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International financial architecture and development, including net transfer of resources between developing and developed countries

Report of the Secretary-General**

Contents

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** This report was submitted after 3 July 2001 because the consultations called for in paragraph 26 of General Assembly resolution 55/186 took one week longer than expected due to the absences of some of those to be consulted.

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I. Introduction

1. The present report has been submitted in response to General Assembly resolution 55/186 of 20 December 2000, and draws upon the analysis and cooperation of various components of the United Nations system, including the Department of Economic and Social Affairs of the United Nations Secretariat, the regional commissions, in particular, the Economic Commission for Latin America and the Caribbean, the United Nations Conference on Trade and Development (UNCTAD), the United Nations Development Programme (UNDP), as well as the International Monetary Fund (IMF) and the World Bank.[1]

2. This report is complemented by two addenda as requested by the Assembly. One was prepared by UNDP on international financial stability as a global public good, and the other by UNCTAD reports on its activities to promote long-term private flows for development. While the present report is self-contained, it may read as an update of the report of last year.[2]

3. Section II of the report summarizes recent developments in the net transfer of financial resources to developing countries, while section III examines the main actions taken and concerns raised on policy issues addressed in resolution 55/186. Section IV, which concludes the report, seeks to consolidate further a broader global agenda for a new international financial architecture, situating it within the process that is leading to the United Nations Conference on Financing for Development, which will take place in Monterrey, Mexico, from 18 to 22 March 2002.

II. Recent financial flows and net transfers

4. Developing countries as a group transferred an estimated $170 billion in financial "resources" in 2000 to other countries.[3] This was about $60 billion more than in 1999, which was itself about $75 billion more than in 1998 (see table 1). Indeed, there have not been significant net financial transfers to the developing countries since the mid-1990s. The increase in net outward transfer in 2000 reflected both positive and negative developments from the perspective of developing countries. On the positive side was the diminished need for net financial flows by oil exporting countries benefiting from a surge in oil prices. On the negative side, many developing countries were in adjustment processes with slow growth paths, with debt repayment and suppressed effective demand for external resources.

5. At the regional level, the largest change was in West Asia, reflecting the steep rise in oil export earnings that far exceeded the financing of imports and allowed accumulation of foreign exchange reserves. On the other hand, the net outward transfer from East and South Asian countries moderated significantly in 2000, as robust economic recovery strengthened import growth, along with a bottoming out of capital outflows. Latin America and the Caribbean produced a small outward net financial transfer in 2000, primarily owing to strong oil and manufactured goods exports in some countries, although reduced access to external credit in Argentina late in the year also had an effect.

Table 1
Net transfer of financial resources to developing countries, 1993-2000
(Billions of dollars)

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*[a]
Developing countries	66.2	34.3	39.9	18.5	-5.7	-35.2	-111.2	-169.8
Africa:	2.5	5.1	6.0	-5.1	-3.3	17.0	6.3	-14.5
Sub-Saharan (excluding Nigeria and South Africa)	19.2	3.7	10.1	12.2	12.9	13.1	16.4	15.8
East and South Asia	10.0	1.9	22.9	24.6	-28.1	-127.7	-125.8	-102.9
Latin America and the Caribbean	14.7	18.1	-1.6	-1.3	20.8	42.0	7.9	-1.6
Western Asia	39.0	9.2	12.6	0.2	4.9	33.5	0.4	-50.8
Memorandum item:								
Heavily indebted poor countries (HIPCs)	13.0	10.7	11.8	11.9	13.6	16.5	12.8	9.2

Source: *World Economic and Social Survey 2001* (United Nations publication, Sales No. E.01.II.C.1), table II.4, based on data of the International Monetary Fund.
[a] Preliminary estimates.

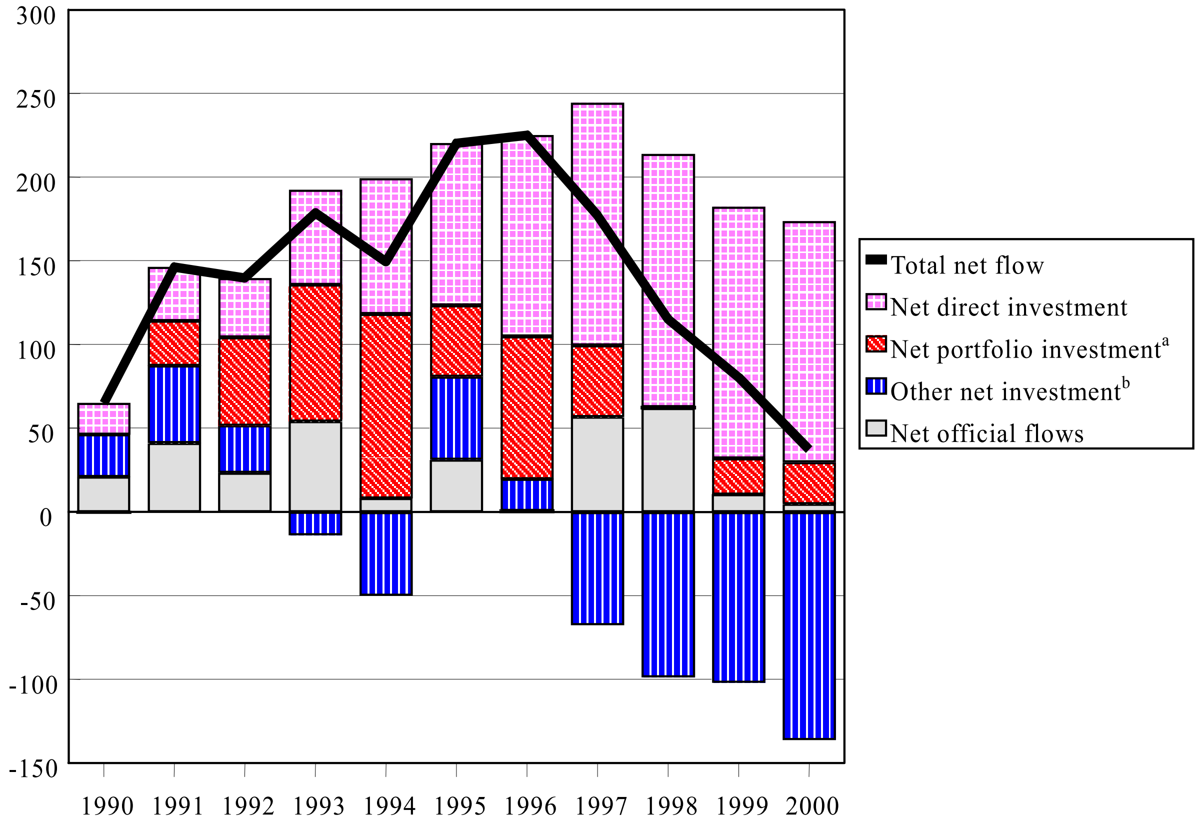
6. The net inward transfer of financial resources to Africa as a whole was reversed in 2000, owing to increased export earnings in several large oil-exporting countries. The net inward transfer of financial resources to cover the balance-of-trade deficits of the oil-importing sub-Saharan African countries were largely sustained, while those to the highly indebted poor countries (HIPCs) were the smallest in several years.

7. These developments in the net transfer of financial resources were mirrored at the level of financial flows to developing countries, with declines in both private and official flows (see figure 1).

Private flows

8. Private financial flows in 2000 were restrained by higher investor aversion to risk, in response to weakening equity market prices, especially for relatively speculative stocks in the second half, and spreading concern about a possible global economic slow-down. This shift in investor sentiment was reflected in the rise in the "spread" between the yield on emerging market bonds and United States Treasury bonds, the standard risk-free benchmark instrument. This was particularly visible in the spreads on bonds of South and East Asian economies in the first half of 2000 and of Latin American issues in the second half, the latter very much affected by the burgeoning difficulties in Argentina (see figure 2).

Figure 1
Net financial flows to developing and transition economies, 1990-2000
(Billions of dollars)

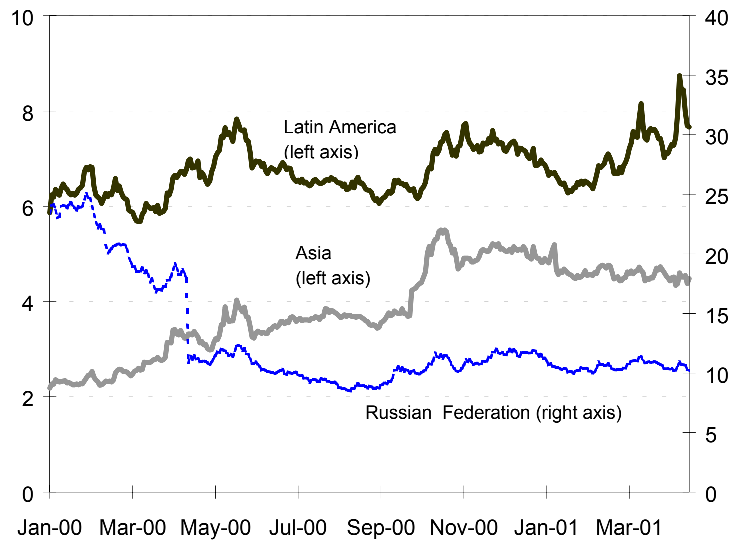


Source: *World Economic and Social Survey 2001* (United Nations publication, Sales No. E.01.II.C.1), figure II.3, based on data of the International Monetary Fund.

[a] Including portfolio debt and equity flows.

[b] Including short- and long-term bank lending. It may include some official flows owing to data limitations.

Figure 2
Yield spreads on emerging market bonds, 3 January 2000 to 30 April 2001
(percentage points)



Source: Data of J.P. Morgan Co., New York.

9. After several months of uncertainty, deteriorating investor confidence was stemmed in mid-2001 when both Argentina and Turkey, a second country threatened by financial crisis, received IMF-led assistance in support of reformulated adjustment programmes. However, persisting uncertainty about global economic growth prospects continued to weigh on investor sentiment, as has concern that the two large country programmes might yet have difficulties.

10. Private credit flows to developing and transition economies in 2000 could be characterized, as in recent years, by a net reduction in the exposure of foreign commercial banks and stagnant net inflows of non-bank credit (mainly bonds). There was continued retrenchment in international bank lending to these countries, further large repayments made by crisis-affected Asian countries, a low demand for new external credit by these countries and, in a different context, by oil-exporting countries, and the loss of access of Argentina and Turkey to the international capital market. One positive consequence has been a lower average ratio of debt to gross domestic product of a number of these countries. On the other hand, borrowing costs for developing and transition economies in international capital markets have remained high since mid-2000, owing to the increase in spreads, despite significant easing of interest rates in developed countries.

11. Foreign direct investment (FDI) flows to developing and transition economies levelled off in 2000 but remained the mainstay of private financial flows.[4] Investment for cross-border mergers and acquisitions in Asia subsided with the end of a wave of asset sales in the countries most affected by the 1997-1998 financial crisis. While countries with large privatization programmes, such as Brazil, Peru and Poland, attracted strong direct investment flows, there was little growth in

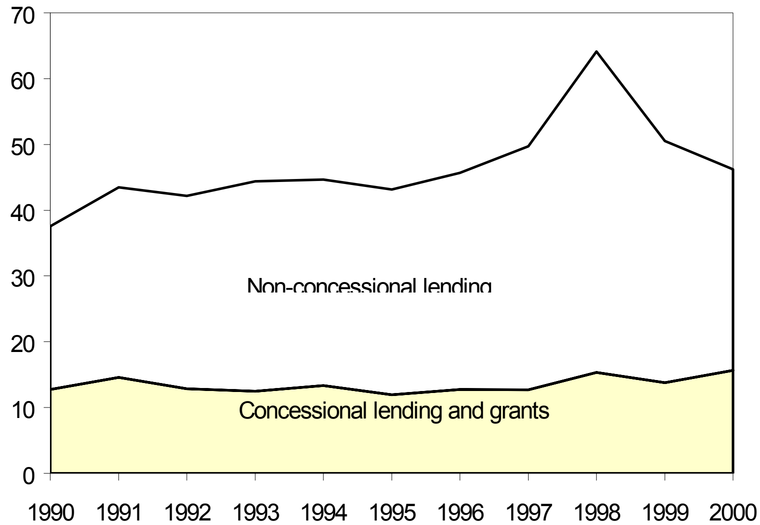
"greenfield" investment in new production capacity. Investment flows continued to be concentrated in middle-income economies in Asia and Latin America. Direct investment flows to the transition economies continued to increase. While investment flows to Africa as a whole declined, there were still significant inflows to certain countries, including Egypt, South Africa and the United Republic of Tanzania. In 2000, FDI in Africa was mainly focused on natural resources and infrastructure sectors.

12. There was a widespread retreat by international investors from portfolio equity investment in developing and transition economies in the second half of 2000. What began as a significant inflow of funds to emerging market stocks at the beginning of the year, became only a small net inflow for the year as a whole. Weakness in emerging market stock prices generally paralleled price declines in developed-economy stock markets, which had been precipitated by the downward revision of earnings prospects of stocks in the information technology sector. The rising concern about the growth prospects of developing countries in a global economic slow-down further weakened emerging market stock prices. Global stock prices continued a sharp decline in the first quarter of 2001 and only began to stabilize and show some signs of rebound in the second quarter.

Official flows and debt relief

13. The decline in flows of official financing in 2000, as seen in figure 1, reflected the continued abatement of emergency assistance for countries in financial crisis. This was particularly pronounced in the case of IMF, which received a net repayment of funds from developing and transition economies totalling about $10 billion for a second successive year.[5] Similarly, largely owing to the end of the surge in emergency lending operations by multilateral development institutions, total resource commitments (loans and grants) of these institutions were down 8 per cent, measured in constant prices and exchange rates, to a level of $42 billion.[6] Within this total, however, commitments of concessional multilateral funds increased slightly in 2000 after a decline in 1999. Indeed, while non-concessional multilateral development funds, principally from development banks, have shown periods of growth as well as decline in the 1990s, concessional multilateral development commitments have largely held constant (see figure 3 below).

Figure 3
Multilateral resource commitments, 1990-2000
(Billions of 1990 dollars)



Source: United Nations/Department of Economic and Social Affairs, based on information supplied by individual institutions.

14. Resources for the concessional multilateral programmes are largely provided out of official development assistance (ODA), which also funds bilateral financial assistance and technical cooperation. Total ODA by member countries of the Development Assistance Committee (DAC) of the Organisation for Economic Cooperation and Development (OECD) declined by 1.6 per cent at constant prices and exchange rates in 2000.[7] ODA as a proportion of the combined gross national product (GNP) of DAC members fell to 0.22 per cent in 2000 from 0.24 per cent in 1999, far below the aid target of 0.7 per cent recommended in various United Nations forums.

15. A major factor in the decline in ODA in 2000 was the 18 per cent reduction in the contribution of the largest donor, Japan, as a consequence of the end of its exceptional contributions in the aftermath of the Asian financial crisis. At the same time, contributions of the United Kingdom and a number of other countries rose. The chances for a return to an increase in total ODA flows are uncertain, as the prospects for flows from some of the major donors are problematic. With the highly uneven distribution of ODA effort among donor countries, as measured by the ratio of ODA to GNP, significantly increasing the levels of ODA of many donor countries is one of the main challenges to increasing total ODA flows today. Meeting this challenge is a particularly important part of the effort to realize the commitment to attain the Millennium Development Goals by 2015, including increased ODA for the least developed countries.[8]

16. Furthermore, donors have channelled an increasing proportion of ODA flows to finance the provision of global public goods.[9] While adequate funding of programmes for global public goods is essential, it should not come at the expense

of ODA.[10] Therefore, it is important to explore sources and mechanisms for additional resources for global public goods.

17. As servicing external debt is frequently a major drain on the government budget and on financial inflows, effectively diverting resources from development and poverty reduction efforts, further progress in the implementation of the enhanced initiative for HIPC is also critical to attaining the Millennium Goals. There is broad agreement that, to meet the need for a significant increase in the net transfer of financial resources to support those efforts, official debt relief must not be at the expense of ODA flows. Indeed, debt relief should be complemented by increased ODA, mainly in the form of grants and highly concessional loans.

18. Under the enhanced HIPC initiative, 22 eligible countries reached the "decision point" for debt relief by 31 December 2000, and one more country — Chad — progressed to this point in May 2001, qualifying for interim debt relief. As of early June 2001, only Uganda and Bolivia had reached the "completion point", qualifying for full relief.[11] The 22 countries will receive about $34 billion of debt relief when their programmes are completed, accounting for two thirds of the international expenditure required for the initiative when applied to all eligible countries. Combined with traditional debt relief and additional bilateral debt forgiveness, total debt-service relief is estimated at $53 billion. The debt relief committed under the enhanced HIPC Initiative will halve, or reduce by $20.3 billion in net present value terms, the outstanding debt stock of the 22 countries. The stock of debt as a percentage of exports of these countries will as a result decline to an average of 126 per cent, still quite high, though about half the levels that prevailed prior to debt relief, and will be comparable to those of other developing countries; their debt-service payments will be reduced by about a third.

19. Some obstacles to the speedy implementation of the HIPC Initiative remain, however. Of particular concern are the low levels of funding of the HIPC Trust Fund. Paid-in bilateral contributions totalled only slightly more than a third of the pledged amount at the end of March 2001. Almost all the multilateral creditors have pledged to provide interim relief as countries reach their decision point. The proceeds of about $800 million from the off-market sale of gold by the IMF is expected to cover its commitments to the HIPC Initiative. Debt relief is also funded by the donor countries and international institutions in the form of a reduction in debt-service obligations owed to the World Bank and regional development banks, and this arrangement is implemented on a "pay-as-you-go" basis. It is therefore central to the smooth operation of the HIPC Initiative that contributions to the HIPC Trust Fund be received on a more timely basis.

20. Another concern is the need to expedite the implementation of a programme of debt relief for post-conflict HIPCs. A programme for emergency post-conflict assistance implemented by IMF, should help to accelerate the process.[12] At the same time, flexibility in the implementation of the enhanced HIPC Initiative, taking into account these countries' track record in macroeconomic policy and institutional reform, would accommodate their special conditions.

21. There have also been concerns about the sustainability of the target level of residual debt of individual countries that are receiving relief under the HIPC Initiative. Some of those countries have suffered significant and protracted deterioration in their terms of trade. As the calculation of the projected export revenues and government revenues of HIPCs did not take these developments into

account, the possibility has been recognized that countries in these circumstances could fall back into an unsustainable debt situation.[13] In such circumstances, adequate additional assistance would be needed, preferably in the form of grants, in order to secure the exit from debt crisis that was sought.

22. In addition to the special needs of the HIPCs, many other developing and transition economies have unmanageable levels of debt and/or a serious mismatch between their financing needs and the maturity structure of their debt. This level and profile of debt leave them vulnerable to abrupt adverse changes in domestic or international economic factors. Improved debt management systems in these countries can play an important part in alleviating this problem.

23. Because most of these countries have access to international capital markets they are obligated to private as well as official creditors. While there is agreement that resolution of debt crises for such countries requires debt restructuring, there is also concern about some of its possible effects. Firstly, there is the risk of “moral hazard”, that is, encouragement given to private creditors to take higher risk (see section III.E). Secondly, and related, is a concern over the possibility that debt relief for these countries will reduce multilateral resources available to other developing countries.

24. As the Paris Club is the centre of restructuring of official bilateral debt, continued improvement is needed in the development of clearer principles and more transparent mechanisms for resolving official debt problems. In addition, incentives should be enhanced for all bilateral creditors to participate fully in debt negotiations.

25. As it appears that private creditors have often underestimated the risks in their lending decisions, the international community is committed to efforts to involve private creditor participation in debt workouts in future debt crises. The necessary mechanisms and the coordination between private and public creditors are being developed in various forums (see section III.E).

III. Reform of the international financial architecture

26. In the wake of the Asian crisis, a broad consensus quickly developed on the need to reduce excessive instability in international economic and financial activity or contain its consequences. By the end of the decade, there was general agreement on broad policy goals to do so, including a sound and stable macroeconomic environment and well-functioning and robust financial systems. These were required in both capital exporting and capital importing countries.

27. There has also been considerable agreement on many of the elements needed to achieve these goals and many of the general conclusions reached over the past several years are being turned into concrete policies and practices. This does not mean that there are no disputes, but policy makers around the world are operating largely from a common assessment of what policies to implement in several areas and the focus has shifted to implementation, assessment and refinement. The major international financial institutions have also been rethinking how best to assist countries in this regard. One of the outstanding issues is how to better integrate the views and needs of all countries into the process for further elaboration of the new international financial architecture.

28. The shift in emphasis to implementation means that technical assistance focused on the particular needs of each country has become a key requirement for the effectiveness of work on the reform of the international financial architecture. Technical assistance and support are crucial to ensure that no country is left behind in the efforts to raise financial resilience globally. It is thus important both to strengthen cooperation among different multilateral and bilateral providers and, given the strong and growing demands for technical assistance, to mobilize additional resources for it.

29. Despite significant progress in reforming the international financial architecture, there is no room for complacency. The recent crisis episodes in Argentina and Turkey are a powerful reminder that much more needs to be done. Also, policy makers have to stand ready to cope with possible disruptions to both the financial system and the real economy caused by imbalances built up in the recent long phase of economic expansion.

A. International standards and codes[14]

30. A fundamental part of the strategy for reform of the international financial architecture is to encourage countries to strengthen their financial and macroeconomic policy systems by establishing international standards and codes of good practice and then promoting their widespread implementation. The key standards and codes cover such areas as transparency in government, financial sector supervision, corporate governance, and appropriate legal and institutional frameworks.

31. The standards and codes are developed in specialized bodies with varying membership. Some of the standards and codes have been developed in IMF (e.g., on financial statistics, monetary and financial policy transparency) and others have been designed in developed country forums (e.g., banking supervision in the Basel Committee on Banking Supervision, corporate governance in OECD). In the latter types of cases, some developing and emerging economies have questioned whether they should be required to apply codes that they have not participated in developing. In response, some limited membership bodies have made efforts to consult with non-member countries, although there is a consensus that more can be done in raising the participation of developing countries in the process as a whole.

32. Another concern is the growing number of new standards. Up to 80 different standards have been issued by various bodies. To cope with the avalanche of standards, the Bretton Woods institutions as well as the Financial Stability Forum (FSF), have had to pick out a core group of standards directly related to promoting sound financial systems (see table 2 below).

Table 2
Key standards for sound national financial systems identified by the IMF and World Bank[a]

Subject area	*Key standard*	*Issuing body*
Data dissemination	Special Data Dissemination Standard (SDDS)/General Data Dissemination System (GDDS)	IMF
Fiscal policy transparency	Code of Good Practices on Fiscal Transparency	IMF
Monetary and financial policy transparency	Code of Good Practices on Transparency in Monetary and Financial Policies	IMF
Banking supervision	Core Principles for Effective Banking Supervision	BCBS[b]
Insurance supervision	Insurance Core Principles	IAIS[c]
Securities regulation	Objectives and Principles of Securities Regulation	IOSCO[d]
Payments systems	Core Principles for Systemically Important Payment Systems	CPSS[e]
Corporate governance	Principles of Corporate Governance	OECD
Accounting	International Accounting Standards (IAS)	IASB[f]
Auditing	International Standards on Auditing (ISA)	IFAC[g]
Insolvency regimes and creditors' rights	Principles and Guidelines on Effective Insolvency and Creditor Rights Systems	World Bank

Source: International Monetary Fund, Public Information Notice No. 01/17, 5 March 2001.

[a] The Financial Stability Forum (FSF) has highlighted a set of 12 key standards, with 11 standards being the same in both the FSF and the Fund/Bank lists. The FSF addition is "The forty recommendations of the Financial Action Task Force on Money Laundering" (http://www.fsforum.org/Standards).

[b] Basel Committee on Banking Supervision.

[c] International Association of Insurance Supervisors.

[d] International Organization of Securities Commissions.

[e] Committee on Payments and Settlements Systems.

[f] International Accounting Standards Board.

[g] International Federation of Accountants.

33. Initially, the work on international standards and codes was seen as a way to place countries into separate groups according to their degree of adherence to particular uniform rules and regulations, with the laggards being "punished" by the international community or financial markets. Now the mainstream view is that the focus on standards and codes is a cooperative voluntary effort to strengthen the global system as a whole and thus both the international and domestic economic and financial environments.

34. To best serve these objectives, the expected degree of country implementation of international standards and codes should take account of different stages of economic and capital market development, administrative capacities and reform policies, as well as cultural and legal traditions. Consequently, implementation requires prioritization even of core standards according to each country's unique circumstances. At the same time, ways should be found to combine appropriate differentiation in implementing and assessing standards with the need to maintain their universality.

35. Assessment of observance of standards and codes conducted by the IMF and the World Bank can have an important role in improving countries' basic infrastructure for growth and stability. It is essential that such assessments not be made in a mechanical "pass-fail" manner. Instead, they should help countries to prioritize relevant standards and/or their parts, as well as gradually improve compliance with them.

36. Implementation of standards will affect the pricing or allocation of credit or investment in an economy only to the extent that market participants use information on that economy's observance of standards in their business decisions. Due to the recent origin of many standards, most market participants are not familiar with them or with the Fund/Bank assessment work. In September 2000, the FSF thus made recommendations aimed at raising the general level of awareness of standards among market participants. The outreach exercises by FSF, as well as by the IMF and World Bank, have already brought results in that several private financial institutions have begun to incorporate the results of standards assessments into their decision-making process.

B. Exchange-rate and capital account regimes

37. One area of international financial policy in which practices differ substantially among countries is the choice of exchange-rate and capital account regimes. Recently, the debate on the choice of appropriate exchange-rate regime for developing countries has focused on the bipolar or "two-corner" solution. According to the proponents of this view, countries that choose to be fully open to international capital flows have no viable alternative between, on the one hand, rigid pegging of the exchange-rate, such as the use of a currency board or dollarization (eliminating the domestic currency), and, on the other hand, free floating of the exchange-rate. They argue that intermediate policy regimes between hard pegs and free floating are not sustainable. This view draws from the fact that each of the major international financial crises since 1994 involved countries with pegged but adjustable exchange rates. Since the Asian crisis, emerging economies have moved generally towards more flexible exchange-rate regimes, while a few countries have adopted the dollar as their national currency.

38. It seems, however, that the two extreme regimes, especially the “hard peg”, may be appropriate only in limited circumstances. There exist a wide variety of flexible rate arrangements and possible degrees of openness of the capital account that could reconcile stability with flexibility and suit each country’s growth and development objectives. Besides the degree of capital account openness, other factors that affect choice of exchange-rate regime include the size of the economy, trade and investment structure and the level of economic and financial development. As these circumstances change, so does the nature of the required exchange-rate regime.

39. All along the development spectrum, consistency is especially important between the level of financial openness and the exchange-rate regime. While indicators of greater financial development are associated with less stringent capital controls and more flexible exchange-rate arrangements, one of the lessons of the crises of the 1990s is the importance of preparing the financial sector for the volatility that accompanies increased openness. Moreover, even countries that applied industrialized-country style regulation, supervision and auditing have been hit by financial crises. Thus, even if successfully implemented, a robust financial sector may not sufficiently protect small emerging economies from the volatility of international capital flows. For such countries, an additional line of defence may include prudential regulations limiting short-term capital flows and the foreign exchange exposures of financial intermediaries.

40. The present consensus view is that to maximize growth and development opportunities while minimizing risks, integration into the global financial system should be gradual and carefully prepared. As part of this preparation, the international community must provide practical advice and technical assistance on the sequencing of financial sector development, capital account liberalization and corresponding changes in exchange-rate regimes.

C. Multilateral surveillance and monitoring

41. Multilateral surveillance of national economic and financial policies is a second major pillar of the international financial architecture, following standards and codes. Surveillance is both a service to individual countries and a global public good. It is the primary tool available to the international community for crisis prevention. The International Monetary Fund has primary responsibility for multilateral surveillance. Along with this global institution, there are arrangements among regional and subregional groupings of countries for mutual surveillance. These arrangements are a useful supplement to multilateral surveillance and should be further encouraged.

42. Beyond the traditional macroeconomic policy areas, surveillance is now focusing on improvement of the transparency of countries’ policies, and the development and implementation of the various standards noted above. Also, increased attention is being paid to the identification and reduction of specific domestic and external vulnerabilities that can increase the potential for financial crisis.

43. In the latter area, particular attention has recently been given to the financial markets, both domestic and international, and their implications for the sustainability of capital flows. In March 2001, IMF and the World Bank finalized

guidelines for public debt management and a handbook on the development of domestic public debt markets. Both documents provide useful tools to help countries to address issues that can arise from volatile capital flows. Also, a preliminary draft of Reserve Management Guidelines was circulated by the Fund for comments. It is expected that revised draft guidelines, as well as a technical paper on early warning systems will be ready before the September 2001 meeting of the International Monetary and Financial Committee of IMF.

44. In May 1999, IMF and the World Bank launched the Financial Sector Assessment Programme (FSAP) to strengthen the focus on monitoring financial sectors. This joint monitoring and assessment initiative is aimed at identifying the strengths, vulnerabilities and risks of the financial system of individual countries, and then helping them to design policy responses and ascertaining the sector's development and technical assistance needs.

45. In setting priorities for which countries to assess, emphasis has been placed on systemically important countries, although the approach is applicable generally. After assessment of 12 pilot countries, experience has shown that the analysis of the financial sector as a whole by a multidisciplinary team of experts can offer valuable insights regarding the weaknesses of domestic financial systems. Indeed, both developed and developing countries have expressed strong demand for participation in the FSAP, which is voluntary. After the pilot phase, the programme aims to cover around 25 countries each year.

46. Along with FSAPs for domestic capital markets, there have been several initiatives aimed at improving understanding, monitoring and surveillance of global capital markets and strengthening the capacity for addressing systemic issues related to capital market development. In order to deepen work in this area, IMF decided in March 2001 to create a new International Capital Markets Department. The Fund has also expanded its discussions with financial market participants through its new Capital Markets Consultative Group. This complements the strengthening of domestic financial markets in capital-importing countries by seeking to reduce volatility at the source of funds.

47. There has also been some progress in the implementation of the recommendations set out in the reports of the FSF Working Groups on Highly Leveraged Institutions (HLIs), Capital Flows, and Offshore Financial Centres (OFCs). Since the reports were published in March 2000, actions have been taken by some OFCs to enhance their supervisory, regulatory, cooperation and information practices. Also, in cooperation with IMF, some of these jurisdictions have started programmes that involve voluntary assessments of implementation of relevant standards, as well as measures to ensure greater transparency and better provision of statistical information by OFCs. Nevertheless, not all OFCs have demonstrated their commitment thus far to meet the relevant international standards. In this regard, it is important to note that financial activity represents the major source of budget revenues for several OFCs. The introduction of international standards will likely diminish the attractiveness of these jurisdictions and thus their earnings from financial activities. Consequently, there is a need for assistance to develop more diversified economic structures.

48. With regard to HLIs, improvements have been made in the management of counterparty risk by HLIs and in the regulatory oversight of the banks that lend to HLIs. Also, in February 2001 a group of 16 major international commercial and

investment banks released a set of trading principles for foreign-exchange market activities. The principles address many of the concerns about trading practices that have the potential to disturb market dynamics in small and medium-sized countries. At the same time, the progress in the area of mandatory public disclosure by HLIs has been limited. Consequently, there is a need for continuing implementation efforts by firms and national regulatory authorities.

49. Efforts to increase transparency of cross-border financial operations have not been limited to OFCs and HLIs. In April 2001, the Basel Committee published the results of a two-year study on public disclosure practices of internationally active banks. The major finding of the report is that, although significant progress has been made over recent years to improve the quality and level of disclosure, disclosure practices have not kept up with the changes in how banks conduct their business and measure their risks. This raises the question of how much information banks should make available to financial market participants who buy and sell financial instruments in various currencies, without unnecessarily moving the boundary between public and proprietary information.

50. One of the outcomes of the ongoing process of financial consolidation has been the creation of very large and complex financial institutions. This development has given rise to concerns that the failure of such an institution may have negative repercussions on the stability of the international financial system. In the light of these concerns, the FSF, the Finance Ministers and Central Bank Governors of the Group of 10 and the Basel Committee formed a joint task force in 2000 to review the modalities for dealing with a very large and complex institution should it get into financial difficulty. A number of preparatory measures to reduce the impact of the failure of such a firm on other market participants were identified. These measures are being reviewed by various national authorities.

51. The increasing sophistication of global financial markets also calls for disclosure in different countries to be sufficient and broadly consistent. That will require further harmonization of accounting standards.

52. In general, significant efforts have been made to improve risk management at financial institutions. In this regard, special attention has been given to a new Basel Capital Accord for banks to replace the Capital Accord of 1988. The major purpose of the new framework is to better align regulatory capital requirements of banks with underlying risks and encourage more effective supervision by banking regulators. The new Accord is expected to be finalized by the end of 2001 and implemented by 2004. It is widely agreed that the proposals are a major step forward. Still, further analysis of the potential impact of the proposed new Accord is needed before implementation. Indeed, there are concerns that the implementation of the new framework may result in a significant reduction of bank lending to much of the developing world. Also, it has been argued that the new Accord encourages "pro-cyclical" lending (that is, creating incentives for excessive lending during booms and more severe lending cutbacks during recessions).

D. Terms and conditions for international assistance

53. The international community has long appreciated that all countries, even the best-managed economies, may need to seek international financial assistance to help to cope with a balance-of-payments problem. The primary source of such assistance

is IMF, and one issue of special concern to the developing and transition economies that draw on IMF support is the terms and conditions for it.

54. In November 2000, IMF implemented important changes to its non-concessional loan facilities. To discourage prolonged use of and deter inappropriately large drawings from IMF resources, the Fund introduced time-based repayment expectations and interest surcharges on credit outstanding above certain levels under Stand-by Arrangements and the Extended Fund Facility (EFF). Also, it was decided that the EFF should be used only in well-defined cases where longer-term official financing is appropriate owing to the country's structural balance-of-payments situation and limited access to private capital. In addition, four little-used facilities that had been established to meet specialized needs were eliminated.

55. A central element of the review of Fund financial facilities was the modification of the Contingent Credit Line to make it more attractive to potential users. Modifications included less intensive monitoring arrangements, greater automaticity in the disbursement of resources once a commitment was made by the Fund, and reduced cost of borrowing.

56. In a related step, the policy conditions that IMF attaches to use of its funds are being reviewed. There is general agreement that the number and detail of structural policy conditions attached to IMF loans in the 1990s were too extensive and restrictive to be fully effective. There are also concerns that excessive conditionality may have undermined the national ownership of programmes and impeded their implementation.

57. The intent of the IMF review is not to weaken conditionality, but to make it more effective and less intrusive and to enhance programme ownership. Accordingly, conditionality is to be better focused on policies essential to restoring and maintaining macroeconomic stability and growth. Structural issues will be covered only if they are critical for these objectives. The difficulty is where to draw the line between what is critical and what is not.

58. At the same time, streamlining IMF programmes is not simply a matter of focusing on macroeconomic conditions. Very often a country needs to tackle structural issues that are not in the Fund's area of expertise in order to reach sustainable macroeconomic outcomes. This would require closer collaboration in programme design between IMF, the World Bank and the other international institutions with specialized mandates and expertise in relevant policy areas.

59. The review of conditionality should also pay particular attention to social aspects of adjustment programmes. Protecting the most vulnerable must be a priority, and so too must reaching the international development goals. This means that social expenditures, especially for health and education, must be preserved. In this regard, there have been proposals that for each adjustment programme, there should be an analysis of the necessary social sector support mechanisms.

60. To supplement IMF activity in countering balance-of-payments crises, new financing arrangements are being put in place at the regional level. In May 2000, 10 member nations of the Association of Southeast Asian Nations (ASEAN) plus China, Japan, and the Republic of Korea adopted the Chiang Mai Initiative. The "ASEAN+3" countries proposed to strengthen regional financial cooperation through an expanded network of swap facilities among their central banks. The initiative involves extending the existing ASEAN swap arrangements and

establishing a network of bilateral swap arrangements between the ASEAN countries, China, Japan and the Republic of Korea. The countries also agreed to strengthen the regional policy dialogue and cooperation activities in the areas of surveillance and monitoring, including capital flows. Since then, the ASEAN countries have agreed on the new expanded ASEAN Swap Arrangement and a consensus has been reached over the basic framework and main principles for the bilateral swap arrangements.

61. The participants in the agreement have stressed that the regional swap arrangements are a complement to existing international financing facilities, in particular, those provided by IMF. The importance of the coherence and consistency between regional monetary cooperation tools and IMF facilities has also been emphasized. Under ASEAN+3, the activation of loans beyond 10 per cent of the agreed bilateral lines will take place in the context of IMF-supported programmes.

E. Private sector involvement in crisis prevention and resolution

62. There is broad appreciation that the international imperative to help countries to fight financial crises, ipso facto, creates a moral hazard in which private creditors come to believe they will be rescued in the event of crisis. They therefore take excessive risk in lending. To counter this, the international community now requires private sector involvement in crisis resolution; this can involve rolling over maturing loans in a crisis or extending new loans or accepting partial repayment of obligations through renegotiation. At the same time, in order to boost confidence of private creditors and encourage private financial flows, the international community has sought to involve them in crisis prevention activities.

63. There has been progress, in this regard, in the development of a framework on private sector involvement (PSI) in crisis prevention and resolution. Such a framework was agreed upon at the IMF/World Bank annual meeting in Prague in September 2000. The basic principle of the framework is that private investors and creditors have to bear the consequences of their decisions. Consequently, neither creditors nor debtors should expect to be fully protected from unfavourable outcomes by official action.

64. For a country in crisis, the framework begins with an assessment of its payment capacity and prospects of regaining market access. In most cases, the combination of catalytic official financing and policy adjustment should be enough for a country to regain market access quickly. However, in some cases, such as when a country faces a large short-term financing requirement but private markets are closed (i.e., unwilling to lend) or if its debt burden has become unsustainable, the country’s private creditors would need to be brought together for collective action to limit their demands for immediate repayment and agree on the orderly restructuring of the country’s debt obligations as a complement to international official assistance. The Prague framework also made it clear that in certain extreme situations, a temporary payments suspension or standstill may be unavoidable.

65. Both the Prague framework and its application in Argentina and Turkey, as well as in sovereign debt restructuring involving bonds issued by smaller countries, have made the private sector more aware that PSI will be a standard element of crisis resolution. However, it is a widely shared view that it is necessary to go further in reinforcing a clear set of presumptions that private sector involvement will

be at the centre of crisis resolution. This means moving further away from the ad hoc model of crisis resolution while retaining the flexibility needed to deal with individual cases and avoiding an overly detailed involvement by the international community. Consequently, work on the development and implementation of the framework to deliver still greater clarity and predictability to market participants should be continued.

66. In this regard, several areas of the framework, including assessment of a country's payment capacity and prospects for regaining market access, the conditions and modalities for implementing temporary standstills, comparability of treatment among creditors, and the lending into arrears policy need to be further clarified. Also, the further development of mechanisms to improve communications between debtor countries and their creditors, as well as between multilateral organizations and the private sector, should be encouraged.

67. Although central to crisis resolution, PSI should not be a substitute for official emergency financing, but complement it. Pure market solutions could be unacceptably harsh and painful. This calls for an appropriate balance between official financing packages and PSI.

IV. Conclusion: global cooperation in a globalized world

68. Amid dramatic increases in global trade, direct investment and capital flows, there has been a growing tendency for economic changes in any country to increasingly reflect developments worldwide. Given these powerful linkages, the stability of the international economic and financial system and its responsiveness to the challenges of development and to the promotion of economic and social equity have increasingly been viewed in the broader context of world economic governance.

69. During the 1990s, there was a burgeoning criticism of the emphasis of multilateral policy prescriptions on reducing excessive inflation, liberalizing market prices and opening access to foreign financial and investment inflows. Sometimes characterized as "sound macroeconomic policy and getting prices right", these recommendations ignored fundamental institutional prerequisites for the policies to work and they were insufficiently sensitive to the social impact of policy reform, especially on vulnerable population groups. They also ignored the politics of economic reform, which requires that there be a political sense of "ownership" in order to be more confident of implementation.

70. Today, it is recognized that social justice and economic growth should not be at odds with one another, but intertwined. This new approach requires all major players — individual Governments, multilateral institutions, the private sector, and non-governmental organizations — to work together more cooperatively. Making globalization work for the benefit of all, including the poorest countries and the poorest people, requires global cooperation.

71. To achieve a more stable and development-friendly international financial system, the responsibility lies, first and foremost, with national policy makers. Thus, many developing countries and transition economies are making substantial efforts to strengthen their financial sectors and pursue sound macroeconomic policies. These efforts should be further encouraged.

72. But this process should not be a one-way street. As in developing and transition economies, there are structural adjustment imperatives in developed countries. Given that economic developments in the major industrialized countries play a key role in setting the international economic environment for development, the major industrialized countries should pay more attention to the coherence of their policies with the global development objectives and priorities that they sponsor and endorse. For example, there are global as well as domestic reasons for an accelerated opening of the protected sectors of developed-country markets to foreign trade. Those who call for "free trade" should do so consistently. However, their willingness to confront specially protected economic interests in their own overall national interest is often weaker than they expect and has been evidenced in reforming developing and transition economies.

73. There is a matter here as well concerning global governance. As economic integration increases, so does the role of international organizations. The effectiveness of international institutions is fundamental to a strong and stable global economic and financial system. It is important to strengthen and broaden the popular sense of the political legitimacy and international support of multilateral economic actions, i.e., to form clear and strong political links between multilateral institutions and different groupings of countries. To carry out the missions of the international forums and institutions effectively, all members need not only to be properly represented, but also to have an effective voice in policy-making and to participate appropriately in decision-making. As all countries are to be subject to the global rules, the process for setting those rules should be more participatory. This would allow each forum or institution to benefit from the diverse perspectives of all concerned countries, which in turn would boost the effectiveness of operations as well as to promote a sense of ownership and trust.

74. In addition, emphasis should be placed on enhancing consistency, coherence and complementarity among different international bodies dealing with financial, trade and developmental issues. Some arrangements for such cooperation and coordination already exist. Nevertheless, much more is needed to further extend and strengthen coherence and consistency among international financial institutions, the World Trade Organization, the United Nations and different forums and committees. This should be a priority of the Financing for Development process.

75. More effective cooperation among international bodies requires improved coordination at the national level among different ministries of government. This is warranted as well for domestic policy coherence.

76. Economic and financial cooperation among regional groups of countries can effectively complement activities at the global level. Regional groups offer opportunities for macroeconomic consultation and coordination, monitoring financial vulnerabilities and administering schemes for mutual assistance, the ASEAN+3 initiative noted above being a case in point. Regional initiatives may also play an important role in representing the interests of developing countries in international institutions and forums. By this means, the structures and processes in global institutions could become broadly inclusive without being unwieldy and ineffective.

77. As the private sector accounts for the overwhelming share of international financial flows, it has important and indispensable responsibilities in crisis prevention and resolution. Thus far, the discussion of the contribution of the private

sector to international economic and financial stability has mainly focused on "bailing in" the private sector in crisis resolution. As noted above, this is not enough and attention has increasingly turned to the private sector role in crisis prevention.

78. In this regard, enhanced dialogue, active and regular two-way contact on policy issues aimed at more stable private sector activity, particularly in emerging markets, could be developed. This presupposes much more advanced levels of interactions and partnership, both nationally and globally. Through such a dialogue, a framework could be developed that would provide a greater degree of clarity about the respective roles, intentions and actions of the parties involved. The recent creation in IMF of the Capital Markets Consultative Group, a dialogue mechanism with large private financial institutions, as noted earlier, is an important initiative in this regard. Modalities for such interchanges more generally in the financial arena are being considered in the Financing for Development process, which has itself embarked on a number of business-sector/governmental interactions to help advance thinking in this area.

79. A closer collaboration with civic groups and non-governmental organizations representing civil society is equally on the agenda for strengthening international processes. The contribution of civil society to multilateral discussions is increasingly seen as vital. It has become clear that acceptance of any international action by global public opinion is of great importance. Little can be successfully accomplished unless it is supported at the grass-roots level.

80. Globalization of economic and financial activity has had dramatic consequences for national economies and for the resulting inter-State and multilateral efforts to manage it. Enhanced global governance requires complementary and enhanced exchanges among all the parties concerned. The United Nations should be among those that bring their own perspective to identifying emerging issues and policy gaps and that convene and facilitate policy dialogue and consensus-building on global economic, financial and development problems. The Conference on Financing for Development to be held in Mexico in March 2002 will be one opportunity for the Organization to fulfil that role.

Notes

[1] Flagship reports of these entities containing more detailed information and analysis than can be included in this report include *World Economic and Social Survey, 2001* (United Nations publication, Sales No. E.01.II.C.1); UNCTAD, *Trade and Development Report, 2001* (United Nations publication, Sales No. E.01.II.D.6); UNCTAD, *World Investment Report, 2001* (United Nations publication, Sales No. E.01.II.D.12); IMF, *World Economic Outlook, May 2001*; and World Bank, *Global Development Finance, 2001*.

[2] "Towards a stable international financial system, responsive to the challenges of development, especially in the developing countries" (A/55/187 and Add.1 and 2).

[3] The data and analysis in this section are largely drawn from *World Economic and Social Survey, 2001*, chap. II. The net transfer of financial resources essentially comprises the net capital inflow minus the net outflow of investment income; it finances the balance of trade in goods and services (for additional detail on the concept, see *World Economic Survey, 1986* (United Nations publication, Sales No. E.86.II.C.1), annex III.

[4] For further detail on FDI, see UNCTAD, *World Investment Report, 2001* (United Nations publication, Sales No. E.01.II.D.12), and United Nations, *World Economic Situation and Prospects, 2001* (United Nations publication, Sales No. E.01.II.C.2), chap. II.

[5] See *World Economic and Social Survey, 2001*, tables A.23 and A.24.

[6] Ibid., table A.27.

[7] One factor in the fall in ODA in 2000 is definitional: the DAC no longer classifies assistance to the following countries or territories as ODA: Aruba, French Polynesia, Gibraltar, Republic of Korea, the Libyan Arab Jamahiriya, Macao (China), the Netherlands Antilles, New Caledonia, Northern Marianas and the Virgin Islands (U.K.). Adjusting for these changes, total ODA fell by only 0.2 per cent at constant prices and exchange rates. The effect of this reclassification is most apparent in the ODA of France (see OECD, "Special factors explain lower official development assistance (ODA) outcome: Development Assistance Committee announces ODA figures for 2000", Paris, 23 April 2001).

[8] See "United Nations Millennium Declaration", General Assembly resolution 55/2.

[9] World Bank, *Global Development Finance, 2001* (Washington, D.C., 2001), pp. 109-110.

[10] For an elaboration of this view by the United Nations Executive Committee on Economic and Social Affairs, see "*Towards a new aid compact*", report of the Executive Committee on Economic and Social Affairs, New York, 20 June 2001 (available at www.un.org/esa/coordination/ecesa).

[11] For additional discussion, see "The external debt and debt-servicing problems of developing countries, including those resulting from global financial instability", report of the Secretary-General (A/56/262). For a detailed analysis of the effects of debt relief on selected debt indicators of these countries, see the report to the Development Committee, "Heavily Indebted Poor Countries (HIPC): Progress report", Washington, D.C., 19 April 2001.

[12] As at March 2001, the countries that were deemed for HIPC purposes to be involved in armed conflict were: Angola, Burundi, Central African Republic, Democratic Republic of the Congo, Guinea-Bissau, Myanmar, Rwanda, Sierra Leone, Somalia and Sudan. Ethiopia recently emerged from an armed conflict situation, signing an agreement to end hostilities on 18 June 2000. (See also Communiqué of the Joint Session of the International Monetary and Financial Committee and the Development Committee (Washington, D.C., 29 April 2001), para. 10.)

[13] See International Development Association (World Bank) and IMF, "The Challenge of Maintaining Long-Term External Debt Sustainability" (Washington, D.C., 18 April 2001), p. 1.

[14] For more detailed analysis of these issues, see "Towards a stable international financial system, responsive to the challenges of development, especially in the developing countries", A/55/187, paras. 24-41.