

The Role of International Policies, Agencies and Agreements

93 This section explores the role of international organisations in facilitating capital flows to developing countries, in particular to those countries that are at risk of marginalisation and have not yet succeeded in attracting significant private investment. The IMF's role in assisting countries to dismantle capital controls and enhancing the confidence of international investors is examined along with the general issue of the IMF modifying its Articles of Agreement to accommodate capital account convertibility. The section also discusses the international policies that have and should be put in place to help countries cope with capital surges. The role of emergency financing, debt workouts and early warning systems of possible problems arising from capital inflows is elaborated. WTO's role in the investment area is also commented upon.

1 Policies by international organisations

94 International organisations such as the World Bank and the IMF can play a catalytic role in increasing private capital flows to the poorer developing countries, by improving the prospects of those countries. They can do so by encouraging sound domestic policies and through their own lending operations, in this way assisting them to reach a stage of development where private flows would be attracted. For some countries, removing an unsustainable burden of debt will be an essential first step. The Group attaches considerable importance to the rapid implementation of the HIPC initiative.

95 The World Bank Group has used guarantees on the limited basis to support private sector development through leveraging its resources. Such guarantees provide ways of mobilising private finance for public sector projects thereby releasing public funds for other investments. The Working Group concluded that IBRD guarantees, which are at present available primarily to foreign investors, should be made available to domestic investors. The Multilateral Investment Guarantee Agency (MIGA) has met with considerable success in promoting FDI by providing investment guarantees against political risks, including the risks of currency transfer, expropriation, and war and civil disturbance. However, the Group noted that MIGA was facing capacity constraints and exposure limits, and that there were also other limitations associated with MIGA guarantees. First, the scheme is only available to foreign investors and the Group was of the view that this was a limiting factor and excluded domestic investors. The Group observed that MIGA might not be competitive, but it fills a gap for political risk insurance and re-insurance not provided by national and private insurers. Further encouragement of private insurers to enter the guarantees market would help to ensure the setting of more appropriate price terms.

96 The Group noted that the Bank is also considering the use of IBRD guarantees as a means to support IDA funding for infrastructure projects by the private sector, which it is currently unable to do under its existing Articles. The view was expressed that under

its Charter, guarantees were substitutable on a one-to-one basis and therefore did not lead to additionality. In addition, bank guarantees must also receive a counter-guarantee at the national government level, whereas many projects come under the jurisdiction of sub-national governments. The Bank is undertaking a review to examine ways in which to increase the flexibility and resources for its guarantee programme, including:

- ❖ issuing guarantees that do not require a counter-guarantee from the host government;
- ❖ guaranteeing lenders to municipal and provincial governments;
- ❖ offering new products to develop domestic financial markets and access to international markets;
- ❖ permitting greater capacity to provide guarantees for projects in IDA countries;
- ❖ not counting the guarantee fully against country borrowing limits; and
- ❖ leveraging capital to a greater extent than is possible for the IBRD guarantee under IBRD articles.

The Group welcomed this review of the guarantee programme and looked forward to its recommendations.

97. More generally, the Group agreed that the International Financial Institutions (IFIs) have a key role to play in encouraging and helping countries to take the whole range of measures set out in Section 3 to enhance and sustain private capital flows.

2 Amending IMF Articles

- 98 Various multilateral, bilateral, and regional agreements and initiatives have contributed to the liberalisation of capital movements. For the most part, however, these agreements are either among a restricted group of coun-

tries (as in OECD Code of Liberalisation of Capital Movements and the EU Directives) or concentrate on the protection of direct investment rather than the liberalisation of capital movements. There is no one agreement that has near universal membership, which covers a broad set of capital movements, including permission for residents to invest abroad, and which also pays due regard to the macroeconomic, structural and balance of payments implications of capital flows.

- 99 The IMF, with its mandate to oversee the international monetary system, is well placed to promote the liberalisation of capital flows. It has almost universal membership and it advises and supports countries as they deal with the many policy issues related to capital flows. The IMF already covers, in its Article IV consultations with its members, issues related to the capital account for assessing the scope of capital account liberalisation. More recently the IMF has begun to consider an amendment of its Articles to reflect developments in global capital markets. There is a broad agreement for giving the IMF a mandate to promote capital account liberalisation together with the appropriate jurisdiction to do so.

- 100 The Group recognised the importance of enlarging the Fund's responsibilities and jurisdiction in this area, and gave general support to proposals in this direction. The Group also recognised that there were a number of issues which required clarification and further discussion including the need for (a) a clear and workable definition of capital account transactions to be covered under such an amendment; (b) suitable transitional arrangements; (c) approval of policies for continuation and/or reimposition of controls under certain circumstances; and (d) consideration of the possible need for Fund resources.

3 International policies on capital surges

101 The move to capital account convertibility by countries will improve their ability to attract capital flows but it also implies that countries run increased risks due either to adverse external developments or to domestic policy mistakes. In this section, we consider suggestions for improving the international monetary system to cope with such situations.

(a) *IMF data standards and early warning systems*

102 The IMF Executive Board agreed in 1995 on a list of indicators that all countries should provide to it on a regular basis. These indicators would serve as an early warning system of possible problems ahead. These indicators included exchange rates, international reserves, central bank balance sheets, reserve money, broad money, interest rates, consumer prices, external trade, the external current account balance, external debt/debt service, the fiscal balance and GDP/GNP.

103 The IMF is developing a set of standards to guide members in publishing economic and financial data, accession to the standards being voluntary, to keep markets better informed. The standards cover apart from the indicators listed above, industrial production, unemployment, wages or earnings, producer or wholesale prices and domestic credit. The IMF is in the process of preparing a general standard for all members. For some of the countries with less developed statistical systems even the general standards could be achieved only over time and with substantial technical assistance. The Group recommends that the Fund (and, possibly, the World Bank) earmark additional resources to support country efforts in this direction.

104 Although all these developments were welcomed, the Group was sceptical that in practice there would necessarily exist a strong connection between the performance of these indicators and the emergence of a crisis. Difficult to measure factors not on the list, including policy-makers' perceived resolve and commitment, would also be important. Nevertheless, any action that increases the information available to markets, and hence improves the ability of markets to anticipate risks, must be welcomed.

(b) *Emergency financing*

105 The globalisation of capital markets is already affecting the role of the IMF as a lender for balance of payments reasons. While countries with increased access to capital markets no longer have to rely on the IMF as a provider of liquidity, others, when encountering financing difficulties, are apt to require assistance on a larger scale than in the past. In these cases the IMF's role should be catalytic. Private lenders may be unwilling to continue financing the country in crisis periods as they have no power to impose policy conditionality on borrowers. The IMF, however, is able to attach conditions to negotiated country adjustment programmes, and once countries are seen to be adhering to these conditions, confidence tends to be restored, and leads to the resumption of private capital flows.

106 The IMF has set up new procedures for activation of the Emergency Financing Mechanism (EFM) to enable the IMF to respond and, if necessary, to provide funds in support of members facing a crisis in their external accounts.

107 These new procedures have just been used in agreeing a programme for the Philippines, but have yet to be tested by a major crisis (on the scale of Mexico). At the

same time, the IMF is increasing its resources by expanding the amounts available to it under the General Agreements to Borrow (GAB) through the New Arrangements to Borrow (NAB). This will permit the Fund to react quickly where exceptionally large sums are needed for the largest countries which pose systemic threats to the international financial system. In addition, the Group would like to see an early increase in quotas that is sufficient to enable the Fund to respond adequately, quickly and flexibly in giving support to all countries when needed. The Group would also like to see an early agreement on an “equity” allocation of SDRs.

108 There is also a role for Central Bank co-operation for emergency assistance in exceptional circumstances. Such co-operation can range from information sharing, co-ordinated foreign exchange operations, foreign exchange swap agreements and more highly structured temporary credit facilities. Such co-operation, often on a regional basis, can be expedited as quickly as it is required and perhaps more quickly than assistance provided by the IMF. But there are limits to its effectiveness and thus it is important that the IMF should continue to have a primary role in managing the international financial system. Recent co-operation among the East Asian Central Banks in supporting the Thai Baht was only temporarily successful in buying time for the Thai authorities. It did not prevent a second wave of speculative attacks on the Thai Baht.

(c) Debt workouts

109 In a crisis, even with strong policy action and some financial support from the IMF and elsewhere, countries may encounter difficulties in meeting debt repayments. In these cases, there may be a need for temporary suspension of payments as a way of gaining time to negotiate orderly debt work-

outs with private creditors. In such cases, IMF may consider lending into arrears provided the debtor country is making strong adjustment efforts and negotiating with its creditors.

4 WTO's role in foreign investment flows

110 Although the primary role of WTO is in the area of trade, agreements concluded at the end of the Uruguay Round expanded its role to encompass a number of trade related foreign investment issues. These agreements established rules and regulations that are geared towards the creation of a hospitable environment in host countries for certain types of trade-related investments. These agreements also established dispute resolution mechanisms.

111 The role of the WTO in this area is still evolving. Four agreements were reached on a number of measures touching on investment, namely Agreement on Trade-Related Investment Measures (TRIMs); Agreement on Subsidies and Countervailing Measures (ASCM); General Agreement on Trade in Services (GATS) and Agreement on Trade Related Intellectual Property rights (TRIPs). Further developments have taken place since the conclusion of the Uruguay Round. For example, WTO's Singapore Ministerial Meeting agreed to establish a working group on trade and investment to examine the linkages between trade and investment issues in the context of existing agreements and agree on a possible work programme.

112 While there is no universal agreement, these developments could have an impact on the consideration of investment issues in WTO. For example, there is the issue of how to reconcile the differential treatments applied to investments in service sectors

and in goods production given the blurring of the differences between trade in goods and services. Differences in national treatment of like products under GATT and services in the GATS can give rise to disputes. These considerations make it necessary, that the WTO examine investment issues in a general framework without prejudice to the final outcome. The WTO Ministerial Council has been given the mandate to begin such an examination.

- 113 The Group felt that in any future discussion of investment issues in WTO, effort should be made to avoid conflicts or duplication with agreements currently being negotiated at the IMF.

5 Conclusions

- 114 The Group stressed that the international community has a key role to play, both in facilitating private capital flows - in particular to those countries that have yet to attract significant private investment and are at risk of marginalisation - and in putting in place the multilateral infrastructure to help countries to cope with capital surges. This section brings together the Groups' conclusions on the role of international policies, agencies and agreements:

- i The IFIs can help to improve the economic prospects of all countries through lending, through advice, through co-financing of public and private projects, and through the provision of guarantees against loans from international banks. By doing so, they play a valuable catalytic role in increasing capital flows - particularly to those countries which are not yet

familiar to international investors.

- ii The Group welcomed the World Bank Group's use of guarantees to aid private sector development and suggested that such guarantees should lead to additional resource flows. It noted the role of MIGA in covering political risks, and that the Bank was endeavouring to provide guarantees to private lenders to support infrastructure development.
 - iii The Group recognised the importance of enlarging the IMF's responsibilities and jurisdiction in respect of capital flows. It noted that, following an appropriate amendment of its Articles, the IMF would be well placed to help its members to liberalise their capital account when they are ready to do so and when satisfactory transitional and other arrangements are in place.
 - iv The Group welcomed the new Emergency Financing Mechanism and the expanded New Arrangements to Borrow, and would like to see an early increase in IMF quotas that is sufficient to enable the Fund to react adequately, quickly and flexibly by lending to countries facing financial crises. The Group also stressed the need for advancing procedures for orderly workouts of sovereign debt.
 - v The Group also supported arrangements among Central Banks at the regional level to provide emergency assistance in dealing with short term capital surges.
- 115 With respect to the role of the WTO on investment matters, the Group recognised the need for consistency – and avoidance of duplication – between the IMF and the WTO in the treatment of investment.