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Macroeconomic policy questions: financing of development, including net transfer of resources between developing and developed countries

Towards a stable international financial system, responsive to the challenges of development, especially in the developing countries

Report of the Secretary-General**

Addendum

Regional perspectives and developments

Summary

The Asian financial crisis and its contagion effect generated a new impetus in favour of fundamental reforms in the international financial architecture to improve the management of financial crises, as well as to prevent a recurrence of similar crises in future. The crisis heightened the awareness of and, indeed, led to a recognition that there is an enormous discrepancy between the sophisticated and dynamic financial world and the institutions that regulate it, that "existing institutions are inadequate to deal with financial globalization" (see report of the Task Force of the Executive Committee on Economic and Social Affairs entitled "Towards a new international financial architecture", 21 January 1999). Accordingly, the regional commissions welcomed General Assembly resolution 54/197 of 22 December 1999 which, inter alia, stressed the need to further define the role and improve the capacities of the international, regional and subregional financial institutions with regard to the prevention, management and resolution in a timely and effective manner of international financial crises, and to encourage efforts to enhance the stabilizing role of regional and subregional financial institutions and arrangements in supporting the management of monetary and financial issues, in accordance with the mandate of each institution. The Executive Secretaries of the regional commissions provided their views on this matter to the Economic and Social Council at its substantive session of 2000 (see the report of the Secretary-General on regional cooperation in the economic, social and related fields (E/2000/10 and Add.1-3)). The present addendum provides an updated account of the relevant developments at the regional levels and the views of the Executive Secretaries of the regional commissions there.

* A/55/150 and Corr.1 and 2.

** The present report was submitted after 3 July owing to the extensive consultation process that was undertaken, as requested in para. 21 of resolution 54/197, which took longer than expected.

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1. The fairly rapid though incomplete normalization of capital markets is giving way to a sense of complacency that could slow down the reform effort and prevent the opportunity from being seized to broaden the agenda and set in motion a representative, balanced negotiation process. The Executive Secretaries felt, therefore, that the agenda should be broadened in at least two senses: first, it should go beyond the issues of financial crisis prevention and resolution (which may be termed the "narrow" financial architecture) to include those associated with development finance and the "ownership" of economic and, particularly, development policies; and, second, it should consider, in a systematic fashion, not only the role of world institutions, but also regional arrangements and the areas where national autonomy should be maintained or strengthened.

2. There are at least three arguments in support of a strong role for regional institutions in the new financial order. The first is that globalization also entails open regionalism. The growth of intraregional trade and direct investment flows are, indeed, striking features of the ongoing globalization process. This factor increases macroeconomic linkages and thus the demands for certain services provided by the international financial system: macroeconomic surveillance and internalization of the externalities that national macroeconomic policies have on neighbouring countries, mutual surveillance of each other's mechanisms for the prudential regulation and supervision of the financial system, and regional effects of potential debt standstills and workout procedures.

3. Secondly, some of these services may be subject to diseconomies of scale and it is unclear whether others have sufficiently large economies to justify single international institutions in specific areas. Traditional issues of subsidiarity are thus raised. For example, macroeconomic consultation and surveillance at the world level may be necessary to guarantee policy coherence among major industrialized countries, but it would certainly be inefficient with regard to managing the externalities generated by macroeconomic policies on neighbours in the developing world (or even within Europe). Owing to differences in legal traditions and the sheer scale of the diseconomies involved, surveillance of national systems for the prudential regulation and supervision of financial sectors, and even the definition of specific minimum standards in this area, may be dealt with more appropriately with the support of regional institutions. Development finance can operate effectively at different scales and can perform certain functions at regional and subregional levels that could not be performed at the international level. Also, although regional and international contagion implies that the management of the largest balance-of-payments crises should be assigned to a single world institution, it is unclear how far this assertion should be pushed. Strong regional institutions can serve as regional buffers, as the post-war Western European experience indicates. Regional reserve funds can also play a useful role in the developing world and, if expanded, could even provide full support to the small and medium-sized countries within some regions. Also, as the rising concentration of balance-of-payments support in a few countries indicates, there may be biases in the response of the international community according to the size of the country, a fact that would argue for a division of labour in the provision of services in this area between world and regional organizations.

4. The third argument is that, for smaller countries, the access to a broader menu of alternatives to manage a crisis or to finance development is relatively more important than the "global public goods" that the largest international organizations provide (for example, global macroeconomic stability) and upon which they will assume they have little or no influence (in other words, they have the attitude of "free riders"). Owing to their small size, their negotiating power vis-à-vis large organizations is very limited, and their most important defence is therefore competition in the provision of financial services from such institutions.

5. There may be a fourth, political economy-related argument: countries are likely to take quite different attitudes to the analyses made by international and regional organizations (and in respect of the attached conditionality). They are probably more likely to "own" the latter, inasmuch as they feel they have a stronger voice in the analyses made by regional organizations. This fact will improve rather than reduce effectiveness. The fear that this may lead to lax arrangements is unwarranted, as the proposal to create and strengthen regional financial institutions entails financial commitments by developing countries to provide the capital for the corresponding reserve funds and development banks, and this will lead the countries to closely monitor the soundness of their activities.

Indeed, the supply of capital will be the single most important restriction to the growth of these regional financial networks. The fact that many of these institutions will raise money in the market will provide an additional means of control over their operations.

6. The current discussion has underscored the fact that some services provided by international financial institutions, including some “global public goods”, are being undersupplied. However, it would be wrong to conclude from this statement that the increasing supply should come from a few world organizations. Rather, the organizational structure, in some cases, should have the nature of networks of institutions that provide the services required on a complementary basis and, in others, should function as a system of competitive organizations. The provision of the services required for financial crisis prevention and management should be closer to the first model, whereas, in the realm of development finance, competition should be the basic rule (and, in fact, should include competition with private agents as well). However, purity in the model’s structure is probably not the best characteristic: it is desirable that parts of networks compete against each other (for example, regional reserve funds versus the International Monetary Fund (IMF) in the provision of emergency financing) and that competitive organizations cooperate in some cases.

7. This implies that IMF of the future should be viewed not as a single, global institution, but rather as the apex of a network of regional and subregional reserve funds. This model should be extended to the provision of macroeconomic consultation and surveillance, as well as to coordination and surveillance of national systems of prudential regulation and supervision complementing, rather than substituting for, regular IMF surveillance. It is important to emphasize that, aside from other functions, subregional development banks can play a significant role as a mechanism for pooling the risks of groups of developing countries, thus allowing them to make a more aggressive use of opportunities provided by private capital markets.

8. An institutional framework such as that suggested would have two positive features. First of all, it may help to bring more stability to the world economy by providing essential services that can hardly be provided by a few international institutions, particularly in the face of a dynamic process of open regionalism. Second, from the point of view of the equilibrium of world relations, it would be more balanced than a system based on a few world organizations. This would increase the commitment of less powerful players to abide by rules that contribute to world and regional stability.

9. There appear to be at least two strategies in which countries, and regional or multilateral institutions can engage in order to avoid or contain the effects of crisis. The first is to engage in surveillance and early warning systems that can detect the possibility of oncoming shocks. The second is to concentrate efforts in making the real and financial economy more robust and less vulnerable to shocks. Closely allied to this are measures to strengthen financial systems and improve risk management. Of course, these two strategies are not mutually exclusive. Rather, in the light of the inherent limitations of surveillance and early warning systems, the second strategy of strengthening the financial system and making the economy more robust against stress should be pursued simultaneously.

10. From the point of view of trade, especially in the regions that suffered from the recent crisis, the growing integration of intraregional trade in East and South-East Asia as well as in Latin America has been an important aspect of the integration of those economies into the global trading system. It was also a contributing factor to the rapid growth of some of those countries prior to the Asian financial crisis, and, subsequently, to their recovery. Nevertheless, since the regional integration of trade, production and financial flows produces both positive and negative consequences on financial stability among those countries, the real issue is not whether regional financial arrangements conflict with the global solutions but, rather, how the benefits of regional integration processes could be reinforced so as to provide greater financial stability and support for high rates of economic growth.

11. Moreover, new and institutional arrangements at the global level without proper recognition of the special situation of the developing and transition economies may have put those countries at a sudden disadvantage. For example, if the Revised Basle Capital Accord was to be put into effect, it would allow for punitive risks weighting in respect of loans to banks in emerging market economies that did not meet the relevant standards. This is not to say that the standards are necessarily undesirable; but the problems of transition and developing economies in creating the

conditions required to be able to comply need to be carefully analysed.

12. The heightened awareness about the regional dimension of financial crisis since the Asian crisis has also generated discussions as well as the articulation of new ideas at intergovernmental levels at various relevant regional and subregional forums, including the regional commissions. The deliberations in those forums increasingly underlined the need to strengthen national policies and technical and analytical capabilities for crisis prevention and crisis resolution. Those discussions affirmed that subregional, regional and global efforts in early warning could be important in ensuring that any situation that had the potential to cause economic and financial instability was clearly signalled. They noted that surveillance and policy coordination at regional level could help reduce the risk of future crises. There are several ongoing initiatives at the regional and subregional levels. Those include the Asia-Pacific Economic Cooperation (APEC), the Framework for Enhanced Asian Regional Cooperation to Promote Financial Stability (Manila Framework), the Asian Recovery Information Centre of the Asian Development Bank and the Association of Southeast Asian Nations (ASEAN) Surveillance Process. The discussions recognized the need to build on those initiatives and to widen coverage to include more countries, in addition to those struck by the recent crisis. The discussions further saw that there was a role for the regional commissions as a source of technical assistance, advice and analyses, and as a forum for the exchange of knowledge and experience on issues of concern, including developments in the debate on the reform of the international financial architecture and participation of the developing countries in that process.[1]

13. During the meeting of the Board of Governors of the Asian Development Bank, held in May 2000, the Ministers of the ASEAN group as well as three other leading countries of that region, namely, China, Japan and the Republic of Korea (ASEAN + 3), held a meeting to exchange views on national economies and financial situations and to discuss further cooperation. They issued a joint Ministerial statement on 6 May 2000 focusing on strengthening policy dialogues and regional cooperation activities in the areas of capital flows monitoring, self-help and support mechanisms and international financial reforms. The ASEAN + 3 Framework is to be used to facilitate the exchange of consistent and timely data and information on capital flows. As a first step towards a monitoring system for the larger East and South-East Asian region, they agreed to establish a network of contact persons to facilitate economic reviews and policy dialogues. They recognized the need to establish a regional financing arrangement to supplement existing international facilities. Thus, the "Chiang Mai Initiative" involves an expanded ASEAN Swap Arrangement including all ASEAN members and the network of bilateral swap and repurchase agreement facilities with the other three partners. They requested the ASEAN secretariat to coordinate a study on other appropriate mechanisms that could enhance their ability to provide sufficient and timely financial support to ensure financial stability in that region. The follow-up work to the Chiang Mai Initiative is under way.

14. As requested by the Preparatory Committee for the High-level International Intergovernmental Event on Financing for Development in pursuance of General Assembly resolution 54/196, the regional commissions, in cooperation with the United Nations Conference on Trade and Development (UNCTAD) and other relevant organizations, are in the process of organizing in the five regions, High-level Consultative Meetings on Financing for Development, to be held between August and December 2000. The topics before these meetings, which focus on regional perspectives, include domestic resources mobilization, external private flows, reform of the international financial architecture together with its regional and subregional support arrangements, innovative sources of financing and the external sector including official development assistance (ODA), and trade. The outcome of these consultative meetings should be of relevant interest for future deliberations on the international financial architecture.

Notes

[1] For instance, please see the record of the discussion at the fifty-sixth session of the Economic and Social Commission for Asia and the Pacific to appear in *Official Records of the Economic and Social Council, 2000, Supplement No. 19* (E/2000/39) (E/ESCAP/1197).