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International financial architecture

5.1 The Asian Financial Crisis and international consideration of its effects have sparked a complete review of the organisational arrangements controlling the international movement of funds, the so-called International Financial Architecture. Examination of these arrangements is not new. Since the beginning of the collapse of the Bretton Woods system in 1971, world financial arrangements and the roles of IFIs have been under virtually constant scrutiny and criticism.[1]

5.2 Following the Mexican crisis in 1994-5, the present phase of review began with the launch by the IMF of its Special Data Dissemination Standard (SDDS). The SDDS specifies basic criteria for economic and financial data provided to the IMF, for later dissemination on its web-site. A General Data Dissemination System was also established, to assist countries to establish and organise the collection and publication of their data.[2]

5.3 The onset of the Asian Crisis in 1997-98, led to an intensified examination of the International Financial Architecture. The Group of Seven (G7) major industrial countries[3] led the call for improvements. The G7 at their summit in May 1998, instructed their Finance Ministers to work towards an improved international financial architecture by developing new approaches. Four key areas were highlighted for attention:

- increasing the transparency of countries' data and economic conditions;
- helping countries prepare for global capital flows;
- strengthening national financial systems; and

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1 Barry Eichengreen, *Globalizing Capital, A History of the International Monetary System*, Princeton University Press, New Jersey, 1996, p.123.

2 John T.Bennett, *Increasing Financial Transparency in a Global Economy*, Economic Perspectives, USIA Electronic Journals, Vol.3, No.4, 1998, p.1 http://www.usia.gov/journals/ites/0898/ijee/ejbenne.htm

3 G-7 membership is: the USA, Germany, the UK, Japan, France, Canada and Italy.

- ensuring that the private sector takes responsibility for its decisions when crises strike.[4]

5.4 The DFAT EAAU has concluded that one of the lessons to be learned from the Asian Crisis, was the value of a strong international financial infrastructure. Its report on Asian Financial Markets highlighted five key issues to be addressed in the process of reforming the International Financial Architecture:

- improving transparency, by increasing compliance with domestic disclosure rules and cross-border information exchange agreements;
- reducing the potential of highly leveraged institutions like hedge funds to destabilise domestic and international markets;
- tightening and enforcing prudential standards in offshore financial centres;
- reducing capital flow volatility by encouraging more stable capital flows; and
- facilitating greater private sector involvement in crisis prevention and resolution.[5]

5.5 The Committee notes that, although these are worthy goals, no-one should pretend that they will be easy to address in a comprehensive fashion.

5.6 One of these issues, volatile capital flows, was a particular problem during the Asian crisis. It became apparent that speculators were able to move funds into, and out of, capital markets, far faster than the counter-measures available to either domestic markets or the international finance market, could respond.[6] Recognition of this problem and concern over the activities of the speculators and the performance of IFIs in the face of the crisis, increased the pressure on monetary authorities to carefully examine the International Financial Architecture and to re-assess the effectiveness of the systems and organisations currently in place.

5.7 The ASX submission commented that speculation has its place in facilitating the flow of new information but that the speed of financial transactions makes it imperative that economic policies are soundly based. The ASX notes that:

> The speed and magnitude of asset allocation decisions is increasing rapidly, which places much greater pressure on

4 Economic Perspectives, *Reforming the Global Financial Architecture*, Electronic Journals of the US Information Agency, Vol.3, No.4, August 1998. http://www.usia.gov/journals/ites/0898/ijee/ijee0898.htm

5 East Asia Analytical Unit, Department of Foreign Affairs and Trade, *Asia's Financial Markets: Capitalising on Reform*, Canberra, 1999, p.34.

6 Jack Boorman, Director, IMF Policy Development & Review Department, *The World Financial System Must Act to Prevent Crises*, 28 June 1999 in the International Herald Tribune, p.1. http://www.imf.org/external/np/vc/1999/062899.HTM

> national governments to implement policies based on sound economic principles. No crisis arises from the vast majority of financial transactions, which suggests that governments in most countries make well founded decisions.[7]

Present structure

5.8 The two key organisations in the present structure of the International Financial Architecture are the IMF and the World Bank Group. These organisations are now more than fifty years old and still operating under the original charters established under the Bretton Woods agreement in the aftermath of World War 2. This fact alone has prompted calls for reassessment of their roles and modernisation of the charters under which they operate.[8]

5.9 The World Bank (officially the International Bank for Reconstruction and Development) was designed to channel funds from world capital markets to assist the recovery of Europe and the economic development of developing countries. Joseph Stiglitz, of the World Bank described its role as a development institution, with a focus: "on project lending and structural reforms that enhance long-run development and poverty alleviation."[9]

5.10 The IMF was originally intended to be the world's central bank:

> The IMF was to have been given sufficient resources to influence the global monetary system, issue its own reserve currency and create international reserves as necessary. The gap between that vision and reality widened over the years.[10]

5.11 The Fund's role is now seen as more of a watchdog. It has a mandate to safeguard the soundness and stability of the international monetary system. To achieve this, it undertakes compulsory annual economic policy consultations with each of its member governments. These discussions, known as Article IV consultations, cover a wide range of policy issues and try to address current problems and anticipate future

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7 Submission No.6, Australian Stock Exchange Ltd, p.2.

8 Financial Stability Forum, *Report of the Working Group on Highly Leveraged Institutions*, 5 April 2000, p.12. http://www.fsforum.org/Reports/RepHLI.html

9 Joseph Stiglitz, Senior Vice President and Chief Economist for The World Bank, *The Role of International Financial Institutions in the Current Global Economy*, Address to the Chicago Council on Foreign Relations, 27 February 1998, p.9. http://www.worldbank.org/html/extdr/extme/jssp022798.htm

10 Wendy Dobson, *What To Do With The IMF?*, in Policy Options, July/August 1999, p.37.

difficulties. In addition, of course, the IMF is the front line of defence when financial crises do occur.

5.12 The US Congressional Record described the IMF as:

> … a cooperative institution that 182 countries have voluntarily joined because they see the advantage of consulting with one another to maintain a stable system of buying and selling their currencies so that payments in foreign money can take place between countries smoothly and without delay.[11]

5.13 Stanley Fischer of the IMF summarised the Fund's primary purposes as follows:

- to facilitate … the balanced growth of international trade, and to contribute thereby to … high levels of growth and real income;
- to promote exchange rate stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation; and
- to provide members with opportunities to correct maladjustments in their balance of payments, without resorting to measures destructive of national or international prosperity.[12]

Reforming the system

5.14 Efforts to reform international arrangements are widespread and involve committees from a number of international organisations. Prominent among the committees working on the review of international financial arrangements, are the Basle Committee on Banking Supervision and the Technical Committee of the International Organization of Securities Commissions (IOSCO). The BIS in Switzerland, the World Bank and the IMF are all involved in the international committees. The United States, in addition to its involvement in the international efforts, has established a Presidential Working Group on Financial Markets. The OECD in Paris, is also very active in these deliberations and the research underlying them.

5.15 Australia has been prominent in these efforts through participation in international forums; a report from a 'Task Force on International Financial Reform' to the Prime Minister; and also a 'self-assessment' report on Australia's standards of transparency and disclosure (which was

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11 Congressional Digest, *Overview of the IMF: Origin, Organization, and Functions*, Vol.77, No.4, April 1998, p.100.

12 Stanley Fischer, First Deputy Managing Director of the IMF, *The Asian Crisis : A View from the IMF*, Address to the Bankers' Association for Foreign Trade, Washington, D.C., 22 January 1998, p.1. http://www.usia.gov/regional/ea/asiafin/fischr22.htm

intended to encourage similar assessments by other IMF members)[13]. Australia's efforts have also extended to more direct means, through participation in financial support arrangements and the provision of technical assistance.[14]

5.16 The Managing Director of the IMF indicated that, in general terms, international efforts are seeking to:

- promote transparency and accountability, and to develop, disseminate and monitor implementation of better standards and best practices;
- strengthen financial systems, including through better supervision and appropriate mechanisms for managing bank failures;
- pay greater attention to the orderly liberalisation of capital markets;
- involve the private sector more fully in forestalling and resolving crises; and
- ensure that systemic issues are adequately addressed, including the appropriate exchange rate regimes and the adequacy of the [IMF's] resources.[15]

5.17 He commented that success would depend on advancing all of these features together and that a high level of cooperation between the government and private sectors would be essential:

> All of these aspects of a strengthened financial architecture are inter-related. The development, dissemination and monitoring of standards is crucial to the strengthening of financial systems; the choice of exchange rate regime and the strengthening of supervisory systems are an integral part of ensuring an orderly process of capital account liberalisation; better data, greater transparency of countries' policies and the Fund's assessment of them, as well as strengthened financial systems are critical to reducing the volatility of private sector flows.[16]

5.18 The Managing Director stressed that the private sector, national governments and international institutions and forums all need to work together in this endeavour. Private financial institutions must adhere to

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13 The Treasury, *Making Transparency Transparent: An Australian Assessment*, AGPS, CanPrint Communications, Canberra, March 1999.

14 Task Force on International Financial Reform, *Report to the Prime Minister*, AGPS, CanPrint Communications, Canberra, 1998, p.3.

15 International Monetary Fund, *Report of the Managing Director to the Interim Committee on Progress in Strengthening the Architecture of the International Financial System*, International Monetary Fund, Washington D.C., 26 April 1999, p.2. http://www.imf.org/external/np/omd/1999/042699.htm

16 International Monetary Fund, *Report of the Managing Director to the Interim Committee on Progress in Strengthening the Architecture of the International Financial System*, International Monetary Fund, Washington D.C., 26 April 1999, p.2. http://www.imf.org/external/np/omd/1999/042699.htm

the new standards that are being set. National authorities need to ensure that those standards are first established and then met, and that supervisory and regulatory agencies are strengthened. It is important that areas of vulnerability are minimised through better management of macroeconomic and financial policies. The Fund and other international institutions and forums also need to ensure that their efforts are mutually reinforcing and effective.[17]

5.19 In a recent study for the Institute for International Economics in Washington, Professor Barry Eichengreen explained the complexities that the Asian Crisis had introduced into the task of reforming the international financial architecture:

> … That crisis … shows how counterproductive it is to think of Asia's financial collapse as a single event. The causes and consequences differed across countries. New financial crises unfolded upon old ones; by the spring of 1998, the IMF's managing director, Michael Camdessus, routinely referred to "crises within crises". To be sure these difficulties were related. But attempting to explain them all in terms of a single set of factors … is unlikely to be helpful. Rather, the Asian crisis suggests that understanding twenty-first-century crises will require one to weave together strands from different approaches. Correspondingly, proposals for reform must address the problems highlighted by each of the relevant models.[18]

5.20 The Report of the Task Force on International Financial Reform supported this assessment:

> No doubt all factors played a role and, as such, highlight that there is not a single solution to the crisis, nor a single measure that will achieve greater stability in global capital markets. Reform will require progress across a wide range of fronts, much of it focussed on sound policies at the national level: countries pursuing appropriate macroeconomic and regulatory policies were much less affected by the financial turmoil that affected others.[19]

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17 International Monetary Fund, *Report of the Managing Director to the Interim Committee on Progress in Strengthening the Architecture of the International Financial System*, International Monetary Fund, Washington D.C., 26 April 1999, p.2. http://www.imf.org/external/np/omd/1999/042699.htm

18 Barry Eichengreen, *Toward a New International Financial Architecture: A Practical Post-Asia Agenda*, Institute for International Economics, Washington D.C., February 1999, p.143.

19 Task Force on International Financial Reform, *Report to the Prime Minister*, AGPS, CanPrint Communications, Canberra, 1998, p.3.

Criticism of IMF policies

5.21 Dr John Edwards of HSBC commented in his evidence that the weaknesses in the present arrangements had become apparent during the Asian Crisis:

> … we did see during the Asia crisis, the crisis in Russia, and the crisis that originated from Long-Term Capital Management in the US, that the current architecture of international financial arrangements is highly vulnerable, and did produce, in the case of Asia, a very severe outcome from which Asia is only just emerging.[20]

5.22 Bearing out Dr Edwards’ comments, during the Asian Crisis the criticism of the IFIs, particularly the IMF, was more strident than ever before. Critics felt that policies were too rigid, recovery packages too harsh and, in some cases, the approach was simply considered to be wrong. For example, one commentator wrote:

> The world financial crisis of the last two years has prompted some of the most damning criticism ever of the Bretton Woods institutions, and particularly the International Monetary Fund. Should the Fund be razed, re-built or renovated? Renovation seems the most likely course. Three areas need attention: the Fund’s role in crisis prevention and management, its approach to exchange rate regimes and its ways of governing itself. On the first it should pay more attention to micro matters; on the second, give up on pegged rates; and on the third, become flexible and representative.[21]

5.23 These comments sprang from wide-spread criticism that the Fund had failed to foresee the crisis and that when it did take action, its prescriptions did not work. Leading critics, Harvard economists Jeffrey Sachs and Martin F. Feldstein, asserted that the crisis was made worse by the IMF’s unimaginative prescriptions. They blamed the Fund’s policies for the capital flight from Asia and the deep economic contraction which followed. The Fund’s recovery package was described as “an overdose of bitter medicine” – pressing governments to raise budget surpluses even higher than they were, tightening bank credit by increasing interest rates and the closing down of weak banks. All of this they claimed, prolonged

20 Evidence, Dr J. Edwards, 22 March 2000, p.96.

21 Wendy Dobson, *What To Do With The IMF?*, in Policy Options, July / August 1999, p.37.

asset-price deflation in the property sector and further eroded investor confidence.[22]

5.24 The Deputy Governor of Australia's Reserve Bank also voiced his misgivings about some of the policies applied by the IMF in Asia:

> … the IMF is seen, by many of us, to have been misguided in aspects of its response, at least to some of the countries in crisis (and here I am thinking in particular of Indonesia). A better deliberative process might have eased this problem; …[23]

5.25 Not all commentators agreed that the blame should be mainly carried by the IMF. An Assistant Professor at the University of San Francisco wrote:

> … the criticism that the Fund failed to anticipate the crisis is untenable. … the IMF's early-warning system *did* work. It not only foresaw the crisis in mid-1995, but senior IMF officials continually warned governments that the combination of pegged exchange rates, poor bank supervision and the build-up of short-term unhedged debt could prove disastrous. … What the IMF did *not* anticipate was the magnitude of the crisis, nor when it was likely to occur …[24]

5.26 Others suggested that the structure of the IMF operation is part of the problem:

> Although it has 182 members, the IMF is largely governed by the G7 (and mainly the United States) and it has kept its decisions and the rationale for its actions confidential. The IMF's Board of Governors, which is ultimately accountable for the Fund's direction, consists of eight individual large-country members and 16 members representing groups of countries. Members are assigned quotas and voting rights according to their economic clout….
>
> The G7 governments dominate decisions. Countries such as Singapore and Hong Kong, which have among the world's largest foreign reserves other than Japan and China, are represented only as part of multi-country constituencies. Taiwan is not a member.[25]

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22 Shalendra D. Sharma, *Asia's Economic Crisis and the IMF*, in Survival, Vol.40, No.2, International Institute for Strategic Studies, Summer 1998, p. 43.

23 Dr S. A. Grenville, Deputy Governor, *Globalisation and the International Financial Architecture: Writing (and Righting) the Rules*, Reserve Bank of Australia Bulletin, Sydney, July 2000, p.9.

24 Shalendra D. Sharma, *Asia's Economic Crisis and the IMF*, in Survival, Vol.40, No.2, International Institute for Strategic Studies, Summer 1998, p. 43.

25 Wendy Dobson, *What To Do With The IMF?*, in Policy Options, July / August 1999, p.41.

5.27 On a more pragmatic note, the Emerging Markets Committee of IOSCO, looking at the regulatory implications of the Asian Crisis, commented:

> The suddenness of the … crisis, the rapid spread of the financial contagion and the extent of the effects of the crisis have raised calls by various quarters for a review of the role of international financial institutions. … two [areas] are particularly relevant to this report.[26]

5.28 The Emerging Markets Committee then discussed the two areas of weakness in global surveillance arrangements that had been highlighted and called on the IFIs to reassess those arrangements. The first issue was the need for a system which would give adequate warning when the likelihood of a crisis increased - early enough to give remedial measures a high probability of success. The proposal was also put forward that IFIs be given sufficient resources and capacity to ensure that proper remedial action can be applied when imbalances appear.[27]

5.29 The second major issue was the establishment of efficient crisis management arrangements – to avoid the rapid spread of contagion so apparent in the Asian crisis. The report acknowledged that this would be a difficult task, given the high degree of integration in international financial markets and indicated that the help of international groupings would be needed and that domestic and international efforts would need to be complementary and coordinated.[28]

5.30 The IMF's Managing Director acknowledged the criticism of the organisation in an address to a symposium in Germany:

> We cannot deny the basic justification of these – at times vociferous – calls for change. No doubt there are at least some elements of validity in each of them. Taken together, they tell us that world public opinion expects its leaders not necessarily to redesign everything from scratch, as if we were back to Bretton

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26 Emerging Markets Committee, IOSCO, *Causes, Effects and Regulatory Implications of Financial and Economic Turbulence in Emerging Markets*, Interim Report, The International Organization of Securities Commissions, Madrid, September 1998, p.79. http://www.iosco.org/docs-public/1998-causes_and_effects.html

27 Emerging Markets Committee, IOSCO, *Causes, Effects and Regulatory Implications of Financial and Economic Turbulence in Emerging Markets*, Interim Report, The International Organization of Securities Commissions, Madrid, September 1998, p.80. http://www.iosco.org/docs-public/1998-causes_and_effects.html

28 Emerging Markets Committee, IOSCO, *Causes, Effects and Regulatory Implications of Financial and Economic Turbulence in Emerging Markets*, Interim Report, The International Organization of Securities Commissions, Madrid, September 1998, p.80. http://www.iosco.org/docs-public/1998-causes_and_effects.html

> Woods; but neither should we limit ourselves to some plumbing and interior decorating of the old mansion.[29]

5.31 He went on to suggest five priority areas in which he considered the Fund should concentrate its efforts:

- efforts to make Fund surveillance more effective and development of a tiered response – i.e. increasingly strong warnings to countries seen to be seriously off course;
- improvement of the availability and transparency of information;
- strengthening financial and banking systems, as well as their supervision;
- establishment of more effective procedures to involve the private sector in preventing and resolving debt crises; and
- liberalisation of capital flows in a prudent and properly sequenced way.[30]

5.32 The Committee supported these proposals and commented that improving the transparency of the IMF's operations would be a very important factor in re-establishing the confidence of developing countries in the international financial system. Having said all of this, it should not be read as exonerating the leaders of these countries, who must bear the major responsibility for creating the climate that led to the Asian Crisis.

Moral hazard

5.33 One of the main criticisms of the operation of international financial organisations concerns the IMF's role as lender of last resort. Critics contend that this role creates a "moral hazard", a phenomenon that "occurs when those who take economic decisions are not required to take the full consequences, when that decision turns out badly."[31]

5.34 The argument is that foreign investors are "bailed-out" and not required to bear the financial cost of bad decisions. Theorists say that when investors are confident that the IMF will provide funding to avoid a system collapse, they are prepared to take greater risks. An example often used is the Mexican Crisis of 1994-5, when a sudden capital outflow was

29 Michael Camdessus, Managing Director of the IMF, *The IMF's Role in Today's Globalized World*, address to an IMF-Bundesbank Symposium, Frankfurt, Germany, 2 July 1998, p.4. http://www.imf.org/external/np/speeches/1998/070298.HTM

30 Michael Camdessus, Managing Director of the IMF, *The IMF's Role in Today's Globalized World*, address to an IMF-Bundesbank Symposium, Frankfurt, Germany, 2 July 1998, p.4. http://www.imf.org/external/np/speeches/1998/070298.HTM

31 Stephen Grenville, Deputy Governor of the Reserve Bank, *The Asia Crisis, Capital Flows and the International Financial Architecture*, talk to Monash University Law School Foundation, Melbourne, 21 May 1998, p.8.

stemmed by a US$ 50 billion support package. The critics saw this as a bad precedent, encouraging risky investment practices.[32]

5.35 The public reaction was summarised by hedge fund entrepreneur, George Soros:

> Moral hazard has become a big issue in the recent crisis. There has been a groundswell of political opposition to the idea that public funds should be used to bail out the private sector.[33]

5.36 The problem is that while everyone is theoretically against the concept of moral hazard, when it comes to practical situations, assistance is often essential to prevent a crisis from becoming even worse.[34]

5.37 An important issue to bear in mind is that, despite popular beliefs, even when a rescue package is applied, investors do not escape unscathed. Referring to the Asian Crisis, Karin Lissakers of the IMF commented in August 1998, that "few investors have gotten away scot-free". She added that equity investors and currency traders had taken big losses and banks were being forced to reschedule claims on Asia.[35]

5.38 The international financial community is still wrestling with the problem of moral hazard. The proposal gaining support at present is to find suitable policies which will ensure that the private sector is closely involved in any plans to deal with financial cries – a process becoming known as "bailing-in" the private sector. As Dr John Edwards explained it:

> … The idea is, instead of allowing private lenders to bail-out of a situation, you force them to remain; a very difficult issue for commercial banks.[36]

5.39 George Soros stressed that the problem is a serious issue which must be solved quickly:

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32 Stephen Grenville, Deputy Governor of the Reserve Bank, *The Asia Crisis, Capital Flows and the International Financial Architecture,* talk to Monash University Law School Foundation, Melbourne, 21 May 1998, p.8.

33 George Soros, *The New Global Financial Architecture,* in Eds Will Hutton and Anthony Giddens, On the Edge, Jonathan Cape, London, 2000, p.88.

34 Stephen Grenville, Deputy Governor of the Reserve Bank, *The Asia Crisis, Capital Flows and the International Financial Architecture,* talk to Monash University Law School Foundation, Melbourne, 21 May 1998, p.8.

35 Karin Lissakers, US Executive Director, IMF, *The IMF and Reforming the Global Financial Architecture*, interview August 1998. p.1. http://www.usia.go/journals/ites/0898/ijee/ejfliss.htm

36 Evidence, Dr J. Edwards, 22 March 2000, p.98.

> The main area of confusion remains the issue of bailing-in the private sector and the uncertainty can be very harmful.[37]

5.40 The risk of moral hazard is not confined to international transactions. Reserve banks face the same problems in dealing with domestic financial crises. An IMF paper commented that the proper response for national authorities is:

> … rigorous prudential supervision and regulation combined with careful design of the lender-of-last-resort facility to limit the scope and incentives for financial market participants to take on excessive risk. More generally, pursuing policies to develop a financial system that relies less heavily on banks and other intermediaries and involves more direct risk bearing by ultimate investors can help to reduce the risks of costly crises and moral hazard.[38]

This is a prescription which could equally well be applied to the international financial scene.

5.41 The Committee commented that international plans to closely involve the private sector in the prevention and containment of financial crises, could substantially reduce the incidence of moral hazard. It noted, however, that the problem of rapid, large scale, destabilising, movement of funds by the larger hedge funds, would not be addressed by this approach.

Progress in reforming the international financial architecture

5.42 The fallout from the Asian Crisis has led to a flurry of activity in international organisations, aimed at improving the operation of the international financial system. Much of this work comes under the surveillance of the IMF and the Fund produces a regular assessment of the progress made, in reports entitled: *Progress in Strengthening the Architecture of the International Financial System and Reform of the IMF.*

5.43 In the Report of 19 September 2000, the Fund reported that many of the initiatives already undertaken are designed to strengthen the operation of the international financial system. The aim is to use the closer integration

37 George Soros, *The New Global Financial Architecture*, in Eds Will Hutton and Anthony Giddens, On The Edge: Living with Global Capitalism, Jonathan Cape, London, 2000, p.89.

38 Barry Eichengreen and Michael Mussa, *Capital Account Liberalisation and the IMF*, in Finance and Development, December 1998, Vol 35, No.4, IMF. http://www.imf.org/external/pubs/ft/fandd/1998/12/eichen.htm

of the global economy to deliver economic growth and higher living standards throughout the world.[39]

5.44 Most of these initiatives are concerned with crisis prevention. They are designed to promote sound policies and increase the institutional strength of financial markets. This has involved initiatives in a wide array of sectors:

- improving transparency and accountability;
- better identifying vulnerable areas;
- strengthening domestic institutions, financial systems and policies;
- developing and implementing standards and codes of good practice in critical areas; and
- helping countries establish policy and institutional preconditions for successful capital account liberalisation and integration into global markets.[40]

5.45 The international effort has also been directed toward improvement of crisis management and resolution. The emphasis here is to ensure that policy responses incorporate an appropriate role for all creditors. The report notes that the IMF has finite resources and that efficient policy responses must therefore include a proper mix between official financing and the involvement of private creditors.[41]

5.46 The involvement of the private sector in crisis resolution and management remains a priority area. The Fund reports that it is now reasonably well accepted, that private sector creditors should play an appropriate role – and bear responsibility for the risks they undertake. To support these initiatives, the Fund has encouraged the adoption of policies to assist in crisis prevention and resolution; some examples are: creditor debtor communications, collective action clauses, and contingent lines of credit.[42]

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39 International Monetary Fund, *Progress in Strengthening the Architecture of the International Financial System and Reform of the IMF*, Report of the Managing Director to the International Monetary and Financial Committee, International Monetary Fund, Washington D.C., 19 September 2000, p.1. http://www.imf.org/external/np/omd/2000/02/report.htm

40 International Monetary Fund, *Progress in Strengthening the Architecture of the International Financial System and Reform of the IMF*, Report of the Managing Director to the International Monetary and Financial Committee, International Monetary Fund, Washington D.C., 19 September 2000, p.2. http://www.imf.org/external/np/omd/2000/02/report.htm

41 International Monetary Fund, *Progress in Strengthening the Architecture of the International Financial System and Reform of the IMF*, Report of the Managing Director to the International Monetary and Financial Committee, International Monetary Fund, Washington D.C., 19 September 2000, p.2. http://www.imf.org/external/np/omd/2000/02/report.htm

42 International Monetary Fund, *Progress in Strengthening the Architecture of the International Financial System and Reform of the IMF*, Report of the Managing Director to the International Monetary and Financial Committee, International Monetary Fund, Washington D.C., 19 September 2000, p.2. http://www.imf.org/external/np/omd/2000/02/report.htm

5.47 Regarding the review of its own operations, the IMF is examining whether its financing facilities and conditionality are able to respond effectively to the greater integration of domestic and international financial markets. It is also examining the safeguard arrangements within central banks and other counterpart agencies in its member countries – to ensure that they are adequate to sustain the integrity of operations and to manage resources, including IMF disbursements. A review has also commenced of quota formulas which determine the level of financial subscriptions to the IMF, access to IMF resources and relative voting shares.[43]

5.48 The Fund, of course, is not the only international organisation involved in the process of reforming the International Financial Architecture. The IMF report noted that other international groups and institutions are playing roles according to their own areas of responsibility. For its part, the Fund is intensifying and expanding arrangements for cooperation and coordination with those organisations.[44]

5.49 The IMF report states that many initiatives have already begun to be implemented, although the extent of progress varies substantially. Some examples are:

- making IMF policy advice public;
- improving data on international reserve positions;
- development of international standards; and
- greater disclosure on IMF activities.

Other projects still in the development stages include the assessment of:

- financial sector weaknesses; and
- observance of standards and codes.[45]

43 International Monetary Fund, *Progress in Strengthening the Architecture of the International Financial System and Reform of the IMF*, Report of the Managing Director to the International Monetary and Financial Committee, Washington D.C., 19 September 2000, p.2. http://www.imf.org/external/np/omd/2000/02/report.htm

44 International Monetary Fund, *Progress in Strengthening the Architecture of the International Financial System and Reform of the IMF*, Report of the Managing Director to the International Monetary and Financial Committee, Washington D.C., 19 September 2000, p.2. http://www.imf.org/external/np/omd/2000/02/report.htm

45 International Monetary Fund, *Progress in Strengthening the Architecture of the International Financial System and Reform of the IMF*, Report of the Managing Director to the International Monetary and Financial Committee, Washington D.C., 19 September 2000, p.2. http://www.imf.org/external/np/omd/2000/02/report.htm

5.50 The disruption produced by the Asian Crisis has forced the IMF to review its own operations and the report commented on the changes which have resulted. It noted that surveillance has been strengthened and greater attention paid to indicators of vulnerability and to exchange rate issues.[46]

5.51 The Fund has acknowledged that refining the International Financial Architecture will be a continuing process, as technology and techniques in the markets change. It has also recognised that it will increasingly have to take on the role of central coordinator in financial stability issues. Finally, it will have to be ready to assist member countries to develop the policies and institutions needed to realise the benefits of globalisation in financial markets.[47]

5.52 The Fund's ability to carry out these tasks has been increased in the last few years by changes to the funding received from member governments. In 1997 a supplemental reserve facility was put in place. This facility is for the provision of loans to countries in crisis – the loans carrying a penalty interest rate. Quotas were increased in 1998 – allowing individual countries access to greater levels of funding. In 1999, a contingent credit line was established; this will be available on stringent conditions and is intended for countries seeking to prevent a crisis.[48]

Conclusion

5.53 The Committee concluded that there is a continuing need for review and reassessment of the operations (and the charters) of the International Financial Institutions. It considered that the rules applied to these bodies, are no longer adequate for the economic conditions in which they operate. Accordingly they are in urgent need of modernisation.

46 International Monetary Fund, *Progress in Strengthening the Architecture of the International Financial System and Reform of the IMF*, Report of the Managing Director to the International Monetary and Financial Committee, Washington D.C., 19 September 2000, p.3. http://www.imf.org/external/np/omd/2000/02/report.htm

47 International Monetary Fund, *Progress in Strengthening the Architecture of the International Financial System and Reform of the IMF*, Report of the Managing Director to the International Monetary and Financial Committee, Washington D.C., 19 September 2000, p.3. http://www.imf.org/external/np/omd/2000/02/report.htm

48 Wendy Dobson, *What To Do With The IMF?*, in Policy Options, July/August 1999, p.39.

Recommendation 5

5.54 **The Committee recommends that:**

- **Australia continue its strong support for the review of the International Financial Architecture with the aim of modernising its institutions;**
- **the Government encourage Australian financial authorities to make the expertise of their experienced staff available to assist developing markets to reap the benefits of globalisation in world financial markets.**