"Reform of the International Financial Architecture: Views, priorities and concerns of governments and the private sector in the Western Hemisphere and Eastern Europe"

<u>Report commissioned by DFID[♦]</u>

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[♦] The views in this study do not necessarily reflect the views of DFID.

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List of Acronyms

ALADI	*La Asociacion Latinamericana de Integracion*
ARC	Advance Release Calender (Russia)
CABEI	Central-American Bank for Economic Integration
CAC	Collective Action Clauses
CAF	*Corporacion Andina de Fomento*
C&S	Codes and Standards
CBR	Central Bank of Russia
CCL	Contingent Credit Line (IMF); see Glossary for explanation
CPCR	*Convenio de Pagos y Creditos Recipricos*
DIS	Department of Insurance (Russia)
EBFs	Extra Budgetary Funds (Russia)
ECLAC	Economic Commission for Latin America and the Caribbean (UN)
EE	Eastern Europe
EFF	Extended Fund Facility (IMF)
FATF	Financial Action Task Force (on money laundering)
FCS	the Federal Commission for the Securities Market (Russia)
FDI	Foreign Direct Investment
FLAR	*Fondo Latinamericano de Reservas*
FSA	Financial Services Authority (U.K.)
FSAP	Financial Sector Assessment Programme
FSF	Financial Stability Forum
GDDS	General Data Dissemination Standard (IMF)
IADB	Inter-American Development Bank
IFA	International Financial Architecture
IFIs	International Financial Institutions
LA	Latin America
MOF	Ministry of Finance (Russia)
OFC	Offshore Financial Centres
PRGF	Poverty Reduction and Growth Facility
PSI	Private Sector Involvement
REDIMA	Network of Macroeconomic Dialogue
ROSCs	Reports on the Observance of Standards and Codes
SDDS	Special Data Dissemination Standards (IMF)
SDR	Special Drawing Rights (IMF)
SRF	Supplemental Reserve Facility
VTB	*Vneshtogbank* (Russia)
WH	Western Hemisphere

Executive Summary

1) This report presents the views of a wide range of government representatives (at the highest levels, including Governors of the Central Banks) of Latin America and Russia on the reform of the international financial architecture (IFA); in particular it focuses on their attitudes towards the implementation of Codes and Standards. It also indicates the areas in which they believe foreign technical assistance is particularly needed. It draws heavily on interview material with senior officials from governments and international organisations.

2) Broadly, Latin American governments welcome the large growth of private capital flows that occurred in much of the nineties. However, they are deeply concerned with volatility and reversibility of these flows. A second concern is the lack of sufficient long-term private flows to finance long-term investments, such as infrastructure. A third concern is excessive concentration of capital flows into the larger, relatively richer, Latin American countries.

3) A further concern expressed by Latin American governments is that after the Asian, Russian and Brazilian crises, the scale of private flows to the region has become insufficient, and their costs very high, a phenomenon which appears to have only a weak link with the countries' macro-economic fundamentals.

4) To help facilitate, encourage and sustain private flows, as well as to complement them when there are market gaps or major reversals of flows, Latin American governments stress the role that large international financial institutions (IMF and development banks) should play in providing liquidity and development finance, as well as in helping catalyse private flows.

5) Latin American governments welcome the progress achieved on reform of the international financial architecture (IFA). This includes the new credit IMF lending facilities, expansion of IMF resources, more preventive focus of IMF surveillance, international efforts to strengthen codes and standards, and the creation of the FSF and the G-20.

6) However, four major concerns were expressed about the progress on international financial reform. First, are the changes deep and significant enough to create an international financial system that supports – and does not undermine – growth and development? Are changes introduced enough to prevent future crises and assure the provision of sufficient international official liquidity in future crises? A second concern is that the process of reform has been asymmetrical, with far more progress on measures to be taken by developing countries (e.g. on codes and standards), and with far less progress being made at the international level. The same point was made by the Russian authorities. Third, developing countries lack participation in key policy fora; again, this point is also made by the Russian authorities who stress that their 'participation' in the FSF, for example, has been very much on the 'receiving end'. And finally, that progress could not only slow down but even be reversed. For example, they fear that the scale of the official financial package during future crises could be reduced.

7) Latin American governments see the enhanced provision of emergency financing in times of crises as one of the pillars of the system to prevent and manage financial crises. They welcome the creation of the Suplemental Reserve Facility (SRF) and the Contingent Credit Line (CCL) by the IMF. As regards the latter, although the CCL has been made more attractive to encourage countries to use it, senior Latin American officials have suggested that it could be further improved. For example, they suggested that several countries could join the CCL at the same time (so as to remove the "stigma" of joining it), and that the "trauma" of applying could be taken out by granting more or less automatically the right to a CCL to countries that have successfully completed their Article consultation, and that have been deemed by the IMF to be following good policies.

8) The Russians are even more sceptical of the CCL and believe that, to be effective, it must be radically reformed. They suggest that activation requirements should be reduced, charges lowered and maturities lengthened. They also express concern about the 'exit problem' in the eventuality that a country ceases to satisfy the requirements of the CCL. More generally, they would like to see conditionality streamlined in Fund facilities.

9) To deal with the issue of scarceness and unreliability of IMF resources during crises, Latin American officials (and regional organisations like ECLAC) have proposed that temporary allocation of Special Drawing Rights (SDRs) are allowed to member countries during episodes of world financial stress; these temporary allocations could later be destroyed once conditions normalise, in order to avoid generating permanent liquidity; this would create an anti-cyclical element in world liquidity management.

10) As regards the provision of development finance, although Latin American governments feel that private capital flows can and should play an important and growing role in international development finance, they believe that there are important market gaps that multilateral bank lending could fill: a) provision of long-term finance, b) channelling resources to activities that are higher risk, but developmentally essential, or to activities where social returns are higher than private returns (such as health and education) and c) provision of counter-cyclical lending, especially to help fund social safety nets in post-crises periods. The proposed World Bank Committed Loan Facility would potentially be a valuable tool for that purpose.

11) As regards Private Sector Involvement (PSI) in crisis prevention, Latin American governments welcome preventive mechanisms such as contingent financing arrangements from commercial banks that can be drawn on in times of difficulty, which they have pioneered.

12) Latin American governments also broadly support measures to ensure PSI during crises. However, they stress that any framework designed and measures taken for PSI during crises should: a) not excessively discourage future private flows and/or increase their costs and b) should be carefully devised so as to avoid creating further instability. The Russian authorities are wary of any moves towards mandatory PSI, believing that these issues are best dealt with on a case by case basis. Also, they argue that during negotiations between debtors and creditors, the

IMF's role should be one of a 'well-informed counsellor' where its contribution is confined to the provision of assistance in the development of a strong programme leading to financial viability.

13) As regards suspension of payments or debt restructuring in serious crises, Latin American governments stress: 1) their clear preferences for actions that are negotiated and agreed with creditors (such as voluntary standstill or inter-bank and trade related credits); avoidance of unilateral actions by debtors, unless absolutely crucial, 2) if involuntary standstills or debt work-outs were carried out, the decision should be left to the country and the IMF should not be involved in that stage. The Russian authorities argue that attempts to make standstills more predictable are impractical given the uniqueness of each situation. Also, they stress the fact that unilateral suspension of payments is unavoidable in some circumstances.

14) To facilitate co-operative restructuring of the debt, Latin American governments agree that the inclusion of "collective action clauses" (c.a.c.'s) in bond contracts may be useful. However, they stress that "international organisations should not force emerging countries to introduce these clauses". LA governments seem excessively nervous that introducing c.a.c.'s could increase the costs of borrowing, which is inconsistent with most empirical evidence. This is an area where some technical assistance or a UK seminar for officials from LA and other emerging economies could be very valuable.

15) Returning to the issue of crisis prevention, more generally two categories of measures can be distinguished: a) national measures, which include implementation of standards and codes, and b) international measures, which include improvements in global regulations, and especially regulations in source countries. Latin American governments attach great relevance to prudential regulation in the financial markets of source countries. Accordingly, they suggest that in the preparation of the Financial Sector Assessment Programmes (FSAPs) on developed countries, it could be very important to examine whether their financial sector contributes to volatility of capital flows to developing countries, and what measures could be taken in the source country to reduce this volatility.

16) Latin American governments also believe that transparency should not be a one way street, and that this should be also applied to private financial institutions, with far better and more frequent disclosure on banks' positions, and especially on opaque institutions' exposure such as hedge funds.

17) At the national level, prevention measures include sound macro-economic policies, appropriate policies on capital account liberalisation and on financial sector regulation. A focus of this study is on the implementation of Codes and Standards (C and S) for major areas of economic policy.

18) There is a total of 65 C and S compiled by the FSF; however, priority C and S were identified in 12 subject areas. In order to assess progress in the implementation of C and S, the IMF has been charged with preparing, with relevant authorities of countries, Reports on Observance of Standards and Codes (ROSCs). The greatest progress in the observance of codes and standards has been

in data dissemination, fiscal transparency, monetary and fiscal policy transparency and banking supervision.

19) Latin American and the Russian governments are broadly supportive of the activities concerning C and S. The Russian authorities stress, however, that these activities should be restricted to areas within the IMF's mandate. The Fund should not 'delve too deeply' in areas not covered by its mandate, unless they impact directly upon a country's macroeconomic situation.

20) In Latin America, there are important differences in the degree of enthusiasm about implementing C and S. The Argentinean authorities are clearly by far the most enthusiastic supporters of C and S. They see them as valuable benchmarks that guide policy-makers to determine best practice; they are also seen as useful for helping to attract private capital flows. Argentina is the most active country in Latin America in implementing C and S. Within Eastern Europe, the most active countries in implementing and publishing ROSCs are the Czech Republic and Estonia. Like Argentina, the Czechs are very positive about the value of ROSCs. The Czechs highlight the need to co-ordinate technical assistance from different sources.

21) Despite their great enthusiasm, the Argentines share with other Latin Americans some reservations, such as the need for C and S to be voluntary, and that they were being defined mainly in G-7 or G-10 fora, with insufficient participation and input of developing countries. Other Latin American governments also point out that though overall they see C and S as valuable, they feel the international community is exaggerating its potential value, as their contribution -though useful – would not be so significant. An important concern with the ROSC process is that the emphasis is seen as excessively evaluating countries against an "ideal" best practice model, and that not enough emphasis is being placed on relative progress achieved vis-à-vis the country's past.

22) Perhaps the most serious concern expressed by LA authorities is the extent to which implementing C and S actually help in avoiding crises. A further concern is that C and S are too mechanical, formal and somewhat simplistic. A related issue was that C and S had on the whole too much of a "one size fits all" element, and that not enough account was taken of countries' specific features, institutions and history. A final complex issue is that whilst countries – and increasingly IFIs - want a more nuanced and sensitive assessment of C and S, the private markets have preference for simple (or simplistic) quantified assessments, that can be directly integrated into risk assessments systems and that can allow for cross-country comparisons and rankings.

23) Finally, it is the view of the smaller and poorer LA countries, that while C and S are important, their rhythm of implementation required is very high, and that this poses especially large institutional, legislative and – above all – human resource constraints for small countries to implement so many standards. This implies that technical assistance to them becomes particularly essential. Such countries would especially value bilateral technical assistance, like that of the proposed UK fund.

24) The Russian authorities also stress the need for adherence to C and S to remain a voluntary exercise. They argue that, in the promulgation of C and S, the relevant bodies need to strike a balance between complexity and feasibility. Different countries have very different capabilities in this area.

25) As regards possible regional initiatives, Latin American governments are showing interest in initiatives of two kinds. The first relates to regional financial co-operation, which could take the form of a regional fund – using countries' own reserves - that could be a first line of defence against a financial crisis caused by sudden and massive capital outflows. The second is to encourage a greater degree of macroeconomic co-ordination amongst countries of the region.

26) A regional fund (proposed by ECLAC), would be aimed at providing financial assistance to countries in times of financial difficulties; it is seen not as a substitute to the IMF, whose role in mobilising financial resources would remain crucial, but as a complementary institutional mechanism to support international financial stability.

27) A regards macroeconomic co-ordination at a regional level, important steps have already been undertaken especially within Mercosur towards promoting common macroeconomic objectives and transparency. These have included agreements on harmonised statistics, publication of fiscal indicators on a regular basis and a new process of macroeconomic convergence through establishing macroeconomic targets, particularly in the fiscal area, but also for inflation.

28) In summary, Latin Americans and East Europeans welcome changes done to the international financial architecture. However, they feel that relatively too much emphasis has been placed on national measures in emerging markets, especially via C and S (even though they see them as important) and insufficient progress has been done in the equally significant changes required at the international level. They would welcome a more gradual and nuanced approach to C and S, and especially speedier and deeper progress in the international dimension.

Part I. The Latin American Perspective

1. Aims of LA governments

Broadly, Latin American governments welcome the large growth of private capital flows that occurred in much of the nineties, as they see external savings as a complement to domestic savings. They particularly also welcome the contribution that foreign capital can make to the transfer of state of the art technology and management know-how, that is particularly linked with F.D.I.

Having suffered from costly and frequent currency and banking crises, LA governments are deeply concerned with volatility and reversibility of private flows. A second concern is the lack of sufficient long-term private flows to finance long-term investments, in areas such as infrastructure. A third concern is excessive concentration of those capital flows into the larger, relatively richer Latin American countries.

Though Latin American governments welcome the return of private flows to the region in the wake of the Asian, Russian and Brazilian crises, they are concerned that the scale of private flows now entering the region is insufficient, and their costs are very high; as regards the former point, a recent report by ECLAC (2000a), shows that for the year 2000 (except for FDI, which continues at high levels), for all categories of private capital to Latin America, net flows have still been negative; a further source of concern is the still high cost and short maturities of foreign borrowing, as well as the reportedly weak link between the cost of such borrowing and countries' macro-economic fundamentals (for the latter see statement by Colombian Finance Minister, Nov. 2000).

The main aim of LA governments is therefore for a new IFA to be created that will provide sufficient and sufficiently stable private flows to the different economies, and that will prevent costly currency crises, as well as managing them better if they do occur. To put it succinctly, a new IFA should address the two major problems relating to private flows to developing countries: volatility and concentration.

To help facilitate, encourage and sustain private flows, as well as to complement them when there are market gaps or major reversals of flows, Latin American governments stress the importance of large international financial institutions (IMF and development banks), to provide liquidity and development finance, as well as help catalyse private flows.

2. Assessment of progress so far

Latin American governments welcome the progress achieved on reform of the IFA made so far. This includes the approval of new credit IMF lending facilities (such as the Supplemental Reserve Facility (SRF) and the Contingency Credit Line (CCL)) and the expansion of IMF resources; the more preventive focus of IMF surveillance; the special impetus to international efforts to strengthen codes and standards of prudential regulation and supervision, information, as well as in other areas, which should make developing countries less vulnerable to crises; the recognition that capital account liberalisation in developing countries generates risks and must be carefully sequenced. Latin American governments also welcome institutional innovations, such as the creation of the Financial Stability Forum (FSF), to identify vulnerabilities and sources of systemic risk, to fill gaps in regulations and to develop consistent financial regulations; especially the larger Latin American governments welcome the creation of the G-20, a body to discuss international financial reform, that includes both developed and developing economies.

There are, however, four major concerns from a Latin American perspective about progress on international financial reform. The first is whether the changes made - important as they are - are deep and significant enough to create an international financial system that supports and does not undermine, growth and development in the new context of large, but very volatile and concentrated, capital flows. More concretely, has enough been done to prevent future crises, and to assure sufficient private flows? For example, Latin American economists and government officials, though welcoming the large financing packages arranged during recent crises, are concerned whether sufficient efforts have been done to provide required international official liquidity in future distress conditions.

A second concern is that the process of reform is asymmetrical in that far more progress has been made on measures taken by Latin American countries, which are being asked to introduce a very large number of codes and standards (even though broadly most LA countries see this as very positive) and far less progress is being made on equally important and complementary international measures. As Jose Antonio Ocampo, Executive Secretary of ECLAC and former Colombian Finance Minister puts it: "There is a paradox in that the new <u>international</u> financial architecture consists mainly of <u>national</u> measures taken by developing countries". [1]

As the G-24 - that represents developing countries including LA ones - pointed out in their statement at the Annual Meetings in Prague in September 2000, standards in the area of transparency are being pressed upon developing countries to improve information for markets without equal corresponding obligations for disclosure by financial institutions, including highly leveraged ones, such as hedge funds, who have no reporting obligation. Better information on financial markets would be of great value to policy-makers, especially in developing countries. Indeed, it would be interesting to explore further what kind of information would be particularly useful for policy-makers of developing countries and how such information can be made readily available to them. Transparency should not be a one way street. Furthermore, while valuable progress is being made in attempting to improve regulation of domestic financial systems in developing countries, there is painfully slow progress in filling important gaps in international regulation of institutions such as mutual funds or hedge funds, or of modifying regulations, as of banks, where current regulations may have contributed - rather than prevented - greater short-termism of flows; the Basle Accord is being revised, but the changes suggested do not totally overcome the regulatory bias towards short-term lending;[2] furthermore, they have not yet been

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[1] Personal communication.

[2] The current proposal requires a minimum of 8% of capital to risk-weighted assets. The risk assigned to sovereigns, banks and corporates varies according to whether countries are OECD members or not, and takes account the loans' maturity. Under the new proposal, the OECD/non-OECD distinction will

implemented, almost four years after the Asian crisis started. Thus in the field of international regulation, progress is very slow especially in the field of implementation. An interesting issue is whether the ROSC and the FSAP exercises (discussed below) when they are extended to developed economies, could, in their evaluation of their financial sector, include possible measures that would discourage volatility of capital flows to LA countries, as well as encouraging long-term flows.[3]

A third concern, which is particularly widespread amongst Latin American governments (even amongst those officials who are otherwise very supportive of the current reforms) is their lack of participation in key policy fora. As one senior official put it: "The architecture is totally irrational in these aspects. Latin American officials (including from systemically important countries) participate in the FSF Working Groups; however, they are excluded from the decision-making forum, the FSF, which is basically a G-7 body. The decisions taken in G-7 or other G-10 fora (such as the Basle Committee) are then communicated via the G-20 to the major LA countries; the IMF - which is a global institution - then encourages and assesses implementation by LA countries of decisions made by the FSF or other G-7 bodies." This concern would become even stronger, should measures adopted within fora where LA governments are excluded, become explicitly part not only of IMF surveillance, but also of IMF conditionality; even those Latin American governments most supportive of the importance of Codes and Standards, stress the need for these to remain as voluntary, and <u>not</u> become part of IMF conditionality.

A final concern of LA senior official is the fear that progress on international financial reform could not only slow down even more, as developing countries recover from recent crises, but that it could be <u>reversed</u>. As Enrique Iglesias, President of the Inter-American Development Bank, put it: "The LA region could become even more vulnerable to crises, if the will to grant large official financial packages, as were granted in recent crises, is absent in practice when the time comes. These packages have been so extraordinarily successful in containing crises and allowing a rapid recovery (as in Mexico and Argentina in 1995 and Brazil in 1998), but, in spite of this, they have lost official support in developed countries in the context of a new doctrine, which wishes to eliminate moral hazard. Our research shows that, at least in our region, there is no evidence that moral hazard is an important factor; for this reason, I dare say that any tendency to diminish official assistance to countries in difficulties would, if it took place, have a negative effect."[4] The type of reversal of progress achieved that Iglesias and other senior policy-makers in LA fear would thus relate to the concern that recommendations (such as reflected in Meltzer et al 2000) would be implemented, that would scale down lending - and several important functions and facilities of the IMF and World Bank. As Iglesias suggests, recommendations a la Meltzer are based on the incorrect diagnosis that government

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be dropped, and the measurement of risk will become more complex, with the risk weights to be determined either by the banks themselves based on an Internal Ratings Based Approach,or by external credit institutions in cases in which banks are still not ready to use their own internal ratings system for the purpose of determining risk weights.

[3] We recognise, however, that there may be some resistance in developed countries to this being done. However, we were encouraged by some support in the Bank of England for this possible extension of ROSC and FSAP exercises.

[4] E Iglesias (2000), Speech at the Regional Consultation of Latin America and the Caribbean on Financing for Development. Bogota. November.

failures (both in developing countries and in the granting of large packages by the IFIs) and, in particular, moral hazard, played a key role in causing recent crises.

3. The provision of emergency financing in times of crises

From a Latin American perspective, the enhanced provision of emergency financing during crises is one of the pillars of the system to prevent and manage financial crises.

More specifically, Latin American governments welcome both the creation of the SRF and the CCL. The SRF was relatively successfully used in Brazil in 1999, and seems to have contributed to making the Brazilian crisis less deep and less developmentally costly. As regards the latter, Latin American Executive Directors were very active in the modifications to make the CCL more attractive, announced before the IMF-World Bank 2000 Annual Meeting, so as to encourage countries to start using it (at the time of writing this report, however, the CCL remained unused).

There are several suggestions by senior Latin American officials on how the CCL could be further improved. The key remaining barriers towards LA applying for the CCL seem to be that: 1) applying for the CCL still seems to imply "joining a club you do not want to be a member of" (with Groucho Marx being the appropriate reference); particularly for the first country to apply, this means that the fear remains that getting a CCL could still be seen by the markets as a sign of weakness, and thus could be counterproductive. 2) Though the second bite of conditionality, at the time of activating the facility, has been reduced in the September 2000 modifications, LA countries still feel it as excessive.

There are several suggestions on how such obstacles could be overcome. LA senior officials[5] for example suggest that: a) several countries join at the same time, and that ideally the group of countries that join together first should also include some developed countries (indeed, reportedly countries like New Zealand, Australia and Ireland have been suggested, but as yet with no positive reply). This approach could not only "take out the stigma of joining the CCL"[6] but could even make having a CCL similar to joining an elite club,[7] b) An alternative very interesting suggestion made by Latin American senior officials as well as by others[5], would be to make the CCL far more automatic and widespread; the "trauma" of applying could be taken out by granting more or less automatically the right to a CCL to countries that have successfully completed their Article IV consultation, and that have been deemed by the IMF to be following good policies. As a result, many countries would have a right to the CCL, and any possible negative signal of having a CCL would be eliminated. The problem of "exit" would also be reduced, as most countries could remain in the CCL.

Though there may not be appetite for further changes of the CCL so soon after the previous revision, this may become urgent if countries continue not to use it; there is a particularly strong case for listening to developing and transition countries'

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[5] Interview material
[6] Interview material
[7] We recognise, however, that the attainability of this proposal is not high.
[5] We thank Andrew Ockenden for interesting suggestions on this point.

suggestions in the case of CCL. Another reason for further changes of the CCL, if it remains unused, is due to greater emphasis by the World Bank on cyclical and contingent lending, with even the likely creation of a new facility for this purpose. Even though this World Bank lending would provide medium-term support, its disbursement could be linked to the CCL; for this additional reason, it would be important to have an activated CCL.

As regards provision of emergency financing in times of distress, more ambitious proposals have been made by Latin American officials and economists, to deal with the issue of scarceness and unreliability of IMF resources during crises, given the large scale of resources required to deal with "21st Century - style" capital account led crises; limitations of IMF resources (and the need for packages to be painstakingly and slowly assembled during crises bilaterally with large industrial countries) risk reducing the stabilising effects of rescue packages, as the market may deem that the package will not supply funds in quantities required and promptly enough; this could deepen and/or spread crises unnecessarily. To overcome this, several Latin American economists ,[8] as well as the UN Regional Economic Commission for Latin America and the Caribbean,[9] argue that the most appropriate response would be to allow the temporary allocation of Special Drawing Rights (SDRs) to member countries during episodes of world financial stress; these temporary allocations could later be destroyed once conditions normalise, in order to avoid generating permanent liquidity; this would create an anti-cyclical element in world liquidity management.[10]

4. The provision of development finance

Latin American governments feel that private capital flows can and should play not only an important, but hopefully a growing role in international development finance. However, their experience indicates that there are clear and important gaps in private lending and investing in developing countries, which can be only filled by multilateral lending. Brazilian senior officials, drawing on the experience of their recent crisis,[11] particularly stressed "that support by multilateral development banks was fundamental to show markets the strength of the country's position."

Other market gaps stressed by Latin American officials, where multilateral bank lending could play a valuable role in filling are: a) provision of long-term finance, b) channelling resources to activities that are higher risk, but developmentally essential (such as lending to the financial sector especially but not only in times of crises) or to activities where social returns are higher than private returns (such as health and education) and c) provision of countercyclical lending. Particularly valuable has been post-crises multilateral lending to help fund social safety nets. The role of development banks in supporting social safety nets should be seen as part of the counter-cyclical role that multilateral institutions are increasingly seen as needing to play; Latin Americans see strong safety nets as particularly essential to manage the social repercussions of crises. The proposed World Bank Committed Loan Facility

[8] Ocampo (2000); Buira (2001).
[9] ECLAC 2000.
[10] This proposal has not been just made by Latin American economists, but by eminent sources in the rest of the world; see for example Camdessus (2000), Council on Foreign Relations (1999), and others.
[11] G. Rodriguez (2000).

(CLF), that would be negotiated ex-ante and available to help protect core programs for the poor in times of financial distress or reduced market access, would seem potentially a valuable tool for this purpose (Ocampo 2000). A very positive feature would be its' flexibility in terms of the timing of its disbursements as well as the hope for speed of disbursement. It would be particularly useful if the scale of the facility would be fairly significant, given the large needs at times of crises.

Latin American governments stress the central role that multilateral banks can play more broadly in the provision of counter-cyclical financing as a complement to balance of payments financing by the Fund; financing from these banks is the only long-term financing available during crises. At the time of crises, when there is strict credit rationing from private lenders, World Bank lending becomes particularly valuable to middle-income countries, which normally have good access to the markets. The CLF would therefore provide valuable insurance to these countries, which would be cheaper than other insurance mechanisms these countries could use (very high reserves, contingency credit lines from the private sector).

Some Latin American governments[12] point to a difficult dilemma relating to some current practice in multilateral lending. On the one hand, multilateral banks encourage cuts in government spending, so as to ensure smaller fiscal deficits; on the other hand, they promote and support new projects that imply an increase in government spending. (The latter is understandable, given the large needs for investment in the countries, and the difficulty to turn down new and important additional projects, that are additional to those existing in the Budget).

A suggested way forward is the creation by the multilateral banks of new products, for example a credit line that would help to finance fiscal spending as a whole, based on a good programme and broad policies that work well; LA government officials stress the need for this support to broad good policies, avoiding excessive or new conditionalities.[13]

Such proposals seem broadly in line with the thinking that is emerging in the Middle Income Task Force at the World Bank, which stresses that in the MICs the most effective way that poverty reduction can be promoted is by providing program loans to support good policies and overall budget priorities.

An additional point stressed by Latin Americans is the value of World Bank guarantees, especially if – as in loans to Argentina and Colombia – they provide additional leverage. A very useful mechanism is that whereby the World Bank guarantees – on a rolling basis – one year interest payments for private loans. This lowers the cost of such borrowing for middle-income countries.

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[12] see for example, Rodriguez, op. cit. and interview material.
[13] see for example, Rodriguez, op. cit. and interview material.

5. Private Sector Involvement (PSI)

Latin American governments strongly support PSI as measures to prevent crises, through mechanisms such as contingent financing arrangements from commercial banks that can be drawn on in times of difficulty; in fact, both Argentina and Mexico were amongst the first developing countries to arrange such bank contingent financing after the Mexican peso crisis. Mexico used its private contingent loan from the banks during the Asian Crisis; however, the use was problematic, as banks claimed the situation in Mexico was not serious enough to justify its activation, and put pressure on Mexico to pre-pay it (partly due to its low cost).[14] Other measures that Latin American countries support in preventive PSI include embedding call options[15] in inter-bank lines to allow for extending maturities and structured bonds linking payment to economic developments (e.g. prices of main exports). However, it seems unlikely that banks and investors will accept such clauses at present; on the contrary they prefer put options, which allow them to demand early pre-payment under certain conditions, e.g. of reduced credit worthiness of the debtor.

Latin American governments are also broadly supportive of measures to ensure private sector involvement during crises, as a way both of "burden sharing" costs of such crises and to help reduce the frequency of crises, by discouraging excessive surges. However, Latin American governments are broadly sceptical of ex-ante fixed rules for PSI during crises, preferring a more flexible approach; particularly, they are seriously concerned that any framework designed and measures taken for PSI during crises should: a) not excessively discourage future private flows and/or increase their costs, both to the country taking the measure and to other emerging countries; this is an important consideration especially in the current conjuncture, as all categories of non-FDI net private flows to Latin America remain negative, and conditions of the flows (e.g. maturities and costs of loans and bonds) remain fairly unfavourable,[16] and b) should be carefully devised so as to avoid creating further instability, as "making it easier for borrowers to prevent the exit of lenders once a crisis is underway is likely also to make investors more sensitive to the possibility of being locked in the event of a crisis, and thus quicker to run in anticipation of one."[17]

As regards suspension of payments or debt restructuring in serious crises, Latin American governments stress: 1) their clear preferences for actions that are negotiated and agreed with creditors (such as the voluntary standstill on inter-bank and trade related credits, agreed by Brazil with its bank creditors in early 1999, in the midst of the 1999 crisis, which is seen by the Brazilian authorities to have worked well);[18] avoidance of unilateral actions by debtors, unless absolutely crucial, 2) if involuntary standstills or debt work-outs were carried out, this was seen as a delicate decision,

[14] Based on presentation by Angel Gurria, then Mexican Finance Minister at HSBC, London 1999. Preliminary overview of the Latin American Economy in 2000. Santiago.
[15] Strictly, call options is a clause that permits the rollover of debt, in certain conditions.
[16] ECLAC (2000) op.cit.
[17] Interview material.
[18] Boorman and Allen (2000) describe the Brazilian deal with private banks as a voluntary agreement, with a "light touch," the latter applied to help resolve problems of collective action among banks creditors through dissemination of data and peer pressure, and without the application of moral suasion by the official sector.

with potentially severe costs for the country involved; therefore, the decision should be left to the country and the IMF should not be involved in that stage.

Some Latin American governments also stress that the negotiations for restructuring should be carried out just by creditors and debtor governments; they emphasise that the IMF should not put pressure on debtor governments, nor act as some informal umpire for such negotiations.[19] However, the IMF is seen by LA governments to play two very valuable roles: (i) the Fund's analysis of medium-term debt sustainability could be a basis for the discussion and (ii) the Fund should provide emergency financing, complementary with the private sector involvement efforts, where the financing gap is so large that they require both.

Latin American governments also tend to emphasise ex-ante measures that will facilitate cooperative restructuring of debt, by ex-ante measures to improve communications between debtors and creditors and by the inclusion of "collective action clauses" (c.a.c.'s) that help overcome the problem of coordination among large numbers of bondholders, in future crises.[20] The Argentinean authorities are the ones that seem most keen to use collective action clauses (Argentina has placed bonds both in London - with c.a.c.'s - and in New York, without c.a.c.'s and notes that there is practically no difference in their cost), though even they stress "that international organisations should not force emerging countries to introduce these clauses" for fear that the market could penalise them.[21]

Other L.A governments have even stronger fears that c.a.c.'s would make access more expensive; they also argue that the G-7 should start using them first; there seems to be some lack of knowledge (and ignorance of recent developments) in both beliefs. Firstly, there is a great deal of evidence that inclusion or not of c.a.c.'s does not increase costs; secondly, even in the New York market, recently creditors have broadened their acceptance of c.a.c.'s, whilst in London they have broadly been accepted for some time and thirdly, G-7 countries have been issuing bonds with c.a.c.'s for some time, with the UK Treasury even issuing short-term notes with c.a.c.'s in early 2000 just to set a clear precedent for several emerging economies. It seems that this is a clear field where some technical assistance or a UK seminar for officials from LA and other emerging economies could be very valuable, and would seem a good candidate for financial support from the suggested DFID fund.[22]

[19] Amongst others, the view was forcefully presented by Pablo Guidoffi, then Under-Secretary of Finance, Argentina at 2000 Com Sec, W.Bank, IMF. (Conference on IFA and Developing Countries), London. June 2000.

[20] Basically, there are four categories of collective action clauses: majority action clauses, collective representation clauses, sharing clauses and non-acceleration clauses. Under English law, bonds normally include majority action clauses, which allow bondholders to convene and change the terms of payments of a bond contract by a qualified majority (normally 75%) of bondholders. Collective representation clauses permit bondholders to be represented collectively, for example by a trustee, thereby reducing co-ordination problems in the negotiation process. Sharing clauses require any payments received to be distributed on a pro-rata basis among all creditors (Dixon, 2000).

[21] Interview material.

[22] Interviews in the City; see also IDS Minutes of the Third Private Sector Discussion Group Meeting (2000) at: http://www.ids.ac.uk/ids/global/finance/prisec.html

6. Crises Prevention

As regards crises prevention, two categories of measures can be distinguished: a) national measures, which include implementation of standards and codes, in capital flow recipient economies, and b) international measures, which include improvements in global regulations and, especially, regulations in source countries. As regards the second aspect, several LA authorities attach great relevance to it. Thus, the IADB President, Enrique Iglesias (2000 op.cit), emphasises that "it is important that contagion is controlled also in its source, the developed countries, via financial regulation. In particular, via a flexible regulation, that is less tight in difficult times, which could be effective to prevent the spread of contagion" (our underlining). Arguing along similar lines, the former Governor of the Central Bank of Chile, R. Zahler (1999), wrote that "the institutional framework, including supervision and regulation of financial and assets markets at the international level, is crucial as these markets present a higher degree of imperfections than at the national level - recent experience suggests that these international swings need to be brought under certain control... The biggest challenge appears to be how to improve prudent regulation in the creditor countries, particularly in relation to short-term bank loans as well as on portfolio flows" (our underlining). Indeed, as mentioned, Latin Americans see that in the preparation of FSAPs on developed countries, it would be very desirable that an important issue to be examined is whether their financial sector contributes to volatility of capital flows to developing countries, and what measures could be taken in the source country to reduce this volatility. LA also stress that transparency should not be a one way street, and that better transparency should also be applied to international financial institutions, with far better and more frequent disclosure on banks' positions, and especially on opaque institutions exposure, such as that of hedge funds; this would be useful for LA policy-makers.

As regards crisis prevention measures, at a national level, there are now a number of important areas, including: sound macro-economic policies, appropriate and more prudent policies on liberalisation of the capital account and on regulation of the financial sector. In this study, we will focus on an area particularly emphasised recently by the international community, which relates to the implementation of Codes and Standards (C and S) for major areas of economic policy. The initial ultimate aim of these standards was to contribute to economic stability, nationally and internationally, though as we will see below some doubts have been raised even in international institutions about their immediate impact on this aim. As the Financial Stability Forum pointed out,[23] the main proximate targets are strengthening domestic financial systems and promotion of international financial stability by "facilitating better-informed lending and investment decisions, improving market integrity, and reducing the risks of financial distress and contagion." The content of the standards largely reflects concerns arising out of recent crises, though they often also build on past initiatives involving mainly developed countries. While the standards were designed to promote stability, as Cornford[24] has argued, their development can be viewed as part of a process of "groping towards a set of globally accepted rules for policy which could provide one of the pre-requisites for provision of international

[23] Issues Paper of the Task Force on Implementation of Standards. March 2000.
[24] A. Cornford (2001) "Standards and regulation" UNCTAD. Mimeo. Draft for Trade and Development Report 200.

financial support for countries experiencing currency crisis." In this sense, they could become an international analogue of national rules for financial sectors, compliance with which facilitates availability of lender of last resort financing; however, at present, as Ocampo [25] has emphasised, there is no international lender of last resort, a la Bagehot, nor even is there automatic limited international liquidity in times of crisis; what is available is provision of official lending - with conditionality - in times of crisis. Indeed, the case for developing countries to comply more fully and enthusiastically with C and S would be significantly increased if more significant steps were taken towards providing international liquidity in times of crises (for discussion on LA perspectives on that see above).

In what follows, we will first describe the scope of what has and is being done on C and S, with particular emphasis on Western Hemisphere and Eastern Europe. We will then discuss the range of attitudes towards C and S in the different countries in those two regions, including positive and more critical positions, as well as views. We will then address more general critiques and issues, as well as steps taken to adopt C and S to take account of critiques.

a. Codes and standards, financial surveillance and the role of the IFI's

1. Financial Sector Assessment Program (FSAP)

The joint IMF/World Bank FSAP was launched in May 1999 to identify financial system strengths and weaknesses and reduce the potential for crisis. Initially, the FSAP was piloted in 2000 with twelve participating countries. The programme will be continued in 2001 and expanded to cover about twenty-four member countries. The FSAPs take a broader view than that of the C&S approach, viewing observance of pertinent C&S as one input into their analyses of financial sector vulnerability and, in the case of the World Bank, considering developmental priorities. Tables 1and 2 as well as Annex 1 provide details.

[25] Personal communication.

Table 1 - Status of the FSAP Pilot. (a)

Cameroon	March 2000
Canada	October 1999
Colombia	July 1999
El Salvador	April 2000
Estonia	March 2000
Hungary	February 2000
India	April 2000
Iran	March 2000
Ireland	March 2000
Kazakhstan	February 2000
Lebanon	May 1999
South Africa	October 1999

Source: IMF (2000).
(a) countries underlined are in Western Hemisphere or Eastern Europe.

Table 2 details the countries participating in the FSAP for FY2001.

Table 2 - FSAP: Ongoing Country Participation and Tentative Schedule for Future Participation (a)

Country	Main FSAP Mission
Mission work completed or under way	
Ghana	July 2000
Armenia	September 2000
Guatemala	September 2000
Israel	September 2000
Peru	September 2000
Poland	September 2000
Iceland	November 2000
Senegal	November 2000
Yemen	November 2000
Slovenia	November 2000
Czech Republic	December 2000
ECCB Area	December 2000

Participation confirmed for FY2001 or later:

Argentina; Barbados; Costa Rica; Croatia; Dominican Republic; Finland; Gabon; Georgia; Korea; Latvia; Kyrgyz Republic; New Zealand; Sri Lanka; Sweden; Switzerland; Tunisia; Uganda; United Arab Emirates; United Kingdom and Uruguay.

(a) Countries underlined are in Western Hemisphere and Eastern Europe.
Source: IMF (2000).

The FSAP fits within the context of the Fund's regular activities under Article IV surveillance, but specifically aims to identify and address financial vulnerabilities with the potential to initiate crises. The collaboration between the Fund and the Bank is expected to produce positive results. A broad approach has been adopted to cover the following: 1.Linkages between macroeconomic developments and the financial sector. 2. Observance of codes and standards. 3. Analysis of overall stability and of key financial sector structural and developmental needs and priorities (IMF, 2000).

It is envisaged that: "The FSAP should alert national authorities to likely vulnerabilities within their financial sectors while assisting the Bank and the Fund, and the international community more broadly, in designing appropriate assistance."[26]

Codes and Standards (C and S), although an integral part of the FSAP, imply a separate process to address these issues in a free-standing but complementary way.

2. Codes and Standards

The FSF has compiled 65 C&S, based on the work of the relevant international bodies in each area. Of these, the FSF has identified priority C and S in 12 subject areas. These priority C and S are detailed in table 3.

Table 3.

Subject Area	Key Standard	Issue by
Macroeconomic Policy and Data Transparency		
Monetary and financial policy transparency	Code of Good Practices on Transparency in Monetary and Financial Policies	IMF
Fiscal policy transparency	Code of Good Practices in Fiscal Transparency	IMF
Data dissemination	Special Data Dissemination Standard/ General Data Dissemination Standard	IMF
Institutional and Market Infrastructure		
Insolvency	Principles and Guidelines on Effective Insolvency Systems	WB
Corporate governance	Principles of Corporate Governance	OECD
Accounting	International Accounting Standards (IAS)	IASC
Auditing	International Standards on Auditing (ISA)	IFAC
Payment and settlement	Core Principles for Systemically Important Payment Systems	CPSS
Market integrity	The Forty Recommendations of the Financial Action Task Force	FATF
Financial Regulation and Supervision		
Banking supervision	Core Principles of Effective Banking Supervision	BCBS
Securities regulation	Objectives and Principles of Securities Regulation	IOSCO
Insurance supervision	Insurance Supervisory Principles	IAIS

Source: FSF website http://www.fsforum.org/Standards/KeyStds.html

[26] see http://www1worldbank.org/finance/html/fsap.html

3. Reports on Observance of Standards and Codes (ROSCs)

In order to assess progress in the implementation of C&S the IMF has been charged with preparing, with relevant authorities of countries, Reports on Observance of Standards and Codes (ROSCs). In some instances these reports represent free-standing processes; in others they have emerged as by-products of the Fund's regular surveillance activities under Article IV or derived from the FSAP. In September 1999, the Fund Executive Directors indicated a preference for a shared ownership approach to preparing ROSCs and invited the World Bank to experiment in preparing particular modules.[27]

The ROSC process is a modular one with observance of the separate codes or standards assessed independently. As of December 4, 2000, 83 ROSC modules had been produced for 32 countries, with 67 being published. It is envisaged that more than 100 ROSC modules will be generated in 2001.

Table 4. ROSC modules completed and published by December 4, 2000

Data Dissemination	Fiscal Transparency	Monetary and Financial Policy Transparency	Banking Supervision	Insurance Regulation	Securities Market Regulation	Payments Systems	Corporate Governance
Argentina Albania Australia Bangladesh Bulgaria Czech R. Hong Kong **Russia** Tunisia Uganda U.K.	Argentina Australia Azerbaijan Bulgaria Cameroon Czech. R. France Greece Hong Kong Pakistan Papua New Guinea **Russia** Sweden Tunisia Turkey Uganda Ukraine U.K.	Argentina Australia Bulgaria Cameroon Canada **Colombia** Czech R. Estonia France Hong Kong **Iran** Ireland Lebanon **Russia** **South Africa** Tunisia Uganda U.K.	Algeria Argentina Australia **Bahrain** Bulgaria Cameroon Canada **Colombia** Czech R. Estonia Hong Kong **Iran** Ireland **Lebanon** **South Africa** Tunisia Uganda U.K.	Cameroon Canada Estonia **Ireland** **South Africa**	Canada Czech R. Estonia **Ireland** **South Africa**	Cameroon Canada Estonia Ireland **South Africa**	Malaysia Poland Zimbabwe
Total completed 11	**18**	**18**	**18**	**5**	**5**	**5**	**3**
Total Published 9	**17**	**13**	**13**	**4**	**4**	**4**	**3**

Source: World Bank.

- Those countries highlighted in bold represent instances of modules that have been conducted but not published.
- Those countries underlined represent countries in Western Hemisphere or Eastern Europe.

As can be seen from the table above, the greatest progress in the observance of codes and standards has been in the first four areas: Data Dissemination; Fiscal Transparency; Monetary and Fiscal Policy Transparency and Banking supervision.

[27] See Reports on the Observance of Standards and Codes: An Update @: http://www.imf.org/external/np/rosc/2000/stand.htm#I

We can conclude that developing countries and IFIs are making major efforts to produce FSAP and ROSCs; this is a vast and costly exercise (both financially and in terms of human resources), even on the current scale, which is providing fairly partial coverage. If more countries and areas were included, the exercise would become far larger and costlier.

TABLE 5

W.H and E.E countries with ROSC and FSAP (a) and Pilot or Post Pilot FSAP (b)

	ROSCs	Non-published (FSAP)	Published ROSC
Argentina	3		3
Armenia	1	5	
Bulgaria	3		3
Colombia	2	2	2
Czech Republic	5		5
El Salvador		2	
Estonia	5	5	5
Guatemala		3	
Peru		3	
Poland	1		1
Russia	3		
Slovenia		5	
Ukraine	1		1

Source: Author's elaboration based on Tables 1,2,4 and Annex 1.
(a) Numbers reflect numbers of modules.
(b) (b) Participation for 2001 or later confirmed for Argentina, Costa Rica, Croatia, Dominican Republic, Georgia, Latvia, Kyrgyz Republic and Uruguay.

Table 5 provides us with a clear overview of WH and EE countries' participation in ROSCs and FSAPs. The most active countries (in terms of published ROSCs, that is where information is publicly available) are by far Czech Republic and Estonia (with 5 each) both are in EE. Bulgaria is also very active in EE, having 3 published ROSCs. The most active in WH (in terms of 3 published ROSCs and a future FSAP) is Argentina: Poland and Ukraine have one published ROSC each. Russia and Colombia stands out as active in ROSCs, but have not published any of them (ROSC publication is voluntary). FSAPs are not published - Estonia is again very active, as are Armenia and Slovenia (each with 5 modules); also active are Peru, Guatemala, Colombia (with 2 modules) as well as Poland and Ukraine (with 1).

b. Appraisal of C and S, from a LA perspective

LA governments are clearly supportive of the aims pursued by C and S. However, there are important differences in the degree of enthusiasm between LA governments for rushing to implement them. However, on balance, LA countries seem more willing to support and adopt C and S, than for example East and Southern Asian ones, or than African ones. Equally there are differences in the extent to which different LA countries are critical of the implementation of these standards.

Within Latin America, clearly Argentina is both the most enthusiastic "implementer " of standards (see Table 5) and the most enthusiastic supporter.[28] Argentinean authorities (both in the Ministry of Economy and Finance, and in the Central Bank), describe Argentina as "very supportive, very compliant, most active in LA, super-keen" and stress the fact that they are the first in LA to start implementing C and S, especially in areas of Transparency, and are attempting to advance also in other areas. They have even created an additional C and S in actuarial matters, which they consider high priority. Progress in ROSCs and in the future FSAPs in Argentina were reportedly to an important extent linked to the recent IMF programme, negotiated when the Argentine economy came under pressure from the markets in 2000. More generally, enthusiasm for implementing C and S by the Argentinean authorities may partly reflect their urgent need to maintain access to markets, given their fragile situation.

The Argentine authorities see C and S as valuable benchmarks, that guide policy-makers to determine best practice and clarify objectives; they are also seen as useful for helping to attract private flows. An additional use of C and S is that, like conditionality in some cases, they may help the economic authorities to implement measures (such as financial regulatory charges) that they wish to do, but that face opposition internally, e.g. in Congress.

The fact that there are so many C and S does not seem to be a particular source of concern to the Argentine authorities themselves as they are relatively well resourced in these areas; they see the justification for so many C and S, as based in the complexities of modern financial systems. To deal with implementing the C and S, and their interactions, the Argentine authorities have created a special strategic unit, reporting directly to the Under-secretary of Economy and Finance. The Argentine authorities interviewed were very enthusiastic about the possible creation of the DFID Fund, greatly stressing its potential value to them and others; even though they have put large resources into these areas, they have gaps, where they would very much welcome technical assistance from such a fund. They even spontaneously suggested that Argentina would be very happy to rapidly become a user of such technical assistance, and that even its experience with such technical assistance, could help set precedents and extract lessons for other countries in the LA region. One area highlighted for possible valuable British technical assistance would be for evaluating systemic risk in the whole of the financial system, especially drawing on the FSA experience, of integrating different regulatory agencies and their assessment of risk.[29]

It should be mentioned that even though the Argentine authorities are such great enthusiasts for C and S, as well as their implementation, they did have some reservations (especially on modalities of implementation); though similar to those of other LA governments, Argentine criticisms were far lighter and more nuanced. Firstly, they emphasised the need for C and S to be voluntary, even though accepting to a certain extent that they should be part of surveillance. Other LA government

[28] Interview with Silvana Vatnik.
[29] Interview material.

officials just stressed even more strongly the need for C and S to be voluntary. Though saying that Argentina was fortunate enough to have resources to start meeting C and S themselves, because they were relatively well endowed in the bank regulatory and other fields, they realised these exercises were very resource intensive and implementing them could be problematic for other countries. As regards the process of defining and implementing S and C, there were criticisms clearly shared by other LA governments of the way they are defined - mainly in G-7 or G-10 fora - with insufficient participation and input of developing countries; there was also some criticism of the support provided by the Bank and the Fund for implementation, as the link implied quite a large effort on the part of the country, but relatively little technical assistance provided in return.

This problem was linked, positively, into the need for more technical assistance, and the value of the potential British contribution.

To extend the comparison to EE, we interviewed the Czech National Bank, as the Czech Republic is one of the two countries in both regions to have most ROSCs (see above). The Czech authorities,[30] like the Argentinean ones, are very positive about the value of ROSCs and even accept that they should be part of surveillance. They are keen on continuing work on their FSAP. They particularly welcome recommendations on strengthening the financial system. The Czech National Bank would particularly value additional insights - and possible technical assistance - on a diagnosis of reasons for bankruptcy of banks (especially recently the third largest one), and what lessons could be learned for improved banking supervision. An important potential problem in technical assistance highlighted is that it comes from different sources; the Czech authorities stress the need for improved coordination, e.g. between EC, FSAP, EBRD and bilateral.

Returning to the LA perspective, other LA countries share Argentina's perception that S and C are potentially important and valuable. However, they both attach less priority and urgency to implementing them and they are more critical.

Amongst LA countries that had not embarked on the ROSC/FASP process - or had done so only partially - emphasis was placed on the fact that they were taking anyway important steps in the fields that ROSCs include, which they agree have high priority (e.g. financial regulation, corporate governance, etc), but were doing so without necessarily embarking on the ROSC process. An important reason for this was lack of time and resources, combined with other key priorities and policy challenges. Overall they saw C and S as valuable, but felt the international community was exaggerating its potential value, as their contribution - though useful - would not be so significant.

A country making important efforts in a number of areas included in ROSCs, but not yet being very involved in ROSCs themselves, was Brazil. Brazil is making important efforts in areas like fiscal policy (including efforts to recognise contingent liabilities, that enhances fiscal transparency, as well as enacting the Fiscal Responsibility Law), strengthening bank regulation (including implementing Core

[30] Interview material.

Principles), improving securities and insurance regulation, as well as enhancing the legal framework for corporate governance.[31]

Recurrent concerns were lack of participation in designing C and S, which they then had to implement, and asymmetries emerging, in that transparency was rigorously required from countries, but not from financial markets.[32]

One important concern with ROSC/FASP processes was that the emphasis was seen as excessively evaluating countries against an "ideal" best practice model. The perception was that not enough emphasis was placed on relative progress achieved (vis-à-vis the country's past), but excessive emphasis on negative aspects and evaluation against an absolute ideal benchmark.

Perhaps an even more serious concern expressed by the LA authorities was the extent to which implementing C and S would actually help in avoiding crises. It is important that a recent IMF document[33] recognises that on their own "standards assessment play a more limited role of identifying immediate financial system vulnerabilities, as these are influenced by a host of macro-economic and structural factors." This document also stresses that FSAPs contribution "to identifying immediate risks and vulnerabilities is limited," though FSAPs contribution is valuable in many other aspects. (This IMF document emphasises linkages between macro economic performance and financial sector soundness, including stress testing and scenario analysis). Whilst doubts remain about the effectiveness of standards assessments for crisis avoidance, it may be difficult to convince some governments with many urgent tasks and priorities to devote an important proportion of their scarce resources to them.

Another concern is that S and C are too mechanical, formal and somewhat simplistic. "There is too much of an element of ticking boxes."[34] A related issue was that S and C had, on the whole, too much of a "one size fits all" element, and that not enough account was taken of countries' specific features, institutions and history.

It is important that in a recent World Bank - IMF document[35] some of these criticisms (especially the latter) have been acknowledged. Emphasis is placed on the fact that "implementation of standards should reflect members; circumstances and other reform priorities," and that "implementation of standards needs to be sequenced and prioritised in light of each member's institutional capacity and economic structure" and that ...assessments should "recount progress achieved over time." This is encouraging.

There is, however, quite a complex outstanding issue. On the one hand, countries want a more nuanced and sensitive assessment - that takes account of country features, history and recent progress; the IFIs seem sympathetic. This leads both to better, but also to longer and more qualitative reports. However, the private sector

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[31] Interview material and Press Release on IMF Article IV Consultation with Brazil. Dec. 22, 2000.
[32] Interview material.
[33] IMF (2000) Financial Sector Assessment Program - A Review. November.
[34] Interview material.
[35] World Bank/IMF "Assessing the Implementation of Standards: A Review of Experience and Next Steps. January 2001.

and the markets have on the whole, preference for brief reports, and quantified assessments, that can be directly integrated into risk assessments systems and that can allow cross-country comparisons and rankings.[36] Both Bank and Fund staff, as well as countries, are broadly against C and S being quantified, and being used as an input into private sector ratings. However, this implies that implementing C and S would not directly increase country's creditworthiness, and access to private flows; the effect on markets would be indirect; if implementing standards lead in the medium-term to stronger financial systems and better policies (and thus less vulnerability to crises), then also in the medium-term countries would become more creditworthy.[37] However, the so-called short-term market incentive (via more or cheaper private flows) would be fairly marginal or even non-existent. To the extent that Keynesian 'beauty contest' analysis is very relevant, improved information could in any case, even if very quantitative, have limited impact on market decisions, as according to that analysis, market actors look more at each others' actions rather than at countries or companies.

It is important to clarify this point, by making more precise the aims of C and S, and clarifying the extent to which - if at all - an important objective should be to provide quantitative signals to the markets, or whether focus should be mainly placed on improving the financial sector and policies. This clarification is important as some LA countries hope that implementing C and S will in the short-term help them attract private flows; others fear that simplistic C and S could be used too mechanically for risk assessment by the private sector; a third group feels C and S implementation is not so important for countries that have fairly good market access.

Last, but certainly not least, it is important to add a different Latin American perspective, that which comes from smaller and poorer countries.[38] Whilst seeing C and S as very important, authorities in smaller countries stress that their rhythm of implementation required is very great, and that this poses especially large institutional, legislative and - above all - human resource constraints for small countries to implement so many standards.[39] This implies that technical assistance to them becomes particularly essential. Though such countries value greatly bilateral technical assistance (e.g. from the UK), they are also interested in regional mechanisms, which could also partly be funded by initiatives such as the UK one.

[36] FSF (2000) Report of the Follow-up Group on Incentives to Foster Implementation of Standards.
[37] We thank John Drage for his perceptive comments on this point.
[38] Interview material.
[39] We thank Dr Eduardo Lizano, Governor of the Costa Rican Central Bank for his insights.

7. Latin American proposals and initiatives at the regional level

In Latin America, a view is emerging that a new international financial architecture should include regional initiatives and arrangements in order to better prevent and manage currency and financial crises, as well as the crucial global arrangements.

Two kinds of proposals are gaining shape. The first is to search for a higher degree of financial co-operation at the regional level. This could take the form of a regional fund, which could be used as a first line of defence against a financial crisis caused by sudden and massive capital outflows. The second is to encourage a greater degree of macroeconomic co-ordination amongst countries of the region, and to promote greater transparency and the creation of common standards.

a. The Regional Fund

A proposal has emerged recently for the creation of a regional fund. This regional fund would be aimed at providing financial assistance to countries in order to help them better deal with a financial crisis, and also with a balance of payments problem caused by an external shock, such as a sudden deterioration in the terms of trade (Agosin, 2000). The Fund would not be a substitute to the IMF, whose role in mobilising financial resources would remain crucial, but as a complementary institutional mechanism to support international financial stability.

A regional fund could be used to help a country ward off a crisis, in which case it would have a preventive role, or to help contain it, in case it does occur. Moreover, by helping prevent or contain a crisis in one country, it would generate important externalities as it would be protecting the other countries from regional contagion effects (CEPAL, 2000). The existence of a regional fund could also enable countries to provide a more effective response to a crisis, as they would have access to financial funds more easily and quickly, and with less conditionalities attached. Indeed, one of the complaints of small LA countries is that if they have a serious crisis, it will take an IMF mission far longer to come to their country than to a systemically important one.[40]

In addition to the benefits above outlined that a fund would bring, it would work as an important mechanism to leverage financial resources available to individual countries of the region. This is a key aspect, as in the past few years the emerging economies have attempted to reduce their vulnerability to a crisis by building-up high levels of foreign exchange reserves. Latin Americans share the view that this strategy is, however, financially very costly to the countries; in addition, it makes the macro-management of the economies more complex and difficult. A larger amount of resources made available by a regional fund would put some of the pressure off the countries for accumulating excessively high levels of foreign reserves.

The main source of resources of such a new regional fund could come from the international reserves held by the Central Banks of LA member countries, through a

[40] Interview material.

quota system; for each country the quota could correspond to a percentage of the country's foreign reserves, which could be around 15%. According to Agosin (2000), 15% of the reserves of 11 countries of the region in a non-crisis year of the 1990s amounted to about US$ 20 billion. With these resources, a regional fund was capable of financing all the short-term debt of any individual country facing sudden capital outflows (Brazil would be the only exception to that). Thus, such a regional fund could act as a first line of defence.

To complement this, the Fund would also have access to emergency credit lines provided by the Central Banks of the member countries. This would enable the Fund to assist with a reasonable degree of effectiveness even the larger economies of the region.

A regional fund in Latin America could build upon the already existing monetary and financial arrangements in the region: the *Fondo Latinoamericano de Reservas* (FLAR), which is a Latin American fund of reserves, and the *Convenio de Pagos y Creditos Reciprocos* (CPCR), which is a chamber of compensation that also offers reciprocal credit lines.

The FLAR has as one of its objectives to support member countries facing balance of payments problems. Though originally including only Andean countries as members, it has recently started to expand membership to countries outside the Andean sub-region, with the recent inclusion of Costa Rica. It has performed successfully in its role of providing financial assistance, especially to the smaller countries of the membership, such as Bolivia. It was particularly helpful in providing Ecuador with a crucial bridge loan during its recent crisis.[41] By mid-1998, the FLAR held resources drawn from its quota system amounting to more than US$ 1billion. The poorer countries like Bolivia and Ecuador could each have access to US$ 437 million at the end of 1997, which corresponded to 3.5 times their quota values. These resources were larger than the IMF quota values these countries had at the time and, in the case of Bolivia, larger than the country's total short-term external debt (Agosin, 2000, Table 2).

The CPCR, in turn, was created in 1969 with the aim of reducing the need of foreign reserves in the trade transactions between member countries of *la Asociacion Latinoamericana de Integracion* (ALADI). The CPCR has been used to cover a significant percentage of the trade operations within ALADI (nearly 20% at the end of 1990). Other important sub-regional organisations created in the past are the *Corporacion Andina de Fomento* (CAF) and the Centro-American Bank for Economic Integration (CABEI).

A possible way forward would be to expand the FLAR and include the bigger economies of the region in it. This would result in a regional fund that would have greater power to mobilise resources and help crisis-affected countries more effectively.

Senior government officials from the small countries of the region very much value the regional initiatives. They believe that the FLAR has been a successful

[41] Interview material.

organisation, and they highly welcome further initiatives to enhance financial support to the smaller economies of the region.

They support in particular the proposal of strengthening the FLAR, though they believe that it would be more appropriate if the FLAR expanded, but still remained a sub-regional organisation. By remaining sub-regional, the FLAR could be more effective and quickly in continuing to provide bridging loans for rescuing the smaller member countries facing financial difficulties.

Lizano (1999) specifically proposes the creation of what he terms precautionary sub-regional funds, to provide immediate financial resources to the small countries being affected by crisis contagion and herding behaviour. Still for the purpose of crisis avoidance, Lizano also proposes the creation of small country emergency finance (to be provided by the multilateral banks, such as the World Bank and the Inter-American Bank), which would be a new credit facility to be used by a small country facing difficulties in raising international resources abroad due to an international financial crisis. In addition, in order to help the small countries to place medium-term bonds on the international capital markets (a difficulty for these countries), Lizano further suggests that the multilateral banks provide small countries with enhancements. According to him, 'this would slash the cost of the issue, (interest rate and other conditions), sometimes substantially, depending on the nature of the enhancement' (Lizano, 1999, page 7).

The view that supports the creation of sub-regional funds (and of additional credit lines of multilateral nature) could be complementary with the idea of a regional fund. If a regional fund were created, there would exist a web of organisations in support of Latin American countries, at different levels – sub-regional, regional and global. The advantage of retaining sub-regional arrangements would be that the smaller countries would have their own channels to voice their needs and views; also, the sub-regional arrangements would serve best the interests of these countries given their greater proximity. These sub-regional organisations could also assist in other tasks, e.g. intermediating technical assistance on Codes and Standards.

As emphasised earlier, Latin Americans in their quest for regional organisations want to make it clear that in a new institutional arrangement it is crucial that the global dimension is retained. This is due to the fact that the effectiveness of a regional fund in averting (or managing) crises in LA is linked to the assumption that crises hit countries sequentially. As the debt crisis of the 1980s and the East Asian crisis show, however, an external shock can hit countries of the same region simultaneously. A regional fund in East Asia could be effective in fighting simultaneous crises, given the very high levels of international reserves held by the countries of the region. As Latin Americans recognise, however, this is not the case in Latin America, implying that a regional fund in the continent would have a rather limited role.

Thus, the possibility of simultaneous crises makes Latin Americans see as stronger the case not only for the preservation but also the strengthening of the global organisations, as only these would be able to cope with a crisis of regional proportions. Furthermore, they could coexist and collaborate with their regional and sub-regional counterparts, thereby creating synergies and enhancing the stability of the international financial system.

A possible form of collaboration Latin Americans are suggesting would be having regional funds working as intermediaries between the countries and the IMF. This would reduce co-ordination problems. By giving Latin Americans greater influence on the prevention and management of crises, regional and sub-regional funds would help to partially address today's problem of under-representation and participation of LA countries in the discussions and decision-making process of the IFA, a widespread concern in Latin American policy circles.

Finally, Latin Americans believe that sub-regional and regional organisations could contribute to the important task of promoting macroeconomic co-ordination in the region. The FLAR, for example, could be used to support a higher degree of exchange rate stability in the continent (Agosin, 2000). In what follows, we discuss the most active regional grouping, Mercosur, and its attempts of macroeconomic co-ordination.

b. Macroeconomic co-ordination

More generally, Latin Americans believe that in order to better prevent the occurrence of a financial crisis and to help sustain growth, there should be regional initiatives to promote macroeconomic co-ordination, greater policy and data transparency and the creation of common standards in different areas (CEPAL, 2000; Itamaraty, 2000a).

As mentioned above, a regional fund could support greater exchange rate stability in the region; in addition, it could support other macroeconomic policies and the creation of common standards, as well as have a supervisory role. A regional fund could be particularly useful in helping strengthen prudential regulation and supervision of the countries' financial sectors.

Important steps have already been undertaken especially within the Mercosur[42] towards promoting common macroeconomic objectives and transparency. In a Mercosur meeting in June 2000, an agreement was reached to promote 1. harmonised statistics with a common methodology; 2. Publication of fiscal indicators on a regular basis and; 3. macroeconomic convergence through establishing macroeconomic targets, particularly in the fiscal area (Itamaraty, 2000a). To support this initiative, a Group of Macroeconomic Monitoring (GMM) was also created, formed by high-level government officials drawn from the countries' Central Banks and Treasuries.

In another Mercosur meeting held in mid-December 2000, further initiatives were taken to establish macroeconomic targets, to be implemented in gradual steps. In 2001, common targets in the fiscal area (e.g. net public debt) and for inflation will be announced. In 2001, a process of monitoring will be launched, with quantitative targets being specified for key macroeconomic variables. These targets include a ceiling of 3% for the budget deficit; a declining public debt ratio until 2010, with a ceiling of 40% of GDP to be met thereafter; and an inflation target of 5% over the 2002-2005 period (Itamaraty, 2000b).[43]

[42] Mercosur is a regional trade agreement that includes Argentina, Brazil, Paraguay and Uruguay as member countries, and Bolivia and Chile as member associates.
[43] See also Interview Material.

It is believed that as other sub-regional trade blocs and financial organisations also start to promote more actively greater macroeconomic co-ordination, it would be desirable if they could exchange information between them. To this end, a proposal is being considered jointly by CEPAL and the European Commission to establish a Network of Macroeconomic Dialogue (REDIMA - Ghymers, 2000). REDIMA's role would be to promote a dialogue between the various initiatives, a way by which greater macroeconomic co-operation and convergence could be truly achieved at a regional level.

REDIMA would thus be a forum in which exchange of information on ongoing negotiations could take place, and in which research related topics could be carried out. As regards the specific case of Mercosur, where a group of macroeconomic monitoring has been created (see above), REDIMA could complement their work by promoting exchange of information and academic debate on macroeconomic topics which are of interest for the whole Latin American region. This broader dialogue could serve as a basis 'for the preparation of possible common positions in different international or multilateral fora' (Ghymers, 2000).

Part II. The Russian Perspective[44]

This part is divided into two sections: the first section transmits the opinion of Russian officials – Ministry of Finance, Central Bank and The State Committee for Statistics, while section 2 summarises some elements of the IMF report on Codes and Standards in Russia.

In general the Russian authorities recognise the importance of adhering to codes and standards but they also expressed frustration that Russia was being expected to observe standards that many other countries, including some with a long tradition as a market economy, did not observe and they considered much of the criticism of Russia to be driven by domestic political consideration in other countries.

<u>1. Aims and perspectives of the Russian Federation as regards access to private financial flows, crisis prevention and crisis management.</u>

a. <u>Financial Stability Forum (FSF)</u>

The Russian Authorities would welcome the incorporation of major emerging countries, including Russia, into the FSF. However, the understanding of the Russian authorities seem to be that the FSF was formed as a "think-tank" of G7 (later joined by a few other industrial countries). At the same time, the ideas generated by the FSF are being tested and disseminated through other fora (like G20) where emerging market countries participate (including Russia). So in a way, Russia feels involved in the FSF work but only at the "receiving end".

b. <u>Contingent Credit Line(CCL)</u>

The Washington Russian office at the IMF advised Moscow officials on this issue. They are are rather skeptical about it, even after the latest adjustments.

Since the adoption of this facility Russian officials have been skeptical of its design and continue to believe that the CCL should be radically modified to strengthen its preventive role. Special attention should be paid to the controversial role of the activation review. The Russian authorities favour reducing further the activation requirements and lowering rates of charge by comparison with the SRF, and also reducing somewhat the commitment fee under the CCL. They also favour the lengthening of the maturity under the CCL, and a closer link between the CCL and a full-fledged program addressing users' vulnerability to financial crises.

The Russian authorities are concerned with a number of aspects of the CCL that are still unclear, particularly the "exit problem"—what to do if a country ceases to satisfy the requirements for a CCL.

[44] This section has been written by Dr Brigitte Granville.

Russia's main emphasis is on the value of standby arrangements with the Fund, which they value especially for its technical advice elements.

c. <u>What should be done in relation to the role of private voluntary capital in financial crises? Is there a case for international regulation of 'hot money' flows, e.g. from hedge funds?</u>

Russia is concerned by the role of offshore financial centers (OFCs) in the international financial system. Russia is one of those countries which suffers from the large-scale use of OFCs by commercial and financial structures and it is seeking effective means of controlling and regulating activity in that sector. In this connection, the start of Fund's cooperation with OFCs is welcomed. Currently there are a variety of opinions on the potential threat of OFCs to the stability of the global financial system. Therefore the Fund's first task should be to analyze in detail the existing and potential risks. In turn, Russia is taking steps in the direction of establishing a system for surveillance and controls on the activities of its own commercial and financial structures at OFCs. In particular, work is currently underway to strengthen a law aimed at fighting money laundering. The new text of the law should have been submitted to the government in October 2000 for its approval. Alexei Kudrin – Deputy Prime Minister and Finance Minister - announced in late December that the draft law was now ready for consideration by the full government before being submitted to the State Duma, but there has been no further news since. Amendments and additions to the law on the foreign exchange regulation are also under discussion in order to improve controls on suspicious transactions.

The Russian authorities conducted in 1999 a review in consultation with the IMF of the problem of capital flight and have identified shortcomings in the exchange control system. In response to these findings, the authorities are considering a number of corrective measures, including tighter bank licensing rules, strengthening the ability of banks to detect and refuse to undertake suspicious foreign exchange transactions, enhanced regulation of correspondent accounts, amendments to the Civil and Criminal Codes to provide for greater penalties for violations of exchange controls, and a system of prior approval of import contracts.

The Russian authorities are not pleased to have been included on the OECD-coordinated Financial Action Task Force on Money Laundering (FATF) list, as a country that was not cooperating in the fight against money laundering. They considered the existing system for countering money laundering in Russia to be no worse than in other transition countries, none of whom had been included on the list. They recognised the shortcomings identified in the FATF report but pointed to the fact that progress was being made in resolving these issues.

d. Does Russia use the collective action clauses in its euro-bond issues, and if not why ?

Since the Russian default of 1998, Russia has not placed any new euro-bond issues. Euro-bonds issues organised by JP Morgan and Warburg (1997) were under English law which typically provide for qualified majority voting. The Russian bonds do have both negative pledge and cross default clauses[45] with certain threshholds, and requiring a certain proportion of bondholders acting collectively (25%) to call default or to accelerate the bonds.

e. Involving the Private Sector in Forestalling and Resolving Financial Crises

The Russian view is that the framework adopted by the Executive Board for elaborating decisions on private sector involvement (PSI) is still far from being a set of clear rules.

Russian officials would not want to see any automaticity in the adoption of this type of decision, because the IMF has to rely on very imprecise forecasts of capital movements when calculating overall financing needs. Because of difficulties in forecasting the balance of payments needs, the variety of debt instruments, and the rapidly changing economic environment, the private sector involvement in specific countries requires a case-by-case approach.

The Russian authorities are against pegging PSI firmly to a predetermined level of access to Fund resources, because this will deprive the PSI mechanism of needed flexibility.

The IMF should not intervene in a country's discussions with its private creditors by suggesting the terms of debt restructuring. The IMF can make the largest contribution in the resolution of crises by assisting the authorities of a crisis-stricken country in developing a strong program leading to financial viability. They would like to resort to concerted private sector involvement only as a last resort, when reliance on the Fund's traditional catalytic role is clearly insufficient.

They see the idea of making standstills more predictable for the private sector as unpractical as its implementation is associated with numerous difficulties and may lead to unforeseeable consequences. There is no doubt that, under certain conditions, unilateral suspension of payments will be unavoidable. In this event, and when holding discussions with creditors, however, such a decision should be taken exclusively by the debtor country, possibly based on the results of informal consultations with the Fund.

The Russian authorities are against the proposal that the Fund officially sanction standstills. They are afraid that this may represent Fund interference in relations between creditors and the debtor on behalf of the latter. They see the IMF' s existing

[45] A negative pledge clause is essentially a clause which precludes a borrower from issuing further debt senior to the issue containing the clause. A cross default clause allows a lender to accelerate its bonds following default on a specified asset (usually another bond).

policy for lending into arrears as a sufficiently strong mechanism for exerting influence on intractable creditors. It would also be hardly advisable to give the Fund the right to protect debtors from possible litigation by amending its Articles of Agreement. First, prosecution of sovereign debtors has been rare thus far. Second, this step could lead to a sharply negative reaction from private creditors to the Fund's actions, where even a hint of possible discussions between the Fund and a country in difficulty could lead to panic and large-scale flight of private capital.

For the Russian authorities, none of the aforementioned signifies that the Fund should avoid any role at all in the resolution of payment crises. Its role, however, should be that of a well-informed consultant capable of assessing the scale of financial difficulties, prospects for the country's exit from the crisis under a Fund-supported program, the amount of external financing needed, etc. At the same time the decision on whether or not to suspend payments should be taken exclusively by the debtor country, which will also bear full responsibility for all the possible consequences of that step.

They regard, thus far, the accumulated experience of concerted involvement of the private sector as being quite limited. It is also still too early to draw conclusions on the impact of the IMF's actions to involve the private sector on the cost of external borrowings by emerging market countries. Owing to the limited amount of accumulated experience, the proposed framework should only be viewed as a sort of intermediate product in need of substantial reworking.

2. Russian Federation perceptions of the IFA as it is now evolving

a. Standards and Codes

The IMF's 'Article IV' report on Russia of July 2000 (made public by the Russian authorities in October 2000) referred to the fact that a ROSC had been completed in the case of Russia. But that ROSC has not been published (see appendix).

The situation with the ROSC reports on Russia is as follows. In July-August 2000 the IMF prepared three ROSC modules on Russia, dealing with statistics, monetary and financial policies and fiscal policy. These reports have been distributed to the IMF Executive Board along with Article IV documents. In principle, the Russian authorities agreed to publish ROSC reports. However, they claim that some issues are presented in these reports inaccurately and want to have them corrected. In turn, the IMF, while being prepared to correct factual slippages, believes that its reports reflect the practices as they were in mid-2000. It is not clear now what may be future developments in this area. It is even possible that the IMF will send its experts to Moscow to update the reports in line with the current practices and to sort out all misunderstandings with the authorities. In any case, the publication of ROSCs in the near future does not seem to be very likely. I believe that there is no point of principle in the non-publication of ROSCs but the desire for it to look better than it has been presented (it is difficult for me to judge to what extent this position is justified).

1. View of Russian officials on: The Fund's Surveillance and Links between Surveillance and Standards/Codes

The joint project of the Fund and World Bank involving the development and voluntary publication of *Reports on Observance of Standards and Codes* is an important step in the area of international standards. A number of countries, including Russia, have taken part in this project. The Russian authorities believe that the preparation of these reports is very useful in that they help identify weaknesses and indicate priorities for additional work, which will contribute to greater transparency and stronger positions for the individual countries in the international financial system. Fund surveillance carried out by the Fund as part of its mandate is welcomed. This encompasses monetary, fiscal, and exchange rate policies pursued by the government and actions taken to foresee and prevent international financial crises. The Fund should not, as a general rule, delve deeply into areas not related to its mandate. The sole exception might be those issues that directly and substantially influence the macroeconomic situation in the country. In these cases, it is important to interact closely with other international organisations and with the World Bank in particular.

The Russian authorities acknowledge the progress achieved by the IMF in the development and dissemination of international standards. In particular, important steps have been taken to strengthen the Special Data Dissemination Standard (SDDS). Publication of timely, comprehensive and accurate data on reserves and external debt of member countries may have a positive effect on the performance of international capital markets and ensure more precise assessment of financial risks. At the same time, constantly "raising the bar" in the SDDS may make it harder for new countries to subscribe to it and for current subscribers to comply with the standard.

The Russian authorities oppose hasty decisions to include the assessment of observance of standards and codes in the practice of the Fund's surveillance activities. The development and introduction of codes and standards is still in a pilot phase, and their implementation by certain countries requires substantial effort and/or outside technical assistance. Therefore, adherence to standards and codes should remain voluntary, and their interrelation with the practice of surveillance should be refined as experience is accumulated and the standards themselves are more broadly disseminated. The Russian position is that a country's observance of standards and codes should remain voluntary. Reports on observance of these standards should be compiled and published, also on a voluntary basis.

When developing standards, a reasonable balance should be found between their complexity and feasibility. It is noteworthy that after "strengthening" the data dissemination standard by introducing what was described by the Russian authorities as an overly detailed list of required information on international reserves, there was no increase in the number of countries participating in that standard. This indicates that there are substantial difficulties, *inter alia* at the technical level, facing countries intending to comply with the standard. It is important to remember that countries have different statistical capabilities and that adaptation to new requirements requires additional time and resources of them.

The Russian authorities endorse the steps taken by the Fund jointly with the World Bank to enhance stability and promote transparency in the financial sector. Here it is important to note the work done on the Financial Sector Assessment Program (FSAP). Preliminary results from the program's experimental phase have demonstrated that it may, some time in the future, become a useful instrument in the performance of the Fund's surveillance functions. The Russian authorities agree with the decision to continue work on this program in 2001. Concerning the selection of countries to participate in the FSAP, Russia continues to maintain the position that the Fund should first analyze the financial systems of the emerging market countries, especially those which are of systemic significance. The position on this issue is based on the fact that Fund's financial and staff resources are limited and should be used most efficiently. Russia also supports the presumption of voluntary participation in the FSAP and voluntary publication of the results. Russia is currently examining the possibility of its own participation in this program.

b. Broader financial architecture

1. Views from Russian officials on reforming the IMF's role in the global economy

1.1 Review of Fund Facilities

The Russian authorities share the desire to make Fund facilities more effective and avoid excessively prolonged and large use of IMF resources in the future. At the same time, they do not see the need for radical modification of Fund facilities.

Greater effectiveness within the framework of the existing facilities could be achieved by measures such as enhancement of Fund programs by streamlining conditionality, more caution in granting access to resources, establishment of the appropriate length for programs, and more efficient use of the Supplemental Reserve Facility (SRF) and Contingent Credit Lines (CCL).

The recent decision by the Executive Board to eliminate four outdated facilities from the Fund's arsenal is another welcome step.

The Extended Fund Facility (EFF): The Russian authorities view is that it should be retained but its application should be more selective. The EFF should be used by countries with long-term balance of payments difficulties, especially when they are implementing ambitious programs of structural reforms. These conditions would pertain to the greatest degree to countries graduating from the Poverty Reduction and Growth Facility (PRGF) and countries at the initial stages of transition to a market economy. They agree that use of EFF as a precautionary arrangement should be possible only in exceptional cases.

The Russian authorities fully understand the concern about moral hazard inherent in large financing packages. From this perspective the higher rates of charge used under the SRF and CCL are certainly justified. They think that it would be a mistake, however, to extend that same logic to the IMF's traditional instruments. Rates of charge are not the main factor determining a country's desire to avail itself of the Fund's assistance. Immeasurably more important are access to the IMF's expertise and the confidence of investors in an economic policy approved by the Fund. Therefore, countries are willing to undertake certain political and economic risks related to acceptance of the IMF conditionality associated with financing. Moreover, they do not quite understand why the Fund should increase the rate of charge on its resources while being effectively protected from the risk of default by the status of a preferred creditor.

The idea that the Fund should introduce a system of graduated charges on its resources according to the amount and/or the length of time IMF resources are outstanding, is not new. In 1993, after prolonged attempts to introduce better incentives through differentiation of the rates of charge, the IMF terminated this practice. There is little reason to believe that it will be more productive under today's circumstances.

In this connection, reservations are expressed about the idea of reducing the length and amount of use of Fund resources by introducing *repurchase expectations* and *the graduated rate of charge*. These measures do not create effective incentives for earlier repurchases and only lead to an increase in the cost of servicing Fund credits. They may reduce the willingness of member countries to apply to the Fund for financial assistance, which contradicts the much-heralded principles of crises prevention. Moreover, increased rates of charge will apply equally to countries with strong or weak balance of payments positions.

Nonetheless, Russia has agreed to the introduction of graduation in the rate of charge with the amount of Fund resources outstanding with the sole purpose of avoiding a split in the Executive Board and preventing difficulties in the implementation of a number of other initiatives at the IMF. In addition, Russia's agreement is conditioned on firm observance of the arrangement whereby new rules for the rate of charge will not apply to the amount of IMF credit outstanding at the time of the introduction of the policy change.

There are also reservations concerning the desirability of early repurchase expectations. In particular, the criteria that the Fund will use to determine whether or not a given country can make an early repurchase are extremely vague, which inevitably makes their application highly subjective. It is not clear how disagreements between a member country and the Fund concerning early repurchase options will be resolved. A strengthening of the balance of payments, which triggers an early repurchase, may be strictly a transitory phenomenon, especially if it is associated with external circumstances. A strong balance of payments is not at all necessarily associated with an equally strong budget position that would allow for painless early repurchases.

The Russian authorities also expressed doubt about the necessity for the introduction of formal *post-program monitoring*. Proof of any serious threat to Fund resources from post-program countries is lacking. Even following expiration of their programs, such countries are under close Fund monitoring and their situation is discussed at informal Executive Board meetings. In addition, should the economic position of a country seriously deteriorate, the Fund has an arrangement for initiating formal consultations with that country at the request of the Managing Director.

1.2. Safeguarding Fund resources

Russia supports basic proposals aimed at reducing the risk of misreporting of information to the Fund. Existing remedial measures to be taken in cases of misreporting may be deemed satisfactory. It is important that these measures be applied uniformly to all member countries.

Russian authorities are however doubtful that the proposed mechanism will prevent deliberate misuse of Fund resources. However, the instrument of safeguards assessments may help reduce risks related to deficiencies in the internal reporting systems of central banks. Also, it might contribute to a strengthening of internal controls in the central banks of member countries.

2. Have any international developments taken place (e.g. BIS banking regulatory recommendations) which jeopardise the IFA's stated aim of improving access to financial flows and reducing the risk of financial market crises?

Concerning new BIS proposals on capital adequacy, the Central Bank of Russia (CBR) is sceptical about their applicability to Russia. The reasons are easily understood if one looked at the present state of the Russian banking system.

Progress with bank restructuring has been disappointing. In particular, a more determined response by the authorities might have prevented some of the asset stripping that occurred in the aftermath of the crisis. In addition while licenses of a large number of banks had been withdrawn, intervention and resolution of the large insolvent banks had been slow and the bankruptcy process seemed to be used to encourage restructuring rather than liquidation.

Also inadequacies in data on the financial soundness of the banking system are such that the new BIS agreement is irrelevant. The absence of international accounting standards precludes proper analysis of the financial condition of the banking sector, a major handicap in the process of bank restructuring. Accounts for commercial banks on a fully consolidated basis are not produced and given the complex pattern of holding and cross holdings between enterprises and banks in Russia within financial-industrial groups (FIGs), accurate assessment of banking system vulnerabilities cannot be made on the basis of data routinely available to the authorities.

Part III

Glossary of Terms

Article IV Surveillance In accordance with Article IV of its Articles of Agreement, the IMF holds consultations, normally every year, with each of its members. These consultations focus on the member's exchange rate, fiscal, and monetary policies; its balance of payments and external debt developments; the influence of its policies on the country's external accounts; the international and regional implications of those policies; and on the identification of potential vulnerabilities. With the intensified global integration of financial markets, the IMF is also taking into account more explicitly capital account and financial and banking sector issues.

Balance of Payments The total movement of goods, services and financial transaction between one country and the rest of the world. In monetary terms, the balance of payments is the total of all receipts from abroad, and of all payments to recipients abroad.

Basle Accords The original Basle Capital Adequacy Accord was published in July 1988 by the Basle Committee on Banking Supervision. The Accord sets down the agreement among the G-10 central banks to apply common minimum capital standards to their banking industries, to be achieved by end-year 1992. The standards are almost entirely addressed to credit risk, the main risk incurred by banks; this was later amended to take account of market risk. In January 2001 proposals for a New Capital Adequacy Accord were published. The New Accord retained the approach to market risk, introduced a new category of operational risk and proposed major changes to the measurement of credit risk. The major thrust of the proposals is to move towards greater risk-sensitivity through increased use of the internal risk management systems of commercial banks.

Basle Committee The Basle Committee on Banking Supervision.

Call option Call option is a clause that permits the rollover of debt, in certain conditions.

Capital Account An element of the balance of payments account which deals with financial transactions, the buying and selling of securities and investment abroad.

Capital Flight Capital flight is an abnormal conversion of financial assets from a national currency to assets in a more stable currency usually in response to or in anticipation of heightened financial risk.

Collective Action Clauses Basically, there are four categories of collective action clauses: majority action clauses, collective representation clauses, sharing clauses and non-acceleration clauses. Under English law, bonds normally include majority action clauses, which allow bondholders to convene and change the terms of payments of a bond contract by a qualified majority (normally 75%) of bondholders. Collective representation clauses permit bondholders to be represented collectively, for example by a trustee, thereby reducing co-ordination problems in the negotiation process. Sharing clauses require any payments received to be distributed on a pro-rata basis among all creditors.

Corporate Governance The relationship between a business's management and its board of directors, its shareholders and lenders, and its other stakeholders such as employees, customers, suppliers and the community of which it is a part.

Conditionality Economic and financial reforms and policies required by the IMF before an assistance package can be disbursed.

Contagion The World Bank identifies three possible definitions of contagion. *Broad Definition*: contagion is the cross-country transmission of shocks or general cross-country spill-over effects. Contagion can take place both during "good" times and "bad" times. Therefore, contagion does not need to be related to crises, however, contagion has been emphasised during crisis times. *Restrictive Definition*: contagion is the transmission of shocks to other countries or the cross-country correlation, beyond any fundamental link among the countries and beyond common shocks. This definition is usually referred to as excess co-movement, commonly explained by herding behaviour. *Very Restrictive Definition:* contagion occurs when cross-country correlations increase during "crisis times" relative to correlations during "tranquil times."

Contingent Credit Line The CCL provides short-term financing to help members overcome the exceptional balance of payments financing needs that can arise if, through contagion, they suffer a sudden and disruptive loss of market confidence. Such circumstances must be largely beyond the member's control and stem primarily from adverse developments in international capital markets caused by events in other countries. The CCL represents an extension of the existing Supplemental Reserve Facility (SRF). Whereas the SRF is intended for IMF members already in the throes of a crisis, the CCL is intended as a preventive measure for members concerned about their vulnerability to contagion but not facing a crisis at the time of commitment.

Debt Restructuring	Changing the maturity and/or terms of a loan.
Debt Workout	The process of moving towards a satisfactory method of paying off a debt by a debtor country, including restructuring, adjustment, obtaining new money and servicing existing debt
Extended Fund Facility	The IMF provides financial support to its members for longer periods and for larger amounts than in its other facilities under the Extended Fund Facility. Extended Arrangements, which normally run for three years but can be extended for a fourth, are designed to correct balance of payments problems that stem largely from structural problems and take longer to correct. The repayment period is 41/2–10 years.
Financial Stability Forum	The Financial Stability Forum (FSF) was convened in April 1999, in response to the major financial crises of the latter part of the 1990s, to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. The Forum brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSF seeks to co-ordinate the efforts of these various bodies in order to promote international financial stability, improve the functioning of markets, and reduce systemic risk.
General Data Disseminat-ion Standard	The Fund's work on data dissemination standards began after the Mexican peso crisis in October 1995, when the Interim Committee (now the International Monetary and Financial Committee or IMFC) endorsed the establishment by the Fund of standards to guide members in the dissemination to the public of their economic and financial data. Those standards were to consist of two tiers: the General Data Dissemination System (GDDS), which would apply to all Fund members, and the Special Data Dissemination Standard (SDDS), for those member countries having or seeking access to international capital markets.
Hedge Fund	Hedge funds are investment pools, typically organised as private partnerships and often located offshore for tax and regulatory reasons. Their managers are generally paid on a commission basis and use a variety of investment techniques, including short positions and (by extensively borrowing) leveraging to raise returns and guard against risk. Hedge funds often use derivative financial instruments (securities like options whose value is "derived" from the value of other, underlying, financial assets, like common stock) in their investment strategies. Hedge funds are unregulated; they are not obliged to disclose their positions.

Lender of Last Resort An institution, usually a central bank, that stands ready to lend to the commercial banking system when the latter is in overall shortage of funds. Its aim is to maintain the stability of the banking system through, for example, protection against bank runs.

Meltzer Report Following a debate in the US Congress in 1998 on whether to authorise US$18 billion of additional funding for the IMF, Congress established The International Financial Institution Advisory Committee. The Committee was charged with addressing the question of the role of the IFIs in the new world economy. In March 2000 the Committee submitted its report, the Meltzer report, named after the Committee's chairman, Allan Meltzer, a very conservative economist. The report recommended a fundamental reduction in the roles of the IMF and the World Bank. It proposed that the Fund concentrated on resolving liquidity crises in emerging markets through the provision of loans at penalty rates and strictly against collateral. The World Bank was to concentrate on the poorest countries, leaving Latin America to the IADB and Asia to the ADB, and move to a system of grants instead of loans. The Meltzer Report has received many strong criticisms.

Moral Hazard Formally can be defined as the actions of economic agents in maximising their own utility to the detriment of others, in situations where they do not bear the full consequences. In the standard economic usage moral hazard refers to a the situation wherein agents take on more risk than they would otherwise do as they are protected, or perceive themselves to be, from bearing the full economic consequences of their actions.

Mutual Fund Fund operated by an investment company that raises money from shareholders and invests it in stocks, bonds, commodities or other financial instruments.

Multilateral Development Banks International institutions that lend money for the purposes of national and regional development. Examples include the World Bank, the Asian Development Bank, the African Development Bank and the Inter-American Development Bank.

Poverty and Growth Reduction Facility In September 1999, the objectives of the IMF's concessional lending were broadened to include an explicit focus on poverty reduction in the context of a growth oriented strategy. The IMF, with the World Bank, develops strategies elaborated by the borrowing country in a Poverty Reduction Strategy Paper (PRSP) which will be prepared with the participation of civil society—including the poor—and other development partners. Reflecting the new objectives and procedures, the IMF established the Poverty Reduction and Growth Facility (PRGF) to replace the Enhanced Structural Adjustment Facility (ESAF)

Special Data Disseminat-ion Standard	The Special Data Dissemination Standard (SDDS) was established by the International Monetary Fund to guide members that have, or that might seek, access to international capital markets in the provision of their economic and financial data to the public.
Special Drawing Right	A form of international reserve created by the IMF in 1970 to assist international liquidity by providing a complement to existing reserve vehicles such as gold and the US dollar. SDRs are allocated by the Fund to its member countries in proportion to each country's quota and are used to acquire other national currencies when needed for balance of payments reasons. Therefore, SDRs are a universally recognised claim on national currencies with the effect of a new currency. They have not been issued for many years.
Standstills	Standstills cover a wide range of approaches to reducing net payment of debt service and/or withdrawal of capital after a country has lost spontaneous access to international capital markets. A standstill could range from a voluntary arrangement to limit net outflows of private capital to various concerted means of achieving this objective. Concerted techniques could include the application of moral persuasion, prohibitions on capital movements or default on government obligations.
Systemic Risk	Although there is no standard definition of systemic risk, it is most typically defined as the risk that the failure of a financial institution will trigger, through the network of credits and debts, the failure of other financial institutions, and hence, impair the stability of the entire national and, ultimately, international economy.
Standby Arrange-ments	Under an IMF Stand-by Arrangement, a country implements, usually for one to two years, a program that includes macroeconomic policy changes to resolve its balance of payment problems. The country, in consultation with the IMF staff, designs the program to achieve its goals. To receive the financing, the member must meet performance criteria that mark its successful implementation of the program. These criteria generally cover ceilings on government budget deficits, credit, and external debt, as well as targets for reserves. The country repays the money it has borrowed over 31/4–5 years.
Supplemental Reserve Facility (SRF)	In December 1997, the IMF Executive Board established the Supplemental Reserve Facility in response to the unprecedented demand for IMF resources resulting from the Asian crisis. The SRF is intended to help member countries experiencing exceptional balance of payments problems created by a large short-term financing need. Such a need may result from a sudden and disruptive loss of market confidence and take the form of pressure on the member's capital account and reserves. Assistance is available when there is a reasonable expectation that strong adjustment policies and adequate

financial support will enable a country to correct its balance of payments difficulties in a short time.

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