather than relying on traditional Basle criteria, could generate growing gaps between the regulatory practices of industrialized and developing countries. The implications of this situation have not been adequately considered. In

particular, given the strong trend towards concentration in the world financial industry, it can distort the conditions of competition between national and international financial intermediaries in the developing countries. It can also increase the barriers to the presence of developing countries' financial institutions in developed country markets and create biases in prudential surveillance (e.g., a stronger focus of regulatory authorities in the developed countries on intermediaries from the developing world). It can also generate regulatory arbitrage, thus weakening the regulatory capacity of developing countries' authorities.

A second issue is the inadequate attention given to specific issues that are likely to affect capital flows to developing countries. Indeed, since these flows are, from the point of view of the industrial countries, marginal, regulatory practices are unlikely to give adequate attention to factors that determine them or, alternatively, they could lead to regulations that are too restrictive. These deficiencies in regulatory practices of industrial countries are, in fact, an essential argument in favor of maintaining a significant degree of autonomy of developing countries in managing their capital accounts.

(e) Greater room for anti-cyclical policies in the developing world

As has been stressed in previous sections, a central objective of international financial arrangements *vis-à-vis* developing countries should be to give them greater maneuvering room to adopt anti-cyclical policies. It is generally agreed that the emphasis should be on preventive policies, through prudent macroeconomic policies, appropriate international macroeconomic surveillance, adequate prudential regulation and supervision of financial intermediaries, prudential capital-account regulations (to avoid overborrowing), and adequate information. In the area of crisis resolution, the focus of reforms should be both on emergency financing and on debt standstills and workout procedures (or, in alternative terminology, private-sector involvement in crises). However, the traditional division between crisis-prevention and resolution tools is not a very useful one. The experience with financial policies at the national level clearly indicates that some of the essential crisis-prevention tools are good mechanisms to avoid financial panics and to manage financial crises.

The inherent limitations of each specific instrument has generated a strong argument for using them as complementary rather than as alternative policy tools. The International Monetary Fund and national authorities, as well as the best-informed market agents —investment banks and credit rating agencies— are subject to the whims of opinions and expectations and are thus likely to have pro-cyclical biases in their actions, a situation that limits the effectiveness of both surveillance and better information. On the other hand, prudential regulation lags behind financial innovation and also tends to have pro-cyclical effects. Prudential supervision is subject to information gaps and may be subject to “policy failures” owing to its discretionary nature. Prudential capital-account regulations can play a very useful role in avoiding excessive indebtedness and in providing some additional degrees of freedom for contractionary macroeconomic policies in times of boom but, as we shall see, may restrict financial development. Emergency financing, on the other hand, raises moral-hazard concerns, particularly if it is not accompanied by strong prudential regulation and supervision, as well as adequate bankruptcy provisions. Debt standstills provide some degrees of freedom for recovery and an adequate share of private-sector involvement in adjustment, but the expectation that they might be introduced could generate financial panic and accelerate crises.

The generation of more room for anti-cyclical policies should be clearly built into the design of all these policy tools. Thus, the essential aim of preventive macroeconomic policies and surveillance should clearly be to avoid the buildup of macroeconomic and financial risks during periods of financial euphoria, as these are the sources of major macroeconomic adjustment and financial difficulties in the ensuing crisis. In developing countries, prudential regulation and

supervision should clearly take into account the macroeconomic risks associated with sudden changes in interest and exchange rates. Prudential capital-account regulations should avoid excessive borrowing and risky external liability structures, thus placing special restrictions on the most volatile sources of capital flows. In turn, international policy interventions during crises should aim at avoiding overkill, thus providing degrees of freedom for expansionary policies consistent with an adequate pace of macroeconomic adjustment.

In the search for an adequate balance between different policy tools, one of the most controversial issues is the relative weight of emergency financing vis-à-vis debt standstills and workout procedures. Emergency financing is under attack because of its moral-hazard effects. It is also argued that it has become less necessary, as crises now tend to be intense but short-lived.¹⁶ This allegation has been contradicted by the facts: the Asian crisis gave way, in fact, to three and a half years (so far) of unstable flows, high spreads, short maturities and the inclusion of options in debt contracts to accelerate repayment. The International Monetary and Financial Committee recognized this in its September 2000 meetings (International Monetary and Financial Committee, 2000). It is widely accepted, on the other hand, that even well-managed developing economies can enter into crisis as a result of contagion and, more broadly, that risk aversion (“flight to security”) during crises and adverse trends in world liquidity can generate severe effects on these economies.

A different line of argument against emergency financing is that, no matter how much “ownership” of policies is taken into account, it involves giving up policy autonomy, which is itself undesirable. This certainly creates a strong argument for debt standstills as an alternative option to emergency financing for developing countries that want to maintain a greater degree of policy autonomy. It must be emphasized, however, that, given the effect this has on their credit rating, most developing countries are likely to use such an alternative only as a truly “last-resort” option, which significantly erodes its virtues. Indeed, the delay in using this instrument, together with the expectation that it might be used, could give rise to strong destabilizing pressures.

Thus, beyond the matter of the advisability of keeping emergency financing and debt standstills and workout procedures as alternative options for developing countries, there are strong arguments for using them as complementary policy tools. Such complementarity has, in fact, been long recognized in national financial policies, focusing on the former in the activities of central banks as “lenders of last resort” in cases of illiquidity and bankruptcy procedures in cases of insolvency. As is well known, the line that divides the two situations is quite thin, and this introduces several complications, including possible “policy failures” (e.g., wrong judgment as to whether a particular situation is to be characterized as one of illiquidity or of insolvency), but is still a useful starting point. Moreover, the fact that poorly managed illiquidity may lead to insolvency is an additional argument for the complementary use of both policy tools. Obviously, international arrangements introduce additional complications, including the aforementioned issues of policy autonomy, the lack of truly international bankruptcy procedures, the large gap between current international emergency financing and true lending of last resort, and the theoretical difficulties of implementing the latter alternative at the international level (Ocampo, 2001).

Emphasis should thus be placed on improving both policy instruments in a complementary way. This involves improving contingency and swap arrangements in cases of illiquidity, other IMF credit lines and its lending into arrears. It also involves establishing universal collective-action clauses in international debt contracts and creating rules for international debt renegotiations, including mechanisms for voluntary or forceful mediation to avoid long or repeated renegotiations. In the design of a balanced mix of this sort, the current bias in debates regarding IMF lending on the forceful use of debt renegotiations as a precondition to access emergency financing (with or without a threshold level) may, in fact, be the worst option. Indeed, it may wipe out the advantages

¹⁶ For a radical view along these lines, see the Meltzer Report. For a more moderate one, see the Council on Foreign Relations (1999).

of emergency financing to face illiquidity, as the forceful use of debt renegotiations could accelerate and intensify crises. It also eliminates the virtue of standstills. “Forcing voluntary negotiations” between borrowers and lenders as a precondition for emergency financing is hardly a way to make good use of such a mechanism, least of all to consider the outcome “voluntary” in any sense of the term.

In the long run, overcoming the cost of existing international financial asymmetries should lead developing countries to create regional currencies, with some partial value as international monies. The scope for actions of this sort is obviously limited. Thus, the most important long-term actions that developing countries might adopt are those aimed at promoting domestic financial-sector development —i.e., the creation of deep and liquid markets that provide security to depositors in the banking system and to investors in securities, as well as lending, covering all maturities at competitive rates, to potential domestic and even some external borrowers (e.g., importers of a country’s goods and services).

It should be noted, however, that there may be tradeoffs between this long-term objective and the short-run virtues of capital-account regulations that cannot be ignored. In particular, foreign portfolio agents may be important in helping to deepen secondary markets, as well as in developing domestic derivative markets, but their activities will be restricted by capital-account regulations. Portfolio flows are, nonetheless, particularly volatile. This and other factors thus introduce complex tradeoffs and sequencing issues. Indeed, premature capital-account liberalization may actually undermine domestic financial-sector development by encouraging domestic agents to use international financial intermediation on a larger scale. Experience also shows that the presence of foreign financial institutions, either in the banking sector or in capital markets, is not a sign of strong financial-sector development. Indeed, some emerging markets (e.g., in Latin America) are now characterized by both high concentration in foreign hands and by the same weakness in financial development that characterized them in the past—inadequate supply of long-term lending, high spreads and lack of deep secondary markets. Financial-sector development is thus a national (and regional) objective that is unlikely to be an automatic outcome of financial and capital market liberalization.

(f) Compensation for concentration of private capital flows

As we have indicated, avoiding the high concentration of capital flows in emerging markets is also a major objective of international financial reform. For low-income countries, the major issues are associated with the need to guarantee adequate development finance, through ODA and multilateral lending, and to generate mechanisms that will allow them to participate more actively in private capital markets. Given the relative magnitude of financing to low-income countries, increasing ODA flows, particularly those originating in the largest industrialized economies, is certainly the most important issue in the near future. Thus, it is important that efforts to accelerate HIPC should not crowd out new ODA financing. Actually, beyond a more ambitious HIPC Initiative, what the world needs is an even more ambitious and permanent “ODA Initiative” aimed at effectively meeting internationally agreed targets in this area. An essential characteristic of this process, as emphasized above, should be an effective “ownership” of policies by developing countries, an element that requires less direction from abroad and more emphasis on national institution building. The latter requires, in turn, respect for the central role that parliaments and governments in aid-receiving nations should have in the global allocation of aid through their budgetary processes and the central role that governments in those countries should have in directing traditional areas of public policy (e.g., social policy and infrastructure), even when civil society is given a central role in execution.

Adequate financing for the provision of public goods and goods with strong international externalities —peace, combating health epidemics, environment, controlling the drug problem, etc.— is also an international priority. Resource flows to guarantee these purposes are generally confused in developed country budgets with ODA. To avoid such confusion and the crowding out of true ODA flows, as well as to guarantee transparency and proper financing for the provision of global public goods, the United Nations (2000) has recently recommended that they should be clearly separated in the budget allocation processes.

Equally important is the acceleration of the growth of multilateral development finance. Such lending will continue to play a central role in at least four areas: (1) to channel funds to low-income countries; (2) to correct market failures associated with the overpricing of risks, which could lead to inadequate access to long-term financing by middle-income countries with an unsatisfactory credit rating; (3) to act as a counter-cyclical balance to fluctuations in private capital markets; and (4) to facilitate the transition to private markets by supporting some innovations in long-term financing to developing countries and signaling creditworthiness. To these should be added the traditional “value added” of multilateral financing: lending-associated technical assistance.

The first of these functions underscores the central role that financing from the World Bank, the International Development Association (IDA) and the regional and subregional development banks will continue to play in the immediate future. It has received widespread support in recent debates. The second and third functions emphasize the role that official development financing will continue to play even for middle-income countries. Nonetheless, some authors reject the validity of these arguments.¹⁷ However, the high interest rates that have characterized private lending to developing countries in the 1990s and the much shorter maturities of private vs. official financing to middle-income countries may indicate that, on average, risk is in fact overestimated.

It must be stressed that the anti-cyclical provision of funds should not be confused with the provision of emergency balance-of-payments financing, which is essentially a task of the International Monetary Fund. However, to the extent that anti-cyclical fiscal policies are a necessary element in counter-cyclical macroeconomic management in general, there may be an argument for development financing during crisis as a counterpart to pure balance-of-payments financing.¹⁸ An alternative would be to allow IMF financing or parallel bilateral emergency financing, or the latitude it offers for domestic credit creation, for fiscal purposes. However, this step would be sub-optimal, as it would either generate inadequate maturity structures of government liabilities or cause confusion regarding the role of central banks. In any case, the large-scale requirements for counter-cyclical financing to middle-income countries during crises may crowd out financing to poor countries, a point which has been made by the President of the World Bank (Wolfensohn, 1998). Thus, if multilateral development financing is not significantly expanded, its role as a counter-cyclical device will necessarily be very limited, and it would certainly be of secondary importance relative to its first two roles, particularly the provision of long-term development financing to poor countries. Thus, a useful counter-cyclical function would certainly require a significant increase in resources available to multilateral development banks or a more active use of cofinancing and credit guarantees by these institutions. The role of development banks in supporting social safety nets, which has received a correct emphasis in recent discussions, should be seen as part of the counter-cyclical role they should play.

¹⁷ See, for example, Gilbert, Powell and Vines (1999).

¹⁸ Such financing could be tied to broader forms of anti-cyclical management, on the basis of counterpart savings in fiscal stabilization funds during the previous boom or repayment conditions that would require acceleration of amortizations if fiscal revenues experience a strong recovery during the subsequent boom.

The fourth function is of fairly recent origin but has been rapidly gaining in importance in the 1990s and should become one of the primary focuses of multilateral financing in future. This function has been associated in the recent past with direct financing or cofinancing to the private sector (by banks or associated financial corporations) or with the design of guarantee schemes to support private infrastructure projects in developing countries. It has also been used recently to support developing countries' efforts to return to markets after crises and could be used to support initial bond issues by developing (particularly poor) countries seeking to position themselves in private capital markets. It must be emphasized, however, that the full development of these schemes would call for a radical change in the management of guarantees by development banks inasmuch as, under current practices, they are treated as equivalent to lending, which severely restricts their use. Such an expansion of the role of development banks in guaranteeing private financing has been criticized on the grounds that it could involve excessive risk-taking by these institutions. Nonetheless, in a world that will be dominated by private financing, it may be absolutely essential to prevent low-income countries from being left out of major developments in capital markets and to facilitate a more active anti-cyclical role for development banks. It should thus receive priority attention in current discussions.

4. Conclusions

In this paper, we have argued that the design of the international financial system should take into consideration three different problems that the current system faces: financial market instability; basic macroeconomic and financial asymmetries that characterize the international economy, which have mainly center-periphery dimensions; and the additional problems generated by the incomplete and asymmetric nature of the current globalization process. Beyond the focus of current proposals on strengthening national macroeconomic and financial policies in the developing world, this paper emphasizes the need to complement these “self-insurance” efforts with an adequate international financial safety net.

Viewed in this framework, we propose a useful analytic distinction between truly systemic issues, which focus on world economic stability, and center-periphery issues, which are closely associated with the correction of existing international financial asymmetries. Based on this distinction, the paper proposes a broad agenda focused on institutional aspects as well as on the services provided by international financial institutions. The first group includes an adequate structure of representation of developing countries and governance structure of IFIs, an active role for regional financial arrangements, and a strong defense of national autonomy and ownership of policies. In terms of services provided by IFIs, it focuses both on the systemic issues and on two center-periphery issues: the need to provide greater room for anti-cyclical policies in developing countries, and the need to compensate for the strong concentration of private capital flows.

Bibliography

- Agosin, Manuel R. (2000), *Fortaleciendo la institucionalidad financiera en Latinoamérica*, Temas de coyuntura series 9 (LC/L.1433-P), Santiago, Chile, ECLAC.
- Akyüz, Yilmaz (2000), “The Debate on the International Financial Architecture: Reforming the Reformers”, Discussion Paper, N° 148, Geneva, United Nations Conference on Trade and Development (UNCTAD), April.
- Council on Foreign Relations, Task Force Report (1999), *Safeguarding Prosperity in a Global Financial System: The Future International Financial Architecture*, Carla A. Hills and Peter G. Peterson (chairs), Morris Goldstein (Project Director), Washington, D.C., Institute for International Economics (IIE).
- Culpeper, Roy (2000), “The evolution of global financial governance”, *Global financial reform: How? Why? When?*, Roy Culpeper and Devesh Kapur (eds.), Ottawa, The North-South Institute.
- Dai, Xianglong (2000), “Meeting the Challenges of Globalization”, *Address on the 21st. Century Forum hosted by CPPCC*, Beijing, June 15.
- Eatwell, John and Lance Taylor (2000), *Global Finance at Risk: The Case for International Regulation*, New York, The New Press.
- ECLAC (Economic Commission for Latin America and the Caribbean) (2001), *Growth with Stability: Financing for Development in the New International Context*, Santiago, Chile, forthcoming.
- _____ (2000), *Equity, Development and Citizenship*, (LC/G.2071(SES.28/3)), Santiago, Chile.

- Eichengreen, Barry (1999), *Toward a New International Financial Architecture: A Practical Post-Asia Agenda*, Washington, D.C., Institute for International Economics (IIE).
- Financial Stability Forum (2000), Working Group Report on Highly Leveraged Institutions, Washington, D.C.
- Gilbert, Christopher, Andrew Powell and David Vines (1999), "Positioning the World Bank", *Economic Journal*, No. 109, November.
- Greenspan, Alan (1998), "The structure of the international financial system", *Remarks at the Annual Meeting of the Securities Industry Association*, Boca Raton, Florida, 5 November.
- Griffith-Jones, Stephany, José Antonio Ocampo with Jacques Cailloux (1999), *The Poorest Countries and the Emerging International Financial Architecture*, Stockholm, Expert Group on Development Issues (EGDI).
- Group of 24 (1998), *Communiqué*, 3 October.
- Hausmann, Ricardo (2000), "Exchange rate arrangements for the new architecture", *Global Finance from a Latin American Viewpoint*, Ricardo Hausmann and Ulrich Hiemenz (eds.), Paris, Development Centre Seminars, Inter-American Development Bank (IDB)/Development Centre of the Organisation for Economic Co-operation and Development (OECD).
- Helleiner, Gerry (2000a), "Markets, politics and globalization: can the global economy be civilized?", *Journal of Human Development*, Geneva, The Tenth Raúl Prebisch Lecture, United Nations Conference on Trade and Development (UNCTAD), forthcoming.
- _____ (2000b), "External conditionality, local ownership and development", *Transforming Development*, Jim Freedman (ed.), Toronto, University of Toronto Press.
- IMF (International Monetary Fund) (1998), *World Economic Outlook*, Washington, D.C., May.
- IMF International Monetary and Financial Committee (2000), *Communiqué*, 24 September.
- Kaul, Inge, Isabelle Grunberg and Marc A. Stern (eds.) (1999), *Global Public Goods: International Cooperation in the 21st Century*, New York, United Nations Development Programme (UNDP), Oxford University Press.
- Kindleberger, C. (1978), *Manias, Panics and Crashes: A History of Financial Crisis*, New York, Basic Books.
- Köhler, Horst and James D. Wolfensohn (2000), *The IMF and the World Bank Group: An Enhanced Partnership for Sustainable Growth and Poverty Reduction*, Washington, D.C., September.
- Meltzer, Allan H. and others (2000), *Report to the US Congress of the International Financial Advisory Commission*, Washington, D.C., March.
- Minsky, Hyman (1986) *Stabilizing an Unstable Economy*, New Haven, Yale University Press.
- Ocampo, José Antonio (2001), "Recasting the international financial agenda", *External Liberalization, Economic Performance, and Social Policy*, John Eatwell and Lance Taylor (eds.), New York, Oxford University Press, forthcoming.
- _____ (2000), *Developing Countries' Anti-cyclical Policies in a Globalized World*, Temas de coyuntura series, No. 13 (LC/L.1443-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), October.
- _____ (1999), *Reforming the International Financial Architecture: Consensus and Divergence*, Temas de coyuntura series, No. 1 (LC/L.1192-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), April.
- Park, Yung Chul and Yunjong Wang (2000), "Reforming the international financial system and prospects for regional financial cooperation in East Asia", Seoul, Korea University and Korea Institute for International Economic Policy, June.
- Pauly, Louis (2000), "Enforcing the rules in a global economy: the emergence of structural conditionality in the World Bank and the International Monetary Fund", paper prepared for a conference on "Critical Issues in Financial Reform", Toronto, University of Toronto, June 1-2.
- Persaud, Avinash (2000), "Sending the Herd Off the Cliff Edge: The Disturbing Interaction between Herding and Market-sensitive Risk Management Practices", London, State Street.
- Soros, George (1999), "On measures to encourage long-term lending to emerging economies", *Safeguarding Prosperity in a Global Financial System: The Future International Financial Architecture*, Carla A. Hills and Peter G. Peterson (chairs), Morris Goldstein (Project Director), Washington, D.C., Institute for International Economics (IIE).
- Stiglitz, Joseph (1999), "The World Bank at the millennium", *Economic Journal*, No. 109, November.
- Stiglitz, Joseph A. and Andrew Weiss (1981), "Credit rationing in markets with imperfect information", *American Economic Review*, vol. 71, No. 3, June.

- Studart, Rogério (1996), "The efficiency of the financial system, liberalization and economic development", *Journal of Post Keynesian Economics*, vol. 18, No. 2.
- Taylor, Lance (1998) "Capital market crises: liberalisation, fixed exchange rates and market-driven destabilisation", *Cambridge Journal of Economics*, vol. 22, No. 6, November.
- UNCTAD (United Nations Conference on Trade and Development) (1999), *Trade and Development Report, 1999* (UNCTAD/TDR/1999), Geneva.
- United Nations (2000), *Report of the Secretary-General to the Preparatory Committee for the High-Level International Intergovernmental Event on Financing for Development*, December.
- United Nations Task Force of the Executive Committee of Economic and Social Affairs (1999), *Towards a New International Financial Architecture, Report of the Task Force of the United Nations Executive Committee of Economic and Social Affairs* (LC/G.2054), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), March.
- Wolfensohn, James D. (1998), "The Other Crisis", *Address to the Board of Governors*, Washington, D. C., World Bank, 6 October.
- Wyplosz, Charles (1999), "International financial instability", in Inge Kaul, Isabelle Grunberg and Marc A. Stern (comps.), *Global Public Goods: International Cooperation in the 21st Century*, New York, United Nations Development Programme (UNDP), Oxford University Press.



NACIONES UNIDAS



Serie

temas de coyuntura

Issues published

- 1 Reforming the international financial architecture: consensus and divergence, José Antonio Ocampo (LC/L.1192-P), Sales No. E.99.II.G.6 (US\$ 10.00), 1999. [www](#)
- 2 Finding solutions to the debt problems of developing countries. Report of the Executive Committee on Economic and Social Affairs of the United Nations (New York, 20 May 1999) (LC/L.1230-P), Sales No. E.99.II.G.5 (US\$ 10.00), 1999. [www](#)
- 3 América Latina en la agenda de transformaciones estructurales de la Unión Europea. Una contribución de la CEPAL a la Cumbre de Jefes de Estado y de Gobierno de América Latina y el Caribe y de la Unión Europea (LC/L.1223-P), Sales No. S.99.II.G.12 (US\$ 10.00), 1999. [www](#)
- 4 La economía brasileña ante el Plan Real y su crisis, Pedro Sáinz and Alfredo Calcagno (LC/L.1232-P), Sales No. S.99.II.G.13 (US\$ 10.00), 1999. [www](#)
- 5 Algunas características de la economía brasileña desde la adopción del Plan Real, Renato Baumann and Carlos Mussi (LC/L.1237-P), Sales No. S.99.II.G.39 (US\$ 10.00), 1999. [www](#)
- Internacional financial reform: the broad agenda, José Antonio Ocampo (LC/L.1255-P), Sales No. E.99.II.G.40 (US\$ 10.00), 1999. [www](#)
- El desafío de las nuevas negociaciones comerciales multilaterales para América Latina y el Caribe (LC/L.1277-P), Sales No. S.99.II.G.50 (US\$ 10.00), 1999. [www](#)
- Hacia un sistema financiero internacional estable y predecible y su vinculación con el desarrollo social (LC/L.1347-P), Sales No. S.00.II.G.31 (US\$ 10.00), 2000. [www](#)
- 9 Fortaleciendo la institucionalidad financiera en Latinoamérica, Manuel Agosín, (LC/L.1433-P), Sales No. S.00.II.G.111 (US\$ 10.00), 2000. [www](#)
- 10 La supervisión bancaria en América Latina en los noventa, Ernesto Livacic and Sebastián Sáez (LC/L.1434-P), Sales No. S.00.II.G.112 (US\$ 10.00), 2000. [www](#)
- 11 Do private sector deficits matter?, Manuel Marfán (LC/L.1435-P), Sales No. E.00.II.G.113 (US\$ 10.00), 2000. [www](#)
- 12 Bond market for Latin American debt in the 1990s, Inés Bustillo and Helvia Velloso (LC/L.1441-P), Sales No. E.00.II.G.114 (US\$ 10.00), 2000. [www](#)

- 13 Developing countries' anti-cyclical policies in a globalized world, José Antonio Ocampo (LC/L.1443-P), Sales No. E.00.II.G.115 (US\$ 10.00), 2000. [www](#)
- 14 Les petites économies d'Amérique latine et des Caraïbes: croissance, ouverture commerciale et relations inter-régionales (LC/L.1510-P), Sales No. F.01.II.G.53 (US\$ 10.00), 2000. [www](#)
- 15 International asymmetries and the design of the international financial system, José Antonio Ocampo (LC/L.1525-P), Sales No. E.01.II.G.70 (US\$ 10.00), 2001. [www](#)

-
- Readers wishing to obtain the above publications can do so by writing to the following address: ECLAC, Special Studies Unit, Casilla 179-D, Santiago de Chile.
 - Publications available for sale should be ordered from the Distribution Unit, ECLAC, Casilla 179-D, Santiago, Chile, Fax (562) 210 2069, publications@eclac.cl.

[www](#): These publications are also available on the Internet: <http://www.eclac.cl>

Name:
Activity:
Address:
Postal code, city, country:.....
Tel.:..... Fax:..... E.mail address:.....