TOWARDS A NEW INTERNATIONAL FINANCIAL ARCHITECTURE

Report of the Task Force of the Executive Committee

on Economic and Social Affairs of the United Nations

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EXPLANATORY NOTE

The establishment of the Executive Committees to coordinate the work of the United Nations entities working in related areas was an important component of the reform process launched by the Secretary-General in early 1997. The purpose behind this was to achieve greater effectiveness and consistency and thereby to enhance the usefulness of the Secretariat to the international community.

This report, "Towards a new international financial architecture", is the product of a collaborative and coordinated effort by the Executive Committee on Economic and Social Affairs [1]/ and presents the unified position of the United Nations Secretariat in the economic, social and related fields on one of the most pressing issues of the day. The

[1]/ The membership of the Committee comprises: Department of Economic and Social Affairs (DESA), Economic Commission for Europe (ECE), Economic and Social Commission for Asia and the Pacific (ESCAP), Economic Commission for Latin America and the Caribbean (ECLAC), Economic Commission for Africa (ECA), Economic and Social Commission for Western Asia (ESCWA), United Nations Conference on Trade and Development (UNCTAD), United Nations Environment Programme (UNEP), United Nations Centre for Human Settlements (HABITAT), United Nations Office for Drug Control and Crime Prevention (ODCCP), Office of the United Nations High Commissioner for Human Rights (OHCHR), United Nations Development Programme (UNDP), United Nations University (UNU), International Research and Training Institute for the Advancement of Women (INSTRAW), United Nations Institute for Training and Research (UNITAR), and United Nations Research Institute for Social Development (UNRISD).

report was brought to fruition by means of a Task Force created by the Committee and led by Mr. José Antonio Ocampo, Executive Secretary of the Economic Commission for Latin America and the Caribbean. The report, which focuses mainly on prevention and management of financial crises, is the first in a series of policy-oriented reports the Executive Committee intends to produce over the coming months. These future reports will, among other things, address such issues as external debt, finance for development and social dimensions of macroeconomic policy. The present report of the Executive Committee should be seen as a first significant contribution to that debate.

1. The international financial crisis and the need for reform

World events since mid-1997, and its precedents in the 1980s and 1990s, have made painfully clear that the current international financial system is unable to safeguard the world economy from financial crises of high intensity and frequency and devastating real effects. The rapid spread of the current international financial crisis, from East and South-East Asia to other developing and transition economies, and even to the industrialized world, has already led to statements and decisions by the authorities of developed countries, who recognize that it is indeed the most threatening event of its kind in more than half a century. The threat is reflected in the successive substantial downward revisions of forecasts of world economic growth in the last year and a half.

The crisis reflects, first of all, the tendency of financial markets to experience sharp boom-bust cycles. During financial booms, lenders and borrowers underestimate the risks involved in high levels of indebtedness, a fact that only becomes apparent, with particular severity, during the ensuing downswings and panics. This volatility is inherent in the functioning of financial markets. It reflects not only imperfections in the flow of information, but also radical changes in its interpretation and sharp revisions in expectations as new information arrives, shifts that can be severe because of the uncertainty intrinsic to the intertemporal decisions that underlie financial transactions. The liberalization of financial flows among industrialized and some developing countries, floating exchange rates, financial innovations and new communications techniques have increased not only financial transactions, but also volatility in recent decades.

The crisis has also demonstrated, with particular severity on this occasion, that financial crises are contagious; that under panic conditions markets do not adequately discriminate between countries with strong and weak economic fundamentals; and thus that crises tend to spread even to countries with sound economic structures and macroeconomic management. The concentration of participants in international financial markets that apply criteria indiscriminately to all countries is a major basis for contagion. In many cases, financial crises spread because highly leveraged investors, faced with losses in one market and ensuing margin calls, sell good assets in another country; investment banks and mutual funds may also engage in similar behavior in order to raise liquidity in expectation of withdrawals by clients.

Developing and transition economies have been highly vulnerable to financial volatility and contagion. They have been particularly prone to periods of rapid expansion and diversification of financial flows, often followed by abrupt reversals. This pattern has been aggravated by premature and hasty liberalization of the capital account, fragile domestic financial structures, and weak financial regulation and supervision. Extended financial booms build up strong pressures on aggregate domestic demand, which make macroeconomic balances unsustainable during the ensuing financial contraction. They also tend to weaken financial structures, as increasing risks are often underestimated. Under these conditions, the downswing may result in domestic financial crisis, which consumes large amounts of the scarce resources available to development, and severely affects economic activity and investment for several years. The impact of financial crises on the real economy is thus far larger than in developed market economies.

External debt and domestic financial crises generate, in turn, substantial social costs. As it happens, poor sectors of society pay a substantial share of the costs of adjustment to debt crises, whereas they benefit rather marginally from financial booms. These costs also tend to fall disproportionately on women and children. The experience of many developing countries in several regions of the world also indicates that the social effects of debt crises continue to afflict countries even after several years of successful economic restructuring and recovery. The Latin American experience since the early 1980s is particularly relevant in this regard. Preliminary evidence suggests that a similar pattern may occur in the East and South-East Asian nations.

Lastly, the recent crisis has demonstrated a fundamental problem in the global economy: **the enormous discrepancy that exists between an increasingly sophisticated and dynamic international financial world, with rapid globalization of financial portfolios, and the lack of a proper institutional framework to regulate it**. In brief, existing institutions are inadequate to deal with financial globalization. This is true of institutions at the international level, which have manifested significant shortcomings in the consistency of macroeconomic policies, and in the management of international liquidity, financial supervision and regulation. It is also true of national institutions in the face of globalization, even in industrial countries. This systemic deficiency and the associated threat of recurring crises in the future have thus underscored the need for a comprehensive reform of the international financial system, geared to prevent costly crises and to manage them better if they occur. The outcome would improve economic and social prospects worldwide.

2. The need for immediate action

In order to prevent the current crisis from deepening, immediate actions are required from the major industrial countries and from the international community. There is evidence that the world economy is experiencing a major slowdown, which may deepen if inadequately managed. Japan is in its worst recession since the war, much of East and South-East Asia is in depression, Russia is experiencing a major downturn, growth has stalled in Latin America, and the prices of primary commodities and a number of manufactures are falling in international markets. We therefore embrace the declaration of the Group of Seven on the need to confront the threat of world recession, and we applaud the decisions by the central banks of the United States and Western Europe to reduce interest rates in recent months, the important fiscal stimulus announced by Japan and its decision to face up to its domestic financial crisis. Authorities in the industrial countries must nonetheless continue to be alert. Several downside risks still remain, and current policies may prove insufficient to prevent the world economy from slipping into recession. Expansionary fiscal policies may thus be required in other industrial economies, in addition to Japan. It is also crucial that the rules of an open international trading system should operate smoothly, allowing the economies that face adjustment to reduce their deficits or generate trade surpluses with the more vigorous industrial economies.

With the full support of the international community, IMF should put together contingency funds to assist countries now experiencing crisis or contagion and others that could become the victims of world financial crisis in the future. These include countries that may be affected indirectly by the effects of such crises on trade and commodity prices, particularly low-income African and Asian countries. We therefore welcome the recent declaration and actions by the Group of Seven to guarantee adequate contingency financing, by completing the implementation of the IMF quota increase and the New Arrangements to Borrow, and the commitment to supplement the Fund's resources when necessary. Moreover, as we argue below, it is essential that this new type of contingency financing, which is to be made available **before** international reserves are depleted, should become a stable feature of the new international financial order, and that the availability of funds should be guaranteed without delay when needed. Developing and transition countries experiencing difficulties must obviously be ready to adopt the necessary adjustment policies, as they have by and large been doing during the recent crisis. Rescue packages and, more generally, adjustment policies should give special emphasis to a fair and progressive sharing of the costs of adjustment. The design of gender-equitable social safety nets is necessary, in particular, to ensure that this burden does not fall disproportionately on the poor and on women.

3. The reform of the international financial architecture

In the longer term, fundamental reforms of the international financial architecture are needed. The international financial system is an organic whole and requires a comprehensive approach. Reform must therefore encompass a number of interrelated aspects of international liquidity management, global consistency of macroeconomic policies and financial regulation, areas essential to the prevention and management of financial crises, as well as finance for development and the resolution of outstanding debt issues. This report addresses international monetary and financial issues in the first group, but some suggestions on broader and related issues are also provided.

With regard to the first group of issues, it must be emphasized that the present system is badly equipped to prevent financial crises and only partly equipped to manage them. Reforms in this area must be addressed with a sense of urgency in six key areas:

- Improved consistency of macroeconomic policies at the global level;
- Reform of IMF aimed at providing adequate international liquidity in times of crisis;
- The adoption of codes of conduct, improved information, and financial supervision and regulation at national and international levels;
- The preservation of the autonomy of developing and transition economies with regard to capital account issues;
- The incorporation of internationally sanctioned standstill provisions into international lending; and
- The design of a network of regional and subregional organizations to support the management of monetary and financial issues.

It is important to underscore the interrelated character of these reforms. Indeed, it is clear that reliance on any one or a few of these proposals would not generate a balanced world system, either in terms of its ability to both prevent and manage crises or of equitable participation by all members of the international community.

We must emphasize that any reform of the international financial system ought to be based on a broad discussion, involving all countries, and a clear agenda, including all key issues. The process must ensure that the interests of all groups of developing and transition economies, including poor and small countries, are adequately represented. The United Nations, as a universal and the most democratic international forum, should play an important role in these discussions and in the design of the new system.

4. Improving the consistency of macroeconomic policies at the global level

The crisis has made evident the need to enhance the coherence of macroeconomic policies in industrial countries, in order to avoid both inflationary and deflationary biases at the global level. The design of international institutions and policies must include, in the first place, clear incentives for national authorities in the industrialized world to maintain their economies at close to full employment while at the same time avoiding inflation. This will have favourable effects, not only for these economies, but also for the world at large. It must be emphasized that consistency in this sense should be primarily aimed at ensuring the global coherence of a set of interrelated national policies, rather than the adoption of identical decisions, since, in fact, inflationary or deflationary pressures will not necessarily be uniform at a given time. In order to achieve this objective, a more effective surveillance of national policies by IMF and regional and subregional institutions is necessary. This surveillance must have broad objectives and a preventive character, acting to warn of impending unemployment and growth retardation, as well as of inflationary pressures reflected in the evolution of domestic prices of goods, services and assets or in the deterioration of external balances.

The most appropriate institution or set of institutions to ensure such consistency should be subject to debate. Proposals include granting greater policy powers to the IMF Interim Committee and broadening the Group of Seven to include representatives of the developing and transition countries. The nature of the relative power relations that underlie these organs should be part of the debate. Hence, these proposals should be seen as consistent with the need to strengthen the Economic and Social Council, as indicated in the Report of the Secretary-General, “Renewing the United Nations: A Programme of Reform”, to provide political leadership and promote broad consensus on international economic issues. The necessarily broader mandates of this Council would then have to be harmonized with those of the specific body in charge of macroeconomic policy consistency. As argued below, a set of regional institutions whose objectives include macroeconomic coordination and surveillance also offers the advantage of a more balanced world order.

Macroeconomic policies, including decisions by central banks, should be subject to public scrutiny, aimed at ensuring proper balance between their multiple objectives (particularly between employment/growth objectives and inflation/balance-of-payments objectives). For the same reasons, IMF should be also subject to public scrutiny on similar grounds, with effective independent evaluations leading to accountable and pragmatic improvements in policy approaches.

5. The provision of adequate international liquidity in times of crisis

The management of international liquidity has a special role in preventing and avoiding contagion from financial crises and lessening their adverse economic effects. Whereas these objectives could eventually be best pursued through the creation of a true international "lender of last resort" (i.e., a world central bank), conditions are not ripe for such a bold reform to existing institutional arrangements. It would require, in particular, the surrender of more economic autonomy and powers of intervention in national policies than countries are willing to accept at present. Nonetheless, much can be done to improve the way IMF operates so that, in effect, it moves in that direction. Today, IMF has inadequate funds; it acts more as an organizer of rescues than as a provider of funds; the conditions attached to the use of its funds are not always appropriate to the problems faced by countries in distress; and it has very limited capacity to stop contagion.

Still, the Fund could do much to stem the spread of financial crises. In the first place, where the problem of contagion derives from reduced export demand and prices, it has the authority to make low-conditionality loans through the Compensatory and Contingency Financing Facility (CCFF). The facility should be used more actively, and more resources relative to country quotas should be provided under it. However, the bulk of the demands on the Fund in times of crises will come from countries experiencing capital account problems. Therefore, recent contingency financing mechanisms should become the basis for a stable, low-conditionality facility for countries experiencing financial contagion. Countries that meet certain *ex ante* criteria would be eligible, and eligibility would be examined during Article IV consultations. Low-conditionality funds would then be made available, though at shorter terms and higher interest rates than traditional IMF resources. The corresponding criteria could include indicators such as those associated to current account deficits, the evolution of the exchange rate, the ratio of short-term debt to reserves, and the ratio of short-term and portfolio capital inflows to exports or GDP.

IMF resources should be enlarged in order to enable it to enhance the stability of the international financial system. Three channels can be considered. First, effective and swift mechanisms should be devised to increase its access to official funds in times of crisis. Second, it could be granted authorization to borrow directly from financial markets under those circumstances. Third, and perhaps most importantly, SDRs could be created when several members face financial difficulties. The SDRs thus created would be destroyed as borrowings were repaid. These mechanisms would facilitate the creation of additional liquidity at times of crises, without the painstaking negotiations of quota increases or arrangements to borrow. Moreover, current arrangements to borrow exhibit the shortcoming that they are activated only under systemic threat and after the approval of the suppliers of funds, with the corresponding delays in making new funds available to the Fund and the countries in distress. Indeed, the anticyclical use of SDRs to manage financial cycles should be part of a broader process aimed at enhancing their use as an appropriate international currency for a globalized world.

IMF conditionality is legitimate for drawings that are made when a country is experiencing balance-of-payments problems originating in inappropriate macroeconomic policies, or for the use of funds greater than the automatic low-conditionality facilities mentioned above when facing either an externally-induced current or capital account crisis. However, IMF should restrict itself to the macroeconomic issues that fell within the purview of conditionality in the past. When domestic financial regulation and supervision are deemed inadequate, it could also recommend (or require) a parallel agreement with the international authorities in that area (see section 6 below). Conditionality should not include issues related to economic and social development strategies and institutions, which, by their very nature, should be decided by legitimate national authorities, based on broad social consensus. Indeed, the imposition, under crisis conditions, of structural and institutional changes that do not fit the national situation or the national consensus potentially generates instability --economic and political, national and international. It also tends to undermine the international consensus on which the Fund itself is built. Nor should conditionality cover areas within the purview of other international institutions and agreements, such as the World Trade Organization (WTO). Inasmuch as the Fund currently has no mandate with respect to capital account convertibility --and, as argued below, should not have it in the future with respect to developing and transition economies--, convertibility should not become a requirement for access to Fund resources, either.

Moreover, conditionality should not be used to force the adoption of a specific exchange rate regime by any country. The experience of industrial, as well as of developing and transition economies in recent decades, indicates that a great variety of regimes can be successfully managed under the current world system. They range from currency boards to total exchange rate flexibility, including intermediate regimes such as crawling pegs, exchange rate bands and dirty floats. What should be made clear to national authorities is that the exchange rate regime they adopt should be consistent with fiscal and monetary policies, which vary according to the regime chosen, and that it may require complementary measures. Thus, fixed exchange rate regimes demand a larger amount of international reserves to be viable, and intermediate regimes generally require more active intervention in the management of the capital account. Therefore, it would appear that the best course of action in this regard is a pragmatic one.

Lastly, in order to avoid overkill, IMF should adopt general practices that allow for automatic reduction of the restrictiveness of an adjustment agreed upon with a borrowing country, if it becomes evident that the contraction of economic activity is greater than originally envisaged in the adjustment programs.

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

A basic consensus in current discussions relates to the need for international codes of conduct in the fiscal, monetary and financial areas, for principles of sound corporate governance, for improved accounting standards, for greater availability and transparency of information regarding economic and financial data and policies, and for enhanced financial supervision and regulation. These should include international standards to combat money and asset laundering as well as corruption and tax evasion. All these initiatives should be consistent with the provisions contained in the main international human rights instruments adopted by the United Nations, particularly in the International Covenant on Economic, Social and Cultural Rights.

These existing and proposed agreements are part of a laudable process, aimed at creating greater transparency in public policies worldwide. They also play an essential role in risk management and crisis prevention. We therefore welcome initiatives by the Fund, the World Bank, the Organisation for Economic Co-operation and Development (OECD), the Bank for International Settlements (BIS), the International Organization of Securities Commissions (IOSCO) and other relevant institutions in these areas.

The role of financial regulation and supervision in risk management and crisis prevention must be particularly emphasized. A central element of a new international financial architecture is the development of regulatory and supervisory mechanisms that will better correspond to today's globalized private capital and credit markets. Such mechanisms should be global in the sense of including all countries (and particularly source countries) as well as different financial institutions and markets, so as to avoid regulatory gaps and asymmetries. However, due account should be taken of different national financial structures and traditions as regards financial regulation and supervision.

The design of minimum standards for financial regulation and supervision should go hand in hand with global regulation. An important proposal in this area is the recommendation to create a world financial authority –or a standing committee for global financial regulation-- in charge of setting the necessary international standards for financial regulation and supervision and of supervising their adoption at the national level. Such an institution could evolve from existing ones, such as BIS and IOSCO. This proposal would require significant expansion of the membership of these organizations. Alternative arrangements include strengthening existing institutions with broader membership, peer review and new regional and subregional organizations.

Minimum prudential standards must be designed not only to cover bank transactions but also, in view of the progressive breakdown of the traditional compartmentalization of the financial industry's activities, to the new actors in financial markets, including hedge and mutual funds. The Core Principles for Effective Banking Supervision of the Basle Committee on Banking Supervision should be worked out more fully as regards international banking and consolidated supervision and become with some urgency an applied standard in all countries taking part in cross-border financial transactions. This would go a long way towards preventing systemic risk at the international level and controlling various risks at the country level. At the same time, a more incremental reform process should also look at standards to prevent restrictive practices and strengthen market integrity in national markets and to foster secure clearance and settlement of the growing volume of international transactions.

In the case of industrial countries, we welcome the Group of Seven declaration of 30 October 1998 on the need to examine “the implications arising from the operations of leveraged international financial organizations including hedge funds and offshore institutions” and “to encourage off-shore centres to comply with internationally agreed standards”. In developing and transition countries, the implementation of the Core Principles should go hand in hand with a significant effort to improve domestic regulation and supervision of banks and other financial intermediaries. More broadly, risks related to the growth of credit, to the matching of assets and liabilities as regards both their currency denomination and time profile, and to the valuation of fixed assets as collateral during episodes of asset inflation require careful definitions in line with the Core Principles.

Changes in key macroeconomic variables --interest and exchange rates, in particular-- have a large impact on the health of banks, especially in developing and transition countries, where they can fluctuate widely; the unpredictability of these variables needs to be taken into account in devising norms of prudential regulation and supervision. In particular, it suggests that capital adequacy requirements need to be higher in developing and transition economies, and that they should be raised during periods of financial euphoria to take account of the increasing financial risks intermediaries are incurring. Owing to the serious adverse macroeconomic externalities of unhedged exposures of non-financial firms, there is also a good argument for authorities of developing and transition economies to monitor their balance sheets and impose limits or matching requirements on them.

Risk-rating agencies are the main private institutions responsible for providing information to investors. Their performance during recent crises has been unsatisfactory. The inclusion of “subjective” elements in their evaluation of sovereign risks has generated a procyclical pattern of risk evaluation, which has tended to promote first excessive investment in developing and transition economies and then huge and abrupt capital outflows. In this way, instead of attenuating financial cycles --the effect that a good information system should have on markets-- they have tended to intensify them. Thus sovereign risk rating should be subject to strict, objective parameters that are publicly known.

Although transparency in information and improved regulation and supervision are certainly important, they are by no means a fail-safe instrument for preventing financial crises, which can also arise from macroeconomic and other factors. Moreover, practices in regulation and supervision tend also to lag behind in a world of constant financial innovations, and they themselves may induce innovations. Furthermore, the information problems that supervisors face should not be underestimated. Therefore, any regulatory framework should give considerable weight to banks’ and other intermediaries’ own **internal** controls and systems of risk management.

It is clear that the principle of transparency of information should also be applied to international institutions, but evidently different standards should apply to the information generated by these institutions and to their **opinions** on countries’ policies.

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

Across-the-board liberalization of capital account transactions has been a policy thrust that some developed countries have pursued insistently in recent years in a number of forums, including OECD, WTO and IMF. What they urge is contrary to their own historical experience, which featured long periods of capital controls and very gradual liberalization of their capital accounts in recent decades. Moreover, the current financial crisis has clearly shown that abrupt or premature liberalization of the capital account is inappropriate for developing and transition economies, a fact that is now generally recognized. Strong domestic financial systems, regulation and supervision are essential elements to guarantee appropriate liberalization. However, even with strong fundamentals in these areas, it has proved quite difficult for developing and transition economies that liberalize the capital account to adapt to the conditions generated by volatile international capital flows, which may in fact weaken or destroy those fundamentals. Boom-bust cycles are frequently associated with portfolio and short-term capital flows. Thus, the **composition** and not only the magnitude of flows play an essential role in generating external vulnerability.

Under these conditions, developing and transition economies should retain the right to impose desincentives or controls on inflows, particularly in times of capital surges, and on outflows during severe crises. A flexible approach in this regard is certainly superior to mandatory capital account convertibility. Best practices in these areas should be analysed, to be replicated when appropriate. They could include reserve requirements on short-term inflows, various taxes on capital inflows intended to discourage them, and minimum stay or liquidity requirements for investment banks and mutual funds that wish to invest in the country. They could also include complementary prudential regulations on domestic financial institutions, such as higher reserve or liquidity requirements on short-term deposits into the financial system that are managed in anticyclical fashion and upper limits on the prices of assets used as collateral during periods of economic expansion. Mechanisms to guarantee an adequate maturity structure for external (and even domestic) public-sector indebtedness are also crucial complementary tools. Such instruments should be regarded as **permanent**, rather than temporary devices, as long as international financial markets remain volatile and domestic economic structures are weak. Parallel reforms should be oriented towards developing long-term segments of the domestic capital markets.

Considerations regarding the autonomy of developing and transition economies to manage the capital account should therefore be incorporated in the current discussions on broadening IMF mandates to include capital account convertibility, and in possible future discussions on multilateral investment agreements, including the agreement being negotiated in the framework of OECD. It must be clear that any ambitious liberalization of the capital account of developing and transition economies would require equally ambitious reforms in other areas of the international financial architecture, particularly a true and effective "lender of last resort", an issue which, as we have seen, is not a priority in the current agenda.

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

A standstill on debt servicing is an efficient alternative to disorderly capital flight, once a country faces severe international illiquidity. Capital flight is bad not only for debtor countries, but also for most creditors. Through chaotic exchange rate depreciation and interest rate increases, capital flight worsens the plight of domestic companies and banks, increasing the chance that what is actually a problem of illiquidity may turn into one of insolvency. Domestically, the economic and social costs of adjustment increase. Externally, the probability that creditors as a group may be repaid decreases. Moreover, bailout operations generate significant problems of moral hazard and an inequitable sharing of adjustment. Government guarantees, which are generally sought for the external liabilities of private debtors by international lenders in the renegotiations involved in these operations, increase moral hazard and equity problems. Indeed, they imply that poor sectors of society that did not share in the capital inflows will bear a significant share in adjustment costs, through cuts in social spending.

One way out of these difficulties would be to allow the introduction of standstills on external obligations and capital account convertibility and then to bring the borrowers and lenders together to reschedule debt, while providing financial assistance to support smoother functioning of the economy. Through these “bailing-in” operations, agents in the distressed country have a better chance of surmounting their problems. If financial crises are twin crises --i.e., simultaneous international illiquidity and bank insolvency--, creditors are also likely to recover a larger proportion of the value of their assets through this approach. The costs of adjustment are also more equitably distributed. Article VIII of the Articles of Agreement of the Fund could provide a statutory basis for the application of debt standstills. To avoid moral hazard on the part of borrowers, it may be advisable that standstills be sanctioned by the Fund. They could then be combined with IMF lending into arrears to make up the liquidity needed by the economy to function during the renegotiation of its debt. An alternative would be for the standstill to be declared unilaterally by the debtor country, but then submitted for approval within a specified period to an independent panel, whose sanction would give it legitimacy. This would be the equivalent in the realm of international finance to safeguard provisions in the realm of trade.

To ensure that this mechanism operates properly, two rules are essential. First of all, there should be internationally agreed "collective action clauses" in international lending. We therefore welcome the support given by the Group of Seven to the introduction of such clauses, which are essential for more orderly debt workouts. Their generalized introduction is crucial to avoid "free riding". Secondly, renegotiations should take place within a specified time limit, beyond which either the Fund or the independent panel would have the authority to determine the conditions of the debt rescheduling. Repeated debt renegotiations have, in fact, been one of the most troublesome features of the international financial landscape in recent decades and an underlying cause of the prolonged periods of crisis or slow growth in some developing and transition economies.

9. Design of a network of regional and subregional organizations to support the management of monetary and financial issues

Most proposals for the reform of the international financial architecture involve strengthening a few international institutions. It can be argued that stronger regional and subregional institutions can play a significant role, in terms of both the stability of the world financial system and the balance of power relations at the international level. The experience of Western Europe, from the Payments Union in the early post-war years to the European Union and the euro today, suggests that regional financial organizations and arrangements can play an essential stabilizing role. More limited experiences at a regional level, including regional and subregional development banks and a few reserve funds, indicate that they can also play an important role in a new international financial architecture, both in crisis management and in finance for development. Strong regional reserve funds would at least partially deter would-be speculators from attacking the currencies of individual countries and thus, among other dire effects, from threatening regional trade and financial relations. They could also supplement IMF funds in times of difficulty. Thus, on both the demand and the supply sides, they could reduce the need for IMF support.

Most regional financial institutions are small, where they do exist, and thus have limited effectiveness, but an investment in their development would certainly pay off in the long run. The design of the new architecture could thus introduce special incentives to develop such institutions. For instance, common reserve funds could be given special automatic access to IMF financing and/or a share in the allocation of SDRs, proportional to the paid-in resources. Indeed, in the long run, IMF could be visualized as part of a network of regional reserve funds, and its operation could then concentrate on relations with these reserve funds rather than on support to specific countries in difficulties.

Moreover, regional institutions and peer review could also play a central role in surveillance, both of macroeconomic policies and of domestic financial regulation and supervision. Indeed, such surveillance and peer review could be more acceptable to countries than that of a single, powerful international institution. It would contribute towards a more balanced globalization.

10. Complementary actions in the areas of finance for development and outstanding external debt issues

During the current crisis, the focus has been on countries with large financing needs that strain the resources of multilateral institutions. It is important that the attention given to these widely publicized cases and the large volume of IMF and bilateral funds that have been committed to them do not crowd out funding for, and international attention to, the problems of the poorest countries and hence to the financing of the Fund's Enhanced Structural Adjustment Facility (ESAF), the International Development Association (IDA) and the heavily indebted poor countries (HIPC) initiative. Nor should they be allowed to crowd out funding and attention to smaller countries that may be facing financial crises.

The inability of the Fund to mobilize all the resources needed for the rescue of countries in financial distress has required it to arrange financing from other sources, including the World Bank and the regional development banks. These institutions were not designed to provide liquidity to countries facing short-term external financing difficulties. A continuation of this practice would impair their capacity to fulfil their fundamental mission, which is to cater to the long-term development financing needs of countries with inadequate access to private markets.

Special attention should be given to safeguarding the access of the poorest countries to long-term resources, at the Fund, the World Bank and the regional development banks. Accelerated implementation of the HIPC initiative is also a world priority, but bolder debt relief initiatives should also be considered. The development banks could contribute to the alleviation of the worst effects of the crisis by providing financial assistance for the establishment or strengthening of gender-equitable social safety nets in both poor and middle-income countries. Strong protection for the poor during crises, through the design of effective safety nets, is still more a matter of rhetoric than of practice. Development banks also have a clear countercyclical role to play in world financial crises, a role that could be enhanced through innovations enabling them to work more actively to "crowd in" private-sector financing by rapidly disbursing co-financing funds or guaranteeing new debt issues of developing and transition economies. New, more effective rules on guarantees issued by these institutions must be designed to ensure this result.

11. The interdependence of the components of a new architecture

The goal of redesigning the international monetary and financial system is to harness the potential of private international financial flows to the service of stability and growth in the world economy. In order to pursue this objective effectively, it is important that the various components of the architecture be addressed at the same time. Indeed, these components are interrelated, and putting one or some of them in place in isolation will have limited impact in reducing the disruption caused.

Thus, improvements in supervision and regulation of financial firms are preventive measures that can reduce the incidence of crises and hence the need for IMF resources to cure them. However, since supervision and regulation are far from foolproof, financial crises and contagion will remain problems that need to be dealt with at the international level. Macroeconomic coordination and surveillance are essential to manage both inflationary and deflationary situations, which lie behind boom-bust financial cycles. Regional and subregional institutions could play an essential role as complements to IMF funding and surveillance activities, as well as in surveillance of domestic financial regulation and supervision.

Likewise, new financing facilities and standstill provisions are not substitutes for better regulation and supervision of financial institutions. Rather, all the above measures, along with domestic measures to deal with short-term capital movements, are mutually complementary. Rules regarding internationally sanctioned standstills are also no substitute for the establishment of an IMF facility to deal with contagion. Standstills have the unintended consequence of shutting off borrowers from access to capital markets for some time. Just as countries have legitimate differences in their preferences for integration into international financial markets, they would also differ in their willingness to call a standstill. The least willing are likely to be those whose liquidity crises are to a great extent the result of contagion and which have a high degree of integration into international financial markets. Therefore, a well-functioning international financial system will require both standstills and institutional innovation at the IMF.

Standstills cannot be implemented without regulations on capital outflows. In effect, capital controls will become indispensable when a country cannot meet its external payments because of a run on its currency. Hence, the recognition of the need for diversity with regard to approaches to the capital account cannot be divorced from the establishment of norms to deal with crisis situations.

Reliance on any one or even a few of these proposals would hardly bring about the changes needed to both prevent and manage crises or lead to greater equity in power relations. There is an evident need for a comprehensive and well-timed approach, in order to generate more balanced and hence enduring globalization process, and to ensure that it contributes effectively to sustainable human development.