

Reform of the Financial Architecture

The present international financial scene is characterised by increased volatility in exchange rates and flows of capital, financial crises and contagion affecting the macro-economic stability of many countries. The latest instance of this is the crisis engulfing Latin America, affecting Argentina, Brazil and Uruguay. Besides directly affecting the countries concerned, increased financial risk dampens global growth prospects and thus enhances poverty worldwide. Despite new measures such as the institution of the Contingent Credit Line in the IMF, the drive to promote financial standards and codes and the like, it is clear that the international financial architecture requires significant reconstruction. It is contended that neither the IMF's lending resources nor its policy have adjusted to the fact that the needs of balance of payments financing in the contemporary world are not dictated just by the current account flows, but by the much larger capital flows that are subject to sudden swings in sentiment, often unrelated to changes in economic fundamentals. A consequence of this is that it forces the IMF to adopt pro-cyclical rather than anti-cyclical stances in policy, and to divert its limited liquidity to attend to the needs of the relatively rich emerging market economies. The criticism has also been made that the IMF, by failing to recognise in time that premature capital market liberalisation can be harmful, has contributed to an exacerbation of global financial instability (Stiglitz, 2002). It is further contended that the lack of agreed orderly procedures for debt standstills and dealing with defaults is also making it difficult to contain financial crises to manageable proportions. It is suggested, therefore, that the objectives of the redesigning of the global financial architecture should be to:

- Enhance the capacity of the IMF to lend in times of crisis through increase in lendable resources, including through SDR allocations;
- Improve responses to crises, including through greater automaticity in the availability of finance;
- Allow for debt standstills and provision for bankruptcy;
- Reduce recourse to big official bail-outs, and more equitable sharing of the burden between creditors and debtors;
- Improve banking regulation to achieve greater financial stability, adapted to the circumstances of each country;
- Improve risk management in relation to exchange rate volatility;

- Build confidence through greater accountability and transparency;
- Improve safety nets;
- Promote greater inclusiveness in the global decision making processes.⁴⁰

These steps constitute a large agenda. While the current efforts to promote agreement on collective action clauses which make it easier to restructure debt by allowing a majority of creditors to impose a deal, and a judicial procedure to arbitrate between creditors in case of default, should help soften the impact of financial crises, a reform of the global financial architecture going beyond these measures is needed.

This will require high level political processes that include poor country democracies. The G20, which brings together 20 major industrial and developing countries, is a step in the right direction in promoting inclusive political processes; but the redesigning of the global financial architecture requires a step change in global consultative processes. We revisit the global governance issues further below.