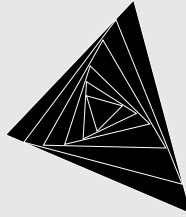


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CASE STUDIES: APPLYING THE CONCEPT OF GLOBAL PUBLIC GOODS



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CORRUPTION AND GLOBAL PUBLIC GOODS

Peter Eigen and Christian Eigen-Zucchi

Earlier chapters in this volume examine the provision of global public goods from a cross-cutting perspective, exploring various dimensions of the process. The case studies in this part, by contrast, look at the provision process from an issue-specific perspective.

The studies show how global public goods are embedded in and matter to people's daily lives. Several authors analyze goods from the perspectives of local communities and developing countries. The analyses show that global public goods are not a luxury desired—and needed—only by rich people. Because of their globalness and publicness, most of these goods reach deep into all corners of the world. As Stephany Griffith-Jones stresses, poor people may lack income and barely participate in formal financial markets. Yet financial crises—through multiple transmission channels—can hurt them badly. Thus international financial stability is important for all people.

Moreover, poor people are often less able to cope with the crises and conflicts that accompany severe underprovision of global public goods. They also find it hard to live with malprovided goods—those shaped in a way that severely constrains the room for policy maneuver available to developing countries and local communities. Ronald U. Mendoza's chapter on the multi-lateral trade regime addresses this issue. Thus it is important to distinguish between publicness in form (consumption) and in substance. The relevant question is, does the global public good offer net benefits for all?

Lyla Mehta, in her chapter on water, also finds that this distinction is crucial. Water is a heavily embattled issue. Its properties are highly context-specific. As Mehta argues, water basically is not a public good. But given its increasing scarcity, it could be desirable to make water a global public good by policy design. Doing so could help ensure, at least to some extent, that it is

available to all people. The notion of global public goods can thus be seen as an important policy tool for a rights-based approach to development.

Another theme emerging from the chapter analyses is the struggle between local and global interests in a particular good. Charles Perrings and Madhav Gadgil, for example, explain how the international community's desire for biodiversity conservation has been focused on the narrow goal of maintaining a global gene pool, whether through zoos and botanical gardens in industrial countries or through the preservation of biodiversity hotspots in developing countries. Yet what matters for local communities is maintaining ecosystems as a whole. Fortunately for poor people, the *ex situ* approach is of limited effectiveness and is being modified to emphasize integrated, comprehensive ecosystem management. This strategy will benefit local communities as well as the international one.

Different interests and approaches often arise because global interconnectedness is not well understood. Many policies are still conceived in terms of national self-interest and countries going it alone—in stark contrast to the indivisibility of fate in a globalizing world. For example, as Griffith-Jones shows, all countries have an interest in international financial stability. But many often fail to recognize this, or at least to act in ways that enhance such stability.

The same is true of the negative global spillovers that can result from the excessive disease burden in developing countries, as discussed by Dyna Arhin-Tenkorang and Pedro Conceição. Such spillovers transcend the health threats that have long been associated with high infection loads of communicable diseases. Global public goods are less likely to be adequately provided when their benefits and costs are not recognized and their importance is not sufficiently assessed.

Even when mutually beneficial arrangements are identified, their realization may be problematic. René Castro and Sarah Cordero show how Costa Rica's ability to provide carbon dioxide sequestration services could be matched with the desire of some industrial countries to buy such services. The revenues could help Costa Rica finance national policy objectives such as providing clean electricity to remote areas. But the evolving intricacies of this arrangement indicate that its implementation is complex and subject to uncertain interactions among countries.

Finally, Peter Eigen and Christian Eigen-Zucchi show how difficult it can be for individual actors, state or nonstate, to break out of a policy dilemma—however irrational and costly it may be. Corruption, the misuse of public office for private gain, undermines the provision of many public goods, nationally and internationally. Corruption control is a global public good that hinges on enhanced publicness and often enhanced globalness—namely, cross-border cooperation.

INTERNATIONAL FINANCIAL STABILITY AND MARKET EFFICIENCY AS A GLOBAL PUBLIC GOOD

STEPHANY GRIFFITH-JONES

Global public goods can be shaped and provided in different ways. Their utility for different parts of the world's population depends on both their quantitative levels (in terms of issues such as adequate spending) and their qualitative properties (involving areas such as ownership of policy reforms).

This chapter examines the global public good of financial stability and market efficiency by focusing on one of its main elements, the international financial architecture. The current international financial architecture is of limited utility—and sometimes even disutility—for developing countries. Most reforms of this architecture have focused on crisis prevention and management, emphasizing efforts by developing countries rather than industrial countries or private financial actors.

But there are ways to correct this situation. All stakeholders have an interest in financial stability and all are at least somewhat interested in economic growth in developing countries. Achieving such growth requires more than just financial stability: it also requires increased financial efficiency. But most industrial countries and private actors have only a moderate interest in increased financial efficiency in developing countries. Thus further reforms require developing country initiatives such as advocacy, building coalitions with the development community and civil society organizations, and pooling expertise and forming strategic alliances.

FINANCIAL STABILITY AND MARKET EFFICIENCY: AN IMPORTANT GLOBAL PUBLIC GOOD FOR DEVELOPING COUNTRIES

Normal financial volatility is priced through higher risk premiums or higher required returns and so requires no public intervention. But excess volatility that

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leads to crises cannot be appropriately priced. When foreign investors run to the exit in some or all emerging markets because of trouble in one, contagion transforms a national public bad into a regional and eventually global public bad.

If excess volatility is the global public bad, what is the corresponding global public good? Much of the literature on this topic focuses on financial stability, notably crisis prevention and management (see Rosengren and Jordan 2000 and Little and Olivei 1999). But while international financial efficiency cannot be achieved without market stability, stability without efficiency is pointless. The provision of both is a global public good. Once achieved, international financial stability and market efficiency are nonrivalrous and nonexcludable, and so possess the properties of a pure global public good. Yet as explained by Kaul and Mendoza in this volume, the publicness of a good simply means that it is public in consumption, affecting all. It does not necessarily mean that it has the same utility for all actors.

So how are the costs of financial instability and excess volatility and the benefits of financial stability and efficiency distributed across countries and groups? For instability, a growing literature—World Bank (2001, pp. 73–74), Reisen and Soto (2000), Obstfeld (1998), and Hausmann (1996)—suggests a strong negative link between financial and macroeconomic volatility and economic growth. Caprio and Klingebiel (2002), Conceição (in this volume), Honohan and Klingebiel (forthcoming) and IMF (1998) document the significant costs of crises in terms of lost output and show how developing countries are particularly vulnerable and suffer high economic costs from financial instability.

Financial efficiency, by contrast, can contribute to development through lower intermediation costs and more sustainable allocations of scarce capital. An efficient international financial architecture also implies that developing countries have better access to capital needed for development and growth. Theoretical and empirical analyses suggest that such capital may be the main benefit of participating in a stable, efficient international financial market (see Agénor 2001; Soto 2000; and Feldstein 1999).

Industrial countries also gain from financial stability and efficiency, including through higher returns on investments in developing countries. In addition, stable growth in developing countries provides new markets for industrial country exporters and increasingly profitable opportunities for industrial country investors, particularly multinational corporations.

More important, poor people in developing countries are also likely to gain from financial stability and market efficiency. As the financial crises of the 1990s showed, the poor often shoulder significant costs during financial instability, despite being innocent bystanders (Friedman and Levinsohn 2001; Berry, Friedman, and Levinsohn 1999; Walton and Manuelyan 1998; Chomthongdi 1998). Such crises hurt the poor in many ways, including through cuts in social spending, slower economic growth, and rising unemployment. Even during sta-

ble periods many developing countries lack adequate access to private and official flows, impeding growth and poverty reduction. Hence poor people in these countries are also hurt by inefficient capital markets—perhaps more silently but no less severely than by “loud” financial crises.

REQUIRED NEW ARCHITECTURE AND PROGRESS SO FAR

International financial stability and market efficiency result from many elements. Among the most important are the workings of the international financial architecture. This section first examines the elements that this architecture should include to foster growth in developing countries, then compares today’s architecture with the desired one. Though a lot of progress has been made on international financial reform since the financial crises of the late 1990s, significant gaps remain.

Essential features

Given the dramatic changes—and crises—in international financial markets over the past decade, industrial and developing countries face a difficult challenge in creating an international financial architecture that supports growth and development. International private capital flows have become large and extremely volatile, and international financial institutions play a smaller role. Though there is no clear blueprint for the new architecture, its key functions have emerged from international discussions and from parallels in mature national credit and capital markets. The international financial architecture should:

- Promote transparency and regulation of international loan and capital markets.
- Provide sufficient official liquidity in times of distress or crisis.
- Develop mechanisms for debt standstills and orderly debt workouts at the international level.
- Provide mechanisms for development finance.

Transparency and regulation will help prevent crises. Official liquidity and debt standstills and workouts will help manage crises better, minimizing their damage. Development finance will channel more public flows to developing countries, particularly those with minimal access to private capital markets. Development finance can also help finance other global public goods and bolster social protection schemes, which are crucial to protect poor people in times of distress. For the international financial architecture to perform these functions, multilateral lending will have to increase.

For at least three reasons, these international mechanisms should be complemented at the regional level (Ocampo 2000). First, growth in intraregional trade and investment has significantly increased macroeconomic links, increasing the

potential for regional contagion during crises. One advantage of a regional approach is that information asymmetries are smaller than at the international level. Hence some policies and functions, such as mutual surveillance, can be better performed at the regional level. Second, contagion during crises almost always starts within regions (Sachs and Radelet 1998). Thus regional mechanisms can complement international mechanisms, particularly for liquidity provision, as a first line of defense. Such a mechanism is being developed by the Association of South-East Asian Nations plus China, Japan, and the Republic of Korea (ASEAN+3) and has existed for several decades in the European Union. Third, regional mechanisms will give smaller developing countries access to a broader range of institutions for crisis management and help them negotiate a more inclusive international financial architecture.

Still, no matter how significant regional arrangements may become, they should be seen as complements to—not substitutes for—international financial institutions such as the International Monetary Fund (IMF), World Bank, and Bank for International Settlements. In addition, some national measures are indispensable, because the provision of financial stability and efficiency must start at the national level. Furthermore, national and international measures are mutually reinforcing. But national measures alone would not be adequate or desirable (Fernandez-Arias and Hausmann 2000; Schneider 2001).

Progress to date

Since the late 1990s several steps have been taken to strengthen the international financial architecture. The IMF's lending facilities for crisis prevention and management have been expanded and adapted, and its total resources have been increased (see www.imf.org/external/np/exr/facts/quotas.htm). Institutional innovations such as the Financial Stability Forum¹ have been introduced to identify vulnerabilities and systemic risks, fill gaps in regulations, and develop consistent regulations for all types of financial institutions. And in 1999 the G-20, with representatives from both industrial and developing countries, was created to advance international financial reform.²

In addition, developing countries have taken steps to reduce their vulnerability, including by pursuing more prudent macroeconomic policies and adopting internationally accepted financial codes and standards—though there are concerns that there are too many standards (64) and that they are too uniform. Some analysts have called for greater flexibility in using these standards (Pistor 2000; UN 2000). Others have argued for a more inclusive process for their development, because developing countries are asked to implement them without being involved in their design (Griffith-Jones and others 2001).

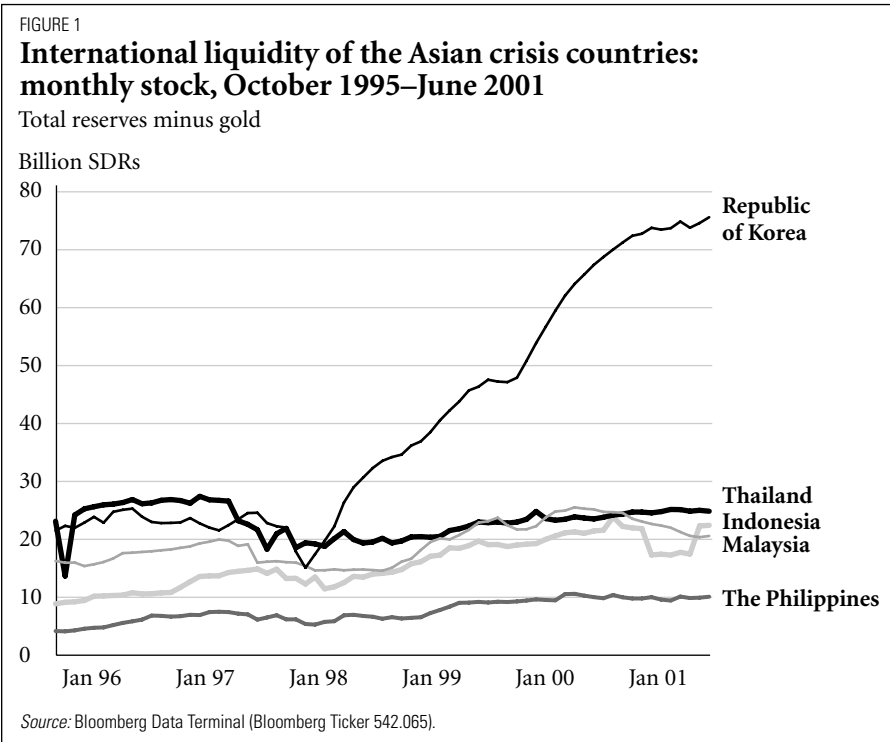
Thus while there has been progress in reforming the international financial architecture, serious problems remain. First, efforts have been insufficient given the changes required. For example, there is no framework for debt standstills or

workouts. Second, no significant initiatives have been made to ensure stable, long-term capital flows to the developing world. Third, there are concerns about a possible reversal on international financial reform should the G-7 take positions like those in the March 2000 report to the U.S. Congress by the International Financial Institutions Advisory Commission (IFIAC 2000). Better known as the Meltzer Report, it argued for drastic cuts in the scale and functions of international financial institutions, particularly the IMF. Such a reversal would be deeply counterproductive, particularly for developing countries. Finally, reform of the international financial architecture has been marked by stark asymmetries in three key areas: strong reform pressures on developing countries but inadequate reforms at the international level, more attention to crisis prevention and management than financial efficiency, and better representation for industrial countries and private market actors than developing countries.

Strong reform pressures on developing countries but inadequate reforms at the international level. More progress has been made on changes at the national level—in developing countries—than at the international level. For example, developing countries are being urged to adopt financial codes and standards to enhance transparency for market actors. But there are few if any corresponding obligations for disclosure by private financial institutions, including highly leveraged ones such as hedge funds.

Furthermore, while developing countries are making impressive progress in improving regulation of their financial systems, large gaps remain in international regulation of institutions such as hedge funds. Moreover, progress has been slow on changing bank regulations that favor short-term flows to developing countries. Some proposed changes to international regulation also present problems. Increasing reliance on banks' risk assessment models—a proposed reform of Basel capital adequacy requirements—will likely amplify the procyclical nature of international bank lending. It will also likely increase loan costs and reduce bank lending to developing countries (Griffith-Jones and Spratt 2001).

In recent years many developing countries have adopted more prudent macroeconomic policies, which is positive. But some are also implementing costly self-insurance against crises (UNCTAD 2001b), including high foreign exchange reserves and deflationary biases in macroeconomic policies. For example, according to the Report of the High-Level Panel on Financing for Development (UN 2001), also known as the Zedillo report, developing countries hold about \$300 billion more in foreign reserves today than they did before the East Asian crisis—an increase of about 60 percent. These self-insurance policies are needed largely because an appropriate international financial architecture is not in place. Thus they are second-best policies—and they hamper growth and poverty reduction. Furthermore, not all countries can pursue such a costly strategy. For example, East Asia's crisis countries have had varying capacity to accumulate reserves since the



region's financial crisis began in July 1997. Of the five main crisis countries, only the Republic of Korea has been able to significantly increase reserves (figure 1).

Moving from crisis prevention to crisis management at the international level, it seems important to increase IMF resources to meet the financing needs of a systemic crisis involving several countries without compromising the liquidity needed to meet normal demands on IMF resources. Former IMF Managing Director Michel Camdessus and others—including the influential U.S. Council on Foreign Relations and representatives from developing countries—have suggested that this increase in emergency financing be partly funded by temporary, self-liquidating issues of IMF Special Drawing Rights (SDRs). This proposal merits further consideration because it would compensate for reductions or reversals in private flows and only temporarily boost world liquidity (Ocampo 2000).

Further modifying the IMF's Contingency Credit Line is a more modest but also important change to facilitate rapid liquidity support. This facility could automatically disburse credit when a crisis occurs in a country that has received favorable recent evaluations from the IMF (that is, during Article IV consultations³). This change would make a large number of countries eligible for the Contingency Credit Line—though few would necessarily ask for disbursements—eliminating the stigma on its use.

Finally, faster progress is needed on an international framework for debt standstills and workouts. UNCTAD (2001a) suggests combining voluntary mechanisms for debt restructuring with internationally sanctioned standstills. Krueger (2001, 2002) offers useful proposals in this regard.

More attention to crisis prevention and management than financial efficiency. Current reforms of the international financial architecture are focused on crisis prevention and management. Though important for middle-income countries with access to capital markets, the focus on these issues has neglected equally—if not more—important issues of liquidity and development finance for low-income countries. For liquidity, IMF facilities for low-income countries (such as the Compensatory Financing Facility and the Poverty Reduction and Growth Facility) should be made more flexible given the volatility in oil prices and the vulnerability of these countries to trade shocks.

For development finance, low-income countries need more multilateral lending and official flows, as well as speedy debt relief. Yet multilateral lending to low-income countries, especially in the form of official development assistance, has fallen sharply. Total official development assistance fell from \$55 billion in 1998 to \$45 billion in 1999, then to \$39 billion in 2000 (World Bank 2001). The cyclicity and volatility of these important flows are also cause for concern. One study found that more than two-thirds of 38 African countries receive procyclical aid, and these flows are about twice as volatile as the recipients' GDP (Pallage and Robe 2000). Both features inhibit the consumption-smoothing effects of these flows and should be addressed.

Furthermore, donors, low-income countries, and international organizations—including international financial institutions—should collaborate so that more developing countries attract international flows of private capital. Sufficient, stable development finance from private and official sources is essential for growth and poverty reduction in the poorest countries. Foreign direct investment is important in this regard because it is more stable and long term than other capital flows (Lipsey 1999). Foreign direct investment is also strongly correlated with growth in developing countries (Soto 2000). Yet in 2000, 10 countries received 77 percent of all foreign direct investment in developing countries; 7 of the 10 were also among the top 10 recipients in 1985 (UN 2001, p. 52). Thus mechanisms are needed to broaden access to such flows and to encourage private flows to developing countries more generally.

Better representation for industrial countries and private market actors than developing countries. Developing countries are poorly represented in international financial decisionmaking, particularly in the IMF, World Bank, and Bank for International Settlements (see Buirra in this volume). These international financial institutions need to consider more representative governance in parallel with

a redefinition of their functions. And although developing countries are represented in some of the Financial Stability Forum's working groups, they are not included in its plenary meetings. It is particularly urgent that developing countries be fully represented in the forum because the issues discussed there have potentially profound effects on their economies, and their insights could contribute to the forum's valuable work.

As noted, developing countries should also be represented on standard-setting bodies such as the Basel committees. The progress being made on new "soft" international law involves a small number of national authorities—usually from G-7 or G-10 countries—agreeing to certain standards.⁴ These standards are then implemented in those countries and passed on as international standards that are broadly implemented in developing countries, often as a result of IMF or World Bank loan conditions or market pressures. This approach has been effective in spreading some regulatory measures but not others. Moreover, regulatory concerns in developing countries are unlikely to be reflected in the process for designing new standards, leading many developing countries to argue that there should be "no standardization without representation."⁵

Both the quantity and the quality of developing country representation need to be addressed. Developing country representatives at the IMF and World Bank, for example, are required to represent too many countries on too many issues. This is partly due to the small number of developing country representatives on the executive boards of these institutions. In addition, developing country representatives do not receive sufficient technical support from their countries or from the other developing countries they represent. Industrial country representatives, by contrast, often receive the full support of the research units in their central banks and finance ministries.

THE POLITICS OF INTERNATIONAL FINANCIAL REFORM

It is not for lack of ideas that international financial reform has not gone farther. Goldstein (2001) and Eichengreen (1999) review numerous reform proposals on such issues as an international lender of last resort, an international bankruptcy court, private sector bail-ins, transparency, the size and role of the IMF, and standards and regulations. So what is impeding further progress? To answer that question, this section first examines how different stakeholders view the goals of enhanced financial stability and market efficiency and of enabling developing countries to share more of the benefits of this global public good. It then explores which reforms the different stakeholders support.

Political support for enhanced reform

Many stakeholders participate, officially or unofficially, in international debates and negotiations on financial reform and the development of a new international

financial architecture. These participants usually include government officials from industrial and developing countries—mainly representing central banks and finance ministries—as well as representatives of banks and financial markets. Other participants may include representatives of national aid agencies, parliaments, trade unions, nonfinancial multilateral agencies, and international financial institutions. Only recently have civil society organizations started to focus on international financial architecture issues other than developing countries' debt (Scholte 2001). To keep the analysis manageable, the focus here is on the three main groups of actors: government representatives from industrial countries, government representatives from developing countries, and bank and financial market representatives. (Civil society organizations are considered in the next section, on policy options.)

All the key stakeholders share two objectives: international financial stability and economic growth in developing countries (table 1). Growth is the main objective for developing countries, but for industrial countries and financial market participants it is a secondary concern. Stability is also a secondary concern of market actors. But the crucial point is that there are shared concerns and common ground for beneficial policy reform—making the limited progress on such reform all the more puzzling.

TABLE 1

Objectives of key stakeholders in efforts to reform the international financial architecture

Stakeholder	Main objectives	Secondary objectives
Industrial country governments ^a	<ul style="list-style-type: none"> • Growth in their economies and other major economies • Profits for their financial sectors • International financial stability and market efficiency 	<ul style="list-style-type: none"> • Growth in developing countries • No international financial crises and no requests for large bailouts
Developing country governments ^a	<ul style="list-style-type: none"> • Growth in their economies • International financial stability and market efficiency • Stable, sufficient capital flows 	<ul style="list-style-type: none"> • Growth in industrial countries
Banks and financial markets	<ul style="list-style-type: none"> • Large profits 	<ul style="list-style-type: none"> • International financial stability^b • Growth in industrial and developing countries

a. Mainly representatives of central banks and finance ministries.

b. Though most financial stakeholders share this objective (in a relatively weak way), some (such as hedge funds) benefit from a certain amount of volatility.

Political support for specific measures

Underlying the general consensus on the broad goals of financial reform are very different views on the desirability of specific reforms. (Table 2 lists the most common of these reforms, some of which are considered below.) Consider capital account liberalization. Banks, which wield enormous influence in industrial countries, seek large profits as their main objective. Hence they strongly prefer open capital accounts, which allow them to move funds quickly across countries. Other participants in international financial markets (hedge funds, mutual funds, options traders) also benefit from this setup.

If such movements are determined by the economic fundamentals of the host country, they enhance efficiency and should be welcomed. But this open environment can also generate excess volatility in arbitrage and speculation, undermining the efficiency of resource allocation and provoking costly crises. Indeed, some financial actors—such as hedge funds—exploit increased exchange rate volatility during crises. Such actors will resist measures to restrict or regulate capital account openness.

Industrial country governments generally share this preference for open economies and free markets (though recent crises have somewhat tempered their views on capital account liberalization). Developing countries, on the other hand, stand to gain more from a gradual opening of their capital accounts. These countries will only benefit from this process if it favors long-term flows and if they are prudent about liberalizing short-term and easily reversible flows, to help avoid crises. Most developing countries that have opened their capital accounts have done so as part of World Bank and IMF programs, reflecting the pressures and preferences of industrial countries and their financial sectors.

On the proposals to provide sufficient liquidity during crises by adapting the IMF's Contingency Credit Line or by issuing temporary, self-liquidating Special Drawing Rights (SDRs), implementation is lacking because industrial country governments oppose both measures.⁶ The U.S. government, which has veto power on the IMF board, is especially resistant. One reason is that industrial countries can borrow in international capital markets on terms similar to what they would receive with such an allocation. But this option is not available to developing countries, which must borrow at a premium (UNCTAD 2001b, p. 22).

As for increased development finance, developing countries clearly support it. Market participants vaguely support it because they benefit indirectly from development finance that helps strengthen banking systems or stock markets in developing countries. But several of the main industrial country governments oppose more development finance. Indeed, the Meltzer Report (IFIAC 2000) recommends significantly reducing development lending. As a result there has been no increase in development finance, and there is even a risk of a decrease (as noted earlier with trends in official development assistance).

TABLE 2

Attitudes of key stakeholders toward specific reforms of the international financial architecture

Reform	Industrial country governments	Developing country governments	Banks and financial markets	Outcome
Capital account liberalization	Support	Reluctant	Support	Implemented ^a
Codes and standards	Support	Some oppose or have reservations	Vaguely support	Implemented
Sufficient official international liquidity	Reluctant	Support	Support	Not implemented ^b
Increased development finance	Very reluctant	Support	Vaguely support	Not implemented
Sufficient, appropriate international regulation	Lukewarm	Lukewarm, linked to representation	Do not support	Not implemented
Debt standstills and orderly workouts	Support, some quite strongly	Support is weak but interest varies	Do not support	Not implemented
Increased developing country participation	Very reluctant	Support	Indifferent	Not implemented

a. By most developing countries. Some major ones—such as China and India—have taken a more gradual, prudent approach.

b. Though IMF resources have been increased and new facilities have been created since the East Asian crisis of the late 1990s, there is insufficient liquidity for quick disbursements should crises occur and spread.

Despite extensive discussions on a rule-based framework for debt standstills and workouts, including in the G-10 and the IMF, there has been little action thus far. Some industrial country governments, backed by the IMF and World Bank, are eager for progress in this area (Brown 2001; Krueger 2001). But most market participants are strongly opposed because of fears that such a framework will make it easier for developing countries to postpone or reduce debt servicing or other capital outflows. Some developing countries, especially Latin American ones and the Russian Federation, also oppose such a framework because they fear that it would discourage new private flows, increase their costs in normal times, and accelerate initial outflows during crises.

Progress has also been limited on increasing developing country participation in global governance. The creation of the G-20 is a welcome development, but it does not appear to be a decisionmaking body. Moreover, international groups such as the Financial Stability Forum have been created with almost no developing country representation—because most industrial country governments oppose it. Canada, the Netherlands, and Scandinavian countries tend to be far more open to such participation, as are most foreign affairs and development cooperation ministries or departments. And the September 2000 Commonwealth Finance Ministers Meeting, which included Australia, Canada, New Zealand, the United Kingdom, and many developing countries, explicitly endorsed developing country participation. Yet the treasuries and central banks of some of the main industrial countries, and especially their civil servants, resist such participation.

Thus when industrial country governments and market participants support reforms, they tend to be implemented. When developing countries support reforms, no action occurs. Industrial country governments seem to be the key stakeholder group, though banks and market actors are also influential. This pattern persists because the reforms of primary interest to developing countries would require industrial countries to provide resources or take other policy action.

SHAPING THE REFORM AGENDA: POSSIBLE INITIATIVES FOR DEVELOPING COUNTRIES

To accelerate and deepen international financial reform, developing countries will have to adopt measures that change the incentives of the two other main stakeholder groups—especially industrial country governments.

Demonstrate win-win opportunities

Developing country governments could argue that a new international financial architecture would provide a key pillar for their sustained economic growth and poverty reduction—in the context of a well-managed global economy—and that such growth would contribute to higher global growth, benefiting all actors. The global public good nature of financial stability and market efficiency also needs

to be emphasized. Indeed, developing countries should be guided by a vision—of the possible and the desirable—that industrial and developing countries can jointly achieve.

Adopt and present common positions

Developing countries should try to develop strong common positions on reforms of the international financial architecture. This is a challenging task because there is considerable diversity across developing countries in development levels and patterns as well as in main needs and priorities for a new financial architecture. Different needs should be packaged and alliances formed so that different groups of developing countries support each other's interests. Developing countries and other concerned stakeholders should build more on what unites them than what divides them, particularly in terms of their joint global interests and the common goal of convergence (South Centre 2001). The leadership of larger, more influential developing countries—Brazil, China, India, Republic of Korea, Mexico, the Russian Federation, and South Africa—will prove crucial in this regard.

Strengthen and pool developing country expertise

To elaborate these common positions, developing countries need to focus their efforts and pool technical capacities. This can be done through existing institutions such as the G-24 or G-77, or by creating a new high-level panel of developing country politicians and experts to develop an integrated vision of international financial architecture reform (South Centre 2001).⁷ Developing countries also need stronger capacity to respond to proposed changes and undertake reforms. As noted, developing country representatives—particularly in international financial institutions—would benefit greatly from increased research capacity.

Build coalitions with the international development community and civil society organizations

Some actors in industrial countries are more sympathetic than others to developing country concerns. Potential allies include development cooperation ministries, trade and industry ministries (if they are looking for new markets and opportunities), and nonfinancial international companies such as multinational corporations (if they support stable, rapid growth in developing countries). A dialogue between developing countries and political parties in key industrial countries—especially parliamentarians—is also important, because many seem likely to be sympathetic to developing country positions and to the common pursuit of financial stability and market efficiency. Groups such as Parliamentarians for Global Action could play an important role in this respect.

Civil society organizations and UN agencies would also be important dialogue counterparts. Civil society organizations in industrial countries are particularly important because they are often influential with their countries'

governments, media, and international financial institutions. When focused on a specific issue, such as development or poverty reduction, civil society organizations can be highly effective—as with the strong influence of Jubilee 2000 on debt relief for heavily indebted poor countries.⁸

Promote regional institutions and complements to international financial institutions

Developing countries could also construct more regional institutions and mechanisms to complement international institutions. For instance, existing mechanisms created by regional institutions such as ASEAN+3 need to be developed further and replicated in other regions. As noted, such entities are particularly relevant in areas such as regional surveillance, coordination of macroeconomic policies, and mechanisms for liquidity provision. Regional mechanisms can also strengthen the bargaining position of developing countries for a better international financial architecture.

Link commitments to national reforms to international reforms

Finally, developing country markets—including their financial ones—are of great interest to industrial country investors, lenders, and exporters. The extent to which developing countries strengthen and regulate their financial systems, as well as liberalize their capital accounts, directly affects these interests. Thus developing countries could say that they would be far more willing to implement initiatives of interest to industrial countries (such as financial regulation or more open capital accounts) if industrial countries started reforming the international financial architecture in ways that facilitate more stable capital flows to developing countries.

Similarly, developing countries could argue that their implementation of codes and standards should be linked to new regulations of industrial countries' financial markets that help avoid excessive surges of potentially reversible capital flows. These regulations could complement mechanisms that encourage long-term capital flows and be accompanied by international liquidity mechanisms—with few or no conditions attached—that protect developing countries from crises and prevent contagion. Thus developing countries with prudent macroeconomic policies and regulatory systems could have almost automatic access to sufficient IMF lending if hit by contagion or terms of trade shocks. Low-income countries in that group should be given sufficient access not just to international liquidity but also to development finance. Collective action problems can be overcome if genuine concessions are made by both industrial and developing countries.

CONCLUSION

Developing countries could draw useful lessons from the bargaining tactics used and the vision presented by John Maynard Keynes in the Bretton Woods negoti-

ations, which led to the creation of the postwar international financial order (Skidelsky 2001a, b). In bargaining, Keynes presented two alternatives: an “ideal” scheme with key international elements (such as a large, capable IMF) and a “second best” case in which the international financial system was not properly developed and the United Kingdom would reluctantly follow a far more closed approach to trade and the capital account. A similar argument, adapted to the features of today’s world economy, could be made by developing countries. The two options for the international community are to:

- Construct an international financial architecture that supports development and makes crises far less likely and less costly—not just for developing countries but for the world economy as a whole. Developing countries can contribute to this new architecture by implementing standards, pursuing sound macroeconomic policies, and fully liberalizing their capital accounts.
- Tolerate an incomplete, lopsided international financial architecture that cannot guarantee support for developing countries’ aims. Under such a system developing countries will not be able to fully open their capital accounts and integrate with the world economy. Instead they will have to defend their policymaking autonomy to protect their interests in a “second best” international financial system.

Developing countries—like Keynes in the 1940s—could show that the “first best” international financial architecture is superior because it would benefit all actors. It would support more stable growth in developing countries as well as benefit many actors in industrial countries. Perhaps more important, it would immediately increase international financial stability and efficiency. Just as Keynes appealed to U.S. internationalism and liberalism to help overcome opposition to his proposals, developing countries could appeal to U.S. ideals of supporting and deepening the market economy around the world. Also like Keynes, developing countries should prepare a clear vision and blueprint of the elements that would need to be included in a “first best” international financial system.

NOTES

1. The Financial Stability Forum was convened in April 1999 to promote international financial stability through information exchange and international cooperation in financial supervision and surveillance. It brings together on a regular basis national authorities responsible for financial stability in significant international financial centers, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. It seeks to coordinate the efforts of these bodies in order to promote international financial stability, improve the functioning of markets, and reduce systemic risk (<http://www.fsforum.org/>).

2. The G-20 is a forum for industrial countries and emerging markets to discuss and assess policy issues, with a view to promoting international financial and economic stability. This international forum of finance ministers and central bank governors includes 19 countries, the European Union, and the Bretton Woods Institutions (the International Monetary Fund and the World Bank). The G-20 member countries include Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, the Russian Federation, Saudi Arabia, South Africa, Turkey, the United Kingdom, and the United States (<http://www.g20.org/indexe.html>).

3. In accordance with Article IV of its Articles of Agreement, the IMF holds consultations, normally every year, with each of its members. These consultations are not limited to macroeconomic policies, but touch on all policies that significantly affect the macroeconomic performance of a country, which, depending upon circumstances, may include labor and environmental policies and the economic aspects of governance. (<http://www.imf.org/external/np/exr/facts/surv.htm>)

4. The G-10 is composed of the countries that participate in the General Arrangements to Borrow. These arrangements were established in 1962, when the governments of eight IMF members—Belgium, Canada, France, Italy, Japan, the Netherlands, the United Kingdom, and the United States—and the central banks of two others—Germany and Sweden—agreed to make resources available to the IMF for drawings by participants and, under certain circumstances, nonparticipants. The G-10 was strengthened in 1964 with the addition of Switzerland, then a nonmember of the IMF, but its name remained (<http://www.imf.org/external/np/exr/facts/groups.htm#G10>).

5. This phrase was coined by Gerry Helleiner.

6. SDRs have not been issued since 1981.

7. Established in 1971, the G-24 on International Monetary Affairs has one main objective: aligning the positions of developing countries on monetary and development finance issues. For a complete list of member countries, see <http://www.g24.org/>. Established in 1964, the G-77 is composed of developing countries that signed the Joint Declaration of the Seventy-Seven Countries, issued at the end of the first session of the United Nations Conference on Trade and Development (UNCTAD) in Geneva. For a complete list of member countries, see <http://www.g77.org/>.

8. For more information, see, for instance, <http://www.jubilee2000uk.org> and <http://www.jubileeusa.org>.

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