

**Preparatory Committee for the International Conference
On Financing for Development**

Third Session, second part

15-19 October 2001

Agenda Item 2

Review of the inputs to the substantive preparatory process and the International Conference on Financing for Development**Note by the Secretary-General****Technical Notes**

On 8 May 2001, at the end of the first part of its Third Session, the Preparatory Committee requested the Financing for Development Coordinating Secretariat to prepare a series of “technical notes” related to issues falling under the substantive agenda for the Conference, on the understanding that such reference notes were to consist of factual, concise listing of existing proposals in a given topic, and not contain any analysis, comparisons, judgments or recommendations. The Bureau of the Preparatory Committee was entrusted with drawing up criteria for the selection of the topics and to finalize the list. At its meeting 15 June 2001, after consulting with members of the Preparatory Committee, the Bureau delivered to Coordinating Secretariat the following list:

1. Existing proposals for enhanced international cooperation on tax matters.
2. Existing proposals for international cooperation to combat corruption, including repatriation of illegally transferred funds to the countries of origin.
3. Existing proposals for innovative sources of finance.
4. Existing proposals to promote the increased and more effective participation of developing countries in the trade and financial decision-making processes.
5. Existing proposals for improved or new processes for coordinated debt restructuring (prevention and treatment of debt problems) in order to sustain growth and support economic and social development.
6. Existing proposals to increase market access to exports of developing countries.
7. Existing proposals on bilateral and multilateral investment agreements and practices towards codes of conduct on TNCs and governments with respect to FDI.
8. Existing proposals on financial crisis prevention, including operation of early warning systems and transparent and predictable international financial markets.
9. Existing proposals to ensure availability of sufficient international liquidity in order, inter alia, to avoid unnecessarily recessive adjustment processes.
10. Existing proposals on strategies for expanding access to micro-credit and for assisting current micro-credit beneficiaries in gaining access to the formal domestic banking sector.

The corresponding technical notes have been put together by the Coordinating Secretariat in close collaboration with, and the generous assistance of, staff from various institutions and other relevant stakeholders engaged in the Financing for Development process. They are presented as individual addenda to this Note.

Technical Note No. 8***ADVANCE UNEDITED VERSION****“Existing proposals on financial crisis prevention, including operation of early warning systems and transparent and predictable international financial markets”****I. Introduction**

Financial crises pose very serious problems for economies everywhere, but they are especially damaging for developing and transition economies. Financial crises not only can slow growth, but can also lead to declines in output and investment, increase poverty and unemployment, and undermine the credibility of national and international institutions. Thus, policies to enhance financing for development should include ways to help reduce the number and severity of such crisis.

The 1997-99 crisis, which began in Asia but spread to many parts of the world, led to numerous calls for creating a “new international financial architecture.” While such a large-scale overhaul has not occurred, a number of important changes have taken place. Some of the most significant innovations relating to crisis prevention include: (1) an increase in the information available about countries’ economic and financial situation, especially through the IMF Special Data Dissemination Standard, which is in the process of being strengthened through guidelines on debt and reserves; (2) an increase in information on the international financial institutions’ own programs and activities; (3) agreement to implement eleven “standards and codes” on monetary and financial policy transparency, fiscal transparency, banking supervision, securities, insurance, payments systems, corporate governance, accounting, auditing, and insolvency and creditors’ rights; (4) proposals –whose implementation has been postponed– for a revision of the Basle Capital Accord; (5) greater recognition by the IFIs that financial and capital account liberalization needs to be a gradual process, accompanied by adequate regulation and supervision; (6) greater recognition by all actors that the private sector must be incorporated into efforts toward crisis prevention; and (7) increased funding for the IFIs and new credit facilities, including the Contingent Credit Line (CCL) that was designed specifically to combat contagion, although it has yet to be used.

*The preparation of this technical note was coordinated by ECLAC. Staff from the following entities collaborated, in a personal capacity, in its preparation: Other UN regional commissions,

UN/DESA, IMF, UNCTAD and various academic institutions.

II. Proposals

Despite these developments, many challenges remain with respect to preventing financial crises. The proposals that are listed below involve a number of levels for action: financial and economic management for both developed and developing countries, international surveillance and regulation, regional innovations to complement measures at the international level, role of the private sector, and early warning and data issues. They are arranged roughly according to these categories, although there is often overlap within a given proposal.

Given the plethora of new ideas that have emerged since the Asian crisis, and the changes that have occurred, the note focuses on proposals presented in more recent years. In the list that follows, the origin of the proposal and the intergovernmental body to which the proposal has been presented have been identified except in the case of Ministerial Communiqués (e.g. the G-24 Ministerial Communiqués are regularly presented to the IMF International Monetary and Financial Committee and the Joint IMF/World Bank Development Committee and the results of the UN Conferences are regularly presented to the General Assembly).

Financial and economic management

1. Origin: G7 – Meeting of Finance Ministers, Rome, Italy, July 2001.
Proposal: “Opening access to capital markets is a complex process that cannot be addressed by a standardized, one-size-fits-all approach. The goal of the international community should be to help countries adopt the appropriate policies towards gaining access to global capital markets, while the final responsibility for adopting those policies rests with the individual countries.”
2. Origin: UNCTAD Trade and Development Report, United Nations 2001.
Presented to: UNCTAD Trade and Development Board.
Summary of the proposal: The Report proposes that “controls on capital inflows should be a permanent feature of policy, to be used flexibly and in the light of circumstances. The techniques available to control inflows are well known and have been discussed at length in past issues of TDR.”
3. Origin: Report of the Regional Consultative Meeting on Financing for Development in the European Region, Geneva, December, 2000.
Presented to: Preparatory Committee
Proposal: “The general view was that exchange rate regimes cannot be discussed independently of the underlying capital account regime. Any recommendations for exchange rate regimes have to take into account the economic conditions in each individual country. Given that these differ, the appropriate regime will also differ across countries. Between the extremes of freely floating exchange rates on the one hand and strictly fixed exchange rates

on the other, there exists a range of intermediate solutions which may fit the specific circumstances of individual countries.”

4. Origin: Report of the Regional Consultative Meeting on Financing for Development in the European Region, Geneva, December 2000
Presented to: Preparatory Committee
Proposal: “The strengthening and restructuring of the financial sector will not be possible without a coherent national regulatory framework. Regulatory reform is therefore a necessary condition for reducing the probability of financial crises and, when they occur, limiting their adverse effects.”

5. Origin: ECLAC Secretariat, “Growth with Stability”
Presented to: Latin American and Caribbean Governments at Regional Consultation on Financing for Development, Bogota, Colombia, November 2000.
Proposal: “The first element of any crisis prevention policy is consistent and flexible macroeconomic management of booms. This management should be oriented towards preventing public and private agents from accumulating large debts, and towards avoiding imbalances in the most important prices, especially the exchange rate and prices of national assets (financial assets and real estate)...The authorities must strive to establish a structural balance –and even a surplus– in public finances in order to help strengthen the economy’s capacity to save and to give themselves more room to maneuver in managing the business cycle...Monetary and exchange-rate policies should be geared towards preventing short-term booms from leading to excessively rapid increases in external and internal credit to the private sector and unsustainable surges in real exchange rates. These measures will be more effective if they are accompanied by prudential regulations on capital inflows, the prudential regulation and supervision of financial systems, and an explicit ‘liability policy’ aimed at improving the time profile of public and private debt.”

6. Origin: Financial Stability Forum, Working Group on Capital Flows
Presented to: Member Governments of FSF, April 2000.
Proposal: “The need for the development of domestic bond markets has been highlighted by recent financial crises. The risky debt structure of the sovereign and corporate sectors, characterized by heavy concentration in short-term and foreign currency debts as a result of the lack of developed domestic bond markets, has often been blamed as the cause of many crises. In the absence of developed domestic financial markets, even countries without a net external financing requirement can incur external or foreign currency mismatches... The government can, in normal times, benefit by having a full array of instruments that it can use for funding, so that it will not have to rely on money creation or foreign currency borrowing. Moreover, debt financing needs rise rapidly in the aftermath of financial crises, as corporate and bank restructuring entails huge costs...In the case of corporations, equity markets have a great role to play as a provider of risk-absorbing long-term capital to finance the firm. Financing through equity issuance will in some cases allow for a better match between the assets and liabilities of the firm than the match available through bond financing. Clearly, well functioning equity markets are important for the management of risks.”

7. Origin: Financial Stability Forum, Working Group on Capital Flows
Presented to: Member Governments of FSF, April 2000.
Proposal: “Many developed and emerging countries have benefited from capital mobility. However, large-scale inflows may have adverse effects on an economy if, by putting unwelcome upward pressure on the exchange rate, they complicate the conduct of domestic monetary policy. Large-scale inflows of short-term claims are also a source of potential vulnerability, as new inflows may cease or existing claims may not be rolled over. The use of controls on capital inflows may be justified for a transitional period in the face of very strong inflows or as countries strengthen the institutional and regulatory environment in their domestic financial systems... But it is vital that controls should not be seen as providing a way of allowing countries to pursue unsound macroeconomic policies or to delay activities to strengthen the financial system.”
8. Origin: Towards a New International Financial Architecture, Report of the Task Force of the Executive Committee on Economic and Social Affairs of the United Nations, United Nations 1999.
Proposal: “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 favorable effects not only for these economies, but also for the world at large.”

International surveillance, standards and codes

9. Origin: Managing Director, International Monetary Fund
Presented to: International Monetary and Financial Committee, April 2001.
Proposal: “The IMF needs to work even harder to put crisis prevention at the heart of its activities. In particular, we have to find ways to sharpen our analysis, reach concrete conclusions, and use these more effectively in the Fund’s policy advice, as well as in underpinning members’ political will and ability to take early and pre-emptive action. In this context, the risks for the global financial system from possible imbalances in advanced economies need to be addressed with the same vigor as those posed by developments in emerging market economies.”
10. Origin: Intergovernmental Group of 24 on Monetary Affairs, G-24, Ministerial Communique, Washington D.C., April 2001.
Proposal: “Ministers recognize the positive aspects of the development of international codes, standards, and best practices in the spheres of data dissemination, fiscal transparency and transparency in monetary and financial policies, and the management of debt as well as reserves. However, they note that the participation of developing countries in discussions on the development of these standards and codes has been limited, and they call for a more inclusive process. Ministers continue to underline the voluntary nature of implementing such codes and standards, taking into account the particular institutional capacities and stage of

development of each country. They also stress the importance of the availability of appropriate technical assistance where needed. Ministers find the application of codes and standards to be highly asymmetric. Standards in the area of transparency are being pressed upon developing countries without a commensurate application of corresponding obligations for disclosure by financial institutions, including the currently unregulated highly-leveraged institutions. Ministers would insist that any monitoring of standards and codes within the corresponding competencies of the BWIs should be done on a strictly symmetrical basis. Moreover, compliance with such standards and codes should not be prematurely integrated into the Article IV consultation process and must not become a conditions for use of IMF resources.”

11. Origin: Report of the Secretary General to the Preparatory Committee for the High-Level Intergovernmental Event on Financing for Development, United Nations, January 2001.
Presented to: Preparatory Committee
Proposal: “The high-level event should underline the importance of full and symmetrical surveillance of all national and regional economies by the IMF on behalf of the international community. Such surveillance should continue to emphasize the systemic consequences of national economic developments and policies, taking into account the differences in circumstances among countries. The content and nature of multilateral surveillance should continue to be kept under review, adapted and strengthened as the world economic and financial environment evolves.”
12. Origin: Asia and the Pacific Region Governments at Regional Consultation on Financing for Development, December, 2000, Jakarta, Indonesia.
Presented to: Preparatory Committee
Proposal: “It was suggested that IMF surveillance over the macroeconomic and financial policies of major industrial countries must be strengthened, particularly with a view to their impact on international capital flows, exchange rates and the debt burden of developing countries.”
13. Origin: Asia and the Pacific Region Governments at Regional Consultation on Financing for Development, December, 2000, Jakarta, Indonesia.
Presented to: Preparatory Committee
Proposal: “In view of the growing size and integration of financial markets, the prevention of a crisis is a concern for many countries and not only for the one immediately affected. Global surveillance of national policies is, therefore, called for....A major factor in the failure of IMF surveillance procedures so far has been their unbalanced nature that gives too little recognition to the disproportionately large global impact of monetary policies of major industrialized countries. In fact, financial crises in emerging countries are often connected to major shifts in monetary and exchange rate policies of industrialized countries. Even though these shifts affect their development policies, developing countries lack mechanisms under the existing system to redress their negative impact.”

14. Origin: Report of the Regional Consultative Meeting on Financing for Development in the African Region, and Preparatory Meeting for the Third United Nations Conference on Least Developed Countries, Addis Ababa, Ethiopia, November 2000.
Presented to: Preparatory Committee
Proposal: “While the proposed measures to reform the international architecture were acknowledged, such as early provision of information, the need to strengthen accountability and transparency, and the need to improve regulation and supervision, it was noted that reform should be undertaken with a view to developing a level playing field in the implementation of a rule-based system in the management of international capital flows. African countries should have a greater say in the functioning of a more transparent international financial system. The main priority for African countries is to ensure that the new international financial system facilitates efficient capital flows from developed countries to Africa.”
15. Origin: Report of the Regional Consultation on Financing for Development in the Western Asia Region. Beirut, November 2000.
Presented to: Preparatory Committee
Proposal: “The current practice in financial regulation and supervision is for the Bank for International Settlements (BIS) to formulate standards expected to be applied by national authorities, rather than to establish a global regulatory agency. There are, however, three sets of problems with this procedure. First, BIS standards do not properly account for risks in international lending. Second, BIS standards are designed to protect the international banking system, not the debtor developing countries. Third, there are potential problems for developing countries in this approach, which applies indiscriminately to all countries irrespective of their levels of development and different institutions. It was advocated that the adoption of such standards should be voluntary and that it should recognize variations among countries. Moreover, the adherence to such standards should not become part of the IMF conditionality.”
16. Origin: UNCTAD Trade and Development Report, United Nations 1999.
Presented to: UNCTAD Trade and Development Board
Summary of the proposal: “The Report suggests that a remedy for the asymmetries in existing surveillance practices might be to use “a mechanism analogous to that used for settling disputes in international trade, where disagreements over the impact of macroeconomic and financial policies could be taken up and their resolution sought.”

Regional role in crisis prevention

17. Origin: Report of the Secretary General to the Preparatory Committee for the High-Level International Intergovernmental Event on Financing for Development, January 2001
 United Nations.
Presented to: Preparatory Committee.
Proposal: “The high-level event should endorse the principle that arrangements among groups of countries for mutual surveillance are a useful supplement to multilateral surveillance, and

should encourage developing and transition economy countries to engage in such exercises. The international financial institutions and such other entities should work closely together to mutually reinforce their respective surveillance and policy coordination endeavors.”

18. Origin: Asia and the Pacific Region Governments at Regional Consultation on Financing for Development, August, 2000, Jakarta, Indonesia.
Presented to: Preparatory Committee
Proposal: “Strong support was expressed for increasing regional cooperation in monetary and financial matters as a means of promoting development and improving prevention and management of financial crises. Measures to increase cooperation were viewed as being complementary to the process of reforming international financial architecture. The discussions on reform so far have tended to ignore the importance of developing a regional financial architecture. It was generally felt that the Asia and Pacific region had great potential for increasing regional cooperation.
- Implementation of regional cooperation should be a phased process, beginning with those measures that are easiest to implement...
 - The use of the inter-bank swap arrangements agreed in Chiang Mai should allow for the participation of countries at different levels of openness and development in regional arrangements. They provide the potential for deeper cooperation in this area.
 - Another area for regional cooperation involves establishing a level and regulatory framework for international banks operating in the region.”
19. Origin: Towards a New International Financial Architecture, Report of the Task Force of the Executive Committee on Economic and Social Affairs of the United Nations, January 1999.
Proposal: “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 postwar 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...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 the IMF funds in times of difficulty...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.”
20. Origin: Asian Finance and Central Bank Deputies, Member Governments of the Manila Framework, November 1997

Proposal: “Deputies agreed on the need and desirability of a framework for regional cooperation to enhance the prospects for financial stability. This framework, which recognizes the central role of the IMF in the international monetary system, includes the following initiatives: (a) a mechanism for regional surveillance to complement global surveillance by the IMF; (b) enhanced economic and technical cooperation, particularly in strengthening domestic financial systems and regulatory capacities; (c) measures to strengthen the IMF’s capacity to respond to financial crises; and (d) a cooperative financing arrangement that would supplement IMF resources.”

Private sector role in crisis prevention¹

21. Origin: Communiqué of the International Monetary and Financial Committee
Presented to: International Monetary Fund, Washington D.C., April 2000.
Proposal: “The Committee underscores the importance of prevention as the first line of defense against crises. Countries participating in international capital markets and their private creditors should seek, in normal times, to establish a strong, continuous dialogue. Collective action clauses could have an important role to play in facilitating orderly crisis resolution.”

22. Origin: Commonwealth Finance Ministers, Grand Cayman, Cayman Islands, September 1999.
Proposal: “Ministers emphasized the importance of ensuring stability in the global financial system through increased transparency and disclosure by financial institutions, particularly relating to the activities associated with heavily leveraged institutions (HLIs); and continuing to consider closer oversight of institutions lending to HLIs. They stressed the importance of action to alter banking regulations that encouraged excessive short-term lending to countries.”

23. Origin: G-24, Ministerial Communique, September 1999, Washington D.C.
Proposal: “Ministers recognize that the role of private capital flows will continue to expand in an increasingly integrated global economy. Therefore, it is difficult to visualize the prevention or resolution of financial crises without direct and timely private sector involvement. In this regard, the major challenge for the international community is to develop a market-friendly strategy for involving the private sector in a manner that does not disrupt or unduly raise the cost of capital flows to developing countries. Ministers suggest that any strategy should minimize spillover effects on other borrowers. They encourage further progress toward voluntary arrangements for private sector participation before crises arise, such as through contingent credit lines, embedded call options, and debt service insurance. Other provisions are also needed to cover both crisis prevention as well as resolution, including bankruptcy procedures, the establishment of creditor-debtor councils,

¹ see also “Existing proposals for improved or new processes for coordinated debt restructuring (prevention and treatment of debt problems) in order to sustain growth and support economic and social development.” (A/AG2??/_/Add.5), section entitled “On engagement of a debtor country with its creditors.”

and in extreme cases the possibility of a standstill of debt repayments. In addition, Ministers stress the importance of symmetrical disclosure of relevant information as between the private and public sectors.”

Early warning systems and other data issues

24. Origin: Managing Director, International Monetary Fund, International Monetary and Financial Committee, April 2001.
Proposal: “Highest on our agenda for the coming months should be further work on early warning systems. There is a need to combine quantitative indicators of vulnerability with judgment from the field and from the markets.”
25. Origin: ECLAC Secretariat, “Growth with Stability”
Presented to: Latin American and Caribbean Governments at Regional Consultation for Financing for Development, Bogota, Colombia, November 2000.
Proposal: “Rating agencies are among the main private institutions responsible for providing information to investors. Their performance during the financial crisis was unsatisfactory... Rather than mitigating financial cycles (which is what a good information system should do), they have tended to exacerbate them. For this reason, the governments of developed countries, perhaps with the support of multilateral financial institutions, must spur private institutions to rate sovereign risk using strict and objective parameters that are known to the public.”
26. Origin: Financial Stability Forum, Working Group on Capital Flows, April 2000.
Presented to: Member Governments of FSF.
Proposal: “Serious efforts have been made by the international community to enhance aggregate data on external debt and capital flows, which are key ingredients for the assessment of vulnerabilities. These efforts must be supported, and the importance of their success highlighted, if they are to maintain the needed momentum. However, while significant progress has been made, there remain gaps in the availability of data necessary for comprehensive risk analysis, as well as apparent inconsistencies in data from different sources... Important gaps remain in national external debt statistics, especially regarding the assessment of liquidity risk: data by residual maturity rather than original maturity; by face value as well as market value; with a distinction by currency as well as residency; information on embedded put options in bond contracts; and amortization schedules (including interest payments).”
27. Origin: International Organization of Securities Commissions (IOSCO), “Causes, Effects and Regulatory Implications of Financial and Economic, Turbulence in Emerging Markets”, Montreal, Canada, November 1999.
Presented to: Member Governments
Proposal: “Economists, analysts, and credit rating agencies play an important role in highlighting potential fault lines in the corporate and financial sectors. That credit rating agencies could have done a better job at predicting the crisis, for example, points to the need

for more effective early warning systems....Among the areas that may merit regular and comprehensive examination are institutional control mechanisms and risk management systems, asset concentration and exposures, disclosure requirements, activities requiring specific approval, and accounting and regulatory standards compliance.”

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