Systemic Reform at a Standstill: A Flock of 'G's in Search of Global Financial Stability

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Introduction

The subject of 'global governance' became topical in the 1990s with a rash of financial crises, the most far-reaching and dramatic one having started in East Asia in mid-1997 and spread around the world before subsiding during the course of 1999. It is worth recalling, however, that global governance has been a hardy perennial since the breakdown of the original Bretton Woods system a quarter of a century ago. Its antecedents include the debate on the New International Economic Order in the 1970s; the North-South Summits of the early 1980s; the UNCED negotiations in Rio de Janeiro in 1992; and the chain of ensuing UN conferences throughout the decade – the Vienna conference on human rights, the social summit at Copenhagen, the Beijing conference on gender and development, and the Cairo conference on population and development. While these discussions have produced a few tangible results, their impact on global governance has been minimal. Although it may sound unpleasant to believers in the rationality of a more equitable world order, perhaps a large reason for the failure of these many attempts to reform the global order is that they have been dominated by the poor and the powerless, while the rich and powerful have not been persuaded of the need for significant changes to the status quo.

Yet, there are signs that the acquiescence in the global status quo of the world's rich and powerful countries may be changing. The financial crises of the 1990s demonstrated that the emerging global capital market, due to various imperfections, is critically vulnerable to systemic failure. Financial crises in Mexico, in East Asia, and in Brazil, Russia and many other parts of the world during 1994–99 accompanied unprecedented volatility in international capital flows, gyrations in exchange rates and accompanying turmoil in financial markets (Fischer, 1999a: F557–F561). Accordingly, in the depths of the last crisis (around September 1998), there were calls by the leaders of the Group of Seven (G-7) industrial

[1]The author is grateful to his colleague John Serieux for comments on an earlier draft of this paper.

powers to 'reform the global financial architecture'. Given that, this time, it is the world's most powerful countries, rather than coalitions of developing countries, seeking to reform global governance is there greater likelihood than in the past that meaningful change will occur?

Systemic failure warrants systemic reform. Yet the character of the reforms initiated since 1998 may be considered, at best, as shoring up the defences of countries entering the global financial markets, in order to reduce their vulnerabilities to systemic failure. A preliminary assessment leads to the conclusion that the reforms to date comprise small, perhaps tiny, steps in the right direction. As Stanley Fischer, First Deputy Managing Director of the IMF, put it recently, the changes contemplated would 'reform but not revolutionise the global financial system' (Fischer, 1999a). To use an architectural metaphor, the scope of reforms currently being undertaken amounts to repairs (albeit important ones) rather than extensive rebuilding, let alone the construction of new edifices. The plumbers and roofers, so to speak, have taken over. The problem is that such modest repairs are not likely to be enough to prepare the world for the systemic financial crises that may be yet to come. Moreover, the reforms being undertaken are asymmetric: they are heavily weighted towards policy changes required of borrowers and debtors, while much less onus is put on lenders and creditors. Accordingly, future crises are increasingly likely to be generated by policy imbalances in or among the world's richest countries rather than in the 'emerging markets'.

This paper critically surveys what has been achieved to date under the leadership of the world's great economic powers. It is organised as follows. The next section briefly sets the context by examining current prospects for the global economy in the wake of the most recent round of financial crises. It then considers the accomplishments and shortcomings of the 'flock of Gs' – the various groups formed by the leading industrial countries since 1960 to oversee international monetary co-operation and reform. These evolved with the changing conditions and challenges posed by a steadily integrating global economy. As a result of the recent Asian financial crisis, two key new institutions were created to spearhead the latest round of reforms, the Financial Stability Forum (FSF) and the Group of 20 (G-20). The subsequent section makes a critical examination of the scope of the reforms being considered by the FSF and G-20. The final section reflects on key systemic challenges that are not being addressed, as well as the possibility of strengthening regional approaches to reform of the global financial architecture.

The focus of the paper is on the issue of how to achieve or restore financial stability in a globalising and increasingly sophisticated capital market.

While the paper dwells principally on the more advanced developing countries and 'emerging markets', it does not delve into issues related to the needs of the poorest countries and people in the emerging global system. Such issues, while at least as crucial as those examined here, raise somewhat different sorts of questions and answers, cogently addressed in a recent Overseas Development Council report (2000) on the IMF and by Griffith-Jones, Ocampo and Cailloux (1999). The author has attempted to address these issues elsewhere in a paper on the implications of financial instability for long-term development financing (Culpeper, 1999).

The Context: Life after the 'Asian Crisis'

According to estimates made during the first quarter of 2000, recovery from the global economic downturn precipitated by the Asian crisis in 1997–98 has been more robust than expected. Global growth in 1999 was 3.3 per cent, some 50 per cent higher than the growth rate projected at the end of 1998 (IMF, 2000a:1). Growth forecasts for the developing countries have also been revised upwards in the years 2000 (by 0.4 per cent to 4.6 per cent) and 2001–2 (by 0.1 per cent to 4.8 per cent) (World Bank, 2000: 2).

Recovery in the crisis-afflicted countries has been spurred by trade and foreign direct investment, fuelled by buoyant growth in the industrial countries, particularly North America. Whether the unpredicted vigour of the 'V-shaped recovery' is due to the IMF-led adjustment and stabilisation efforts adopted by the emerging market countries, as claimed by the IMF (IMF, 2000a:4), or to other underlying factors, should be the subject of debate for some time to come.

Despite the strong economic recovery in 1999, both globally and in the emerging markets, private flows from capital markets to developing countries continued their retreat, to levels last seen in the early 1990s. The conspicuous exception was foreign direct investment, which remained resilient through the crisis years, to become the single largest source of long-term finance at a record $192 billion, compared to $35 billion in 1991 and $131 billion in 1996 (World Bank, 2000:3).

Notwithstanding the pleasantly surprising recovery, there is reason to express concern about the outlook for the next decade. First and foremost, speedy recovery from crisis is the handmaiden of complacency. Lessons learned will soon be forgotten as the severity of the crisis is attenuated in the minds of those who should know better, and incentives to seek long-term solutions are dulled. But, particularly if the global recovery continues for a few years at its current vigorous pace, a repetition of the volatile capital flows and boom-bust cycle experienced by some parts of the world is altogether likely. Presumably, if the reform initiatives launched in 1999–2000 are widely implemented in the emerging market countries, these countries might be better able to prevent financial crises or become less likely to be affected by contagion from other countries. The question, however, is whether such measures will be enough, and whether remedies for larger systemic crises will be in place.

In this context, the area of greatest concern is perhaps the outlook for the world's major economies. In particular, the US current account deficit is at record levels, alongside persistently large surpluses in Japan. The US current account deficit, which ran at an annualised rate of $400 billion in the last quarter of 1999, now exceeds the previous record of 3.4 per cent of GDP reached in 1985–86 (a time of currency disequilibrium and uncertainty, resolved for a time by the Plaza and Louvre Accords). Current forecasts indicate a further rise in the US current deficit over the next two years to unprecedented levels.[1] The mirror image of the growing current account deficit is the continuing growth of US private debt and borrowing, also at record levels; private net saving became negative in 1996 and now stands below –5 per cent of GDP (IMF, 2000:9, fig.1.2).

This lopsided pattern in the world's principal currency areas is unlikely to be sustainable, judging from recent and past experience. Two related factors are the persistent overvaluation of the US dollar relative to the euro, and the unprecedentedly high stock market valuations in the USA and elsewhere. A significant risk exists of sudden changes in market sentiment toward the US dollar and stock prices, with the possibility of very disruptive realignments and corrections, which could well spill over into a major recession in the industrial countries and around the world (IMF, 2000a:4). Ironically, the USA may be subject to the same sequence of events besetting Asia in 1997–98: a sudden reversal of the inflow with massive capital flight, along with rapid currency depreciation and asset deflation, including a stock market 'meltdown'. This time, however, world recovery may not be around the corner, as the scope for offsetting policy initiatives by other countries is far more limited than in 1998 or in 1985, when the world's major currencies were last egregiously misaligned (Krugman, 1999a).

These particular threats to global economic stability are mentioned here because they now present the major challenges to the world's financial

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[1]According to the IMF, the US current account *deficit*, at 2.5 per cent of GDP in 1998 and 3.7 per cent in 1999, is forecast to rise to 4.3 per cent in 2000 and 4.4 per cent in 2001. The corresponding data for Japan are a *surplus* of 3.2 per cent (1998), 2.5 per cent (1999), 2.2 per cent (2000) and 2.3 per cent (2001) (IMF, 2000a:5, Table 1.2).

architecture – challenges that are as yet barely on the reform agenda and thus represent its greatest shortcoming.

The Evolution of Global Financial Governance

The post-war era has given birth to a host of deliberative fora within which international monetary and economic co-operation have been discussed – the G-10, the G-7/G-8, the G-24, the G-22 and, most recently, the G-20. To this 'gaggle of Gs' can be added the recently-created Financial Stability Forum. While none of these groupings has any operational or implementation capability, what they all have in common (with the notable exception of the G-24) is membership of the world's most economically powerful countries or, in the more euphemistic jargon of today, the most 'systemically significant' nation-states.

Therein lies their importance. A review of the past indicates that nothing consequential happens in the formally constituted international organisations that do have operational capabilities – the IMF, the World Bank, the Bank for International Settlements (BIS) – without the prior consent, and usually the active endorsement, of the 'Gs' (here used as a short form for all the deliberative groups and committees dominated by the major industrial countries). Therefore, the overall policy direction chosen by the flock of Gs has a major impact on the formal institutional infrastructure – both as to its scope and its detailed activities. Couched in terms of the debate over the last two years on the 'global financial architecture', the reform of the international financial system has essentially been determined by these deliberative bodies.

A brief history

The Bretton Woods Institutions (BWIs) – the International Monetary Fund and the World Bank – were created at the end of World War II to provide a framework of institutional co-operation that would promote relatively stable exchange rates, growth in trade and commerce, and development of the world's poorest countries. The BWIs were deliberately designed in such a way that the economically more powerful members had a greater voice and vote within them. But the influence of the economically powerful countries, from very early on in the post-war period, was by no means restricted to the BWIs. A series of fora was established outside the BWIs in which the world's leading industrial powers were the exclusive members.

The first such forum was the Group of 10 (G-10), formed in 1961 to supplement the resources of the IMF through the General Arrangements to

Borrow (GAB). The G-10 evolved from Working Party 3 of the OECD, consisting of finance ministry and central bank officials from the ten largest OECD member countries[1] plus Switzerland.

The crucial significance of the establishment in the 1960s of the G-10 for the subsequent evolution of global financial governance cannot be underestimated. The GAB was explicitly designed by the G-10 to circumvent the need of the richest industrial countries to seek balance of payments financing exclusively from the IMF. As historian Harold James put it, the main attraction of the GAB for the USA and UK was that 'it would be speedy and non-interventionist. It would bring money quickly without "advice" or control from multilateral agencies.' In other words, the GAB provided the G-10 countries with an escape hatch from the IMF.

Agreement was reached among the ten to provide up to $6 billion to members of the group to forestall or cope with an impairment of the international monetary system. Soon, however, the GAB aroused the suspicion that a new ideology of co-operation between industrial countries had replaced the universalist aspirations of Bretton Woods. The G-10 seemed a very exclusive club, dividing the world into haves and have-nots; conspicuously absent were representatives of the developing countries, many of which were just emerging from colonialism. Indeed, serious discussion about how to manage the international monetary system shifted during the 1960s to this new forum, with the developing dollar glut and gold shortage, and the rise of the Euromarkets, much to the chagrin of the IMF, whose Managing Director believed it should host and oversee this debate (James, 1996:161–5).

During the 1960s discussions among G-10 Finance Ministers, and the work undertaken by the G-10 deputies (senior officials of central banks and finance ministries), eerily anticipated similar preoccupations in the 1990s. There were talks about how to generate liquidity for use in emergency situations (resulting in the creation of Special Drawing Rights in 1968), and recommendations about the need for an 'early warning system' to head off serious currency crises (turmoil in the 1990s resulted in the creation of the IMF's Special Data Dissemination Standard for this very purpose).

Notwithstanding the similarity of members of the G-10 – they were all advanced industrialised countries – there were also important schisms in this group almost from the beginning. In particular, the USA balked at the heavy representation of Europeans in the group (comprising seven of the

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[1]The G-10 comprised the G-7 (USA, Japan, Germany, France, Italy, UK and Canada) plus the Netherlands, Belgium and Sweden. Switzerland later joined the G-10.

ten). Accordingly, in its discussions the G-10 only went so far: it was blocked by the Americans from exercising any surveillance over the policies of its members and the discussion of the dollar was off-limits (James, 1996:183).

The dollar crisis of 1971, again reminiscent of problems in the mid-1980s and late 1990s, was preceded by growing current account deficits in the USA. With the suspension of the dollar's convertibility into gold in August, the Bretton Woods fixed exchange-rate system came to an end. There ensued a series of failed discussions aimed at reforming the international monetary system, principally by trying to restore the fixed parities at new equilibrium rates. In the increasingly chaotic setting of the 1970s, the G-10 was convened many times, but was unable to function as a deliberative forum to reach viable agreement[1] on a new system. The Americans increasingly found the G-10 to be an unsuitable forum to discuss systemic reform, and in securing outcomes sought by the USA.

Meanwhile, between September 1972 and June 1974, a 'Committee of 20' (C-20), based on the membership of the IMF Executive Board (with representation at ministerial level rather than by officials as on the Board), took up the challenge of reform. Unlike the G-10, the C-20 was more universal, and significantly included representation of the developing countries. But its deliberations were encumbered by the large number of participants (three from each country plus advisers) and feeble secretariat support. Moreover, discussions on whether and how to reform the system, including the objective of a return to fixed exchange-rate parities, were difficult and hamstrung by continuing differences between the current account deficit-ridden USA, on the one hand, and Japan and Germany (both in current account surplus), on the other. The oil price crisis of 1973 further complicated matters by sparking a world-wide cycle of inflation that was not extinguished for over a decade.

Regrettably for those to whom the C-20 seemed a more inclusive and universal body (than, say, the G-10) in which to deliberate on global monetary reform, the experiment ended in failure, or at any rate without resolving the long-term problems that had led to the demise of the postwar exchange-rate system (Williamson, 1977; Mohammed, 1996). After its last meeting in June 1974 the C-20 had to acknowledge its inability to return the world to a stable and fixed (but adjustable) exchange parity system (James, 1996:256). The lasting impact of the C-20 was to transform itself into the policy-deliberating Interim Committee, and eventually, in 1999, into the International Monetary and Financial Committee, a

[1]With the possible exception of the Smithsonian Agreement of December 1971, which broke down over the next year.

more inclusive ministerial body than the G-10 before it or the G-7 after it. Soon after the creation of the Interim Committee, a parallel 'Development Committee' was set up, comprising mostly the same members, but focused on long-term resource flows to developing countries. In contrast, the Interim Committee deliberated on issues concerning short-term balance of payments financing and adjustment policy for borrowers requiring access to such short-term financing.

The American aversion towards the G-10 had in the meantime led increasingly to bilateral discussions on international financial issues with France, Japan and Germany. Eventually, a more informal group, the G-5 (comprising Finance Ministers and Central Bank Governors from the USA, Japan, Germany, France and the UK), began to meet as the 'Library Group' from March 1973 and continued to meet until 1986, when it was superseded by the G-7 (with the addition of Italy and Canada). And at Rambouillet, France in November 1975, the first Economic Summit was convened for heads of government of the G-6 (the G-5 plus Italy). The second such summit was hosted in Puerto Rico by the USA and, at the Americans' insistence, Canada was invited to join. In the new group, European countries comprised four out of the seven, rather than eight out of the eleven in the G-10 (including Switzerland). In this new setting, the Americans had fewer problems dealing with a united European front, and the group's *modus operandi* was also far less formal. The G-7 was born.

The G-10 was superseded by the G-7 as the pre-eminent forum for the largest industrial countries. However, instead of disappearing, the G-10 began to play a different role, one focused more on relationships built around the BIS in Basle (the original venue where the GAB was actually negotiated) (Griffith-Jones and Kimmis, 1999:29–30). Now primarily a forum for Central Bank Governors, the G-10 has recently been pivotal to discussions on financial stability and regulation, which emerged dramatically during the Asian financial crisis (see below).

Although the key participants in the G-7 summits were government leaders, and their agenda was eventually caught up with political issues, the original intention was to deliberate on key economic issues. Hence, the Finance Ministers (and Central Bank Governors) have always been key players in the G-7. The centrality of Finance Ministers to the G-7 process has been evident since the 1986 Tokyo Summit. Since that time, the G-7 Finance Deputies have developed their own rhythm of consultation throughout the year (Bayne and Putnam, 1995).

The power of the G-7 to shape the international rules of the game soon became apparent. The Rambouillet Summit endorsed floating exchange rates that had become the *de facto* system since the breakdown of the short-lived Smithsonian agreement. Soon after, in January 1976, the G-7's proposals were accepted by the new Interim Committee and led subsequently to the Second Amendment of the IMF's Articles of Agreement. The latter sought to promote a 'stable system of exchange rates' (that is, floating rates responsibly managed) rather than a 'system of stable exchange rates' (as under the moribund Bretton Woods system).

For the next quarter of a century, the G-7 dominated global financial governance, as it continues to do today. However, it is quite evident that during its first decade, the G-7 members were mostly preoccupied by frictions among themselves, particularly regarding exchange-rate relationships and balance of payments financing. In the late 1970s attention was focused on financing the current account deficits of the UK and Italy, via both the soft-conditionality GAB and hard-conditionality IMF (these turned out to be the last major IMF programmes among the developed countries). Then, in the 1980s, with the US dollar trading at unsustainably high levels against the yen and D-mark, much of the energy of the G-7 was consumed in discussions leading to the Plaza Accord (1985) and the Louvre Accord (1987) on currency co-ordination.

In contrast with its preoccupation over exchange rates, the onset of the developing country debt crisis in 1982 did not trigger intervention by the G-7 until the Baker Plan in 1985. That flawed initiative maintained that 100 per cent of the debt would be repaid. Emanating from US Treasury Secretary James Baker, it was an American scheme formulated in Washington and conveyed to G-7 partners, involving little prior collaborative discussion. The issue of third world debt was thereafter explicitly put on the G-7 summit agenda for the first time in 1986, although it had been secretly discussed at Williamsburg in 1983 (James, 1996: 390). The failed Baker Plan was followed in 1989 by the Brady Plan (Nicholas Brady was Baker's successor at the US Treasury), a far more successful initiative than its predecessor since it encouraged voluntary debt reduction. However, like the Baker Plan, it also seemed to involve little prior consultation with the G-7; rather it developed out of pilot projects with Wall Street firms (such as Morgan Guaranty Trust) involving discounted debt swaps with Mexico.

On the surface, throughout the 1980s, when it came to exercising global financial governance to deal with major issues such as the debt crisis, policy direction seemed to have reverted to the Bretton Woods Institutions, particularly the IMF and the two new ministerial-level committees that emerged from the C-20 discussions, the Interim and Development Committees. But in fact, during the Reagan and Bush administrations, the USA had a determining influence on decisions taken either through the ministerial committees or the Executive Boards. However, even though it is the largest shareholder, it would be impossible for the USA unilaterally to impose its will on the entire membership of the IMF or World Bank. But with the support of the G-7, it commands close to one-half of the total voting power. The G-7 thus provided a 'rubber stamp' for decisions already taken by the USA and, in turn, the Bretton Woods organisations rubber-stamped declarations of the G-7 (Kafka, 1994:215).

The only counterweight to the G-7 was the G-24, a committee of developing country finance ministers established in November 1971 when international monetary reform first moved to the forefront. The G-24 meets regularly before the scheduled meetings of the Interim and Development Committees and issues a communiqué in which the views of developing countries are put forward. However, while the G-24 has gradually developed a capacity to critique current policies and articulate cogent policy alternatives[1] to those being adopted under the aegis of the G-7, its influence on actual policy cannot be described as more than marginal.

The *modus operandi* of the G-7 established during the 1980s, in which the USA acted as the undisputed first among equals (a status reinforced by the demise of the Soviet Union), persisted well into the 1990s. The Mexican peso crisis of 1994–95 perhaps represented the last expression of US hegemonic initiative in this form. Involving a rapidly-assembled $50 billion bail-out package (of which $20 billion came from the USA and $17.7 billion from the IMF), the locus of the crisis clearly prompted the USA to act quickly and not get bogged down in consultations with G-7 partners, much to the irritation of the Europeans.

Although side discussions between the G-7 leaders and the Russian President began in 1991, it was not until the Naples Summit of 1994 that Russia was admitted as an equal partner, but only in the political discussions, which by then occupied half of the agenda of the heads of government. However, Russia was not admitted as an equal partner with the G-7 Finance Ministers; hence the schizophrenic summit designation since Naples of 'G7/G8'.

Recent developments

Even though the 1994–95 currency crisis was handled in ways reminiscent of the debt crisis of the preceding decade (with the USA taking the

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[1]Particularly noteworthy is the research under the direction of Sidney Dell, Gerry Helleiner and (currently) Dani Rodrik, resulting *inter alia* in the multi-volume series *International Monetary and Financial Issues for the 1990s*, cited extensively in this paper.

initiative and the G-7, along with the international financial institutions, following suit) important signs emerged that the USA and the G-7 now recognised the need to involve other 'systemically significant' countries in the governance of the international financial system. This transpired for several reasons. The scale of the intervention in Mexico was historically unprecedented. The capacity of the IMF, even with an increase in resources anticipated from the Eleventh Quota Review, would have been severely stretched to meet other such exigencies. Global financial market integration was proceeding at an accelerating pace. With the rapid growth of cross-border portfolio equity and derivatives markets, as well as short-term bank lending, greater uncertainty and unpredictability than ever was attached to surges in international capital flows. Perhaps not the least significant factor was that the US dollar was itself caught up in the currency turmoil of 1995.

Accordingly, at the 1995 Halifax Summit, the G-7 countries resolved to mobilise additional emergency funding, on the model of the General Arrangements to Borrow which had been in existence for 33 years. Financing available under the GAB, which had been renewed every four or five years and utilised on ten occasions (including for the UK and Italy in the late 1970s), was augmented to SDR17 billion (about US$23 billion) in 1982. At Halifax, the G-7 sought to supplement funding through the GAB, but from a larger body of creditors, including the 'emerging market' countries. Including the 12 original G-10 members involved in the GAB, the New Arrangements to Borrow (NAB) now comprised 25 participants and added a further SDR17 billion to the resources available under the GAB, to make a total of SDR34 billion (about $46 billion).[1]

As with the GAB, the NAB was formally established through a decision of the IMF Executive Board, in January 1997, and it became effective in November 1998. Also consistent with the policy endorsed for the GAB, a proposal for calls on the NAB by the IMF's Managing Director can become effective only if it is accepted by the NAB participants, and the proposal is then approved by the Executive Board.[2]

The NAB, which emerged from the Mexican peso crisis, was the precursor of the G-7 initiatives launched in the wake of the ensuing Asian

[1]The members of the NAB included the G-10 plus Australia, Austria, Denmark, Finland, Hong Kong Monetary Authority, Korea, Kuwait, Luxembourg, Malaysia, Norway, Singapore, Spain and Thailand. Saudi Arabia, which had previously been an associate member of the GAB, was also a member of the NAB.

[2]When this paper was written, the NAB had been called upon once, to finance an IMF programme for Brazil in December 1998.

financial crisis which erupted in Thailand in July 1997. These initiatives have further widened the scope of discourse on global financial governance. The first step was taken by the USA at a summit meeting of APEC leaders in Vancouver in November 1997. That meeting generated an invitation by US President Bill Clinton to Finance Ministers from a group of 'systemically significant' economies. The 'Group of 22' met in Washington in February (at the Willard Hotel, thus the nickname 'Willard Group') and again in April 1998 as the crisis continued to deepen in Asia and spread to other parts of the world. Its purpose, according to US Treasury Secretary Robert Rubin, was to examine issues related to the stability of the international financial system and the effective functioning of global capital markets.

The membership of the G-22 was never quite settled and remained somewhat fluid for the duration of its work. But significantly, in addition to the G-7, it included members of the industrial, transition and developing countries, reminiscent of the C-20 in the early 1970s. There, however, the resemblance stopped. The agenda of the G-22 was far more focused on the minutiae of financial instability rather than on reforming the 'architecture' of the global financial system. To wit, its efforts were organised under three working groups – the first on enhancing transparency and accountability; the second on strengthening financial systems; and the third on managing financial crises.

Nonetheless, the G-22 has had a significant impact on shaping – perhaps limiting is a more accurate description – the reform efforts that followed. In October 1998 the three working groups submitted their reports. The report on enhancing transparency and accountability recommended that the IMF prepare a Transparency Report summarising the extent to which an economy meets internationally recognised disclosure standards, presaging the Reports on Observance of Standards and Codes (ROSCs) launched by the IMF early in 1999. The report on strengthening financial systems recommended, among other things, the establishment of a Financial Sector Policy Forum to discuss sector issues, foreshadowing the Financial Stability Forum which first met in April 1999. The group on managing financial crises perhaps had the most formidable task, but contented itself with setting out principles and features of regimes facilitating rapid and orderly work-outs from excessive indebtedness, and exhorted countries to 'make the strongest possible efforts to meet the terms and conditions of all debt contracts in full and on time' (US Department of the Treasury, 1998; IMF, 2000b).

By the time the G-22 reports were tabled at the IMF/World Bank Annual Meetings in October 1998, the G-7 was meeting to consider how to reform the international financial architecture in light of the discussion at the Birmingham Summit during the summer and statements made by UK Prime Minister Tony Blair and President Bill Clinton on the need for a 'new Bretton Woods'. To this end, G-7 Ministers and Central Bank Governors met in mid-September and twice in October. Hans Tietmeyer, the retiring Governor of the German Bundesbank (shortly to be superseded by the new European Central Bank), was commissioned to report on international co-operation and co-ordination in the area of financial market supervision and surveillance.

This flurry of activity resulted in Tietmeyer's report, which recommended establishing the Financial Stability Forum (see below).[1] The G-7 Ministers and Central Bank Governors also spelled out a 36-point 'Plan for Implementation' for the Global Financial Architecture, which was submitted to the G-7 Heads of Government in December 1998 (Group of Seven, 1999a). At the ensuing 1999 G-7 Köln Summit, there were calls for the establishment of an informal mechanism for discussions among a broad group of countries on the international financial system. When G-7 Finance Ministers and Central Bank Governors met in September 1999, the Group of 20 (G-20) was proposed as a new international forum consisting of Finance Ministers and Central Bank Governors representing 19 countries, as well as representatives of the European Union and the BWIs.[2] Its purpose was 'to ensure broader participation in discussions on international financial affairs among countries whose size or strategic importance gives them a particularly crucial role in the global economy'. Canada's Finance Minister, Paul Martin, was nominated as the G-20's first Chair. The first meeting of the G-20 was held in Berlin in December 1999.

The two vehicles crafted by the G-7 in 1999 – the FSF and the G-20 – are now the principal vehicles of international financial reform. For different reasons, explored in greater depth below, these two institutions have broken new ground with regard to the scope of participation. While it is important to acknowledge the advance they represent over the G-7, with respect to their inclusiveness and their legitimacy, it is also evident that they are still heavily dominated by the G-7. Moreover, the agendas they have embarked upon have all the hallmarks of previous reform

[1]The title of Tietmeyer's report, 'International co-operation and co-ordination in the area of financial market supervision and surveillance', is indicative of the narrow scope of his enquiry.

[2]In addition to the G-7, the following are represented on the G-20: Argentina, Australia, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey and the EU. The Bretton Woods Institutions are also represented by the IMF Managing Director, the World Bank President and the Chairman of the Development Committee.

attempts through the G-22, the G-7 and G-10 – attempts that have concentrated more on fine-tuning the details of the current global financial system rather than on addressing the most fundamental challenges posed by it.

Systemic Reform: Architects v. Plumbers

The financial crises of the 1990s have been the subject of considerable debate and analysis. A considerable degree of consensus has emerged as to the systemic nature of the problems (Mishkin, 1999; Krugman, 1999), if not the solutions.[1] However, it is possible, even at this point, to examine the kinds of solutions being contemplated by the FSF and the G-20, in order to determine whether they are likely to be *sufficient* to resolve the systemic problems.

What is to be reformed?

First, a short digression into the causes of emerging-market crises is necessary in order to distinguish the different kinds of solutions being proposed under the rubric of 'architectural reform'. Much of the analysis in the literature has dwelt on financial market imperfections. For example, problems of asymmetric information between borrowers and lenders leading to adverse selection (i.e. lending to the riskiest borrowers) and herding (bandwagon effects in which lenders follow the lead of others with little due diligence); self-fulfilling panics (herding in the opposite direction making a bad situation much worse); the possibility of multiple equilibria; and the lack of adequate bankruptcy mechanisms are all cited as causal factors underlying the crises (Rogoff, 1999). The fact of the matter is that these phenomena have been known for some time – much of the work of Hyman Minsky, for example, focused on the dynamics of financial instability (and the spillover of such instability into the real economy) arising from the fact that financial markets are *not* efficient (Kindleberger, 1996: 11).

The point, however, is that these phenomena pertain to *all* financial markets, and most financial markets are essentially *domestic*. Accordingly, the solutions, although not fail-safe, are largely domestic as well. They include greater transparency and disclosure by borrowers, supervision and regulation of the banking sector, bankruptcy mechanisms to settle creditors' claims when borrowers are illiquid or insolvent and a lender of last resort (usually the central bank). The world's most sophisticated financial

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[1]See the numerous dissenting statements in the Goldstein and Meltzer Reports. Council on Foreign Relations, 1999; International Financial Institutions Commission, 2000.

markets, in the industrial countries, took many decades to develop the necessary institutions and infrastructure, and still experience widespread financial turmoil, for example the US savings and loan meltdown in the 1980s and widespread bank failure in Japan in the 1990s.

In other words, much of the 'architecture' necessary to contain potential financial turmoil is also essentially domestic. To the extent that financial markets become international, as they have over the past several decades, with lenders and borrowers situated in different countries, the possibility arises of devising international variants of these domestic solutions. Indeed, many analysts have proposed creating a new international lender of last resort, an international bankruptcy court, a world financial authority, an international deposit insurance corporation and so on (see Rogoff, 1999 for a quick summary).

But, with the possible exception of transforming the IMF from its current status as a revolving fund into a true international lender of last resort (Mohammed, 1999; Fischer, 1999b), the prospects for such radical institutional innovation at the global level are not bright, given the conservative proclivities of the G-7 (Akyüz and Cornford, 1999).

To the extent that there is extensive scope for institutional reform, it is at the domestic level. What became clear in the Asian and Mexican crises was the considerable lack of disclosure and transparency in both the public and private sectors, and the inadequacy of regulation and supervision in the financial sector. Such domestic reforms, moreover, have international impacts by reducing the risk and uncertainty faced by foreign investors contemplating lending or equity investment. In other words, more transparency, better regulation and workable bankruptcy procedures provide foreign creditors and investors with greater comfort as to the security of their investment and legal recourse in case things do not work out. These are precisely the areas in which most reforms are currently taking place and in which the World Bank is playing a leading role (Caprio and Honahan, 1999). However, these domestic reforms should not be confused with reforms of the *international* architecture. At best, they may be considered repairs to the plumbing.

Some important caveats are also in order. The history of the advanced industrial countries suggests that the institutional infrastructure required to oversee the efficient and equitable working of the domestic financial sector takes a long time to develop; and, as mentioned, it still does not guarantee that financial crisis will not erupt. There may be a problem with putting undue emphasis on domestic reforms in emerging markets if it leads to a widespread presumption that those destinations are thereby relatively safe for foreign investment. Thus, herding could still arise (leading to excess lending, asset bubbles and self-fulfilling panics), even as the problem of asymmetric information is resolved.

Moreover, regulation and standard-setting in the financial sector are evolving arts rather than immutable science. Just at the point that developing countries and emerging markets are being asked to adopt 'universal' standards of risk management, the industrial countries are moving to more flexible regulatory approaches based on assessing the sophisticated risk-management systems employed by banks and non-bank financial institutions themselves (Ahluwalia, 1999; Institute of International Finance, 2000). Finally, there is a rationale for not rushing the process simply in order to expedite financial liberalisation and openness to capital flows, since there is now a great deal of evidence to indicate that hasty financial liberalisation typically precedes banking and currency crises (Fanelli, 1998; Kaminsky and Reinhart, 1999).

What does constitute truly *international* reform? By definition, it is any reform to relationships between participants, public or private, in the international market, or to international institutions governing those relationships. Putting aside the creation of new institutions, the principal examples are: (1) the exchange rate regime; (2) rules governing capital flows; (3) the role of the private sector in crisis prevention and resolution; and (4) the policies and operations of the international financial institutions, particularly the IMF.

A UN Task Force reviewing the financial crisis in early 1999 provided a comprehensive articulation of the required scope of international reform (United Nations, 1999). It included firstly improving the consistency of the macro-economic policies of the major industrial countries, in order to reduce the possibility that they will collectively exert an inflationary or deflationary bias on the global economy. Secondly, it called for the provision of adequate international liquidity in times of crisis. The report suggested augmenting the IMF's resources via increasing its access to official funds, borrowing from the financial markets, and – a novel suggestion – by extraordinary and anti-cyclical emissions of Special Drawing Rights to countries experiencing crisis; such SDRs would be destroyed as they are repaid. Moreover, the Task Force argued for low-conditionality assistance from the IMF. In particular, IMF 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'.

The Task Force also endorsed international codes of conduct, improved information and enhanced financial supervision and regulation, urging that they be applied to developing and industrial countries equally. It particularly emphasised preserving the autonomy of developing and transition countries with regard to capital account issues, and urged that controls on capital flows should not be regarded only as temporary instruments, as they now are by the IMF. It also argued for an internationally sanctioned 'standstill' provision to be incorporated into international lending, and for adequate sharing of adjustment costs with private investors.[1] Finally, it proposed strengthening regional and subregional organisations so that they could play a greater role in preventing and managing crises.

The reform agenda

Against this backdrop, we may now turn to the reforms under active consideration. The most comprehensive recent summary is contained in a report by the Acting Managing Director of the IMF, Stanley Fischer, to the International Monetary and Financial Committee (IMF, 2000b). The report puts considerable emphasis on 'key measures to ensure a more resilient international financial system', by which is meant enhancing transparency and accountability, assessing and enhancing members' standards[2] and codes (through ROSCs and comprehensive reports on standards and codes prepared in collaboration with the World Bank) and better identifying financial sector vulnerabilities.

These are precisely the set of reforms at the domestic level referred to above, designed to strengthen the ability of countries to withstand a greater degree of international financial turmoil. What of reforms to the international architecture? Firstly, the report also discussed the need to streamline the IMF's own facilities and increase its transparency. Both these proposals were major recommendations of the Goldstein and Meltzer reports.

Secondly, with respect to capital account liberalisation, the report says that 'progress has been made and discussions continue', but admits to 'differences of view on the merits of capital controls' and the 'need to carefully manage and sequence liberalisation in order to minimise risks'.

Thirdly, with regard to exchange rate regimes, the report recognises the difficult choice faced by most countries between, on the one hand, maintaining truly flexible rates and, on the other, 'hard' pegs (via a currency

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[1]Canada has been a proponent of 'emergency standstill clauses' in debt contracts, which would give debtors the right to suspend payments for a specified period of time in the event of a financial emergency (Martin, 2000).

[2]For example, the Special Data Dissemination Standard developed by the IMF after the 1994–95 crisis.

board or common currency). Referring to the three major currencies (the dollar, yen and euro), among which flexible rates are likely to continue, it also points to 'large misalignments and volatility' in their exchange rates as being a cause for concern, particularly for small, open commodity-exporting countries. However, the report does not discuss any initiatives on the part of the international community, implying that the dollar-yen-euro relationship can only be sorted out between the USA, Japan and the EU.

Finally, with regard to involving the private sector, the report asserts that there has been some progress in working toward 'an operational framework for securing private sector involvement' in forestalling and resolving financial crises. It goes on to discuss the appropriate balance between IMF financing, adjustment policy and the role played by private sector creditors, emphasising the need to honour contracts as far as possible and to seek co-operative solutions to members' emerging debt difficulties. However, it hints that 'more concerted forms of private sector could be required if the financing requirement is large and the member has poor prospects of regaining market access in the near future or if the member has an unsustainable medium term debt burden' (IMF, 2000b: 15–16).

The contentiousness of the subject of private-sector involvement is evident from the report's tortured allusions to divided opinions on the IMF's Executive Board, as the following excerpt illustrates: 'Determining whether a debt burden is unsustainable is a judgmental exercise, and it could take time for the member and its creditors to reach agreement on the extent of the problem and its solution. In such cases, the IMF would be prepared to lend to a member in arrears to its private creditors . . . provided the member was negotiating with its creditors in good faith.' The report adds: 'Where private sector involvement is required, its precise form will have to be decided on a case by case basis'. It concludes: 'Only limited progress has been made in lifting institutional constraints to debt restructuring. Executive Directors encouraged the establishment of creditor committees if needed and on an *ad hoc* basis, and see merit in incorporating collective action clauses into international sovereign bond contracts . . . Directors considered that temporary and *voluntary* standstill arrangements could be desirable in some circumstances to minimise the risk of disruptive litigation, and some considered there should be further consideration of issues related to Article VIII, Section 2(b)' (IMF, 21000b:17; emphasis added).[1]

The only conclusion that can be drawn from this agenda is that the pre-

[1]This section of the IMF's Articles of Agreement has been invoked by those favouring a cessation of debt-servicing, sanctioned by the IMF as part of an adjustment programme.

scribed actions are long on domestic measures to reduce developing countries' vulnerability to financial crisis, while they are relatively short on measures that can be said genuinely to address the international architecture. There may be considerable merit in strengthening financial governance at the national level. But if the strengthening measures are premised on greater openness to foreign capital flows (albeit on a 'gradual and cautious' timetable), without stronger measures to exercise controls on capital markets (either at the national or international levels), they can also be viewed as half-measures. Such an impression is reinforced by a review of the initial work of the FSF.

The Financial Stability Forum

At its meeting in Petersberg, Bonn in February 1999, the G-7 Finance Ministers and Central Bank Governors endorsed the recommendation in the Tietmeyer report to convene a forum '. . . to ensure that national and international authorities and relevant international supervisory bodies and expert groupings can more effectively foster and co-ordinate their respective responsibilities to promote international financial stability, improve the functioning of markets and reduce systemic risk' (Group of Seven, 1999a: para.15).

The first thing to note about the FSF is its composition. The G-7 communiqué added that: 'While the Forum will initially be the initiative of the G-7 countries, we envisage that over time additional national authorities would be included in the process. The issues to be addressed affect all countries, including both industrial and emerging market economies, and the G-7 regards this initiative as a step toward broader participation'. However, 'broader participation' clearly implied the inclusion only of the few countries most actively involved in global financial markets. For example, the countries or territories represented at the third meeting of the FSF in Singapore (March 2000) included, in addition to the G-7, Australia, Hong Kong Special Autonomous Region, Netherlands and Singapore. (It is worth noting that each of the G-7 countries was allowed three representatives, compared to only one from each non-G-7 country.)

In addition to national participants responsible for overseeing domestic financial stability, the Forum comprises representatives of the IMF, World Bank, BIS and OECD; representatives of the Basle Committee on Banking Supervision, the International Organisation of Securities Commissions (IOSC), the International Association of Insurance Supervisors (IAIS); and representatives of the two BIS-based committees, the Committee on the Payment and Settlement System, and the Committee on the Global Financial System. Fourteen of the 39 participants were officials from IFIs, International Regulatory and Supervisory Groupings and committees of central bank experts. The person appointed to chair the FSF was Andrew Crockett, General Manager of the BIS.

At its first meeting, the FSF commissioned three working groups: the first to address concerns related to highly-leveraged institutions (or HLIs, primarily hedge funds); the second on capital flows; and the third on off-shore financial centres. The working groups published their reports in March 2000 (Financial Stability Forum, 2000).

It is clear that the scope of the three FSF working groups was to examine some of the thorniest international aspects of the recent financial turmoil. Hedge funds, for example, were widely suspected of complicity in the speculative frenzy around the Asian crisis, including its spread to Hong Kong. And with the near-insolvency in 1998 of Long-Term Capital Management, the New York-based giant hedge fund, many of its US creditor banks narrowly escaped heavy losses. Had a concerted rescue not been organised by the Federal Reserve Bank of New York, the implications for the USA and world economies might have been very serious.

But in its report, the FSF working group on HLIs put most of its emphasis on enhancing the 'risk-management practices' and greater disclosure of counterparties and creditors to the HLIs, and of the HLIs themselves. (The latter is somewhat ironic, since most hedge funds are designed to be high-risk, high-return, closely-held and fairly non-transparent vehicles for very wealthy individual investors.) The group considered, but did not recommend 'at this stage', direct regulation of currently unregulated HLIs, although it kept the door open to this possibility if subsequent reviews pointed in that direction.[1]

The recommendations of the working group on capital flows followed suit; most of the emphasis was put on *managing the risks* to countries faced by greater capital flows. The group's assumptions were revealing: 'Industrial and emerging market economies alike share a common interest in building a strong and safe system for global flows of capital . . . A healthy capacity to mobilise external capital is critical to financing a growing and successful world.' From this follows the report's assertion: 'Realising the full benefits of capital flows will require adopting policies that control the risks associated with them'.

The report accordingly focused on urging emerging markets to develop

[1]An earlier report on hedge funds commissioned by the US President had also reached similar recommendations. *Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management.* Report of the President's Working Group. Washington, April 1999.

sound practice guidelines for sovereign debt and liquidity management, and for management of official foreign currency reserves. In contrast, the report was rather critical about managing or controlling capital flows themselves. To begin with, it focused only on controlling inflows, emphasising the limitations of 'Chilean'-type inflow restrictions, even though these have been widely endorsed as a means of reducing the volatility of capital surges (see Edwards, 1999 for a critique of the Chilean system). And the Working Group did not discuss controls on capital outflows in depth. Such controls, its report stated, should be thought of more as an element of crisis management and, as such, were beyond the scope of the group.

Finally, the Working Group on Offshore Financial Centres (OFCs) concluded that, perhaps contrary to their reputation, these centres are not a major causal factor in systemic financial problems. It did, however, raise both prudential concerns and market integrity concerns (the latter referring to the facilitation of illicit activity by some OFCs). Its report was consistent with those of the other two groups in recommending the strengthening of transparency and disclosure and the adoption of international standards of behaviour by public authorities and private actors. It also encouraged onshore jurisdictions to engage in more effective consolidated supervision in banking and insurance where their activities involved dealings in OFCs.

In sum, while the scope of the FSF, and the work programme it has adopted, enables it to address some of the most difficult international dimensions of recent financial instability, the approach it has chosen clearly demonstrates a preference for risk management over 'behaviour management'. The rationale appears to be to reduce the vulnerability of countries subject to increasing volatility in the capital markets, rather than controlling the behaviour of those who are generating the problems. Given the highly selective composition of the FSF, with representation restricted to the world's leading financial centres and the world's financial regulators, this outcome may not be surprising. Thus, it could be argued that the FSF is biased in favour of liberalised and against regulated markets, reflecting the interests of its financial constituencies.

The G-20

In contrast to the highly select FSF, the G-20 comprises countries from throughout the world. The composition of the group has been carefully crafted: there are ten developing or emerging market countries, nine industrial countries comprising the G-7, Australia and the EU, plus one transition country, Russia.

As mentioned, the decision to establish the G-20 was taken by G-7 Finance Ministers in September 1999, when they committed themselves to ensure broader participation in discussions on international financial affairs among countries whose size or strategic importance gives them a particularly crucial role in the global economy.

It seems probable that the more inclusive G-20 was created, in part, to complement the more select FSF, and thereby deflect criticism that participation in the latter needs to be broadened to include some developing countries (Ahluwalia, 1999). In creating the G-20, the G-7 was clearly attempting to enhance the legitimacy of the decision-making process on international financial matters, a process which the G-7 has dominated over the past century (Porter, 2000).

But will it succeed? While it is reminiscent of the C-20 formed almost three decades ago to discuss fundamental international monetary reform, a stronger antecedent is the more recent G-22, with its focus on remedying financial fragility in countries at the periphery of the global system, rather than reforming the system as a whole or, for that matter, weaknesses in countries at the centre. Indeed, the initial focus of the G-20 is narrower than that of the FSF, which took on an examination of hedge funds, capital flows and offshore financial centres (although it resisted recommending any radical policy changes in these areas).

The relatively narrow orientation of the G-20 was evident even during its first meeting in Berlin in December 1999. The following summary indicates the kind of discussion that took place:

> *Ministers and Governors at this inaugural meeting discussed the role and objectives of the G-20, and ways to address the main vulnerabilities currently facing their respective economies and the global financial system. They recognised that sound national economic and financial policies are central to building an international financial system that is less prone to crises. They noted the importance of strengthening national balance sheets to help cushion against unexpected shocks. They encouraged steps to strengthen sovereign debt management, and greater attention to the impact of various government policies on the borrowing decisions of private firms. They recognised that unsustainable exchange rate regimes are a critical source of vulnerability, and that a consistent exchange rate and monetary policy is essential. They discussed a range of possible domestic policy responses to the challenges of globalisation, and exchanged views on the role of the international community in helping to reduce vulnerability to crises.*[1]

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[1]G-20 Finance Ministers and Central Bank Governors Meeting, 15–16 December 1999. Available at http://www.fin.gc.ca/g20/news/001-e.html.

The four priority areas chosen for its work agenda were the following: (1) A comprehensive stock-taking of progress made by all member nations in reducing vulnerabilities to crises; (2) an evaluation by countries of their current compliance with international standards and codes in the areas of transparency and financial sector policy; (3) the completion of Reports on Observance of Standards and Codes (Transparency Reports) and Financial System Stability Assessments by the IMF with the co-operation of the World Bank; and (4) an examination of differing exchange-rate regimes and their role in cushioning the impact of international financial crises.[1] The similarity between this agenda and that of the G-22 working groups on enhancing accountability and transparency, strengthening financial systems and managing financial crises is quite striking.

Nor is the continuity with the work of the US-convened G-22 altogether coincidental. In a speech to the London Business School immediately prior to the first meeting of the G-20 which he was to attend, US Treasury Secretary Lawrence Summers stated: ' . . . helping countries to develop the capacity to realise the benefits of a global flow of capital and to manage its risks . . . is the goal at the heart of the global initiative that has come to be called the reform of the international financial architecture, which will take another step forward this week in Berlin as finance ministers and central bank governors from key industrial and emerging market economies gather for the first regular meeting of the G-20'. He went on: 'Refining our understanding of what makes countries vulnerable to modern-style crises and helping countries to guard against those risks will be a central focus for the G-20 as it carries forward its work'. He concluded: 'We believe that the IMF should work with member countries, including through the G-20, to develop and publish a set of explicit quantitative indicators that provide more meaningful guides to the adequacy of a country's reserves than simply their size relative to imports'.[2]

In other words, addressing domestic vulnerability to financial crises precipitated by capital flows appears to be the prevailing focus of the G-20. Even with respect to the one truly 'international architecture' issue, namely exchange-rate regimes, the discussion appears to be constrained to examining the choices available to developing countries along the spectrum from complete flexibility to 'hard pegs' through currency boards or currency unions.

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[1]Press release, 'New G-20 Searches for Solutions'. Berlin, 17 December 1999.

[2]'The Right Kind of IMF for a Stable Global Financial System'. Treasury Secretary Lawrence H. Summers' remarks to the London School of Business, 14 December 1999.

Moreover, on this subject, the advice increasingly being given to emerging markets and developing countries is that 'corner solutions' (complete flexibility or 'hard pegs') are more viable than intermediate solutions involving managed flexibility. In practice, however, this advice amounts to a preference for 'hard pegs', since few countries are likely to be willing to countenance the volatility associated with complete flexibility. Furthermore, the question of the exchange-rate relationships among the three major currencies (the dollar, yen and euro) – relationships that have a profound effect on the rest of the world because of their trade, investment and debt with the three blocs – is not a subject for discussion.

It is hard to resist the conclusion that, so far, the G-20 is acting as a sounding-board for reforms endorsed by the G-7 and carried out with its blessing in the BWIs and the FSF. In this sense, the G-20 may embody the 'G7-isation' of international decision-making (Kirton, 1999) rather than a genuine broadening of participation. However, unlike the G-22, an ad hoc body with a short life span, the G-20 is as yet in its infancy, and the possibility exists of its non-G7 members taking initiatives and broadening its agenda.

Indeed, Canadian Finance Minister Paul Martin, the G-20's first Chairman, declared to the press after his appointment, 'There is virtually no major aspect of the global economy or international financial system that will be outside of the group's purview', an assertion he repeated when he appeared before a committee of the Canadian House of Commons (Martin, 2000). The scope for broadening the G-20's agenda will depend, in part, on which country is nominated to chair the group (in particular, whether a non-G7 country will ever be allowed to chair it). It will also depend on the willingness of the members of the G-7 to countenance a forum in which views are aired that are at variance with those of its principal members, notably the USA.

It is worth noting the striking contrast between the current 'architectural agenda' and that set out in 1999 by the UN Task Force. The current agenda is heavily weighted with financial concerns and interests and puts little emphasis on safeguarding the autonomy and welfare of the poorest countries and people. For example, the UN group emphasised that the exigencies of financial crises, serious as they are for the entire global community, should not crowd out funding for and international attention to, the problems of the poorest countries, and to the smaller countries as well. It asserted that 'strong protection for the poor during crises, through the design of effective safety nets, is still more a matter of rhetoric than of practice'. Moreover, it warned against diverting scarce, long-term development financing from such institutions as the World Bank and the regional development banks in order to provide liquidity to countries experiencing financial crisis (United Nations, 1999).

Conclusion: The Unfinished Global Reform Agenda and Regional Alternatives

For the past 40 years, global financial governance has been shaped by a 'flock of Gs' – the G-10, the G-5 and, finally, the G-7, which has ruled supreme during the last two decades. However, the core members of these groupings have always been the USA, Japan and Germany – the 'G-3'. In the 1990s the EU has taken the place of Germany in this triad.

With the calls for a 'new Bretton Woods' precipitated by the Asian, Russian and Brazilian crises, there were signs that the G-7 was finally prepared to engage more expansively in dialogue with the rest of the world; those aspirations have come to fruition in the Financial Stability Forum and the G-20. But as the above review of the work of these bodies to date indicates, there is little so far to suggest that the G-7 and the USA are not still firmly in charge of the agenda. Moreover, that agenda has been dramatically scaled back from discussion of genuinely international reform questions, which seemed possible at the height of the last crisis, to addressing financial fragility and vulnerability to crisis at the domestic level. While this approach is no doubt necessary to help countries cope with financial crisis, it hardly seems sufficient to help either prevent future crises or manage them.

Nevertheless, it is possible that these new deliberative bodies, particularly the G-20, perhaps with the leadership of some of its developing country members, might set off in a different direction. Hopefully, they might even address some of the larger challenges with regard to reforming the international financial architecture.

What are those challenges? Many were articulated by the UN Task Force summoned in 1998 to consider policy options to deal with international financial volatility (United Nations, 1999). They include:

- More universal surveillance of macro-economic and exchange-rate policies, including those of the G-3. The next crisis may be generated by current account imbalances and asset bubbles in this group, and the potential for a global crisis arising from sudden shifts in exchange rates and asset prices is large. So it is in the interest of the world community to try to engineer a 'soft landing';
- Transforming the IMF into a genuine lender of last resort, able to issue its own liquidity;

- More concerted approaches to debt restructuring, including the use of concerted payment standstills mandated by the IMF;
- A more stable exchange-rate regime – in particular, exploring options other than pure floating and 'hard pegs', for example, regional arrangements (see below);
- A more flexible approach to capital account liberalisation, including the development of policies regarding capital controls, not as instruments inexorably to be abolished, but as permanent safeguards that can be invoked, when necessary, by countries vulnerable to capital surges;
- Greater regulation of bank and non-bank flows (including portfolio equity and hedge funds);
- Greater country 'ownership' of adjustment policies adopted in crisis conditions;
- A thorough review and reform of IMF conditionality, particularly of the pervasive and intrusive sort evident in the Asian crisis.

This is a long list of extremely complex issues. The world has been struggling with all of them, off and on, for the past 40 years, as this paper's brief historical review has suggested. And it will not be easy to resolve any of them, certainly not quickly. However, if the G-20 is able to transform itself into a deliberative body that can help generate consensus on some of these issues, and if the G-7 is able to surrender the decision-making prerogatives it has enjoyed for the past two decades, there may be hope that over time the global financial architecture will be reformed in directions appropriate for the majority of the world's population.

Finally, if such global solutions are simply too intractable politically, it may be possible to register more modest progress on some of these issues by pursuing more regionally differentiated, or even less universal, solutions, rather than seeking global ones. Early on in the post-war period, the industrial countries, through the G-10, devised a mechanism, the GAB, that was designed as a first line of defence against currency crises in their own countries. Why cannot groups of developing countries do likewise? It is plausible that if regional groupings of developing countries come together to form their own 'self-help' groups, they may also serve to contain financial contagion in times of crisis by supporting all countries in the region. In so doing, they would also help prevent disruptions to regional trade and investment brought about by the crisis and by competitive devaluations. Finally, they could also engage in mutual surveillance, which would be far less likely to carry the imprimatur of

Washington-based institutions (Mistry, 1999).

Indeed, in the early stages of the Asian financial crisis, the Asian countries, led by Japan, discussed the possibility of pooling $100 billion of their resources in an 'Asian Monetary Fund' in order to stem the growing crisis and the possibility of contagion. Unfortunately, the plan was stillborn due to the opposition of the USA; the Americans felt that the universality of the IMF should prevail. In principle, such an initiative would be no different from the GAB and NAB, but much better funded. Arguably, if such a facility had come into being, much of the ensuing turmoil and misery in Asia and perhaps the rest of the world would have been avoided (Wade, 1998).

The possibility of Asian monetary co-operation did not, however, die; indeed, it resurfaced in May 2000 during the annual meetings of the Asian Development Bank in Thailand. According to reports, a proposal backed by Japan, Korea and China to establish a network of bilateral currency swap arrangements and pooled reserves to defend regional members against currency attacks was endorsed by a broad group of Finance Ministers. Details are sparse, but it appears that Ministers agreed in principle to a regional initiative and to develop it further in due course. It is also worth noting that the idea was roundly criticised by several private bankers, including William Rhodes of Citigroup, who felt that the greater need in Asia was to follow through on the financial sector reforms required by the IFIs as part of the adjustment programmes agreed during the crisis.[1]

While Asian countries contemplate closer financial co-operation to fend off future crises, analogous solutions in other regions may be more complicated. In Africa there is no regional power like Japan capable of providing the bulk of the resources, although in this case the need for a short-term crisis facility may be less acute. In the western hemisphere, however, the country in the region most able to provide the resources necessary for crisis prevention or intervention (the USA) is the *least* likely to sanction such a scheme *ex ante*. It is more probable that the USA would intervene on a case-by-case basis when it sees its own interests threatened, as it did in Mexico in 1994–95.

In view of the political complexion of the region, a more controversial (and, to some, a more disturbing) approach to regional monetary cooperation in the western hemisphere may be achieved through 'dollarisation'. Advocates of this approach argue that fixed exchange rates (via

[1]Thomas Crampton, 'East Asia Unites to Fight Speculators', *International Herald Tribune*. Paris, 8 May 2000.

'soft pegs') were shown to be vulnerable to attack in the Asian crisis, and that truly flexible rates are an open invitation to volatility. That leaves only currency union (as with the euro) or currency boards (adopted by Argentina), both variants of 'hard pegs' (Hausmann, 1999). One obvious option, also being promoted by some prominent figures in the USA (Mack, 1999 and 2000), is unilateral dollarisation – an option chosen by Panama almost a century ago.

Advocates of unilateral dollarisation are growing in number. In February 2000, Ecuador, in the midst of an acute financial crisis, adopted the dollar. Debates on unilateral dollarisation are intensifying in many countries throughout Latin America, including Argentina, Mexico and smaller countries in Central and South America.

There has also been a debate in Canada, where proponents of dollarisation believe that ever-closer economic integration with the USA makes a common currency not only desirable, but inevitable (Courchene and Harris, 1999). However, these proponents advocate negotiating a common currency with the USA, along the lines of the euro, rather than espousing unilateral dollarisation. Critics of such a proposal argue, with some reason, that the analogy with Europe is far-fetched. Instead they contend there is very little likelihood that the USA would be interested in forming a currency union with its hemispheric neighbours and, further, that significant costs attach to unilateral dollarisation (McCallum, 2000; Sachs and Larrain, 1999).

The debate on dollarisation is likely to persist for some time. Even if no other countries formally dollarise, informal dollarisation, involving the growing use of the dollar for transactions and savings deposits and investment in countries throughout the region, is causing problems for macroeconomic management (Helleiner, 1997). Meanwhile, other options for the region need to be explored, including the possibility of sub-regional monetary unions (for example, among the members of Mercosur or the Central American Common Market).

In the end, Hausmann (1999) might be right in asserting that a world with 105 currencies is an anomaly, one that has only met with limited success in the post-war period. A world with five currencies may make more sense and may even be more financially stable (Mistry, 1999). The problem, of course, is which currencies and how to get there from here. Finally, will such a system be any more subject to multilateral surveillance for the benefit of the entire global community than the present one, a virtual oligopoly of the G-3?

These questions require urgent research and policy attention in the coming months. But they also suggest the need for an alternative process of policy development, one that brings together researchers and practitioners from both North and South. The objective must be to seek viable policy alternatives for achieving and maintaining global financial stability – alternatives that attract the support of policy-makers in both the industrial and developing countries.

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