## CONCLUSIONS AND RECOMMENDATIONS

A year after the East Asian crisis started, its financial and economic consequences have not yet been contained. The crisis has spread to other emerging economies in different regions of the world. Increasingly, it has also been transformed in the affected countries into a serious crisis in the real economy with substantial downward adjustments in output, income and asset values resulting in heavy socioeconomic damage which has disconcerting implications for political stability. A number of affected countries (such as Indonesia) will lose a significant part of their previous growth gains, with long-term structural damage to their economic and social systems resulting from the successive shocks.

As in the case of earlier crises, divergent views have surfaced on the causes of the East Asian crisis. One school of thought emphasises the failure of national policies and governments, while another points to the failure of markets as the main cause. The truth, as usual, lies somewhere in between. The lessons to be drawn from the crisis depend to a large extent on the causes of the crisis. Most explanations of the East Asian crisis tend to begin with a long list of the perceived problems of the East Asian countries. This approach can lead to the fallacy of erroneous connection, with any problem that existed prior to the onset of the crisis being seen automatically as its cause. Some of these explanations are inconsistent with the facts while others are too partial or insufficiently convincing to explain the onset or the depth of the crisis. To be convincing, the causal explanations provided must be consistent with the past record of the region. They must clearly identify those specific factors that brought about so dramatic a change, from rapid growth to deep crisis. The explanations provided must also satisfactorily distinguish between those factors that triggered the crisis and those that made it spread across the region through contagion.

The causes of the East Asian crisis are several and complex, domestic and external. However, there are three key elements which distinguish the present crisis from other recent financial crises: (a) the roots of external imbalances in East Asia were grounded largely in a rapid build-up of unhedged, short-term, private sector debt which carried large term transformation as well as exchange risks; (b) the crisis was a consequence of "over-investment" rather than "over-consumption" on the part of either the public or private sectors; and (c) it was triggered primarily by sudden capital flow reversals by global commercial banks resulting in a sharp deterioration in confidence throughout the region and outside it as a result of contagion. The most surprising aspect of the crisis was that it affected countries with a long track record of good macroeconomic management that had been remarkably successful over extended periods, in terms of economic growth, dynamism of their export sectors, low rates of inflation and high saving rates.

What went wrong? Clearly, there were a number of emerging structural deficiencies and policy failures in the countries themselves: a "bubble effect" in domestic financial systems; very rapid growth (and inadequate monitoring) of short-term commercial bank debt; an inconsistent exchange rate and monetary policies which induced the inflow of speculative funds; premature and ill-conceived capital account liberalisation in some instances; and the progressive appreciation of real effective exchange rates betwen 1995-1997 when the US dollar appreciated sharply vis-à-vis the Japanese yen, causing deterioration in the competitiveness of many of these economies. There was, however, another crucial factor which has not received sufficient attention and which affected the speed of contagion and financial market collapse across Asia: i.e. the role played by the "herd behaviour" of internationally mobile capital flows in triggering the crisis. The crisis was also aggravated by the way it was managed by international agencies who dealt with it as if it was a crisis of domestic policy failure, rather than a crisis also reflecting capital market failure and the inadequacy of risk assessments by international lenders and investors.

## Six main lessons can be drawn from our analysis of the crisis

a) the East Asian crisis was essentially a short-term liquidity crisis when it started; but the way it was managed resulted in its becoming a crisis of solvency, political stability and long-term development;

b) the benefits of capital flows can be considerable in stable market conditions but in unstable and irrational markets, they can become highly damaging, requiring skillful management and a degree of policy flexibility in dealing with capital surges and reversals;

c) there are serious risks in relying excessively on foreign capital to finance investment, especially when domestic savings are high; more attention needs to be given to improving the quality of investment, which will also help to reduce over-dependence on foreign capital;

d) whatever adjustment measures are taken to contain the crisis and accelerate recovery, affected governments must give priority to restoring stability and confidence and to ensuring that the social impact of the crisis is minimised;

e) priority should be given to crisis prevention and containment measures because of the high economic, social and political costs of financial crises and the speed with which they can spread through contagion and become a worldwide debacle; and

f) since markets react sharply and swiftly to perceived weaknesses in economic fundamentals, it is of critical importance that responses to financial crises be swift, unambiguous and substantial; it also means that in the absence of a lender-of-last-resort, priority needs to be given to negotiating dorderly ebt workouts with private creditors at an early stage to ensure a more efficient outcome.

These considerations suggest that a comprehensive strategy for dealing with financial crises needs to be directed at four levels: national actions to reduce the likelihood of future crises; regional actions to limit damage in the immediate neighbourhood; international actions to co-operate effectively in preventing and/or managing future crises when and if they happen; and, finally, strengthening international regulatory frameworks in order to enhance global stability.

## Crisis Prevention

As crises are costly and spill over swiftly into other countries, high priority needs to be given to crisis prevention measures. A number of proposals to reduce the probability of future crises are currently being discussed in different international fora. The three main ones are: improving the availability (and transparency) of economic information and policies to both the IMF and the financial markets; strengthening domestic and international surveillance; strengthening domestic financial systems, by improving regulation and supervision; and encouraging more orderly and properly sequenced liberalisation of capital accounts. The Group believes that while these proposals represent necessary steps towards a stronger international financial system, they are not sufficient to prevent future crises. Strengthened surveillance by itself is only a partial and weak remedy. Defences at national, regional and global levels also need to be strengthened to contain and reverse crises swiftly instead of letting them get out of hand, as happened in Asia in 1997 and is now happening in some other parts of the world. Better mechanisms are needed to cope with market over-reaction and to implement far-reaching financial sector reforms in emerging markets. Similarly, early warning indicators can often be unreliable and can lag behind an unstable dynamic process. Thus, by the time available indicators are visibly out of line, it is usually too late to attempt to prevent a crisis.

With each successive crisis it has become clear that the signals and indicators being looked at were not necessarily the right ones. The East Asian crisis has made it clear that market signals are as important to track as macroeconomic indicators. Recent developments have also highlighted the problems that can occur when fragile emerging market economies open their capital accounts prematurely. While capital account liberalisation should remain an ultimate goal, the approach to such liberalisation should be cautious. Liberalisation should be introduced in phases and move in tandem with the strengthening of the domestic financial system. It also follows that (in the event of an amendment to the IMF Article relating to capital account issues) countries opening their capital account should have the necessary flexibility to reverse liberalisation measures, temporarily, if changes in the macroeconomic or political conditions, at home or abroad, call for it.

All these considerations suggest that an effective crisis prevention and/or management strategy will require the use of sharper and a more comprehensive array of tools at the national, regional and international levels than have been proposed so far.

## Increasing the Transparency of Market Operations

The focus of the current call for improved transparency and surveillance has been at the recipient country level. It is equally important that the same precepts apply to market participants. In particular, greater attention needs to be given to the risks posed by potential large reversals of capital flows and, in particular, the role played by financial markets, especially the roles of currency traders and hedge funds, in influencing currency and asset price movements in thin and imperfect markets which are particularly vulnerable to attack. The possibility of extending large trade and position reporting systems (now practised in the futures trade) to cover currency trading and hedge fund activity should be examined as a matter of urgency. Just as timely and accurate information on the macroeconomic and financial situation of a country is necessary to facilitate decision-making in financial markets, a more transparent market structure and operation would enable governments in both recipient and source countries to implement effective market-responsive regulations and policies. For better monitoring and understanding of markets, government regulators and international institutions should build on the current practice of increased dialogue with traders and private financial institutions.

## Strengthening Surveillance and Peer Reviews

There is also a need to better co-ordinate surveillance of domestic financial systems in all countries. Recent events have clearly demonstrated that domestic financial sector problems can spread regionally or internationally. It is, therefore, in the interest of all countries that proactive steps are taken to ensure stability at national, regional and international levels. In this context, the Canadian proposal called the "International Supervisory and Surveillance Initiative" is of particular interest and needs to be considered seriously. It calls for the establishment of new international arrangements to improve supervision and regulation of domestic financial systems and to identify financial sector problems before they become international crises. The proposed arrangement would also involve close collaboration with the Bretton Woods institutions and the BIS, and would bridge the roles that surveillance, peer pressure and support can play in encouraging countries to build strong financial systems according to international standards.

## Regulating and/or Taxing Capital Inflows and Outflows

There is a strong case for capital-receiving countries themselves to discourage sustained surges of short-term capital flows. In particular, they should be wary of short-term foreign currency borrowing by banks and corporates and consider using market-based discouragements such as taxes or non-remunerated reserves (involving interest-free deposits with central banks). Such measures have been used successfully by Chile and Columbia to: increase the share of foreign direct investment and long-term loans within total capital flows and decrease the share of short-term and potentially reversible flows; increase the autonomy of domestic monetary policy and drive a wedge between domestic and international interest rates; and to curb large over-valuation of the exchange rate, caused by a surge of capital inflows, which discourages exports and poses the risk of growing and unsustainable current account deficits. Two of the attractive features of the Chilean-type measures are that they are market-based rather than quantitative, and they apply to all short-term flows, thus simplifying administrative procedures and reducing possibilities of evasion. These measures have not always been uncontroversial; they need to be designed with particular care to avert the prospect of their deterring capital flows altogether.

It is encouraging to note that major financial institutions now explicitly recognise that – despite some limitation and microeconomic disadvantages – market-based measures taken by recipient governments to deal with surges of short-term capital flows can play a positive role, if they are part of a package of policy measures that include the establishment of sound macroeconomic fundamentals as well as strong and well-regulated domestic, financial systems. International institutions should undertake further work on the feasibility of such measures and assist governments in emerging markets to design appropriate instruments and contingency measures which could be suitably applied at times when countries are receiving excessive inflows of short-term capital and when other key conditions are in place. While the use of market-based measures to regulate capital inflows are to be preferred, it may be necessary for countries to consider a careful application of capital controls of an administrative character or exchange controls, on a temporary basis, in the event of a crisis as serious as in East Asia. Such controls would seem to be justified in exceptional cases where the costs of any resulting distortions are likely to be lower than the alternative of an economic slump which progressively worsens.

In addition to using regulations and controls, capital-receiving countries could also explore other market-based instruments to discourage currency traders from taking short positions on their currencies. While the market uses a myriad of derivative instruments, central banks tend to limit themselves to traditional instruments. If they were to use the opportunity of capital inflows to take advantage of financial insurance instruments, they could consider creating incentives which would have the effect of deterring market participants from speculating against the local currency in times of trouble. When large, international commercial and investment banks request banking and securities licences, governments could insist that one condition for granting such licences would be for the central bank to buy (for a modest fee) from these banks, some insurance against future currency volatility with a call option on the existing value of the dollar vis-à-vis the local currency. This would oblige the seller of the option (the international bank) to sell at a future time to the central bank a pre-agreed volume of dollars at the existing exchange rate, thus incurring the risk of a loss on its own speculation. This is a new proposal; it has not been studied thus far and requires further examination, both in terms of its practicability and its impact on the cost of capital.

## The Role of Counter-cyclical Policies

The role of counter-cyclical monetary and fiscal policies of capital-receiving countries in regulating capital inflows is also important. It is when inward surges of short-term capital occur that recipient countries have greater degrees of freedom for policy-making than when capital is flowing out. A tightening of macroeconomic policies is particularly desirable when indicators of vulnerability to a currency crisis point to rapid deterioration, or when they pass certain prudent thresholds. Thus, adequate levels of net usable foreign exchange reserves and limits on the level of short-term external liabilities are crucial for preventing currency crises. An appropriate exchange rate regime with a consistent internal interest rate regime is also important to make economies less vulnerable to currency attacks. There are often good reasons to have a pegged nominal exchange rate; but problems with a pegged rate arise when it becomes overvalued. If countries wait until a nominal peg is attacked, it will be too late to avoid a crisis by floating the currency. In such a case, countries could move much earlier to some sort of managed float, which can help avoid real appreciation. Rapid sharp increases in interest rates could also be effective in some, but not in all, cases for preventing large currency depreciations. Such increases are never effective if they have to be maintained for very long. They can be particularly counter-productive in economies which are highly leveraged, as in East Asia, and convert what may essentially be a crisis of liquidity into one of insolvency. While some increase in interest rates may be necessary to provide a signal, this should be supplemented by slowing down credit growth; the use of ceilings on lending for property; and the use of prudential regulations.

## Crisis Management and Containment

Once a country enters into a financial crisis, it usually cannot cope on its own. International assistance has to be called in to mount a rescue effort. While each situation has its own dynamics, there are a few obvious lessons that can be drawn from recent experience.

### The role of International Financial Institutions (IFIs)

The first response when a large currency crisis starts unfolding in one or more countries, is to activate a timely, large and credible injection of official liquidity to provide the important public good of stability. The best solution is to enhance the capacity of the IFIs to perform this function more effectively. Improvements need to be made first in the speed of such lending, given the incredible speed with which markets move today. Secondly, the scale of existing facilities and the resources available to international financial institutions need to be enlarged significantly, in view of the vastly greater scale of private funds flowing through international markets. To enhance the scale of official facilities, priority needs to be given to securing an immediate increase in IMF quotas; the possibility of co-financing or standby facilities with the private sector – and particularly with private banks – also needs to be explored urgently.

Finally, the issue of appropriate conditionality attached to financial packages needs to be re-examined to ensure that in any future crises, conditionality is designed to restore stability and market confidence as quickly as possible without damaging growth in the countries affected. A number of valid criticisms have been made of IMF programmes during the East Asian crisis. It has been argued that conditionality has been too intrusive and too comprehensive, attempting to make dramatic structural changes in very short periods even before stabilisation has been achieved. Conditionality has also been inappropriate in several important respects (e.g. indiscriminate bank closures, over-adjustment through excessive tightening of fiscal policy, over-emphasis on full debt repayment involving bailing 'out' rather than bailing 'in' creditors, especially commercial banks, which engaged in imprudent short-term lending). Many observers have pointed out that some of these measures might well have added to, rather than corrected, the panic in markets which the crisis unleashed. A key challenge for IMF (and country) programmes is to design appropriate macroeconomic responses for currency crises that mainly originate in private sector imbalances and not – as traditionally Fund packages were accustomed to dealing with – public sector imbalances, reflected in fiscal or current account deficits. They should aim, first and foremost, at stabilisation and the restoration of market confidence before tackling longer term issues.

### Bailouts, standstills and orderly debt workouts

Because of the large scale of capital flows in the 1990s, public inflows from the IFIs can no longer be relied upon to finance private outflows during a crisis. In response to this situation, as well as to increased concern over moral hazard issues, a more efficient means of imposing creditor discipline and burden-sharing is required, with banks and investors taking more of the responsibility for the ongoing provision of loans or credits to borrowers in crisis-affected countries. Accordingly, there is an urgent need for early agreement on orderly debt workout procedures, which would bring about the rapid resolution of crises, while reducing the scale of official financing needed. In a short-term liquidity crisis (such as in East Asia), the timely provision of significant further credit by the private sector could avoid the imposition of unnecessarily severe austerity measures on affected economies. In such cases, the official sector should focus less on permitting private creditors to exit and more on bailing them in by enforcing early debt negotiations as a precondition for its support. Indeed, the present basis of providing official finance first and then negotiating debt relief as a residual should be reversed, with the amount of official financing needed becoming the residual, after other alternatives are exhausted.

In addition, new rules of the game in international finance should require the enforcement of 'standstills', or temporary payment suspensions, to become a necessary and early part of the crisis resolution process. Consensually agreed protocols for payment suspension, as part and parcel of crisis management, need to be designed to encourage creditors to agree to rapid debt renegotiation on appropriate terms. This will also require agreement on the trigger points at which such measures can be invoked. If it becomes accepted international practice for governments to be able to impose a standstill as part of a process of co-operative and non-confrontational debt renegotiation, creditors would have no reason to penalise them; moreover, it would serve as a disincentive for irresponsible lending by commercial banks.

It is unfortunate that though orderly debt workout initiatives were endorsed by the G10 in 1996, nothing came of them by the time the Asian crisis began in the summer of 1997. It is imperative that significant progress is made in implementing such initiatives before the next one occurs. The official sector should now press for the inclusion and implementation of contract clauses in commercial bank loans, market bonds and other credit instruments to facilitate orderly restructuring of securitised and commercial debt. At the same time, the IMF should signal its approval of the process by agreeing to lend into arrears to countries whose policies and prospects are considered acceptable.

### Concessional finance for low-income countries

Distributional questions also need to be taken into account. The existing procedures for emergency financing are primarily invoked in crises which pose a systemic threat at the global level. However, there are a large number of smaller and poorer countries in Africa, Central America and the Pacific which have been hit by rapid reversals of capital flows as a result of contagion. They need adequate official international assistance since they have virtually no access to alternative sources of market funding in crisis circumstances. It is therefore important to introduce greater flexibility in access to the IMF's emergency financing mechanism, as well as to IDA resources, to assist these countries in times of crisis.

### Dealing with the social impact of crises

The World Bank, other IFIs and bilateral donors should act early and on a sufficient scale to help countries deal with the social implications of financial crises. Within crisis-affected countries, the immediate protection of public expenditures for social programmes, food security and safety nets is essential and the programmes agreed with the IFIs need to have adequate funding. The IFIs and bilateral donors were not sufficiently involved in addressing social impacts in the affected East Asian countries from the outset. Failure to do so resulted in social and political difficulties being magnified with further perverse effects on market confidence.

### Crisis containment, reversal and recovery

Crisis containment and reversal should be crucial elements of any crisis management strategy. In the short-term, one of the primary tasks in containing crises is to restore the confidence of domestic and foreign investors in the economy. This would involve influencing and changing the direction of market expectations by giving clear signals of national commitment to undertake the necessary adjustments. Long-term financial support from the IFIs is also essential for the recapitalisation and restructuring of the banking sector in order to get the domestic financial sector working again, and for tackling supply side issues, such as the provision of adequate working capital and export credit facilities which usually dry up during financial crises. It is equally important to ensure that the reform process in the crisis-affected countries is co-ordinated so that slippages in one or two countries do not hold back recovery in others.

### Filling regulatory gaps in the international system

Actions by recipient countries and international agencies by themselves are not enough to deal with the problem of capital surges and the risk of their reversal. It is equally important to complete and improve international prudential supervision and regulation to adapt them to the new scale and nature of private flows, and to fill existing regulatory gaps.

There are four major areas where such gaps need to be filled.
Firstly, recent experiences demonstrate that the way in which the global financial system operates is not always well understood by governments nor for that matter by the IFIs. 'Miracle economies' in one month can suddenly be denigrated as bastions of 'crony capitalism' the next. Such selective and fickle perceptions need to be corrected or avoided. Moreover, while there is a need to ensure that regulation across financial markets which are integrating rapidly, is consistent and comprehensive, there is no reason to force all countries into the same rigid and standard regulatory mould. Instead, regulatory regimes and policy frameworks that are developed internationally should be flexible enough to accommodate different models of market economy, and financial systems, while ensuring prudence, probity and integrity.

Secondly, it is important to ensure a degree of symmetry in prudential supervision and regulation in source countries, and to adapt it to the new scale and nature of private flows. There are two categories of flows to emerging markets where additional international and/or source country regulation and supervision may be necessary: (a) short-term bank loans (particularly culpable in the 1982 debt crisis and in the 1997 Asian crisis); and (b) easily reversible short-term portfolio flows (especially important in the Mexican peso crisis) which are invested in short-term, exchange risk-proof instruments. International bank loans (including short-term ones) are already regulated by industrial countries' central banks and co-ordinated by the Basle Committee. However, existing regulations are clearly not sufficient to discourage excessive short-term bank lending. For example, for non-OECD countries, loans of residual maturity of up to one year have a weighting of only 20 per cent for capital adequacy purposes, while loans over one year have a weighting of 100 per cent. As a result of this rule, short-term lending is more profitable for international banks. A narrowing of this risk differential by raising the risk premium for short-term lending should therefore be pursued.

In the case of portfolio flows to emerging markets, at present there is no regulatory framework for taking account of market or credit risks on flows originating from institutional investors in developed countries, such as mutual funds (and more broadly for flows originating in non-bank financial institutions). However, this is a new and contentious topic and it is important that any regulatory proposals in this area should emanate from guidelines formulated by a working group consisting of representatives of source as well as emerging market countries, as was done in developing the Basle Core Principles.
Thirdly, the East Asian crisis has highlighted the need to establish or upgrade domestic "financial safety nets" supported by internationally

agreed standards or best practice. Such safety nets would consist, inter alia, of deposit insurance schemes, lender-of-last resort policies, (i.e. policies for extending solvency support and exit policies) and prompt corrective actions, including the orderly closure of insolvent financial institutions. Properly conceived financial safety nets reduce the probability of financial crises, curtail their duration and expansion when they occur and facilitate crisis management. Internationally agreed standards represent independent benchmarks against which transparency and the accountability of national policies and practices can be compared. Despite significant progress, their development is incomplete. Current efforts need to be directed particularly at developing or improving the implementation of international standards relating to banking supervision, securities and derivatives market regulation, insurance supervision, auditing and accounting, bankruptcy, fiscal transparency and corporate governance.

In addition to filling gaps in the existing regulatory framework, various suggestions have been made recently for cross-border taxes on currency transactions to slow down speculation in currency trading. The Group believes that the problems which arise with the implementation of such proposals raise serious doubts about their efficacy. However, the degree of speculation that has taken place in the recent crisis and its serious negative consequences have raised acute concerns. It therefore seems appropriate to continue exploring how market-based disincentives might be created to discourage excessive speculation. Furthermore, in seeking solutions to East Asian-type crises, it is also important to take account of the microfactors behind position taking within global financial institutions, as well as other practices that induce high-risk trading in financial markets, especially as such practices may encourage currency speculation and exacerbate its highly negative effect on systemic stability.

Finally, further examination is required to detect and cover any other existing monitoring and/or regulatory gaps, in three major areas. The first relates to instruments such as derivatives and institutions such as hedge funds. The second concerns the need for an independent peer review of the methodology and modus operandi of credit rating agencies, whose sudden retrospective changes in country ratings can reinforce market volatility and create perverse expectations. The third concerns the need for a better understanding of recent changes in global credit and capital markets, and of the criteria used by different categories of market actors – including banks, mutual funds, hedge funds and others – to go in and out of countries as well as the incentives that explain these patterns.

## Regional Initiatives

In policy discussions on the East Asian crisis, not enough attention has been paid to the potential role of regional arrangements and mechanisms in crisis prevention and management. In coping with financial crises, there can be little doubt that regional arrangements can play an important "mezzanine" role between the national and international institutions. This would be easiest among countries with a clear regional identity. The absence of suitably designed regional arrangements (except in Europe) in the present array of institutions, facilities and instruments which exist to combat such crises, reflects a serious gap in the international financial system. Precisely what such arrangements should be, will inevitably depend on the particular characteristics, needs and circumstances of the countries in each region.

Clearly, a comprehensive set of arrangements – with matching institutional capacity – would need to encompass the following functions and capacities: i) surveillance and early warning capacity, coupled with the institutional ability to exert peer pressure in inducing essential policy changes and course corrections swiftly and effectively; ii) the capacity to avoid repeated rounds of competitive devaluations from occurring in neighbouring countries and preventing countries from adopting beggar-thy-neighbour policies to exit from a crisis likely to engulf the region; iii) sufficient intervention capacity in currency and financial markets to restore market confidence and forestall the prospect of free falls in currency or financial markets; iv) the ability to provide sufficient post-stabilisation liquidity and long-term finance in tandem with multilateral and regional development banks, to prevent disruptions to financial systems, economic growth and social stability at critical junctures in the stabilisation and adjustment processes; and v) the collective capacity to induce essential long-term structural changes in financial markets and institutions and to promote greater capacity for self-regulation and prudential behaviour on the part of private sector institutions as well as national regulatory authorities.

Such arrangements can complement to an important degree the global arrangements which now exist. They can be tied to the institutional structures which have already been created in the regional development banks. For example, regional networks or lines of credit could be established or expanded before or during a crisis to act as a form of constructive contingent arrangement. The absence of an effective international lender-of-last resort also opens up the possibility for other forms of regional co-operation such as Japan's stillborn proposal for an Asian Monetary Facility, which should be resurrected in Asia and explored for other regions.

In the long-term, as greater regionalisation of trade and investment takes place across the developing world, more structured regional monetary integration through the development of currency blocs should be considered (though this might not always be practical in all cases). The existence of regional currency zones would provide more formal arrangements for countries to pool foreign exchange reserves as well as integrate banking and capital markets, and perhaps enter into monetary unions. They would also enable countries standing together to be in a stronger position to withstand speculative attacks. Precedents for this already exist in the Eastern Caribbean Currency Union and in the decision of the European Union to establish a common currency for the region, as well as attempts by other regional groups (such as in Western and Southern Africa) to move in the same direction.

## Developing a New International Architecture

In contrast to the way the 1994-95 Mexican crisis was handled, and the positive role played by the US in containing it, the East Asian crisis has been protracted and has spilled over to other regions because of Japan's inability to serve as an engine of growth in the region, and the reluctance of the major players to take the lead. Japan has already supported Asian currencies but its capacity to do more is now severely constrained. Since the Asian crisis has spread to other emerging markets, it is all the more necessary for the G-7 and the IFIs to act swiftly to achieve better global co-ordination of monetary policies by reducing interest rates and reflating the global economy in order to contain the crisis and avert the risk of global recession.

There is another important global dimension which needs to be addressed urgently. The present international monetary and financial system is inherently prone to crises due to inadequate arrangements for global economic governance and the absence of safety-nets which can be introduced when markets fail. There does not seem to be any concerted effort to agree a new architecture for the international financial system, which can cope with crises of the kind we are witnessing. Several piecemeal efforts have been made, but no tangible progress has been achieved.

The Group believes that serious discussions to develop this new architecture should be pursued to enable the defence mechanisms which are available to developed countries (and which were deployed in the 1987 and 1992 crises) to be extended to developing countries, and to examine the possibility of a credible lender-of-last-resort.

To be meaningful, these discussions need to be democratic involving representation from industrial, emerging and other countries at different stages of development. Such dialogue also needs to integrate concerns about growth and development into the discussion of international financial issues, since the ultimate purpose of stable and supportive financial systems and arrangements at national and international levels is to underpin the growth of output, employment and human progress. The Group, therefore, sees an advantage in a summit meeting of these different groups of countries and the IFIs to consider the shape of the new architecture. The Group recommends that Commonwealth Finance Ministers should consider the feasibility of a Commonwealth role in promoting such a summit meeting.