



Washington, DC



Lima, Peru



United Nations Headquarters



Nairobi, Kenya



New Delhi, India

**Final Report and Recommendations
Derived from Multi-Stakeholder
Consultations
Organized by New Rules for Global
Finance Coalition
November 2004 through September 2005**

On “Addressing Systemic Issues”, Section F,
Monterrey Consensus Document
International Conference on Financing for
Development
Monterrey, Mexico, March 2002

Prepared for
UN 2005 World Summit,
Segment on Financing for Development,
September 14-16, 2005



**New Rules for
Global Finance**

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I. INTRODUCTION

The New Rules for Global Finance Coalition is a gathering of non-governmental organizations and academics which started in 1999. Because of their commitment to greater economic justice, members volunteer their time and talent to identify and promote viable policy options that can prevent financial crises, or mitigate their effects, especially for poor people and poor countries. The members believe that financial stability, equitable and environmentally sustainable growth, when combined with transparent and accountable governments and public and private financial actors, can be powerful means toward poverty eradication. New Rules has been engaged with the Financing for Development process since 2000. Because of the expertise that the Coalition brings, and its long-standing commitment to FfD, the UN Financing for Development Office invited New Rules to serve as the civil society convener of this series of multi-stakeholder consultations.

The New Rules for Global Finance Coalition has worked for the past year on Multi-Stakeholder Consultations on Systemic Issues in order to promote implementation of Section (F) of the Monterrey Consensus Document. In each of five sessions—in Washington, DC at the IMF; in Lima, Peru; in Nairobi, Kenya; in New Delhi, India; in New York City at the United Nations — New Rules has worked with other multi-stakeholder participants to identify well-researched and politically viable policy proposals that could leverage significant change toward the goals articulated at the Monterrey Conference.

Each session explored the same core agenda:

- 1) Assessment of official steps taken to prevent and reduce global financial crises;
- 2) Policy proposals to prevent financial crises;
- 3) Policy proposals to provide credit to countries in financial crises;
- 4) Mechanisms to manage risks arising from financial crises; and
- 5) Governance of the IMF, World Bank, and other financial rule-making bodies, including the Bank for International Settlements, the Financial Stability Forum, and the Basle Committees.

The original plan was presented to UN country delegates on July 21, 2004. Each step of the process has been documented on the New Rules website and through a link on the UN Financing for Development (FfD) Office website: www.new-rules.org and www.un.org/esa/ffd.

The New Rules for Global Finance Coalition expresses its deep appreciation to all who participated in these Consultations. Each person shared deeply and generously his/her analysis insights, and values. The recommendations set forth here are exclusively those of the New Rules Coalition. As agreed in the terms of reference for the Consultations, these recommendations do not represent any consensus or majority position among participants. Nor can they begin to capture the rich and varied dialogue of those gatherings.

The Coalition also thanks the co-conveners: in Lima, the Asociacion Latinoamerica de Organismos de Promocion de Desarrollo (ALOP); in Nairobi, the Kenya office of the Southern and Eastern Africa Trade, Information, and Negotiations Institute (SEATINI) and the Friedrich Ebert Stiftung; and in New Delhi, the Institute for Human Development and International

Development Economics Associates (IDEAS) Network. None of this would have been possible without the financial support of the Open Society Institute, the Swedish Foreign Ministry, the Commonwealth Foundation, the Friedrich Ebert Stiftung, the UN Development Program, the UN Foundation, and of course the excellent staff of the UN FfD Office. New Rules would also like to thank the Ford Foundation for core funding, and the Financial Policy Forum for serving as the fiscal agent.

A. GOAL OF THE MULTI-STAKEHOLDER CONSULTATIONS ON SYSTEMIC ISSUES

The ultimate goal of these Multi-Stakeholder Consultations is to improve financial market stability in order to better prevent financial crises and encourage more stable financing for development, thereby contributing to poverty eradication. Instrumental goals include identifying specific concrete policies that can contribute to this end, in collaboration with a broad array of stakeholders--policy makers, policy experts, business people, NGOs and the like. These policy recommendations can contribute to the debate, but hopefully, they will be implemented and become tools to achieve that ultimate goal

New Rules and the many participants in this consultative process also have a commitment to the United Nations, to strengthening its role and effectiveness in the global challenge to finance development. The specific focus of our energies is to ensure that the follow-up process to the UN's International Conference on Financing for Development provides a successful vehicle for generating dialogue, proposals for change, and effective outcomes.

Each of the five meetings had a specific focus and therefore a specific contribution. In the first meeting at the IMF, three key themes arose: first, the need to integrate all development funding and initiatives and to tailor them to specific country situations; second, the need to ensure that the World Bank and IMF's Standards and Codes as well as the Basel II Standards, that developing countries are encouraged to use to strengthen their financial sectors, be genuinely suited to each country; and third, that the IMF requires reform of its governance, and then and only then, additional resources to serve its proper role in the global market.

In Lima, the fact of negative net flows to most developing countries, including middle-income countries, was the pervasive reality influencing the discussion. This was counter-balanced by the awareness that capital now flows from developing countries to developed countries to secure hard currencies that serve as expensive self- insurance against financial crises. This twin reality supported the recommendation for an international debt forum, and debate around the proposal for borrowing in local currencies.

Nairobi put three issues squarely on the table: first, that commodities are a key problem for the least developed countries, given their short term price volatility and their long term negative price decline; second, that credit for small and medium enterprises has all but disappeared in the quest for fiscal discipline and privatizations; and third, that African countries especially have virtually neither voice nor vote on the Boards of the World Bank and IMF.

New Delhi brought the perspective of the more successful South and East Asian countries. The discussion confirmed the need for an active and capable government to compensate for market failures. India's long and deep experience with micro-finance contributed nuance and caution to the enthusiasm over micro-finance institutions, along with the need for "universal" access to banking and financial services. Thirdly, India's leadership in the WTO lends a note of caution to the governance reform debate. Trade negotiations are increasingly bilateral and regional, rather than global, with greater power asymmetry than in the WTO.

While the Consultation at the United Nations was largely a reporting event, three strong themes emerged there as well. First, the need—and the difficulties surrounding the need—for developing country governments to be able to engage in counter-cyclical policies to smooth out financial crises. This debate echoed the IMF discussion, where abrupt and severe adjustment policies were associated with insufficient financial support from the Fund to the country in crisis. Second, the private sector and developing country representatives joined with the civil society representatives to call for greater openness and broader representation in the often-obscure rule-making bodies such as the Bank for International Settlements, the Financial Stability Forum, and the various Basel Committees. And third, a solid discussion of the centrality of taxes as the primary source of development financing. However decisions on international tax protocols tend to be made in another exclusive body, the OECD. There, the concerns of developed countries, such as those about money laundering and money to fund terrorism and drugs are addressed, but the interests of developing countries go unrepresented.

This report cannot do full justice to these many rich discussions. And, according to the ground-rules established by the UN Financing for Development Offices, all recommendations can only belong to New Rules. This arrangement ensured that representatives of governments and intergovernmental organizations could participate actively in the Consultations, since they were not involved in formal negotiations over the language of recommendations.

B. ASSESSMENT OF THE STATUS QUO

The financial system is vast, complex, and imperfect, fraught with myriad problems. Before launching these Consultations, New Rules identified three core problems to guide its analysis and prescriptions.

1. The current financial system is too often characterized by disturbances, instability and uneven distribution of capital. There are cycles of boom and bust, of financial surges and droughts, over and under valuations of commodities, securities and of currencies. Markets can change from being risk averse to risk loving. These fluctuations often impede development and worsen poverty, particularly for low-income and commodity dependent countries.
2. For too many developing and emerging market countries, international financial capital flows have often been insufficient to promote sustained development. As conduits for these flows, financial markets frequently lack the appropriate level of prudential regulation. This is especially the case in areas such as hedge funds and over-the-counter derivatives.

3. The governance structures of global financial rule-making bodies do not conform to contemporary standards of legitimacy, thereby undermining their effectiveness. While virtually all countries are members of the IMF and World Bank, these bodies are effectively organized and led by the developed countries. In fora such as the Bank for International Settlements (BIS), the Financial Stability Forum (FSF), and at the Basel Committees, there is no pretense of global membership or representation even though their rule making impacts all countries. In addition, private standard setting bodies such as those for auditing and accounting, also formulate international financial policies. Governance is an issue of justice as well as effectiveness.

Official steps to promote global financial stability, adequate investment finance, and greater equity in governance of rule-making bodies have been disappointing. Reforms have focused excessively on changes to financial sectors in developing countries, while insufficient attention has been given to reforms of developed countries' financial markets, or other key areas. At the same time, the IMF lacks adequate and appropriate resources and facilities to respond promptly to financial crises.

Some recent progress has been made around several of the recommendations. For example, an IMF document examining the commitments made by the G8 at Gleneagles opens the possibility for a new facility for countries facing external shocks. Also, strong voices from private banks and from several middle income countries are endorsing the need for an arrangement along the lines of an International Debt Framework, recommended here.

C. REPORT'S RECOMMENDATIONS

This report contains New Rules' recommendations of concrete, viable policies for improving the financing of development. These measures, when implemented, will encourage more stable capital flows, more equitable distribution of capital across regions and economic sectors, and help provide sufficient amounts of finance for growth that will raise living standards. The recommendations also address needed changes in the governance of global financial rule-making bodies.

Some recommendations require action by the UN, and some require action in other international fora. Others can be implemented by individual countries acting alone. These recommendations represent the 'art of the feasible.' They might best be described as a process of "radical incrementalism"¹ that will bring the world closer to realizing the vision of Monterrey. The hope is that these Recommendations will inform the policy debate, and, of course, ultimately and hopefully soon, that they will be implemented by all relevant actors.

¹ This approach was described and recommended by Francisco Sagasti, Keith Bezanson, and Fernando Prada, in The Future of Development Financing: Challenges, Scenarios and Strategic Choices (Institute of Development Studies, University of Sussex, for the Global Development Studies Series, Expert Group on Development Issues, Ministry of Foreign Affairs, Government of Sweden, January 2005).

II. RECOMMENDATIONS: PREVENTING FINANCIAL CRISES

53. ...*We also underscore our commitment to sound domestic financial sectors, which make a vital contribution to national development efforts, as an important component of an international financial architecture that is supportive of development.*

Source: Monterrey Consensus Document.

Despite the severity and reoccurrence of financial crises, too little has been done to design and implement preventative measures. Pursuing good macro-economic policy is not enough, and the policy of opening financial markets to international transactions before first establishing proper prudential regulatory measures and enforcement authorities was reckless to begin with and has ended in numerous disasters.

The challenge of proposing effective and viable remedies to financial instability was addressed at each Consultation. The discussions and proposals in the Multi-Stakeholder Consultations on the issue of crisis prevention focused largely on the following four areas: 1) The need for domestic prudential regulation of financial markets and especially derivatives; 2) The need for developing countries to be able to implement counter-cyclical policies; 3) The wisdom of borrowing in local instead of hard international currencies; and, 4) The challenge to reduce exposure to commodity price volatility through the use of derivatives and other measures.

A. PRUDENTIAL REGULATION OF FINANCIAL MARKETS

Prudential regulations can improve the resiliency and viability of financial institutions, as well as enhance the efficiency, dependability and stability of financial markets and the overall economy. This latter point is sometimes overlooked. The Standards and Codes project of the International Monetary Fund (IMF), World Bank,² Bank for International Settlements (BIS) and Financial Stability Forum (FSF), amongst others, focuses their efforts primarily on accounting, governance and capital adequacy of financial institutions in developing and emerging market countries. It does not adequately address issues such as how they act as dealers in over-the-counter (OTC) markets for foreign currency, securities, derivatives and repurchase agreements. Prosperous financial firms might well withdraw from market making activities in these markets, and leave them illiquid at critical moments. The results can be economically catastrophic.

Similarly, derivatives are treated primarily as a matter of credit risk to individual financial institutions, and not also as a matter of market risk and overall liquidity risk. Transparency is praised, but it is but not enforced with regard to reporting requirements for market prices, trading volume, open interest in the market and large trader position. Proper market surveillance by regulatory authorities is not possible without such information. And without such transparency and surveillance to detect and deter fraud and manipulation, investors cannot be assured that prices are fair and honest. Liquidity too is praised, yet regulators do not require that dealers in OTC markets maintain binding quotes throughout the trading day. A notable exception is for primary dealers in US Treasury securities markets where such market-making activities are

² The IMF and World Bank are often referred to jointly as the Bretton Woods Institutions since they were both founded at the Bretton Woods Conference in 1944.

required as a condition for being registered as a primary dealer. The result is to assure that U.S. government securities markets are liquid throughout the trading day. The point is not to be ‘anti-derivatives’, a concern raised by the Consultation in Washington, D.C., but rather to promote their use for risk management while discouraging the build-up of large, speculative positions, such as occurred prior to the Mexican and East Asian crises and their misuse in Enron-type activities.

In addition to the need to apply prudential regulations to markets and financial transactions and not just financial institutions, the application of prudential regulatory measures to developing country financial markets should also take into consideration their particular national circumstances and the intense impact of macro-economic risks on domestic financial institutions and markets.

New Rules recommendation:

1. Design and implement prudential regulations for financial markets and financial institutions in order to enhance transparency, govern risk taking and foster orderly marketplaces. This should reduce the build up of exposures to risks in such areas as foreign exchange, maturity mismatch, liquidity, and concentrated credit exposures. Especially important is the application of prudential regulation to derivatives markets, which are growing rapidly in the developing world.

B. COUNTER-CYCLICAL POLICIES³

Developing economies have too often suffered from pro-cyclical monetary and fiscal policies due to pressing needs to defend their foreign exchange rate regimes or to urgent shortcomings in their ability to raise tax revenue or borrow abroad. Developing countries need to avoid the pro-cyclical effects of contracting their economies during hard times and stimulating their economies during boom times, and they need to create sufficient policy space for counter-cyclical policies.

One policy tool that can help to create useful policy space is the adoption of price-based capital controls – especially the unremunerated reserve requirement like those adopted by Colombia, Chile and now Argentina – which can contribute toward preventing exchange rate appreciation during the boom period and thereby free up monetary policy for other objectives, such as expansionary policy in the event of an economic contraction.

Another policy tool involves the use of prudential regulation. While these measures aim primarily at the safety and soundness of financial institutions and market activity, they also can have the effect of limiting certain types of risk taking and this will create more latitude within which governments can conduct counter-cyclical policy.

³ Jose Antonio Ocampo, “Capital-Account and Counter-Cyclical Prudential Regulations in Developing Countries,” Prepared as part of the UNU/WIDER-ECLAC Project on Capital Flows to Emerging Markets Since the Asian Crisis, February 2003.

However some prudential measures can act in a pro-cyclical way. This includes the required accumulation of loan-loss reserves by banks. This measure reduces the availability of credit once the economy is in a recession or crisis and thus reduces the capacity of banks to increase credit so as to move into a recovery. Capital requirements can also act pro-cyclically if the market value of regulatory capital or the measurement of credit risk exposure moves in a pro-cyclical manner. Another example is the collateral management policy of OTC derivatives dealers who require no collateral up front but then require rapidly increasing amounts once their counter-party gets into trouble – this serves, in effect, as a crisis accelerator. Moreover the tendency to adopt new and stronger prudential measures during a downturn also has the pro-cyclical effect of dampening recovery efforts.

In contrast, forward-looking prudential regulatory provisions can interject counter-cyclical forces into the financial sector. Examples of this include requiring that funds for loan-loss be put aside at the beginning of the loan and that collateral for OTC derivatives be posted in sufficient amounts from the beginning – the policy longer required for exchange traded futures and options.

Included under prudential regulation is the government's own debt management policy. Governments should foster the use of longer maturity and fixed-rate debt instruments so as to help prevent the government's interest payments and funding requirements from generating pro-cyclical fiscal effects during a crisis.

New Rules recommendation:

2. Adopt appropriate prudential regulations and, when needed, price-based capital controls in order to facilitate the use of counter-cyclical monetary and fiscal policies by developing country governments. Appropriate prudential regulations include forward-looking loan-loss provisions and collateral requirements for derivatives.

C. INTERNATIONAL LENDING IN LOCAL CURRENCY

The buildup of enormous amounts of debt denominated in major currencies – most of all the US dollar – poses one of the largest, if not the largest, single source of instability in the developing world. These large exposures to foreign exchange rate and interest rate risks make developing countries more vulnerable to foreign shocks as well as disturbances in their own economies. The experience of the last 25 years indicates that the hard currency debt has acted as catalyst and fuel for most of the financial crises in the developing world.

One big step toward solving this problem is for developing countries to avoid foreign currency exposures by borrowing in their own currencies (and accordingly for international investors to lend in those local currencies). The benefits to the developing countries are clear: substantially lower foreign exchange exposures; better credit ratings; more seigniorage; and improvements in the efficiency of local securities markets.

The benefits to investors are great but perhaps less obvious. By employing the risk management technique of diversification, investors can capture substantial benefits by creating portfolios of low correlated local-currency denominated government debt securities. Through such diversified portfolios, investors can obtain a return-to-risk that competes favorably with security indexes in the major capital markets.

The gains from diversification are based on the low degree of correlation between the returns of the various local currency assets. While the rate of return on any one local currency asset may be highly volatile – thus creating a poor risk-adjusted rate of return – the combination of highly volatile but lowly correlated returns produces a portfolio with returns that are the average of the returns in the various currencies but with a variance that is substantially lower. One study found shows that such a portfolio had lower volatility than the S&P500 and EMBI+ (dollar denominated emerging market debt) over the period from 1992 to 2004.⁴

New Rules recommendation:

3. Promote international lending in local currencies in order to prevent buildup of foreign exchange rate risk and to encourage improvements in local financial markets, and promote international investing through the use of diversified portfolios of local currency assets.

D. COMMODITY PRICE RISK MANAGEMENT⁵

37. *..It is also important to empower developing country commodity producers to insure themselves against risk, including against natural disasters*

Source: Monterrey Consensus Document

Many developing countries are highly dependent upon the price of a few commodities for a majority of their export earnings. This situation often results in a high degree of correlation between the prices of those commodities and their export earnings, GDP and government revenues. Through this macro-economic impact, commodity price risk has profound consequences for governments, individual producers and consumers in developing countries.

This has long been recognized as a serious problem. Singer expressed this 55 years ago as, "fluctuations in the volume and value of foreign trade tend to be proportionately more violent in that of underdeveloped countries and therefore a fortiori also more important in relation to national income."⁶ The World Bank concurs. "The fact that commodity prices have become more volatile since 1973 has hit low-income countries the hardest. This is because they tend to rely on commodity price exports for a larger proportion of their export earnings. Research shows that downturns in commodity prices tend to vary in length but can last several years."⁷

⁴ Randall Dodd and Shari Spiegel, "Up From Sin: A Portfolio Approach to Financial Salvation," G24 Discussion Paper, January 2005. Available at www.g24.org

⁵ Randall Dodd, "Protecting Developing Economies From Price Shocks," Financial Policy Forum Special Policy Brief, September 2004. Available at www.financialpolicy.org

⁶ H. W. Singer, "The Distribution of Gains Between Investing and Borrowing Countries," *American Economic Review*, May 1950, pp. 473-485.

⁷ World Bank "DevNews" item from March 5, 2004.

The Consultations in Nairobi and New Delhi addressed the problem of commodity price volatility and expressed concerns about both the long-term and short-term dimensions of the problem. This reflects a long-standing awareness of the problems, expressed by Singer as, “The case for stabilization of terms of trade has, it seems to me, nothing to do with the existence of their secular trends but a great deal to do with their large and extremely damaging cyclical and short-term fluctuations. Long-run trends are if anything an argument against stabilization of terms of trade, as I believe most sensible people agree. But the violent cyclical and short-term fluctuations certainly add to the underlying difficulty discerned by Prebisch and others.”⁸

Developing country governments need to hedge their budget revenue’s exposure to commodity price risk. There are a variety of derivative instruments available on exchanges (mostly futures and options) or in over-the-counter markets. While most trading on derivatives exchanges is in near-term contracts, these can be rolled-over in order to provide an effective, low-cost hedge over a longer period of time. This approach was viewed with some skepticism by some participants at the Consultations. However, the experience in many countries over many years is of the private sector, and sometimes the public sector, successfully employing this hedging strategy to manage a vast array of risks. While there are costs and risks to hedging, New Rules believes they are small and manageable in comparison to the costs of not hedging.

Developing countries also should provide improved risk management tools to their small producers. This can entail offering free, non-transferable put options to farmers, in order for them to benefit from some price certainty and longer-term price signals. The government would then need to hedge its exposure from these written put options by selling futures or using OTC derivatives contracts.

New Rules recommendation:

4. Encourage better commodity price risk management by supporting government efforts to hedge the correlation between budget revenues and commodity price fluctuations, and by helping governments provide simple and affordable risk management to small, local producers.

⁸ H. W. Singer, “Comment: The Terms of Trade and Economic Development,” *The Review of Economics and Statistics*, Vol. 40, No.1, 1958, pp.85-90.

III. RECOMMENDATIONS: HEALTHY FINANCING FOR THE REAL ECONOMY--INSURANCE AGAINST FINANCIAL CRISES

Eradicating poverty requires attention beyond the financial sector. Indeed, it requires putting the financial sector to work at the service of the real economy, in order to meet the Millennium Development Goals. A healthy and prosperous real economy is itself a form of insurance against financial crises. Throughout the Consultations, three important themes emerged that addressed the need for direct support for the real economy. The first was the need for greater international tax cooperation to enable developing and emerging market countries to keep domestic wealth at home, and through domestic taxes, provide more resources for development. The second was to ensure that developing and emerging market countries enjoyed sufficient policy space to design their own path to development. And the third, was to recognize the growing need to guarantee universal access to credit, including through restored and reformed national development banks, and through ensuring the growth and integrity of the micro-finance industry.

A. TAXES, THE REAL ECONOMY AND FINANCIAL CRISES⁹

64. To strengthen the effectiveness of the global economic system's support for development, we encourage the following actions:...

- Strengthen international tax cooperation, through enhanced dialogue among national tax authorities and greater coordination of the work of the concerned multilateral bodies and relevant regional organizations, giving special attention to the needs of developing countries and countries with economies in transition.*

65. We commit ourselves to negotiating and finalizing as soon as possible a United Nations convention against corruption in all its aspects, including the question of repatriation of funds illicitly acquired to countries of origin, and also to promoting stronger cooperation to eliminate money-laundering....

Source: Monterrey Consensus Document.

Tax evasion and loopholes in the international tax system have become defining features of global financial markets in recent years. While most of these undeclared funds originate from developed countries, a significant portion also come from developing countries, and deprive them of funds needed for development. The loss in tax revenues generated by evasion in developing countries may be equivalent to the sums needed to achieve the Millennium Development Goals.¹⁰ It seems pointless to think about poverty reduction, if at the same time little is being done to help to rebuild these countries' taxation capabilities, both of their own residents and on foreign-owned capital. The share of these activities in financial markets by trans-national corporations (TNCs), which are prepared to make use of loopholes in the international economy, imparts an unfair competitive advantage over domestic competitors and small and medium size enterprises that do not have the global reach of the TNCs.

Contrary to tax competition, governments agree, in principle at least, on the need to fight tax evasion. However, developing countries are unlikely to want to cooperate with current initiatives of tax

⁹ Sony Kapoor and Meenoo Kapoor, Section on Plugging the Leaks in "Toward the MDGs, *What needs to be done?*", An Issues Paper and Call to Action for Heinrich Boell Foundation, United States, May 2005.

¹⁰ Landau Report, by the working group on new international contributions to finance development, Paris 2004 p. 38.

cooperation, such as developed by the OECD, unless they are fully involved in the discussions and their particular concerns are addressed. A more balanced approach should not only acknowledge that developed countries suffer financially from large scale tax evasion, but that major financial centers in the North serve as the major destination for flight and tax evading capital from developing countries.

According to a comprehensive study by the IMF¹¹, financial services in offshore centers in small island developing states contribute, on average, just a small amount of national revenues, and employ few of the national workforces in these locales. A development approach on the issue of tax evasion should therefore take into consideration both the lack of benefits and of economic alternatives for small island states in the world economy. The need for development assistance to help small, poor and vulnerable economies to diversify from reliance on harmful tax practices is self-evident.

New Rules recommendations:

5. Improve international tax cooperation and introduce systems for automatic information exchange with national tax authorities to combat tax evasion and harmful tax practices.

6. Design an approach to tax evasion, through the UN Committee of Experts on International Cooperation in Tax Matters, that incorporates the need of small, poor and vulnerable economies for development assistance in order to diversify from harmful tax practices.

7. Develop measures that curb tax avoidance in financial centers in developed countries through initiatives such as the one adopted by the OECD to regulate developing countries' performance.

B. POLICIES TO SUPPORT THE PRODUCTIVE ECONOMY, NATIONAL DEVELOPMENT BANKS¹²

53. ... We also underscore our commitment to sound domestic financial sectors, which make a vital contribution to national development efforts, as an important component of an international financial architecture that is supportive of development.

56. We stress the need for multilateral financial institutions, in providing policy advice and financial support to work on the basis of sound, nationally owned paths of reform that take into account the needs of the poor and efforts to reduce poverty, and to pay due regard to the special needs and implementing capacities of developing countries and countries with economies in transition, aiming at economic growth and sustainable development....

Source: Monterrey Consensus Document.

Increasing broad-based growth and productivity rates and reducing poverty call for the development of a financial sector capable of supporting the needs of the productive economy. The market has an important role to play in determining the pattern and allocation of investment.

¹¹ IMF working paper : Caribbean Offshore Financial Centers: Past, Present, and Possibilities for the Future; Washington D.C. , 2002

¹² C.P. Chandrasekhar, "Thematic Summary Report: Financial Liberalization," Independent Report, Commissioned by UNDP, 2004. Available at www.new-rules.org

However, as noted in a growing body of literature, the market sometimes fails to ensure the optimal pattern and allocation. There are especially important shortages for small and medium sized enterprises, for the rural sector, for the agricultural sector, and for financial services for the poor. Over reliance on the market can also lead to undesirable levels of credit concentration. It can hamper credit whose collective or social rate of return (such as innovative activities) is higher than the rate of return that could motivate individual market participants.

The remaining question is how intervention should be implemented. The state can choose from a range of institutional frameworks to influence the pattern of investment. It can become an actor in the financial market through its own participation in providing credit, regulate the private/commercial share of credit, and/or establish development finance institutions.

A menu of policy instruments includes: a) directed and subsidized credit, b) partial subsidies on credit insurance premiums or partial guarantee funds, c) differential and preferential interest rates, d) ceilings and other measures aimed at affecting the deposit-credit ratio, e) state-owned equity investments, and f) the establishment of state-backed development finance institutions.

Many of these policy instruments, far from being new, were used, and remain in use, by today's developed countries at earlier stages of their development, as well as by some late developers. One example is the German reconstruction credit bank. Another is the US Community Reinvestment Act, whereby banks, thrifts and other lenders are required to make credit available in low and moderate-income neighborhoods. The East Asian countries achieved sustained rates of growth and development over long periods of time using similar policies. Today, however, developing countries have been required to dismantle many of these same instruments in the name of financial liberalization.

New Rules recommendations:

8. Design and implement financial regulations that create incentives for private financial service providers to supply adequate availability of long-term credit, on affordable terms and including all sectors and regions, to support the productive economy.

9. Establish national development banks in order to provide affordable long-term financing, as well as technical assistance, to areas and sectors not adequately serviced by the private sector.

C. MICRO-FINANCE

18. Microfinance and credit for micro-, small and medium-sized enterprises, including in rural areas, particularly for women, as well as national savings schemes are important for enhancing the social and economic impact of the financial sector.

Source: Monterrey Consensus Document.

Micro-finance has been the subject of much promise and praise. It appeals to many different people and perspectives through its potential to reduce poverty through market mechanisms,

economic incentives, community participation and group discipline. It also teaches financial literacy and encourages small entrepreneurs to boot-strap themselves out of poverty. It is an anti-poverty policy that costs governments virtually nothing. The donor community and the for-profit private sector have been moving into this area for years. Even major financial institutions, such as Citigroup, have embarked on their own micro-lending ventures. Within the context of the UN Decade for the Eradication of Poverty, the UN General Assembly designated the year 2005 as the International Year of Microcredit stating that the Year will be an important opportunity to give impetus to micro-finance programs throughout the world.

One advantage that has received less attention is its potential to provide credit to small enterprises during times of economic stress. Micro-finance institutions have a different business model than banks. They do not have any large single credit exposures, but instead a multiplicity of small ones. The loans are short-term and the ability of micro-borrowers to repay tends to be less correlated with the overall state of the economy. Moreover, where the funding for micro-lending is more long-term – either donor capital, retained earnings or more recently private capital issuances – it is less sensitive to macro-economic disruptions than bank deposits or interbank loans. Together, these features help make micro-lending a non-cyclical activity.

While such praise has merit, it should not drown out the need for appropriate policies to ensure that micro-finance proceeds with safety and soundness and in the right direction. These new and emerging financial services deserve a prudential regulatory framework that suits their special features. Many micro-lending institutions do not accept deposits or raise capital through public capital markets. Thus these firms need less prudential treatment than those institutions that do. Many micro-lending institutions do not make or receive cross-border transactions (except donor capital), and so these firms need less prudential treatment and suspicious transaction surveillance than those that do. In general, they do not play the same role of making and clearing payments for goods, services and financial transactions in the economy that banks do. Their regulation should reflect this different role. Lastly, most micro-lending institutions seldom or never engage in transactions larger than \$1,000, or even \$500, hence these firms should be largely exempt from concerns about money laundering and terrorist financing.

So far, the regulatory interest in the micro-finance sector has focused on removing anti-usury laws that place a ceiling on interest rates. This effort should not be used as a stalking horse for wider financial market deregulation and the undermining of consumer protections. Micro-finance should be subject to anti-predatory lending laws, truth in lending laws and other such consumer protections. As micro-finance organizations grow in size and scope, they should fall under prudential regulatory rules and supervision like the credit unions and savings associations that have preceded them.

New Rules recommendation:

10. Establish prudential regulatory frameworks that micro-finance institutions need and deserve, that are consistent with their special characteristics and that protect the public interest from financial instability, fraud, and predatory lending.

IV. RECOMMENDATIONS: WHEN CRISES STRIKE

While the emphasis of the Consultations was on crisis prevention, financial crises—from myriad causes—are likely to continue to strike developing and emerging market countries with severely adverse effects. Recognizing this reality, the Consultations explored three areas for action:

1) the need for a comprehensive framework for sovereign debt restructuring, beginning with middle-income countries; 2) ensuring that the IMF has the resources and flexibility to serve as a lender of last resort; and 3) the desirability of establishing a grant facility for the poorest countries when they are beset by commodity shocks.

A. A COMPREHENSIVE FRAMEWORK FOR SOVEREIGN DEBT RESTRUCTURING IN MIDDLE-INCOME COUNTRIES¹³

60. To promote fair burden-sharing and minimize moral hazard, we would welcome consideration by all relevant stakeholders of an international debt workout mechanism, in the appropriate forums, that will engage debtors and creditors to come together to restructure unsustainable debts in a timely and efficient manner.

Source: Monterrey Consensus Document

The lack of an orderly debt restructuring mechanism for middle-income countries not only generates significant costs, it also endangers the stability of the international financial system. Existing ad hoc machinery for debt workouts are disorderly, delayed and inefficient, thereby generating excessive costs for both debtors and creditors. They are also a source of contagion for all emerging market countries. The growing use of collective action clauses (CAC) for bond debts does not involve adequate aggregation of different debt instruments. The business sector's voluntary code of conduct can not solve collective action problems since it lacks binding authority.

Insolvency procedures, such as the Sovereign Debt Restructuring Mechanism (SDRM) of the IMF, or the proposal by Kunibert Raffer modeled after Chapter 9 of the US bankruptcy code, would provide a legal framework for dealing with over-indebted countries. However, major obstacles thwart progress toward debt restructuring: financial market investors and developing countries' governments declined to give the IMF, itself a major creditor, a leading role as a debt negotiator through the SDRM. Political will is lacking to translate new legal measures on international insolvency procedures into national legislation.

These Multi-Stakeholder Consultations presented a new proposal for an International Debt Framework (IDF) that opens a middle ground between legally binding insolvency procedures and a voluntary code of conduct. The mechanism would be initiated by the Group of 20 Finance Ministers from developed and developing countries. It would be available to all middle-income countries, and not limited to G20 member states. To ensure predictability for international

¹³ Kathrin Berensmann and Frank Schroeder, [A Proposal for a New International Debt Framework \(IDF\) for the Prevention and Resolution of Debt Crisis in Middle-Income Countries. A Proposal for a New International Debt Framework \(IDF\) for the Prevention and Resolution of Debt Crisis in Middle-Income Countries,](http://www.new-rules.org) February 2005. Available at www.new-rules.org

creditors the proposed mechanism would provide a general set of principles such as those embodied in the proposal for a code of conduct. The IDF would have two functions: crisis prevention and crisis resolution. The new framework could contribute toward crisis prevention through an IDF secretariat, where permanent debtor-creditor dialogues could take place, along with transparent provision of timely information on emerging market debts.

As a second step, an IDF Commission could facilitate an orderly debt-restructuring mechanism for a financially distressed debtor, convening representatives from the debtor, private creditors, multilateral lenders and sovereign creditors. In contrast to other insolvency proposals, such as the SDRM, the underlying framework for the IDF is not statutory and the mechanism would aim for a coherent and comprehensive restructuring of all types of debt. The IDF Commission would decide on the amount of financial support needed, along with the economic adjustment path that could guarantee long-term debt sustainability.

While many participants in the Consultations acknowledged the importance of a new insolvency procedure for middle-income countries, concerns were addressed regarding its political feasibility. Some concerns referred to whether the private sector and developing countries would support such a mechanism and whether the G20 would be the appropriate forum to initiate the IDF. The discussion clarified that first, in-depth analysis and risk assessments on emerging market debt markets were sorely lacking, and second, the absence of regular dialogues between debtor and creditors was a major obstacle to crisis prevention. Hence, the IDF Secretariat could serve an important function by providing technical expertise and convening regular dialogues.

Moreover, the recent tense debt negotiations between Argentina and its creditors has increased the private sector's interest in new solutions and eased the fear of developing countries that a new international debt restructuring mechanism might delay restoration of access to capital markets. The discussion clarified further that the proposal does not envision the upgrading of the economic decision-making capacity of the G20. However, because of the rejection of the SDRM in the IMF and the lack of political consensus in other multilateral organizations, the framework could be initiated on the level of finance ministers in the G20. It was also noted that as soon as a new International Debt Framework was established, it would be necessary to refer to the rules of the IDF in contracts between debtors and creditors, such as bond contracts and investment treaties, to prevent individual creditors from resorting to litigation.

New Rules recommendation:

11. Develop a new mechanism, the International Debt Framework (IDF), to improve crisis prevention and resolution in the international financial system. The mechanism could be initiated by the Group of 20 Finance Ministers from developed and developing countries. After its establishment, the IDF should not be limited to G20 member states.

B. IMF: LIQUIDITY IN TIMES OF CRISIS¹⁴

59. Noting the impact of financial crisis or risk of contagion in developing countries and countries with economies in transition, regardless of their size, we underline the need to ensure that the international financial institutions, including the International Monetary Fund, have a suitable array of financial facilities and policies. The International Monetary Fund has a range of instruments available and its current financial position is strong. The contingent credit line is an important signal of the strength of countries' policies and a safeguard against contagion in financial markets. The need for special drawing rights allocations should be kept under review....

Source: Monterrey Consensus Document.

Like their domestic counterparts, international financial markets are more stable when there is an adequate lender of last resort. The IMF is expected to serve this function, but its resources have proven inadequate, it has been slow to respond in some circumstances, and its policies often inappropriate. The magnitudes of recent financial crises have shown that more loanable funds are needed to restore market order and commence economic recovery. In a different vein, the lack of participation in the IMF's contingency credit facilities demonstrated significant design flaws, and hence the inability to provide credit to countries faced with natural disasters or commodity price shocks.

Developing countries pay a heavy price for these shortcomings. Recovering from crises is all the more slow and burdensome without adequate resources to promote new investment and growth. Absorbing natural disasters and price shocks is particularly costly when there is a lack of resources for counter-cyclical measures.

In addition, developing countries are harmed by not having access to sufficient emerging credit to help stem incipient capital outflows, speculative attacks on their currency or other financial disruptions. In some cases, the burden shows up as a self-insurance policy that involves the accumulation of large foreign reserves of major currencies – especially the US dollar – which is a costly form of self-insurance against financial crises that could be more productively employed elsewhere in developing economies.

The situation is even more severe for the least developed countries, which, unable to borrow in their local currencies, have to borrow hard currencies on the international market or from international financial institutions to finance fiscal and current account deficits. Appropriate facilities and instruments for developing countries for the provision of foreign-exchange liquidity are, therefore, an important element in economic development.

The Consultations in Washington and Lima discussed the possible use of additional allocations of Special Drawing Rights (SDRs) to increase available credit to developing countries. This would allow countries to build reserves without any hindrance for public spending.

In contrast to the expectation that the private markets would always supply global liquidity, Article XVII of the IMF Articles of Agreement empowers the IMF to create liquidity needed to accomplish its purposes. The SDRs were designed to serve that end. The quota revision should

¹⁴ Ariel Buira, "The IMF at Sixty: An Unfulfilled Potential?", The IMF and the World Bank at Sixty, (London: Anthem Press, 2005).

bring resources back to the size set in 1944, where Fund resources were roughly 58 percent of world trade. They currently stand at approximately 4 percent.

In addition, the Fund should expand the size of the first tranche of an arrangement, which now stands at one-third of the total amount of the arrangement, in order to better accommodate borrowing needs at the onset of a crisis. Further, the IMF should create a new contingent credit facility to improve on shortcomings of the defunct Contingency Credit Line and Compensatory Financing Facility.

New Rules recommendation:

12. Increase the amount of IMF credit available in times of crisis by expanding the use of SDRs and increasing the size of quota-linked funds. The IMF should also facilitate the recycling of surplus funds from countries with current account surpluses to those with deficits using vehicles such as the oil facility. Establish a new version of the CCL with more funding and fewer costs and conditions than its predecessor.

C. RESPONDING TO EXOGENOUS SHOCKS¹⁵

56. We stress the need for multilateral financial institutions, in providing ... financial support... to pay due regard to the special needs and implementing capacities of developing countries and countries with economies in transition, aiming at economic growth and sustainable development.

59 ... (W)e underline the need to ensure that the international financial institutions, including the International Monetary Fund, have a suitable array of financial facilities and resources to respond in a timely and appropriate way in accordance with their policies.

Source: Monterrey Consensus Document.

Low-income countries suffer from multiple, frequent and severe shocks, ranging from instability of aid and trade flows, to natural and climatic disasters. At the same time, planning and management of these shocks is poor, with the international financial institutions persistently under-estimating their risks and impact. Shocks impact negatively on GDP and evidence now suggests that they hit the poor the hardest, thereby provoking a major set-back for progress towards the Millennium Development Goals (MDGs). Furthermore, economic shocks undermine debt sustainability in a number of indebted low-income countries, as well as threatening countries' fiscal position.

The international community has been ineffective in protecting against shocks and/or cushioning the impact. More attention must be given to avoiding the occurrence of such shocks through better forecasting and policies as well as counteracting them rapidly with financing that is cheap, flexibly, sufficient, and free of excessive conditionality.

Private sector solutions such as self- or regional country insurance mechanisms could complement an anti-shocks facility. However, this solution would be useful only for single

¹⁵ Matthew Martin and Hannah Bargawi, "Protecting Africa Against "Shocks."" Debt Relief International, September 2004. Available at www.new-rules.org

shocks, not for multiple shocks across time and locations. In addition, the price and technical capacity needed to use many of these mechanisms reduce their utility for low-income countries. Commodity price agreements or stabilization tools could be useful tools but only for some types of shocks.

An effective anti-shock facility should be created through the provision of extra financing. In designing this facility it is unavoidable to examine the adjustment vs. financing balance. In this context, it would be important to limit the adjustment element, so as to ensure that financing decisions are driven by the needs of the country affected by the shocks, and not by the political agenda of various donors.

New Rules recommendation:

13. Establish a fast-responding, overarching, grant-financed shocks facility for low-income commodity dependent countries. It could be administered by a Bretton Woods Institution.

V. GOVERNANCE

A. GOVERNANCE OF THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND¹⁶

An overarching concern of these Consultations was the need to ensure broad political and strategic guidance at the international level that is essential to the implementation of the complex development agenda. The need for mechanisms along the lines of the Secretary General's proposal for establishing an Executive Committee of ECOSOC at the intergovernmental level was underscored.¹⁷ The following recommendations address more specific and complementary proposals that would implement the Monterrey Consensus mandate to reform the governance of: the Bretton Woods Institutions, and of other financial agenda and standard-setting bodies.

61. Good governance at all levels is also essential for sustained economic growth, poverty eradication and sustainable development worldwide. To better reflect the growth of interdependence and enhance legitimacy, economic governance needs to develop in two areas: broadening the base for decision-making on issues of development concern and filling organizational gaps.

62. We stress the need to broaden and strengthen the participation of developing countries and countries with economies in transition in international economic decision-making and norm-setting.

63. A first priority is to find pragmatic and innovative ways to further enhance the effective participation of developing countries and countries with economies in transition in their international dialogues and decision-making processes. ...we encourage the following actions:

- *International Monetary Fund and World Bank: to continue to enhance participation of all developing countries and countries with economies in transition in their decision-making, and thereby to strengthen the international dialogue and the work of those institutions as they address the development needs and concerns of these countries. ...*
- *Ad hoc groupings that make policy recommendations with global implications: to continue to improve their outreach to non-member countries, and to enhance collaboration with the multilateral institutions with clearly defined and broad-based intergovernmental mandates.*

53. Important international efforts are under way to reform the international financial architecture. Those efforts need to be sustained with greater transparency and the effective participation of developing countries and countries with economies in transition.

Source: Monterrey Consensus Document.

The current Boards of the World Bank and International Monetary Fund¹⁸ continue to reflect the economic weights of the world of 1944, with 60% of the votes allocated to the industrialized countries and 40% to the rest of the world. Today, these allocations do not conform to the size

¹⁶ Murilo Protugal, "Improving IMF Governance and Increasing the Influence of Developing Countries in IMF Decision-Making," G24 Technical Group Meeting, March 2005, and Vijay L. Kelkar, Praveen K. Chaudhry, Marta Vanduzer-Snow, and V. Bhaskar, "The International Monetary Fund: Integration and Democratization in the 21st Century," G24 Technical Group Meeting, March 2005. Available at www.g24.org

¹⁷ UN Secretary General, "In larger freedom: towards development, security and human rights for all." Integrated and coordinated implementation of and follow-up to the outcomes of the major United Nations conferences and summits in the economic, social and related fields. Follow-up to the outcome of the Millennium Summit. A/59/2005, 21 March 2005.

¹⁸ Discussion will focus on the IMF since the allocation of votes and seats on the World Bank depends in large part on IMF quota allocation.

of economies or of population. Indeed the very formula for allocation is unscientific and biased toward the existing largest vote holders.

Three elements should be included in any future quota formula: 1) Measurement of economies by Purchasing Power Parity (PPP), instead of the current approach which translates the national GDP into market-based exchange rates, thereby unfairly underestimating the size of developing country economies. 2) Measurement of a country's need for IMF support, which could be captured by the variability of the current account, external debt, volatility of capital flows and general economic vulnerability indexes. 3) Countries belonging to a currency union such as the Euro Currency Union are not subject to internal balance of payments crises. Hence, intra-currency union trade should be excluded from the quota formula. Discontinuing the current practice would reduce the size of the Euro-currency zone countries' quotas, which are currently over-represented. The quota formula can be revised without an amendment to the Articles of Agreement. However, any quota increase—the only vehicle for adjusting quota sizes—must be approved by 85% of the vote (the US holds over 17%; the EU combined accounts for over 30%).

The Bretton Woods Conference recognized the legal equality of all member states by allocating 250 basic votes to each member. Initially basic votes represented 11.3% of the total; today they are 2.3%. The main beneficiaries of bringing basic votes back to 11.3% of the total will be the African countries. The Articles must be amended to achieve this change.

Double majorities can be shaped so as to increase the participation of developing countries in decision-making. For instance, certain decisions could be subject to a majority of the total weighted vote of member countries plus the numerical majority of all developing countries. This tool could be used immediately on a pilot basis subject to evaluation, while paving the way for their introduction via reform to the Articles of Agreement in the longer term. Currently the number of chairs occupied by European members symbolizes the skewed distribution of power on the Boards. Of the 24 seats, European countries occupy either 8 or 9 when Spain holds the seat of the constituency it shares with Mexico, Venezuela, Bolivia and five Central American countries. Two African EDs represent 42 countries, all of which have programs or loans. Mixed constituencies (representing developed and developing countries) are represented by the industrial country member, and cannot split their votes nor note dissenting views among the members. The Euro-currency countries should share a single chair reflecting their single currency. Seats vacated by reduced representation of European countries could be allocated to middle-income countries receiving additional votes and to the Sub-Saharan African countries, which should gain two additional chairs based purely on their workload.

While normative judgments may drive recommendations in a clear direction, political challenges abound. Status quo powers argue that the current system works well, since votes are rarely taken. Borrowers are concerned about antagonizing donors, and possibly the market. Pessimists question whether any changes in policies or outcomes would happen given the monolithic economic discipline. Optimists share the perspective of those acting on normative criteria: new voting structures (and leadership selection mechanisms) could result in new power dynamics and new alliances; allow space for more diverse policy views; and greater diversity among senior staff selection. Change is clearly needed. Restoring the credibility and effectiveness of the institutions should be based on a normative approach.

New Rules recommendations:

14. Work actively to conform the governance structure of the World Bank and IMF to democratic principles to restore their effectiveness and credibility. The IMF Executive Board should:

- **Expand and reallocate quota-based votes using a new formula that: a) measures the size of economic output and financial transactions, and b) a measure of vulnerability, and hence reflects potential need for Fund resources.**
- **Reallocate basic votes to the percentage effective at its creation (back to 11.3%, from the current 2.3%)**
- **Establish clear and democratic processes for leadership selection at the World Bank and IMF, such as those identified in the Report by the Joint Working Group of Fund and Bank Executive Directors, endorsed by the Executive Boards in April, 2001**
- **Use double majorities that require a majority of developing countries in order to adopt certain decisions**

In the interim, the chairs of the respective Boards, the President in the case of the World Bank and the Managing Director in the case of the Fund, should refrain from taking a decision when the Board is split between “number of votes” and “number of Executive Directors” or “number of countries.” The chair should instead work toward a genuine consensus where policy matters are concerned.
- **Open Board decisions including the content of the debate and the positions taken by each Executive Director.**
- **Open the actions of the institutions and of the relevant Executive Directors to scrutiny by national Parliaments, public media, and civil society.**
- **Allocate immediately, as an interim arrangement, two additional Executive Directors for Sub-Saharan Africa.**

B. GOVERNANCE OF FINANCIAL AGENDA AND STANDARD-SETTING BODIES¹⁹

57. It is essential to ensure the effective and equitable participation of developing countries in the formulation of financial standards and codes

63. ...Bank for International Settlements, Basel Committees and Financial Stability Forum: to continue enhancing their outreach and consultation efforts with developing countries and countries with economies in transition at the regional level, and to review their membership, as appropriate, to allow for adequate participation;

Source: Monterrey Consensus Document.

More than sixty standards and codes have been developed by bodies of a public, private or private-public nature. The Financial Stability Forum (FSF), a body established by the Group of Seven in 1999 in response to the Asian financial crises, has identified 12 of those standards as essential to achieving financial stability. Subsequently, those standards have become the basis for

¹⁹Stephany Griffith-Jones and Jenny Kimmis, “The Reform of Global Financial Governance Arrangements,” Institute of Development Studies, University of Sussex. Report prepared for the Commonwealth Secretariat, 2001. Available at www.new-rules.org

Financial Sector Assessment Programs (FSAPs) and Reports on Standards and Codes (ROSCs) carried out by the World Bank and the IMF. These programs are the basis for the surveillance, conditionality, technical assistance and policy dialogue with member countries regarding their financial sector reforms. The Bank and Fund exercise far greater leverage over their borrowing country members than over the industrialized countries, making the implementation process highly asymmetrical.

These standards have been designed by bodies with limited or no access or membership from developing countries. For instance, the Basle Committees are committees of the Group of 10, representing the Central Banks of 10 large economies. While the Basle Committee on Global Financial System regularly invites some emerging market countries to its meetings, participation cannot happen without an invitation. The Basle Committee on Banking Supervision has no participation from developing countries, though they have separate consultations. The International Accounting Standards Board comprises 14 members, 3 from continental Europe and the remaining from the US and the UK.

The Financial Stability Forum also performs broader functions relating to global financial stability, but has only four member countries apart from the G-7 countries. The FSF also has representatives from the World Bank, IMF, Organization for Economic Cooperation and Development (OECD), the International Association of Insurance Supervisors (IAIS), the European Central Bank, the 3 above-mentioned Basle Committees, and the International Organization of Securities Commissioners (IOSCO). While developing countries have occasionally been involved in some ad hoc working groups of the FSF, participation only happens by invitation.

Many of these bodies, in spite of their limited membership, do engage in extensive consultations with developing countries. However, consultation and outreach do not substitute for effective and formal representation. Limited membership is sometimes justifiable on an efficiency basis, but, mechanisms (such as rotation and reporting) could guarantee better representation without large increases in membership. If greater participation by developing countries were to serve as a drag on achieving consensus on standards, and threaten to reduce standards to the lowest common denominator, then a two-track process could be established. This would recognize that standards needed today in highly capitalized economies are not necessarily a priority in lesser developed economies. Only participation by smaller and less developed economies ensure that potential harmful effects of such standards on their economies are taken into consideration. Some of the current limitations of the Basle Capital Accord II seem to reflect the lack of participation of developing countries in the Committee.²⁰

New Rules recommendations:

15. Include developing countries, in accord with principles of representation and rotation, in the membership and deliberations of financial agenda and standard-setting bodies, beginning with the Financial Stability Forum, the Basel Committee for Banking Supervisions, the Basel Committee on the Global Financial System, and the Bank for International Settlements

²⁰ See discussion above under II. A. “Prudential Regulation of Financial Markets.”

16. Invite all interested countries to participate in current and future working groups of these entities.

17. Establish a Committee as soon as possible (with participation of the standard-setting bodies as well as of developing countries) for implementing and evaluating specific proposals to achieve recommendations #15 and #16.

18. Employ double-majority rules for all decisions regarding design, endorsement and implementation of financial standards and codes at the Bretton Woods Institutions

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The extensive program of Consultations organized by New Rules this past year reveals widespread agreement that the international financial system, as now structured, despite its benefits, fails to address widespread poverty and economic inequities that afflict the developing world. More hopefully, however, these Consultations also reveal that a number of practical, concrete steps can be taken, by governments and international financial institutions, that will bring about significant improvements.

With further dialogue, and goodwill on all sides, the following list of Recommendations offers a serious, pragmatic approach to meeting the goals of Monterrey Consensus and meeting the Millennium Development Goals.

FINAL RECOMMENDATIONS²¹

- 1. Design and implement prudential regulations for financial markets and financial institutions in order to enhance transparency, govern risk taking and foster orderly marketplaces. This should reduce the build up of exposures to risks in such areas as foreign exchange, maturity mismatch, liquidity, and concentrated credit exposures. Especially important is the application of prudential regulation to derivatives markets, which are growing rapidly in the developing world.**
- 2. Adopt appropriate prudential regulations and, when needed, price-based capital controls in order to facilitate the use of counter-cyclical monetary and fiscal policies by developing country governments. Appropriate prudential regulations include forward-looking loan-loss provisions and collateral requirements for derivatives.**
- 3. Promote international lending in local currencies in order to prevent buildup of foreign exchange rate risk and to encourage improvements in local financial markets, and promote international investing through the use of diversified portfolios of local currency assets.**
- 4. Encourage better commodity price risk management by supporting government efforts to hedge the correlation between budget revenues and commodity price fluctuations, and by helping governments provide simple and affordable risk management to small, local producers.**
- 5. Improve international tax cooperation and introduce systems for automatic information exchange with national tax authorities to combat tax evasion and harmful tax practices.**
- 6. Design an approach to tax evasion, through the UN Committee of Experts on International Cooperation in Tax Matters, that incorporates the need of small, poor and vulnerable economies for development assistance in order to diversify from harmful tax practices.**
- 7. Develop measures that curb tax avoidance in financial centers in developed countries through initiatives such as the one adopted by the OECD to regulate developing countries' performance.**
- 8. Design and implement financial regulations that create incentives for private financial service providers to supply adequate availability of long-term credit, on affordable terms and including all sectors and regions, to support the productive economy.**
- 9. Establish national development banks in order to provide affordable long-term financing, as well as technical assistance, to areas and sectors not adequately serviced by the private sector.**

²¹ Not all members of the New Rules for Global Finance Coalition agree with every aspect of every recommendation. We operate in a mode of tolerance for differences and respect for one another's expertise.

10. Establish prudential regulatory frameworks that micro-finance institutions need and deserve, that are consistent with their special characteristics and that protect the public interest from financial instability, fraud, and predatory lending.

11. Develop a new mechanism, the International Debt Framework (IDF), to improve crisis prevention and resolution in the international financial system. The mechanism could be initiated by the Group of 20 Finance Ministers from developed and developing countries. After its establishment, the IDF should not be limited to G20 member states.

12. Increase the amount of IMF credit available in times of crisis by expanding the use of SDRs and increasing the size of quota-linked funds. The IMF should also facilitate the recycling of surplus funds from countries with current account surpluses to those with deficits using vehicles such as the oil facility. Establish a new version of the CCL with more funding and fewer costs and conditions than its predecessor.

13. Establish a fast-responding, overarching, grant-financed shocks facility for low-income commodity dependent countries. It could be administered by a Bretton Woods Institution.

14. Work actively to conform the governance structure of the World Bank and IMF to democratic principles to restore their effectiveness and credibility. The IMF Executive Board should:

- **Expand and reallocate quota-based votes using a new formula that: a) measures the size of economic output and financial transactions; and b) a measure of vulnerability, and hence reflects potential need for Fund resources.**
- **Reallocate basic votes to the percentage effective at its creation (back to 11.3%, from the current 2.3%).**
- **Establish clear and democratic processes for leadership selection at the World Bank and IMF, such as those identified in the Report by the Joint Working Group of Fund and Bank Executive Directors, endorsed by the Executive Boards in April, 2001**
- **Use double majorities that require a majority of developing countries in order to adopt certain decisions.**

In the interim, the chairs of the respective Boards, the President in the case of the World Bank and the Managing Director in the case of the Fund, should refrain from taking a decision when the Board is split between “number of votes” and “number of Executive Directors” or “number of countries.” The chair should instead work toward a genuine consensus where policy matters are concerned.

- **Open Board decisions including the content of the debate and the positions taken by each Executive Director.**
- **Open the actions of the institutions and of the relevant Executive Directors to scrutiny by national Parliaments, public media, and civil society.**
- **Allocate immediately, as an interim arrangement, two additional Executive Directors for Sub-Saharan Africa.**

15. Include developing countries, in accord with principles of representation and rotation, in the membership and deliberations of financial agenda and standard-setting bodies, beginning with the Financial Stability Forum, the Basel Committee for Banking

Supervisions, the Basel Committee on the Global Financial System, and the Bank for International Settlements.

16. Invite all interested countries to participate in current and future working groups of these entities.

17. Establish a Committee as soon as possible (with participation of the standard-setting bodies as well as of developing countries) for implementing and evaluating specific proposals to achieve recommendations #15 and #16.

18. Employ double-majority rules for all decisions regarding design, endorsement and implementation of financial standards and codes at the Bretton Woods Institutions.