The Reform of Global Financial Governance Arrangements

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I Introduction

The subject of global financial governance acquired great topicality in the wake of frequent, costly and widespread financial crises during the 1990's. It became clear that the very rapid and dynamic growth of global private financial markets - characterised by a number of major imperfections - had not been accompanied by sufficient development of global public institutions to provide an appropriate framework, that would help ensure both global financial efficiency and stability. In September 1998, the crises spread - via contagion - not just to other emerging markets, but also very briefly, but also quite deeply, to the US. At that time calls emerged from the G-7 for a "new global financial architecture." However, as crises and their impact (particularly in the G-7 economies) diminished, a certain degree of complacency has set in. As a result, progress on international financial reform has been both insufficient and asymmetrical; indeed paradoxically, the majority of measures taken for reforming the international financial architecture have been taken at the national level, by developing countries (Griffith-Jones:2001, Ocampo:2001). Progress at the international level (both as regards global measures and measures in the source countries) has been clearly insufficient.

There are a number of reasons for limited progress, and the inherent asymmetry in the measures taken, to reform the international financial architecture. These include a certain lack of vision on the part of world leaders, especially in industrialised countries (Helleiner, 2000). A further very important reason for this slow progress is extremely limited participation of developing countries in the fora where reform has been discussed, and - more generally - in the institutions of global financial governance.

As a consequence, enhancing the participation of developing countries in global financial governance would have one particularly important advantage not normally recognised by either policy-makers or analysts. It would imply significantly greater impulse for necessary changes in the global financial architecture. These changes, and the resulting positive impact on global financial stability and efficiency that could help ensure more rapid global growth, would not just benefit developing countries; would also have significant direct and indirect benefits for the developed world. These key actors in the developed world would benefit from greater, and more stable, growth in the developing countries; investors would gain from more profitable investment opportunities and exporters would benefit from growing markets. Equally, or more importantly, a more stable international financial system would benefit developed countries more broadly, ensuring for example that crises arising in emerging markets do not spread to them.

There are, naturally, other very important benefits from greater developing country participation in global financial governance. First, developing countries would benefit by having a stronger voice. Second, international institutions would benefit from enhanced legitimacy; after all, developing countries represent 85 per cent of the world's population and a significant proportion of global GDP, especially when measured using Purchasing Power Parity (see Section III, by Buira). Last, but certainly not least, greater participation by developing countries in global financial governance would ensure greater commitment by these countries to free and open markets, an aim shared by all G-7 countries, and especially by the US and the UK.

In this paper we will present proposals for enhancing the participation of developing countries in the long-established institutions of international financial governance, the International Monetary Fund (IMF) (see sections II and III), as well as the Bank for International Settlements (BIS) and the Basle Committees (see section IV). We will then examine in some detail the two new fora created by the G-7 in 1999 - the Financial Stability Forum (FSF) (section V) and the G-20 (section VI) - where much of the modest discussion of international financial reform currently takes place. The paper will conclude by examining other ways in which developing countries can increase their influence in global financial governance, such as through participation in regional initiatives (section VII).

The Financial Stability Forum is potentially a very valuable institution, given its' objective to effectively foster and co-ordinate responsibilities of national and international authorities, including Finance Ministries, Central Banks and supervisory bodies, in order to "promote international financial stability, improve the functioning of markets, and reduce systemic risk". Particularly positive was the way in which the FSF was set up so speedily after the crises of the late 1990s, and that it has started to tackle some of the most crucial and complex international dimensions of recent financial instability.

However, two aspects of the FSF are disappointing and are source for serious concern. First, while several of the reports of the FSF Working Groups have been truly excellent[2], there has been some bias in the reports themselves, but <u>particularly in their implementation</u> towards measures taken in developing countries (see Culpeper, 2000 and below). Important as these national measures are, global measures and measures in source countries are equally important, and have been acted on only to a very limited extent.

Second, the composition of the FSF is very problematic as developing countries are <u>totally excluded</u> from the FSF membership, even though they have some ad-hoc participation (by invitation only) in the Working Parties. As financial instability (the key concern of the FSF) has in the 1990's practically always originated in developing countries, this is clearly a case of "Hamlet without the Prince".

It is important to stress the link between the two points. The lack of participation by developing and transition countries in the FSF is a very important factor behind the fact that measures proposed by the Forum, and particularly then implemented nationally, have such a strong bias towards reform in developing countries. This in contrast to the lack of progress taking place in the equally important measures needed to be taken globally, or in developed countries.

In contrast to the developed country based Financial Stability Forum, the G-20 was created with a far more inclusive membership. Membership of the G-20 includes those developing and transition economies whose size or strategic significance gives them a particularly crucial role in the global economy. The composition of the group was carefully designed to include ten developing countries, nine industrial countries (including the G-7) plus a transition country, Russia. The far broader membership of the G-20 is clearly very positive.

The creation of the G-20 partly responded to criticism of the G-7, as an exclusive and undemocratic grouping. The more inclusive G-20 was also created, in part, to complement the restricted FSF, and thereby deflect criticism that participation in the latter needs to be

[2] For example, the reports on Highly Leveraged Institutions and Capital Flows.

broadened to include some developing countries (Ahluwallia, 1999). The creation of the G-20 also represented a potentially very important step to ensure broader participation in discussions, and hopefully in decisions, on international financial reform.

The creation of an informal forum for dialogue between major developed and developing countries at the highest level - with some meetings between Finance Ministers and Central Bank Governors and others with their Deputies - is thus very positive, and is seen as such by developing countries. Useful exchanges, and even some concrete progress, has taken place at the G-20 on specific modifications to the architecture of interest to developing countries, such as changes to IMF and World Bank lending facilities. Furthermore, the existence of a forum where developed and major developing countries' most senior financial authorities can informally exchange views and explore policy responses is clearly a valuable one.[3] It potentially represents the beginning of a valuable process of greater dialogue and consultation between major developed and developing countries.

However, there are major limitations in the way the G-20 has till now operated. The main one is the fairly narrow orientation and lack of ambition in the formal agenda developed. As will be discussed in the paper in more detail, it would be highly desirable for the G-20 to have a broader agenda. This would ideally include the key subjects on reform of the international financial system, including systemic issues, such as enhanced liquidity and development finance and issues arising in the G-7 countries, such as better co-ordinated macro-economic management especially by G-7 countries. A far more ambitious agenda could transform the G-20 from a body useful at a fairly basic level, to one with the potential to make a truly valuable contribution to meaningful reform of the international financial system.

To conclude, enhanced participation by developing countries in the fora and institutions that both discuss international reform, and that help manage the international economy, would perform several important roles. For this to be achieved, it is firstly important to increase developing country influence in the institutions to which they belong, but where they are under-represented due to existing governance structures, such as the IMF and the World Bank Group. Second, it is essential to expand the participation of developing countries in the Bank for International Settlements, while the G-20 would also benefit from some representation of low-income and small economies, to make it fully representative. Third, and perhaps most importantly, developing countries should be included on a rotational basis in crucial fora from which they are currently excluded, including the Financial Stability Forum and the G-10 Basle Committees.

A final point needs to be made. Developing countries must also complement the very legitimate pressure they exercise for increased representation in the global and G-7 dominated fora, with their own actions to enhance their influence. This can be done, for example, by strengthening their own regional arrangements for financial governance (such as the recent Asian Chiang Mai initiative).

[3] Interview material

II The International Monetary Fund

The International Monetary Fund (IMF) has a long-established key role in global financial governance, strengthened by legitimacy it draws from having near universal membership. The Fund has also been a key actor in the recent reforms to the international financial architecture. However, although the IMF is an international organisation, its governance structure ensures that all member countries are not equally represented. This is because voting power, which plays a key role in Fund governance, is appropriately distributed among member countries. Insufficient voice of developing countries has been an important factor in influencing the nature of the polices adopted within the IMF, that are often insensitive to the needs and aims of developing countries.

The financial crisis in Asia, and criticism of the IMF's role in managing aspects of the crisis, sparked some serious soul-searching, both within and outside the Fund, on the institution's future role in the rapidly changing global economy. Since 1998, there have been a series of reforms at the Fund, centred on making the institution more responsive to the problems arising in the increasingly integrated global economy and re-focusing the IMF on its core responsibilities. However, the changes introduced are insufficient to meet the reforms needed and to be made asymmetric in that they have placed too much emphasis on changes by developing countries and insufficient emphasis on changes in the IMF itself.

At the same time, there have been increasingly vocal demands for the IMF to become more representative, democratic and accountable. Despite some changes, such as the setting-up of the External Evaluation Unit, there has been little progress on making the IMF more representative.

II.I IMF Membership and Voting System

The IMF currently has 183 member countries. When a country joins the IMF, it is assigned a quota expressed in SDRs. The level of quota is based on ability to contribute, as it determines the level of financial commitment to the IMF of each member country as well as that country's voting power.

Voting power at the IMF actually consists of two components. First, each member has 250 basic votes simply by virtue of its membership; this is a symbolic recognition of the principle of the legal equality of states. Second, each member also has one additional vote for each SDR 100,000 of quota. Successive quota increases at the IMF have meant that basic votes have fallen to a negligible proportion of total votes (it is currently just over two per cent).4

The way votes are distributed among IMF member countries leads to some serious anomalies in Fund governance. The G7 countries exert a powerful grip over Fund governance, while the participation of small countries in decision-making is marginal. More broadly, the voice of developing countries in IMF governance is insufficient.

As IMF votes are distributed according to economic strength, they usually correlate fairly closely with share of global GNP measured at market exchange rates, although there are some

[4] See the section on 'The Cooper Report' in this paper by Ariel Buira for a full description of IMF voting power.

countries that are either over- or under-represented. There are, however, very large discrepancies when votes are measured against share of world population (see Table 1); there are also large discrepancies even by economic strength, if other indicators such as GNP, measured at purchasing power parity are used (see next section for details).

Table 1: Share of IMF Votes, Global GNP, and World Population for Selected Countries

Country	Votes	Percentage of Total IMF Votes	Percentage of Global GNP	Percentage of World Population
Belgium	46,302	2.14	0.8	0.2
Switzerland	34,835	1.61	0.9	0.1
UK	107,635	4.97	4.7	1
Russia	59,704	2.76	1.1	2.4
China	63,942	2.95	3.5	21
Brazil	30,611	1.41	2.4	2.8
Mexico	26,108	1.21	1.4	1.6

Belgium, Switzerland, the UK and Russia are all over-represented in IMF voting according to both share of global GNP and world population. Belgium, for example, enjoys 2.14 per cent of votes at the Fund yet has only a 0.8 per cent share of global GNP and a 0.2 per cent share of world population. All the G-7 countries that have their own Executive Directors at the Fund – the US, Japan, Germany, France, and the UK – are vastly over-represented compared with the share of world population they represent.

Some developing countries – including China, Brazil, and Mexico – are under-represented at the Fund according to both share of global GNP and world population. China, for example, has 2.95 per cent of votes at the IMF yet has a 3.5 per cent share of global GNP and represents 21 per cent of the world's population. Brazil has 1.41 per cent of the votes at the IMF, yet has a 2.4 per cent share of global GNP and represents 2.8 per cent of the world's population.

Many other developing countries actually have a higher percentage share of votes at the Fund than their share of global GNP, while large industrialised G7 countries – particularly the US and Japan – have a lower share of Fund votes than their GNP share;[5] this is the case under the assumption that GNP is measured at market exchange rates. This is why the proposed quota calculation system in the 'Cooper Report' would actually increase the representation of some G7 countries, and decrease that of some developing countries.[6] However, in terms of population share, most developing countries are under-represented through Fund votes – some vastly so, such as India and China. India, for example, has 17 per cent of the world's

[5] The Japanese called for a redistribution of Fund quotas at the G7 and annual Bank-Fund meetings in Prague in Autumn 2000. The Japanese were interested in increasing their quota share, but their ideas were strongly opposed by the Europeans as it would mean a corresponding cut in their share.
[6] For a full discussion on the implications of the proposals in the Cooper Report, and on the most appropriate measures of national income, see the following section.

population yet just 1.93 per cent of votes at the IMF. Also, developing countries are under-represented if GNP is measured at purchasing power parity.

The distribution of voting power ensures an over-representation of strong vis-à-vis weaker countries. One key manifestation of this is the power of veto enjoyed by the United States, as with a 17.16 share of Fund votes, the US acting alone can influence the most important decisions that require a super-majority of 85 per cent. However, as Evans and Finnemore (2001) point out, even in the case of normal decisions that require a simple majority, the ten industrialised countries of the G-10 enjoy 52 per cent of the votes, and can therefore outvote the other 173 members. The 80 poorest countries, by contrast, have only around 10 per cent of total Fund votes. Even acting together, they would be incapable of preventing a change to the IMF's Articles of Agreement that require the 85 per cent majority. As Evans and Finnemore note 'voting power is structured so that the Fund is incapable of taking any action that the industrialized countries feel contradicts their national interest or the interests of private actors based in their jurisdictions' (2001:13).

II.II The Executive Board and the Interim Committee

Voting rarely takes place at the IMF, but the power balance is reflected in the consensus that usually emerges from Fund discussions. The unequal distribution of voting power is also reflected in the representation of countries on the Executive Board, which is itself then reflected in the membership of the International Monetary and Financial Committee (IMFC – previously the Interim Committee).

The Executive Board is responsible for conducting the day-to-day business of the Fund and meets regularly throughout the year. The Executive Board makes decisions on overall Fund policy, as well as on individual country programmes. The Board is composed of 24 directors, who are appointed or elected by both individual member countries and groups of countries, or constituencies. While the Executive Board does occasionally vote on some policies, the majority of decisions are arrived at by consensus.

Eleven of the 24 Executive Directors are from developing or transition countries. This does give developing countries more voice in Board discussions than they gain through the formal voting structure. However, while Evans and Finnemore describe the consensual process as 'one of the important democratizing features of Fund governance', it would require a strong degree of consensus among developing countries themselves in order for them to exert real influence (2001:27). This can be time consuming, and sometimes politically difficult. This is particularly the case for the developing country EDs that mostly represent a far larger group of countries than their developed country counterparts.

The five largest shareholders – the USA, France, Germany, Japan, and the UK – all have their own Executive Director, as do China, Russia, and Saudi Arabia. The other member countries all belong to constituencies, each of which selects one country to represent the group on the Board. There are constituencies that have a mix of developed and developing countries, as well as those that are made-up entirely of developing and transition countries. Where there is a mix, at present in all but one case (the Venezuelan ED represents Spain) the Executive Director is from a developed country. Examples include the Finnish ED who represents the Nordic and Baltic countries (including Latvia and Estonia), the Belgian ED who represents Eastern European transition countries, the Swiss ED who represents a number of central Asian transition economies, and the Canadian ED that represents a number of Caribbean countries.

The African constituencies are by far the largest, in which more than 40 countries in Sub Sahara Africa are represented by just two Executive Directors.

As well as resulting in an unequal distribution of power at the Fund, this situation also puts many of the Executive Directors representing developing countries under considerable pressure. This is particularly the case with the very heavy workload of the African EDs following the introduction of the PRSP process and the continuation of the HIPC initiative.[7] This overload negatively impacts on equitable governance, as these EDs are so taken up representing constituency interest that they have little time left to focus on influencing general Fund policy. In their recent paper, Evans and Finnemore cite one IMF Executive Director who said that continuing on the current path would mean that the voice of African EDs would 'effectively shut down' (2001:29).

The International Monetary and Financial Committee (the IMFC), formerly the Interim Committee, plays a key role in Fund governance and drives global policy-making on a range of macroeconomic and financial issues. The IMFC usually meets twice a year at the time of the Spring and Autumn Bank-Fund meetings. The membership of the IMFC reflects the composition of the IMF Executive Board: each member country that appoints an Executive Director, and each constituency that elects one, also appoints a member of the Committee.

Table 2 shows how the composition of the Executive Board and the IMFC serve to extend the dominance of the G7 countries to the governance of the IMF itself. As the table graphically shows, the European and North American G7 countries maintain a stronghold over all of the major institutions and groupings involved in global economic governance. Conversely, developing countries – particularly the poorest – are under-represented in these institutions and groupings.

[7] See the G-24 Communiqué, Spring 2001.

Table 2: Membership of the G-8,IMF Executive Board, IMFC, the Basle Committee of the BIS, the Financial Stability Forum, and the G-20; according to IMF constituency.

G8	IMF Exec Board	IMFC	Basle Committee	FSF	G20
France	France	France	France	France	France
Germany	Germany	Germany	Germany	Germany	Germany
Italy	Italy	Italy	Italy	Italy	Italy
UK	UK	UK	UK	UK	UK
US	US	US	US	US	US
Canada	Canada	Canada	Canada	Canada	Canada
Japan	Japan	Japan	Japan		Japan
Russia	Russia	Russia			Russia
	Saudi Arabia	Saudi Arabia			Saudi Arabia
	China	China		Hong Kong	China
	Argentina	Argentina			Argentina
	Australia	Australia		Australia	Australia Korea
	Belgium	Belgium	Luxembourg		Turkey
	Brazil	Brazil			Brazil
	Gabon	Gabon			
	India	India			India
	Netherlands	Netherlands	Netherlands	Netherlands	
	South Africa	South Africa			South Africa
	Switzerland	Switzerland	Switzerland		
	Iran	Algeria			
	Finland	Denmark	Sweden		
	Venezuela	Mexico	Spain		Mexico
	Indonesia	Thailand		Singapore	Indonesia
	Egypt	United Arab Emirates			

III A Critique of the Cooper Report on IMF Quota Formulas and elements for an alternative proposal, by Ariel Buira[8]

The “Report to the IMF Executive Board of the Quota Formula Review Group” (Cooper Report) was submitted to the Managing Director and to the Executive Board of the Fund on the 28 of April 2000. Because of its importance and since it will be considered by the Executive Board in its next quota review, which should be completed by early 2003, it seems very appropriate to offer comments on its scope and recommendations in the context of this study. Elements for an alternative proposal are then provided.

The Report of the Executive Board to the Board of Governors on the increase in quotas under the Eleventh General Quota Review reaffirmed the view of the Interim Committee that the quota formulas should be reviewed following the completion of that Review. Accordingly, in 1999 the Managing Director requested a group of external experts to provide the Board with an independent report on the adequacy of the quota formulas, including proposals for changes

[8] This section incorporates comments by Stephany Griffith-Jones.

if appropriate. This Quota Formula Review Group (QFRG) was formed by eight experts, consisting of Richard Cooper (Professor at Harvard University) as chairman; Joseph Abbey (Executive Director, Center for Economic Analysis, Accra, Ghana) Montek Ahluwalia (Member, Planning Commission, New Delhi, India); Muhammad Al-Jasser (Vice-Governor, Saudi Arabian Monetary Agency); Horst Siebert (President ,Kiel Institute of World Economics, Germany); Gyorgy Suranyi (President, National Bank of Hungary); Makoto Utsumi (Professor, Keio University, Japan); and Roberto Zahler (former President of the Central Bank of Chile).

The terms of reference for the study given to the group were broad and included the following main areas:
--"To review the quota formulas and their working, and to asses their adequacy to help determine member's calculated quotas in the IMF in a manner that reasonably reflects member's relative position in the world economy as well as their relative need for and contributions to the Fund's financial resources, taking into account changes in the functioning of the world economy and the international financial system and in the light of the increasing globalization of markets."
--" To propose, as appropriate, changes in the variables and their specification to be used in the formulas."
--"To examine other issues directly related to the quota formulas."(my italics)

III.I The Size of the Fund

Note firstly, that the work of the QFRG is necessarily developed in the framework of the Articles of Agreement, which set out the purposes of the Fund. Take into account that two of the three roles performed by quotas in the Fund are the provision of contributions to and access to Fund resources (the third being voting rights). Secondly, observe that the terms of reference state that the mandate of the group is a broad one and explicitly includes changes in the functioning of the world economy, and the international financial system in the light of the increasing globalization of financial markets.

The first question to address would appear to be the adequacy of Fund resources in relation to the tasks it has been assigned. i.e. Is the size of the Fund, the sum total of quotas, appropriate to enable it to fulfil its mission? Recall that the purposes of the Fund include:" To give confidence to members by making the general resources of the Fund temporarily available to them… providing them with the opportunity to correct maladjustment's in their balance of payments without resorting to measures destructive of national or international prosperity." (Article I, section V of the Articles of Agreement) (My italics).

Recall also that there has been a substantial decline in the size of the Fund in relation to world trade (See table 3); as a result Fund quotas accounted for barely 6 per cent of world imports in 1998. This is a sharp decline from the percentage in 1950, when quotas represented 58 per cent of world imports. Consequently, the resources of the Fund are not adequate to enable it to provide sufficient credit to its member countries suffering trade imbalances. This would allow them to adjust without resorting to a sharp reduction in aggregate demand leading to a downturn in economic activity and to adopt other measures destructive of national and international prosperity.

Table 3- Fund Quotas as a Proportion of Imports and GDP

	1944	1950	1965	1970	1978	1990	1998
Ratio of Quotas to Imports	0.58	0.17	0.15	0.14	0.09	0.06	0.06
Ratio of Quotas to GDP	0.04	0.02	0.02	0.02	0.01	0.01	0.01

Source-Report to the IMF Executive Board of the QFRG, Table7, page37

In recent years, the extraordinary growth of international financial markets and the increased dependence of a significant number of emerging market and transition economies on this source of financing has made them highly vulnerable to the volatility of short term capital. The amounts of financing required to deal with such crises are much greater than those necessary to address traditional payments imbalances, which originated in the current account.

As we have seen in the cases of the Mexican, the Asian and other recent financial crises, the resources of the Fund have proven to be entirely inadequate to provide the support required by countries that come under a massive speculative attack to allow them to avoid measures destructive of national and international prosperity. Generally, Fund resources were supplemented by credits from other sources, with the resulting increase in complexity, delays and at times, unwarranted conditionality demanded by certain creditor countries for participating in the financial rescue package.(See M. Feldstein 1998) Nevertheless, in all cases, the countries affected have suffered a massive devaluation, followed by a deep recession associated with income losses equivalent to several percentage points of GDP, a sharp rise in inflation and unemployment, and often a banking crises as a result of a wave of bankruptcies, while their trading partners a faced substantial losses in exports to them. (See Buira 1999)

Thirdly, note the QFRG is mandated to examine other issues directly related to the quota formulas. One such issue could be the inclusion of one or more variables to relate quotas with the growth of the world economy or of world trade and the development of international financial markets.

Surprisingly, although it was given a broad mandate and asked to examine “their relative need for and contributions to the Fund’s financial resources, taking into account changes in the functioning of the world economy and the international financial system and in the light of globalization of markets” the independent QFRG interpreted its mandate narrowly to preclude the consideration of the adequacy of quotas and chose to focus only on the distribution of quota shares among member countries. Did the QFRG consider the size of the Fund to be unimportant? Perhaps they knew that a review of this broader question would lead them to call for a sharp increase in the Fund resources, a result major industrial countries would not welcome.

III.II The Question of Voting Power

Recall that in 1944 at the Bretton Woods Conference a compromise solution was adopted between two approaches to the determination of voting power, one which would relate it solely to members contributions or quotas and another based solely on the legal principle of the equality of states. The compromise based voting rights on a combination of the two: it gave each member country one vote for every $100,000 of quota (later for every SDR100,000) plus 250 basic votes. Basic votes, and the voice in decision making they gave smaller countries were also considered to be necessary in view of the regulatory functions of the Fund in certain areas. (See J.Gold, 1972)

With the increase in quotas the share of basic votes in the total falls, which raises the relative voting power of larger countries. With the accession of new members, the total number of basic votes rises, but not necessarily their share; nevertheless, the importance of the basic votes of any given member in the total continues to diminish. The expansion in membership from 45 to 68, caused the share of basic votes to rise from 11.3 per cent in 1945 to 15.6 percent in 1956 simply because no significant increase in quotas had taken place. But with the nearly 37fold increase in quotas since then, the share of basic votes in the total has declined to 2.1 percent, despite the quadrupling in the membership. This has substantially shifted the balance of power in favour of large countries, away from the result of the compromise agreement to protect the representation of small countries, contained in the Articles.

Consequently, today quotas are virtually the sole determinant of voting power and basic votes are of very little significance. As a result, the voice of small countries in the discussions has been substantially weakened and their participation in decision making reduced to the point of becoming negligible.

Since this would appear to be a significant issue in the governance of the Fund it is surprising that, despite the broad mandate given to the group, the Report fails to consider the possibility of revising basic votes. The only reference contained in the Report goes to say that:
"The IMF's co-operative nature suggests that potential debtor countries should continue to have a significant voice in IMF decision –making, a feature that would be dropped by basing quotas solely on the ability to contribute (unless redressed by increasing substantially the fixed or basic votes to which each country is entitled, which now accounts for about 2 percent of total votes-a change that would require amendment of the Articles).With quotas and hence voting power, based solely on the ability to contribute , some feel that the perspective of prospective borrowing countries would not be properly reflected in the management of the IMF."

Thus while recognising that the co-operative nature of the Fund should imply having prospective borrowers represented in decision making, the authors of the Report appear to believe that with basic votes accounting for 2.1 percent of the total vote, including the vote of developed countries, potential debtors have a significant voice in decision making. It is difficult to take this disingenuous argument seriously. One may ask in what parliamentary body would such a small representation be considered to give a major party an adequate participation in decision making? The authors of the Report appear to have forgotten the reasons for the compromise that led to basing voting rights on a combination of two criteria and the evolution of basic votes over time.

However, the preservation of the share of basic votes in the total would not be an exceptional practice among international institutions. Note that being sensitive to the political dimension of its work, MIGA would allocate developing countries as a group the same voting power as developed countries if all members of the World Bank joined the Agency; that the Asian Development Bank 's Articles of Agreement provide that the relative importance of basic votes will remain constant over time as a proportion of the total vote (Article 33- 1) and that the Articles of Agreement of the Inter-American Development Bank provide that no increase in the subscription of any member will become effective if it would reduce the voting power of certain countries or groups of countries below given percentages of the total. (See External Review of Quota Formulas-Annex, Box 3.1 page 38)

Restoring the share of basic votes to say the original 11.3 per cent of the total (Op. cit. page 32) would require a more than five fold increase in the basic vote of every member country (from 250 to 1323); restoring the proportion of basic votes per member to what it was in 1945 would raise the total basic votes to nearly half of total voting power (11.3 x 4.07=46 per cent). An intermediate solution that would partially restore the role basic votes were meant to have, would be to assign to basic votes say 25 per cent of the total voting rights. This would mean raising the basic votes of each member country from 250 to 2,927.In addition, to prevent the future erosion of the share of basic votes in the total, a formula could be adopted by which in future, in every quota review total basic votes increase in the same proportion as total quotas. These changes would require an amendment of the Articles of Agreement.

III.III The Variables Included in the Proposed Formula

After looking at issues such as the history of the formulas, how variables affect the calculated quotas under existing formulas and a number of related issues and undertaking a substantial amount of econometric work looking at issues such as the factors that have determined the evolution of quotas over time and the degree and pace of convergence of actual to calculated quotas, the QFRG decided to take a fresh approach and design a new formula. This formula is supposed " to reflect the underlying changes in the functioning of the world economy and the international financial system, take account of the increasing globalization of markets, and simplify the existing formulas." (Cooper Report page 55)

"We recognize that Board discussions have often focused on whether developing countries as a group have sufficient voice in the Fund and any decisions on the quota formula for the future will have impact on this issue. However, since our terms of reference do not make any reference to developing countries as a group, we have not taken this aspect into account in recommending a quota formula." (op.cit. page 56) They go on to state their view that: any new formula should have a sound economic basis and should reflect changes in the world economy; that the form and content of any new formula should be consistent with the several functions of quotas; that the variables contained should not give members incentives to adjust their policies adversely to IMF principles; that any new quota formula should be more transparent and easier to comprehend than the existing set of formulas and any modification of the quota formulas should be feasible, and where problems of data quality or availability arise, such modification should be contingent on the resolution of these problems.(op.cit.pages 56-57)

The QFRG set about their task by proposing two variables that will, in their judgement, best represent:1) the member's ability to contribute and 2) the member's need for IMF resources. These are:

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GDP
The work of the QFRG led them to review the variables included in the formulas and to suggest a welcome simplification of said formulas. The QRFG agreed unanimously that the most relevant variable for measuring a country's ability to contribute to the Fund is the country's GDP. However, the group differed as to how GDP measured in domestic currency was to be converted into a common currency to determine the relative ability of the country to contribute. The majority favoured conversion at market exchange rates, averaged over several years, but a minority preferred to measure GDP for purposes of the quota calculations using PPP-based exchange rates. They considered that market exchange rates do not necessarily equalize prices of tradable goods across countries, even after taking into account transport costs and quality differences and that this creates an index numbers problem in which the GDP in developing countries is understated in relation to developed countries if market exchange rates are used.

They noted that while real growth rates in these countries have been significantly higher than in industrialized countries, the expected increase in relative size of GDP of developing countries is eroded by exchange rate depreciation when converted at market exchange rates.(op.cit. pages 57-58)

"The majority view argued that while PPP based conversion rates were appropriate for measuring relative per capita income for comparing economic well being across countries, they were not appropriate for indicating a country's ability to contribute to international endeavours. Second, market prices properly reflect the costs of moving goods from one place to another, and equating prices of equivalent goods regardless of location, as is done in PPP calculations, gives a seriously misleading indicator of the ability to contribute to international undertakings… The IMF is a monetary institution, requiring financial resources for use when members are in financial difficulties in their relations with the rest of the world. A country's ability to contribute is therefore determined by its capacity to provide funds at market exchange rates," (op.cit. page 58)

In view of the majority, PPP based GDP, as a measure of a country's ability to contribute would produce serious anomalies, suggesting for example that China's could contribute one third more than Japan, or that India could contribute more than France. Are these criticisms valid?

While it may be the case that in some unspecified sense the ability of Japan to contribute is greater than that of China and that the ability of France to contribute is greater than that of India, note that this is not related to the level of international reserves, since this variable is excluded "since they may fluctuate from year to year and may reflect international short term borrowing."

In any event, and contrary to what is suggested, the relationship between actual contributions as determined by quotas and the ability to contribute as a proportion of GDP is very far from a being a binding restriction. Consider firstly that quotas are a very small proportion of GDP, only 1 per cent at the time of the Eleventh Quota Review in 1998 measured in market exchange rates (Table 1) and an even smaller proportion today. Secondly, note that since conversions of GDP at market rates produce significantly smaller GDP's than PPP based conversions, the potential contributions by developing countries are such a small proportion of their GDP that the argument loses significance. Thirdly, note that only 25 per cent of the member's contribution or quota is paid in foreign currencies. Taken together, these facts weaken the ability-to- contribute argument, the main argument against the use of PPP-based

GDP, to the point where it becomes irrelevant. In any case, countries are free to accept or reject quotas proposed and any country that did not feel able or did not wish to accept an increase in its contribution could decline any proposed increase in its quota.

Moreover, recall that the desire to limit quota increases and to adjust quota shares to changed conditions in the international economy has led the Fund to seek to supplement its available resources by entering into two borrowing arrangements, the General Arrangement to Borrow and the New Arrangement to Borrow, with a number of countries in a strong international reserve position that enables them to provide additional financing for Fund operations when required.

Another argument presented against the use of PPP based GDPs is the lack of data. At present, PPP based GDP estimates are available for only 117 countries representing 95 percent of world GDP. Of course, with effort, data deficiencies can be eliminated over time. (Cooper report, page 58). You might consider that the availability of data for countries accounting for some 95 percent of the total world GDP is not a bad starting point if you can work to extend the coverage to other countries, particularly if you have several years in which to prepare the appropriate estimates.
Recall the situation prevalent as regards balance of payments data at the time of the Eleventh Review of Quotas," when data for current receipts and payments through 1994 were used in the quota formulas. At the time Balance of Payments data supplied for publication in the IMF's Balance of Payments Yearbook were not available for 53 countries (out of the 183 that participated in the quota review).These gaps were filled by information provided by area department desk economists, based on official information, and by staff estimates" (External Review of the Quota Formulas -Annex 7, Balance of Payments Data used in the Quota Formulas, page 77) Could not the same be done for PPP-based GDP estimates?

Consider on the other hand, the range of the exchange rate fluctuations and misalignments among major currencies. Simply recall that the exchange rate between the dollar and the Euro has gone from 1.18 US dollars per Euro to under 0.86 US dollars per Euro, a variation of 37 percent in a lapse of less than two years. This alone would introduce substantial distortions in market exchange rate conversions of GDPs measured in these currencies and in others linked to these currencies. The problem is only somewhat reduced but does not disappear with the use of three yearly averages as proposed in the Report. In the example below even the use of five yearly averages was not sufficient to eliminate significant fluctuations in market rate based GDP estimates. Contrast these changes with the stability displayed by PPP based GDP estimates. (See Table 4)

Table 4 Ratio of Japan's GDP to US GDP

Conversion method	1985	1990	1993	1996
Annual average exchange rate -	33	54	67	62
Five year average exchange rate -	39	59	65	61
PPP based estimate-	35	41	41	40

Source; OECD Website "Purchasing Power Parities" quoted in External Review of the Quotas-Annex5, page 46

Moreover, the well-known shortcomings of market exchange rate based conversions are magnified in the case of developing and emerging countries, where large devaluations are not the exception. In recent years these included inter alia devaluations in Mexico, by 115 per cent; in Indonesia, by 228 percent; in Korea, 96 percent; Thailand 87 percent; Russia, 135 percent; etc. Since large devaluations introduce mayor distortions in GDP converted at market rates which are only partially-and unevenly- corrected by three year averages, it seems that the argument of the majority, for the use of market exchange rates for conversions (rather than the use of PPP based GDP) to avoid the introduction of errors in estimation, is not a solid one.

The point has considerable political significance. The GDP of the industrial countries is substantially larger when converted to a common currency in terms of market exchange rates than when it is based on PPP. The opposite is true for the GDP of developing countries; this is particularly dramatic for countries such as India (see Table 5). To visualise the importance of the differences simply consider the following table:

Table 5 Comparison of PPP based GDP and Exchange Rate Based GDP of Selected Countries in 1994

Country	Share in World Total		Rank	
	PPP	ER	PPP	ER
US	21.5	26.7	1	1
China	8.8	2.1	2	9
Japan	8.5	17.8	3	2
Germany	5.2	7.9	4	3
India	3.9	1.2	5	15
Russia	3.1	1.0	9	16
Brazil	3.1	2.9	7	10
Mexico	2.0	1.6	11	12
Netherlands	0.9	1.3	22	13
Indonesia	1.7	0.7	14	23

Source: "External Review of Quota Formulas" Annex 5 EBAP/00/52 Supplement 1

The main reason for this difference is that the use of market exchange rates substantially undervalues the GDPs of developing countries. This is because in developing countries the prices and wages prevailing in the tradable goods sector are higher than those prevailing in the non-tradable goods sector, a phenomenon that is not of significance in developed countries. As the non-tradable sector represents a substantial part of the economy, the valuation of this sector at market exchange rates pulls down the valuation of this sector, and therefore of GDP as a whole below its valuation at PPP based rates. This represents a major distortion inherent in the market exchange rate based GDP which would argue against its use in GDP comparisons between developed and developing countries. Since PPP based GDP estimates on the other hand, are much more stable and do not introduce a measurement bias against any group of countries, they would appear to be preferable for this purpose.

In any event, to the extent that GDP is a major determinant of quotas, the method of GDP conversion has a very large influence on the distribution of quotas.

Since the weakness of the available PPP based GDP data in some countries is no worse than that of some other data used in the calculations, the decision should be to work toward its improvement instead of the abandonment of the concept. There are very large discrepancies between GDP estimates based on market exchange rates and those PPP-based estimates; but if all estimates have statistical problems and one measure favours one group while another measure favours a different one, would it not be reasonable as a minimum to consider using both, perhaps to average them?

TheVariability of Receipts

In looking at the members potential need for financial support from the Fund, the QFRG finds that the single most relevant variable for measuring a country's vulnerability to external disturbances is the variability of its international receipts.

It is proposed that the variability of international receipts be measured as the standard deviation from trend of current account receipts over a 13 year period, with the trend measured by the centered five year moving average. The Report admits the possibility of refining this variable "by adding to receipts some measure of autonomous net inflows of capital, e.g. net long-term borrowing plus foreign direct investment, assuming that reasonably accurate information was available on a timely basis." While these are undoubtedly relevant variables, and this is the traditional way of looking at balance of payments vulnerability, they are not the whole story. In looking at external vulnerability, one may consider:

1- the degree of openness of an economy,
2- the composition of exports
3- the concentration of exports
4- the dependence on external financing, particularly on short-term capital flows.

The first of these variables, the degree of openness may be measured by the sum of imports and exports as a proportion of GDP. Obviously, a closed economy, say one where the external sector accounts for 6 percent of GDP will be less affected by external developments than a very open one, where external sector represents say 50 percent of GDP. In the first case, a collapse of exports will have a limited impact on the level of domestic economic activity while in the second case an export collapse will have major consequences in terms of output and employment. Thus, since an open economy is more vulnerable than a closed one, the degree of openness should be seen as a separate variable, to be distinguished from the variability of current receipts. This variable is not considered by the QFRG.

As is well known, export composition is an element of vulnerability since exports of commodities are subject to greater price fluctuations than exports of manufactures. Thus, a country with a high concentration of exports in one or two primary products, say as cocoa, coffee, copper, etc. is subject to wide fluctuations in export revenues.

Similarly, the concentration of exports in one or two markets, whether of manufactures or primary products will result in substantial cyclical variations in export revenues and in a high degree of vulnerability for the exporting country. While these well known factors are not mentioned explicitly by the QFRG, only the second and third, can be subsumed in the proposal for the measurement of variations in current revenues.

However, trade variables can not open the way to the consideration of the major financial crises that have dominated Fund financial operations in recent years. Excluded from consideration by the QFRG is the member's dependence on international financial markets, particularly the volatility of short-term capital flows, which as is widely recognized, has been the determining factor in the financial crises suffered by emerging market economies over the last few years.

Recall that the terms of reference explicitly refer to "changes in functioning of the world economy and the international financial system and in the light of the increasing globalization of markets". Since the increasing role of financial markets and their globalization are probably the single most important change that has taken place in the international economy, it is surprising that although explicitly referred to in the mandate to the group, the variables proposed refer to current account receipts. While admitting the possibility of including long term capital flows, the QFRG exclude the consideration of short-term capital movements, whose reversal played a major role in balance of payments difficulties of emerging markets.

III.IV Shortcomings of the QFRG Proposed Formula for Quotas

The Report recognises the significant changes that have taken place in the world economy since 1944, in particular the greater global economic integration, the rapid expansion of private capital flows and their volatility that have made countries more exposed to external shocks, (particularly those countries without assured access to private capital markets) in view of a decline in official financing, and that the correction of countries imbalances takes longer than envisaged at the Bretton Woods Conference.

Taking into account the role of quotas in the IMF, the group was requested to review, inter alia, issues that have arisen in recent discussions by the Executive Board. Some of the main issues in recent reviews have focused on whether the quota formulas are currently adequate and also whether the variables in the formulas reasonably reflect the main features of the world economy.

On the whole, the Report prepared by the QFRG, presents a proposal for the revision of quotas that must be seen as disappointing in the light of the broad terms of reference it received, and of several of the important issues that have been the object of discussion both inside the Board as well as outside it.

Among the main issues that would appear to require further consideration are:

1-the overall adequacy of Fund quotas

2-the share of basic votes in voting power and the appropriate participation of small members in decision making

3-the inclusion of the degree of openness of an economy as a factor of vulnerability

4-the role of short-term capital movements and their volatility in the assessment of a country's vulnerability.

5-the exclusion of PPP based GDP data from consideration for the purpose of determining a member's ability to contribute resources to the Fund. This exclusion results in a substantial underestimation of developing countries GDP in quota calculations and in an unwarranted reduction in developing countries quotas and participation in decision making.

Through their choice of variables, the group has proposed a formula that does not take fully into account some of the major changes that have taken place in the world economy, in particular the increased participation of the developing countries as a group in world output and trade and the rapid growth of some of the larger economies among them. Additionally, the report fails to provide for the solution of the problems of vulnerability posed by the extraordinary expansion of financial markets and in particular, by the volatility of short-term capital movements.

While recognising that original quotas were politically determined (see Report page 7,and Mikesell,R.F.) and that the resulting quota structure has tended to persist as a result of the relative small size of selective element in quota adjustments (and the gap between calculated and actual shares has persisted over time), the Report does not favour changing quotas rapidly, as circumstances of individual members may change from one review to the next. (Report, page5)

It may be fair to say that, taken as a whole, the 'Cooper Report' judgements, explicit or implicit, on the size of the Fund, the question of basic votes, the measurement of GDP, on the issue of vulnerability appear to reveal a certain bias in favour of the preservation of the status quo in which a small group of industrial countries holds the majority of the voting rights, limits the growth of the Fund and access to its resources and excludes the majority of Fund members from appropriate participation in decision- making. The quota formula proposed, in addition to being subject to the shortcomings mentioned above, would lead to a further concentration of power in the hands of industrial countries.

The formula proposed by the QFRG fails to address a basic issue: the appropriate representation of members in the governance of the Fund. The formula proposed, like the current decision making process does not address the concerns of the vast majority of the membership about the lack of transparency and the limited influence they have on decision making. Indeed, if adopted it would increase these problems. Decision making by the Fund must acquire a broader legitimacy, greater participation and representativeness of the membership. For the reasons above, it is not difficult to predict that their recommendation will be rejected by the developing countries as a whole.

Towards an Alternative Proposal

By their proposal, the QFRG has made us consider what are the relevant issues involved in the revision of the quota formulas and reflect on which are the appropriate variables to be included in it. Despite the shortcomings of the formula proposed, the initiative for the simplification and increasing the transparency of formula posited by the Report, has considerable merit and should be accepted. Additionally, much of the historical and analytical background material may also be useful. Some suggestions for improving the proposed formula, that address its shortcomings are presented below:

1. Relate overall quotas to world trade and capital movements or to world GDP. A first approach would be to establish that the size of the Fund should not fall below an agreed proportion of world trade or of world GDP. Note that simply establishing a ratio of say 15 percent of imports would more than double Fund resources, enabling it to reduce the costs of adjustment to members and make the institution far more relevant to their problems. Total quotas could be adjusted at three yearly intervals to keep them from lagging significantly behind the expansion of the international economy. Additionally, total capital flows to prospective borrowing countries could also be considered in determining countries potential need for Fund support. (This would not preclude an industrial country from turning to the Fund for support.)

2. Restore the role of basic votes to their original function. This should lead to increasing them to an agreed proportion of total voting rights, say 20 percent of the total and provide that in future, basic votes will increase in the same proportion as total quotas.

3. Use PPP based GDP estimates in the quota formulas in order to avoid the current underestimation of the economic size and ability to contribute of developing countries and emerging market economies. This should also correct their under representation at the Board. Increasing the stake of developing countries in the Fund should also lessen the concern of current creditor countries over the risk of Fund credits.

4. Include additional elements in the variable that measures the external vulnerability of countries in the quota formula. The inclusion of a measure of openness of the economy and of the dependence of countries on international financial markets, particularly on short term capital movements, would appear to be necessary.

With these simple technical changes the major shortcomings of the proposed formula could be overcome.

However, the determination of quotas is as much a political as a technical exercise, and no amount of technical work can take the place of the necessary political discussions and eventual negotiations towards a broad agreement. Will the G-7 and other industrial countries that hold a privileged position be prepared to yield some of their power to the broader membership of the Fund?

There are sound political and economic reasons for doing so. Much has changed in the world economy since 1945. As a number of former colonies became sovereign countries, and the Soviet Union gave way to a number of independent economies in transition, the membership of the Fund expanded from 45 to 183 countries. World trade expanded beyond expectation and as official flows declined, the growth of international financial markets has been explosive, giving rise to new opportunities and challenges. The structure of the world economy has also changed as developing countries account for a growing share of the world's output and trade, and newly industrializing countries overtake others as major economic players, without attaining adequate representation in the Fund Board. The process of European integration, which is well underway, and monetary unification that has already taken place among twelve countries, prompts questions as to their appropriate representation at the Executive Board.

Because these political and economic changes have not been appropriately reflected in the decision making structure of the Fund, it has become dysfunctional as the governance of the Fund and the legitimacy of Fund decisions have become increasingly questioned. Too often the design of programs is seen by member countries more as inevitable impositions, aimed at serving the economic and political interests of certain parties than as the result of an exercise in monetary co-operation, in which their full participation gives them a sense of ownership.
In the face of the major changes that have taken place in the economic and political panorama of the world, a more representative and transparent decision making process is required to enhance the democratic legitimacy of an institution so involved in the economic governance of its members. The success of the Fund as a multilateral institution is crucial if globalization is to work for all countries. Democratic legitimacy and participation are not contrary to the strict application of clear principles in the exercise of the Fund's competencies.

IV The Bank for International Settlements (BIS) and the Basle Committees

The Bank for International Settlements (the BIS) was created under international law with a specific mandate of promoting central bank co-operation for the purpose of maintaining global financial stability and providing additional facilities for international financial operations (Giovanoli, 1989; Helleiner, 1994). An important aim of this increasing central bank co-operation has been to promote international financial stability. With rapidly integrating financial markets in the world, and with risks of crises also increasingly spreading internationally, international central bank co-operation is becoming even more essential. Naturally central bank co-ordination at the BIS has also focussed on improved coherence of monetary policies in particular, and macro-economic policies in general. It also acts as a bank, offering banking services to virtually all central banks.

The Governors of the G-10 central banks meet regularly on the occasion of the Basle monthly meetings. These G-10 meetings of central bankers in Basle have become an important forum in which much wider activities –including setting up the key Basle Committees[9] – have been put in motion by the G-10 central banks in the pursuit of international financial stability, for example in the fields of financial market monitoring, banking supervision, payment and settlements systems. While these meetings and activities traditionally focussed on events in the G-10 countries (looking at developments in LDCs more in terms of their impact on developed countries), an increasing number of meetings now focus on developments in emerging markets as well, or on the world economy.

However, even when emerging markets countries are the focus of discussions, still too often the perspective from which developments in them are analysed is that of the G-10 countries. Indeed, some of the important meetings at which developing countries are discussed, are still reportedly only attended by G-10 country representatives, though Governors of the major developing countries (particularly from Asia and Latin America), as well as Russia are increasingly invited to attend.

The modality through which the BIS and, in particular, the Committees under the aegis of G-10 Central Bank Governors have operated has been via international co-operation based firmly on home country (state) control, rather than through entrusting it to some international institution. Members of the various committees that meet at the BIS negotiate positions amongst themselves, each reflecting more their national interests; each has also consulted with private sector actors, especially financial institutions, in his/her own country[10]. The aim is to reach a negotiated agreement acceptable to all G-10 countries, and to the public and private sector actors involved. These agreements are often ratified by Ministers and Governors of the G-10 countries, and – if required – are approved by G-10 legislatures. Even though the committees meetings at the BIS are basically drawn from G-10 countries, most of the agreements reached have been accepted and implemented by developing countries.

The acceptance by non-G-10 countries, of standards agreed by G-10 countries, has been encouraged by the fact that non G-10 countries see them as broadly desirable. This is not only

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9 The main committees are: the Basel Committee on Banking Supervision; the Committee on Payment and Settlement Systems; and the Committee on the Global Financial System.

10 As matters are – and above all are perceived to be – broadly "technical", there tends to be little consultation at a more general level in national contexts. The question needs to be asked whether, in the interests of greater democracy and accountability, consultations should be broader at the national level, to include for example discussions in Parliament.

due to efforts made by various Basle committees to disseminate their agreements, but also because private rating agencies consider meeting Basle capital adequacy standards as an important element in rating financial institutions. The IMF, the World Bank and the regional development banks have also played a big role, especially through their surveillance and through conditions attached to their loans, in the spreading of the standards adopted by the BIS committees.

However, the fact that standards are increasingly set in G-10 fora, that have then to be implemented by countries that do not participate in those fora and in those decisions, is both deeply unfair and inefficient. This is a major reason for involving developing countries in the Basle Committees.

There are serious questions that need to be addressed over whether this method of 'bottom-up' global governance continues to be appropriate as financial globalisation deepens, and as the role of developing countries in the global economy increases. If the Basle process is to continue, however, there is a clear need to include participants from developing countries directly in the Committees, on a more systematic and formal basis. This is so not only because several developing countries are major financial and economic actors; it is also because many of the key issues relating to international financial stability relate to and deeply affect developing countries.

According to some observers, it may be difficult to make compatible an expansion of BIS membership with maintaining the intimate club-like modus operandi, which reportedly facilitates agreement and consensus decision-making. However, these problems should not be over-stated, as mechanisms (such as a rotating membership) can be found to make consistent a far broader representation in the Basle process (to include different categories of developing countries including poorer and smaller countries) with continued efficiency in decision-making. Furthermore, participation - on a rotating basis - by developing countries would improve the quality of decision-making in relation to impacts and application, as well as ownership of developing countries, very significantly.

IV.I The Basle Committee on Banking Supervision

The Basle Committee on Banking Supervision, which is the most well known of the committees that have their secretariat at the BIS, was established by the central bank governors of the Group of Ten countries in 1975. Since its creation, the Basle Committee has been working to improve banking supervision at the international level. The work of the Committee covers three main areas. First, it provides a forum for discussion on supervisory issues. Second, it co-ordinates the supervision of international banking groups and their cross border activities. Third, it aims to improve financial stability by improving standards of supervision.

The Basle Committee is made up of senior representatives of bank supervisory authorities and central banks from twelve countries; the G-10 plus Switzerland and Luxembourg. While the work of the Basle Committee was originally centred on supervisory issues arising in the context of the G-10 countries, the rapid pace of globalisation, and the resulting need for international co-operation to involve a wider group of countries, have been reflected in the recent efforts of the Basle Committee to extend its reach. One example of the Basle Committee expanding its links with non-member countries was in the preparation of the

Core Principles for Effective Banking Supervision in 1997. In developing the principles, the Committee worked closely with the supervisory authorities in fifteen emerging market countries. This was a major step for Basle Committee towards increasing the participation of emerging market countries in their discussions and decision-making processes.

However, the absence of formal participation by developing and transition economies continues to affect the efficiency of the some areas of Basle Committee work. A very recent example is provided by the preparatory work to replace the 1988 Capital Accord. Significant changes in the nature of banking, risk management, supervision, and financial markets in the period since 1988, meant that the Basle Capital Accord required up-dating. The Basle Committee has been working on proposals for a new Accord since 1999, with a key aim of introducing a more risk-sensitive framework.

In January 2001, the Basle Committee presented a second proposal for a new Accord. The proposed changes have met with widespread concern from both those within the banking industry and those concerned with developing country access to international private bank flows. Although developing country supervisors were consulted on the proposed changes to the Basle Accord, it seems evident that <u>the lack of formal developing country participation in their preparation has impacted negatively on the efficiency and legitimacy of the process</u>. This has led to a set of proposals that would increase significantly the cost of borrowing for developing countries and reduce their access to foreign borrowing.

IV.II The Proposed New Basle Capital Accord[11]

The 1988 Basel Capital Adequacy Accord was a milestone in the approach to bank regulation. However, in recent years criticisms from many quarters have been levelled at the functioning of the Accord, with critics arguing that the regulatory requirements are crude and do not correspond to actual levels of risk.

From a developing country perspective, the OECD/non-OECD distinction in risk-weights is crude, unfair and provides a distorting incentive for developing countries to seek OECD membership. Most importantly, the lower (20%) risk-weights attached to short-term loans for emerging markets created a bias in their favour whilst credit to non-OECD banks with over one year maturity was discouraged by a far higher (100%) risk weight. This contributed towards the 1997/8 Asian crisis wherein the devastating impact of rapidly reversible short-term lending was demonstrated.[12]

The changes in the proposed New Accord appear to be geared towards the interests of a small number of large internationally active banks. Hence, the major thrust of the proposals aim to increase the risk-sensitivity of capital requirements and thereby more closely align these requirements with actual risks. To this end, a major proposal is to move towards ever-greater use of banks' own internal risk management systems.

However, although the focus of the proposals are aimed towards the needs of major banks from the G-10, it is likely that the New Accord, when implemented, will have significant, and broadly negative, repercussions for the developing world, both internationally and domestically.

[11] This section on the New Basle Accord draws on
[12] See Cailloux, J and Griffith-Jones S. (1998).

Developing and transition country's sovereigns, corporates and banks wishing to borrow in international markets will find the lending environment greatly worsened, as the major banks' lending patterns are significantly changed by the adoption of the use of their own internal risk management systems (or IRB approaches). The outcome of these changes is likely to be a significant reduction of bank lending to the developing world, and/or a sharp increase in the cost of international borrowing for much of the developing world. Preliminary calculations reveal that the outcome could be that speculative grade borrowers (BBB- or lower) are effectively excluded from international bank lending.[13] The median sovereign rating for non-OECD countries in 2001 was BB, with 31 of the 53 rated non-OECD countries being rated below BBB-.

It is estimated that the proposed changes will be neutral or broadly positive for sovereigns rated triple-B or higher. However, for sovereigns rated below that, the situation is very problematic. For example, for sovereigns such as Brazil and India, rated double-B, under the current Accord, each $100 lent requires $8 capital requirement. Under the new standardised approach this would be unchanged. However, under the IRB approach it can be seen that the capital required for the same $100 would rise to $30.3 and spreads would have to increase by more than a thousand basis points. Even more dramatically, for countries such as Argentina and Pakistan, rated at single-B, spreads would have to increase by 3709 basis points under the IRB approach to produce an equivalent level of risk adjusted return as under the existing Accord.

Greater use of banks' internal risk management systems seems likely to be inherently pro-cyclical and therefore likely to amplify the economic cycle, thus increasing frequency and scale of crises. As developing countries suffer disproportionately from financial crises - given the relatively small size of their economies *vis-à-vis* international capital flows, and the thinness of their markets - this is a cause for great concern.

Domestically, developing country banks will feel a direct effect on their competitive positions. Greater competition from internationally active banks could see banks from the developing world being taken over by foreign banks, at a pace even quicker than has occurred in recent years. This greater competition would be linked to the fact that the less sophisticated developing and transition country banks would tend to use, for a significant period, the standardised approach described below which requires more capital. Whilst the large international banks would be able to use the more advanced approach, which requires less capital. If developing and emerging banks attempt to switch to the more sophisticated approach (so as to avoid a higher capital requirement, that increases their costs), they will find it extremely complicated and demanding to do so, if not impossible in the medium term.[14] As one of the most senior financial authorities in Europe recently said, "the jump to the more sophisticated approach, is too big and too rapid; will regulators and banks especially in emerging markets have the resources to be able to implement it?"[15]

Consequently, if greater competition produces 'consolidation' in the banking industry (with the dominance of the major internationally active banks increasing), and levels of lending to the developing world from these banks is reduced, then developing countries may suffer through less access to international capital. This negative impact would then be compounded if an amplified business cycle did indeed lead to larger scale crises.

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[13] Calculations based on a methodology developed by Deutsche Bank and employed by Helmut Reisen, 2001.
[14] Interviews in several emerging markets
[15] Personal communication

It is ironic and particularly problematic that these proposals (which would imply less and more costly as well as more pro-cyclical lending to developing countries), have emerged at the same time as developing countries are being urged to make greater use of private capital flows to replace aid flows. The short-comings detailed above may have been less likely to appear in the proposed New Accord if there had been significant developing country participation in the Basel Committee, or even if developing countries had been better informed of the proposed changes and their potential implications.

IV.III Developing Country Participation in the BIS and its Committees

The Bank for International Settlements is playing an increasingly important and very often positive role in relation to developing countries, and it is likely and desirable that it will continue expanding in the future. However, its membership, and also its management structure, do not reflect sufficiently the rapidly growing role of developing countries in its activities, even though some important steps have been taken to remedy this.

As regards BIS membership, before 1996, it was constituted by the G-10 and Switzerland, as well as other developed countries, the main East European countries and only two developing countries, South Africa and Turkey. In 1996, several large developing countries were invited to join the BIS; they were Brazil, India, China, Korea, Saudi Arabia, Hong Kong, Mexico and Singapore. Russia also joined that year. The developing countries invited to join were clearly the largest ones – both in GDP and population – as well as those which are very large financial centres and/or have very high incomes. It is clearly a very positive step that the BIS has broadened its membership, to include several key developing countries.

The Basle Committee on Banking Supervision and other Basle Committees however, presently has no developing country representation among its membership.[16] The Committees members are from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. Each member country is represented by their central bank, and by the authority responsible for banking supervision in that country where this is not the central bank. The Basel Committee does have a group of 13 non G-10 countries, including Russia and China, which meets every two months to review developments and comment on current work.

The statutory organs of the BIS are the General Meeting and the Board of Directors. Forty-nine central banks have voting rights and representation at the General Meetings. The Board of Directors, which has 17 members, comprises the Governors of the central banks of Belgium, France, Germany, Italy, the UK and the Chairman of the Board of Governors of the US Fed, as ex-officio members, each of whom appoints another member of the same nationality. The Statutes of the BIS also provide for the election to the Board of not more than nine Governors of other member central banks (BIS, 1998). The currently elected members of the Board are currently all from developed countries, as they are Canada, Japan, the Netherlands, Sweden and Switzerland.

As regards the monthly Governors' meetings, these are two-day meetings. Typically, only one session in the whole two days tends to have participation from all LDC Governors; thus, the majority of those key meetings seem to be exclusive to G-10 Governors. Greater developing country participation here seems very desirable. However, there are a number of

[16] See Table 2 in this paper.

other international meetings at the BIS in which senior LDCs increasingly participate. There is also a growing range of specific activities for LDCs, organised by the BIS, such as the two regional conferences (one for Asia and one for Latin America). Though these are clearly very valuable, it seems even more essential to integrate more fully LDCs into the mainstream work of the BIS and its Committees.

Increasing the representation of developing countries in the BIS and its Committees would provide the institution with a more solid base to carry its work forward in the global context. The increased role of the developing countries in the BIS would not only be appropriate for representation and legitimacy reasons, but also because it would provide expertise and perspectives that are essential, given the increasing global integration of financial markets and the larger role LDCs play in them; in particular, it will provide the BIS with useful insights on areas of the world, where its work is likely to be expanding significantly.

Two caveats seem important in relation to the increased role of developing countries in the BIS. Firstly, as stressed by BIS officials, probably this needs to be done in ways that do not undermine the effectiveness and intimacy of the "Basle style", that reportedly so much facilitates agreement and decisions-making on the basis of consensus, though maybe the importance of small size for efficiency is a bit overplayed. Possibly instead of thinking of expanding too much membership of the BIS's Board or Committees, it may be more desirable for developing country participation to be included, at least initially, on a rotating basis.

V The Financial Stability Forum

The Asian crisis was followed by a period of intense discussions amongst the international community on how to reform the international financial architecture and improve global governance. These discussions took place in a variety of fora – most notably in G7 meetings and the twice yearly Fund-Bank gatherings – and spawned a number of reports. At the G7 meetings in the Autumn of 1998, Hans Tietmeyer, the retiring governor of the Bundesbank, was commissioned to report on international co-operation in the area of financial market supervision and surveillance.

The so-called Tietmeyer report[17] recommended setting up the Financial Stability Forum to help carry forward the process of international financial reform. At the Bonn meeting in early 1999, the G-7 endorsed Tietmeyer's recommendation and established the FSF. The G-7 communiqué outlines the Forum's principal objective as ensuring co-ordination among national and international authorities and supervisory bodies to promote international financial stability. More specifically, the Forum would have three main areas of work: i) the identification of vulnerabilities in national and international financial systems and sources of system risk; ii) ensure that international rules and standards of best practice are developed, and gaps are identified and filled; and iii) arrangements to ensure consistency in rules across all types of financial institutions are improved.

The creation of the Financial Stability Forum has been a very valuable step towards co-ordination of various bodies and actors to improve global stability. However, the lack of representation of developing countries at the Forum is highly problematic.

The G-7 Communiqué that announced the creation of the Forum stated:

'While the Forum will initially be the initiative of the G-7 countries, we envisage that over time additional national authorities would be included in the process. The issues to be addressed affect all countries, including both industrialised and emerging market economies, and the G-7 regards this initiative as a step towards broader participation' (Group of Seven: 1999: para 15).

The Forum was indeed initially made up of just the G-7 countries, with the addition of four new members – Australia, Holland, Hong Kong, and Singapore - by the third meeting in Singapore in March 2000. FSF membership is made up of three representatives each from each G-7 country (one from the finance ministry, one from the central bank, and one from the supervisory agency), and one representative each from the four more recent members. In addition to these national participants, the FSF members also include the IMF and the World Bank which have two representatives each, as does the Basle Committee on Banking Supervision, International Organisation of Securities Commissions (IOSCO), and the International Association of Insurance Supervisors (IAIS). The BIS, and the other two Basle-based committees – the Committee on Payment and Settlement Systems and the Committee on the Global Financial System - each have one representative on the Forum. Together with the chair, Andrew Crockett (General Manager of the BIS), the FSF has a total of 40 representatives at present.

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V.I FSF Areas of Work and Representation at the Forum

At the first meeting of the Financial Stability Forum, three working groups were commissioned to address key issues affecting international financial stability. The first working group examined concerns related to Highly Leveraged Institutions (such as Hedge Funds). The second group looked at capital flows, while the third group examined the problems posed by offshore financial centres. Two further groups were later established; one to work on the implementation of international standards, and the other to review deposit insurance schemes. The Forum's working groups presented their reports in March 2000.

The quality of the reports from the three initial working groups was very high, particularly those on highly leveraged institutions and capital flows. However, there has been some bias in the selection of topics for study and, more notably, in the implementation of recommendations coming out of the reports. Implementation of reform has been heavily focused on measures that needed to be taken in developing countries. Important as these measures are, global measures and reforms on the supply-side are equally important, and have been acted on only to a very limited extent. This reflects a preference within the Forum for what Culpeper termed 'risk management over "behaviour management"' (2000:17)

Of the working groups themselves, it is worth noting that they comprised officials of developed and developing market economies, as well as international financial institutions and supervisory groupings, and also drew on work completed or under way in various public and private sector forums. It is interesting that senior officials from developing countries were included, where their expertise was seen as particularly relevant. For example, the group that studied measures to reduce volatility of capital flows included senior representatives from Chile and Malaysia, two countries that have implemented measures to curb inflows and outflows.[18] However, there is evidence to suggest that some developing country participants in the FSF working groups felt that their opinions did not carry the same weight as some of their developed country counterparts. [19]

Turning to implementation, measures to improve disclosure of highly leveraged institutions suggested by the relevant FSF Working Party, for example, have not been acted on because the necessary laws could not pass in the US Congress (see White:2000). This is in clear contrast with the measures on implementing Codes and Standards (the concern of another FSF Working Party), where there has been considerable activity in developing countries, in spite of their reservations on these.

The bias in the prioritisation of reforms recommended by the FSF and its working parties can be seen as a direct reflection of the Forum's membership composition. As currently constituted, the Financial Stability Forum does not include any representatives from developing countries. However, it has been increasingly accepted, especially since the Mexican peso crisis and international financial crisis of the late 1990s, that international finance is increasingly globalised, that developing countries are important actors in this globalised financial system. Currency crises in less developed countries pose both systemic threats to the international financial system and threats to their development prospects.

There is strong case for the inclusion of developing countries in the Financial Stability Forum, in terms of both legitimacy and efficiency, as their inclusion would provide the body with a

[18] Malaysia for both inflows and outflows, and Chile for inflows.
[19] Interview material.

wider range of expertise and perspectives. While the representation of developing countries in the ad-hoc Working Groups is clearly a positive development, it is no substitute for formal integration into the organisation.

There is also considerable support among G-7 and other industrialised countries for creating a more representative Forum. The Commonwealth Finance Ministers Meeting of September 2000 – that included the UK, Canada, Australia and New Zealand – explicitly endorsed developing country participation at the FSF. The chair of the FSF, Andrew Crockett, has also publicly expressed sympathy for the case of the inclusion of developing countries.

A specific formula could be proposed to include developing countries, without making the Forum too large. With six representatives from developing countries, the membership of the FSF would rise from 40 to 46, which is slightly more than 10 per cent. This would allay fears that a larger Forum would become less able to act effectively. Developing countries, perhaps those countries with large levels of private capital inflows in proportion to GDP, could be selected on a regional basis. One formula would be two representatives each from Asia, the Western Hemisphere and Africa. This would ensure that the perspectives of some of the poorest countries were also represented. Developing country representatives could be appointed for a fairly limited period – for example two years – and then rotated to ensure the participation of as many countries as possible. This type of representation model operates well in other contexts such as the Boards of the IMF and the World Bank.

The Forum for Financial Stability is a very important initiative, that hopefully will reduce vulnerabilities in the international financial system, by promoting co-ordination and co-operation among G-7 regulators, central bankers and international financial institutions. Adding a small representation from developing countries to the Forum would increase those countries' commitment to its aims, add valuable insights to its decision-making process, and increase its global legitimacy and. It is a change that is clearly desirable.

VI The Group of 20

The genesis of the G-20 was very similar to that of the Financial Stability Forum. In late 1997, at the Asia Pacific Economic Co-operation (APEC) meeting, US President Clinton set-up the Group of 22. This ad-hoc group was designed to discuss the crisis that was underway in Asia, and to help formulate an effective international policy response. In 1999, following an announcement at the spring G-7 meeting in Cologne, the G-20 was established in the September.

The G-7 had long come under criticism as an exclusive and undemocratic grouping, where the most powerful countries formulated policies that were then imposed on the rest of the world. There had been repeated calls to increase the legitimacy of the G-7 by expanding the membership. However, the defenders of the G-7 argued that it was only by keeping the grouping so small that it would remain effective. These arguments seemed to hold sway, for in over a decade only Russia had succeeded in gaining entry in 1998. And even Russia remains excluded from discussions on financial and macroeconomic issues that are still debated by the G-7 finance ministers.

The Asian crisis had highlighted the huge contradiction that existed at the heart of the G-7. The increasingly integrated global economy was giving rise to new and difficult problems, yet these were being debated by a very limited group of powerful industrialised countries. Developing and transition countries, in which the most severe crises were taking place, not only had a right to be at the table, but could also bring an alternative perspective and experience to the discussions.

The G-20 was therefore established to facilitate dialogue between a broader group of countries on international financial affairs, operating as an informal grouping in a similar way to the G-7. The G-20 consists of finance ministers and central bank governors from 19 industrialised and emerging market countries, together with representatives of some of the major international organisations. G-20 member countries are: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, and the United States. Also represented at the G-20 are the European Union Presidency (currently held by Sweden), the European Central Bank, the International Monetary Fund, the International Monetary and Financial Committee of the IMF, the World Bank, and the Development Committee of the IMF and World Bank.

The finance minister of Canada, Mr Paul Martin, was chosen as the first Chair of the G-20. Since its inception, the G-20 Ministers have met once a year and their deputies meet twice a year.[20] While Canada's chairmanship was initially planned for the first two years only, this was then extended for a further year meaning that Paul Martin will chair the 2001 ministerial.

VI.I A Major Change to Global Governance?

It is very early days to draw any concrete conclusions on the role of the G-20 in global economic and financial governance. However, there are two key issues regarding this fledgling institution. First, to what extent does the inclusion of a limited number of large emerging market countries really address the legitimacy problems that have clouded the G-7? Second, how much capacity will the G-20 have to influence international policy-making –

[20] In 1999, the G-20 ministerial was held in Berlin, and in 2000 it was held in Montreal. At the time of writing, the exact date and location of the 2001 ministerial was yet to be announced.

especially given the competing influence of other institutions such as the G-7 the IMF, the IMFC, and the Financial Stability Forum?

The inclusion of countries such as Brazil, China and India – selected because their size or strategic importance gives them a key role in the global economy – clearly represents an important step toward better global co-operation on financial issues. The G-20 includes member countries from every region. As the G-20's literature is proud to point out, the G-20 members account for 66 per cent of the world's population, 88 per cent of the world's economy and almost 60 per cent of the world's poor. Non-G-7 countries actually outweigh G-7 countries at the G-20. Some have even argued that the participation of the World Bank and the IMF gives the G-20 'a claim to at least a second-hand representation of the universal membership of the global community' (Kirton:2001).

There is, however, no direct representation of the poorest or smallest countries on the G-20. As with other key decision-making fora, Africa is under-represented at the G-20. Moreover, as the only regional organisations represented being the European Union and the European Central Bank, Europe is over-represented at the G-20. Calls for enlargement of the G-20 have met the familiar argument that there is a very real trade-off between size and effectiveness with these informal discussion fora. According to this line, if G-20 membership were increased, it would lose its vital capacity to discuss issues in an effective way. There is also some difference of opinion over whether a non G-7 country should be selected as the next chair of the group. While some feel that such a move would enhance legitimacy, others have argued that it would only serve to marginalise the G-20 further.

On balance, it would seem that the G-20 would benefit from some representation of low-income and small countries, to make it fully representative, but that the organisation would benefit from a developed country chair at least in the short-term. However, these issues are perhaps secondary to the question of the effectiveness of the G-20 and to what extent the grouping will be able to influence international decision-making.

Some commentators feel that the creation of the G-20 amounts to little more than window-dressing on the part of the G7. The powerful industrialised countries, it is argued, hand-picked some of their strongest developing country counterparts in what amounts to little more than an outreach exercise. Under this analysis, the G-20 will simply be a vehicle for endorsing G-7 policies amongst a broader group of countries, with little autonomous decision-making role.

The G-20 is clearly a young institution that has yet to realise its potential, but there may be room for optimism. As some observers note,[21] the G-7 itself was not very effective in its initial meetings. Nevertheless, it later became far more effective. An optimistic interpretation (which hopefully will materialise) is that also the G-20 could develop into an institution that will be increasingly effective and take or suggest meaningful decisions.[22] The creation of the G-20 has definitely been a valuable step towards ensuring a broader participation in discussions on international financial reform. The G-20 provides an informal forum, with discussions taking place amongst the most senior policy-makers, such as Finance Ministers and Central Bank Governors. Developing country policy-makers welcome the opportunity for such discussions. Furthermore, useful exchanges, and even some concrete progress, has taken

[21] Interview Material
[22] We thank Angel Gurria and Jose Luis Machinae for valuable insights.

place at the G-20 on specific modifications to the architecture of interest to developing countries, such as changes to IMF and World Bank lending facilities.[23] Also, individual developing countries represented there use this forum to advance specific negotiations they are undertaking on international financial issues.

Remaining optimistic about the potential of the G20, there have undeniably been major limitations in the way the grouping has operated in its first two years. The main one is the fairly narrow orientation and lack of ambition in the formal agenda developed.

In its first year in operation, the G20 agenda consisted of a set of tightly defined and fairly narrow architecture issues: stock-taking on progress made by member countries in reducing vulnerability to crises; compliance with international codes and standards; completion of transparency and financial sector assessment reports by the IMF and World Bank; and an examination of exchange rate regimes. This agenda placed heavy emphasis on addressing domestic vulnerability to financial crises in developing countries, rather than on addressing systemic issues or even problems originating in G10 countries (such as lack of transparency in markets, or more specifically, the problems of hedge funds). Furthermore, the question of policy co-ordination among the G7 or G10 countries has not been a subject for discussion at G20 meetings. For example, the question of exchange rate relationships between the three major currencies, that have a strong impact on the rest of the world, are not discussed.[24] There has also been little discussion on the role of the IFIs. The narrow agenda also fed speculation that the G-20 would simply be a vehicle for endorsing G7 policies and priorities among a broader group of countries.[25]

At the second G-20 ministerial in Montreal in 2000, there was clearly some, albeit limited, progress on shifting the agenda beyond these confines. The group went beyond the expected agenda dealing with response to financial crises and the work of the FSF, to a substantive discussion on the costs and benefits of globalisation. In what Paul Martin called ‘the Montreal consensus’ it was agreed that more effort was needed to ensure that the benefits of globalisation were shared by all and that the poor were protected from its harshest consequences.[26] However, the Montreal meeting remained weak in terms of concrete commitments on reform of the international financial system.

It would be highly desirable to have a broader agenda on which concrete progress could be made, that would ideally include the key subjects in reform of the international financial system:

- more effective and co-ordinated macro-economic management especially by G-7 countries
- appropriate source country regulations to increase stability of private flows to developing countries
- provision of sufficient liquidity in times of distress or crises
- a stable and equitable system of development finance for different categories of developing countries
- an appropriate framework for orderly debt work-out and standstill mechanisms.

[23] Interview material
[24] The dollar, the Yen, and the Euro. See Culpeper 2000.
[25] What Kirton termed the ‘G7-ization’ of international decision-making, Kirton 1999.
[26] See G20 Press Release from the Montreal meeting.

A far more ambitious agenda could transform the G-20 from a body useful at a fairly basic level, to one with the potential to make a truly valuable contribution to meaningful reform of the international financial system.

VII The Representation of Developing Countries in Reformed Governance Arrangements

There have been a series of important changes to the way the global economy is governed in recent years. However, a key flaw of the previous system has not been sufficiently remedied. Developing and transition economies are still far from adequately represented in the key institutions and groupings – the IMF Executive Board and the re-named IMFC, the BIS and its sister organisation in Basle the FSF, and even in the G-20.

Looking at representation by region, the Asia region has faired considerably better than the other major developing country regions at the two new fora created in 1999. Asia is well represented at the G-20, with China, India, Korea and Indonesia all members, and the presence of Singapore and Hong-Kong at the FSF is encouraging. Latin America has no representation at the FSF, but Brazil and Mexico do have a seat at the G-20. Africa, as is often the case, fairs worst of all with just South Africa represented at the G-20 and no representation at the FSF.

The reformed global governance arrangements pose a number of questions for developing and transition economies:

i) To what extent are the voices of developing countries heard in the fora in which they do participate, either formally through membership or informally through consultation and working groups?

ii) Will those institutions and groupings that include developing and transition economies become central to international decision-making, or will the G-7 dominance of global economic governance largely continue?

iii) How can the smaller and poorer developing countries, largely excluded from the revised global governance arrangements, increase their influence over international decision-making?

Increasing the representation and influence of developing countries in international decision-making on financial affairs is clearly important, and could be addressed through two main channels. First, it is important to enhance participation by developing countries in the fora and institutions that both discuss international reform, and that help manage the international economy. Second, developing countries would benefit from exploring complementary ways of enhancing their influence by, for example, developing joint positions and strengthening regional arrangements.

To enhance their position in the current global governance arrangements, it is firstly important to increase developing country participation in the institutions where they already are represented, but insufficiently so. The main examples are the IMF and the World Bank

Group, where developing countries have important, but insufficient, participation. As we have seen in sections II and III of this paper, the governance problem at the heart of the IMF, namely the out-dated and complex quota system, has yet to be properly addressed. The Cooper Report on Fund quotas proposes a new quota calculation system that would actually serve to increase the voting power of some of the already powerful countries and decrease that of many of the poorer countries. The basis of an alternative proposal was presented in section III of this paper that, through elements such as the restoration of the role of basic votes and the use of PPP-based GDP estimates, would help correct the under-representation of developing countries. This should also correct their under-representation on the Executive Board, and therefore also at the IMFC. An additional measure that would improve Fund governance would be to reform the constituency representation on the Executive Board. For example, the European countries could agree to cede one or more of their chairs to the sub-Saharan African countries which are seriously under-represented (Ali Mohammed:7).

Also of grave concern is the clearly insufficient participation of developing countries in the Bank for International Settlements, an institution that is increasingly important, due both to its' technical excellence and the growing significance of its main mandate, the pursuit of financial stability. With regard to changes needed at the BIS, it seems important and urgent to: a) ensure participation of developing countries in the Board of the BIS; b) ensure greater – and more formalised – participation of developing countries in crucial meetings, for example in monthly meetings of Central Bank Governors; c) increase the number of developing country staff in the BIS (have some LDC participation in BIS management); and d) expand the number and types of developing countries included in the BIS, also including representation from low-income and small countries.

The G-20, although a welcome step towards broader participation in discussions on international financial affairs, would also benefit from some representation of low-income and small economies to make it fully representative.

Equally, or more importantly, developing countries should be represented in the crucial fora where they currently have no voice, and where important decisions that affect them are being taken. This would certainly include the Financial Stability Forum and the G-10 Basle Committees. Although efforts to increase ad-hoc consultation which these bodies carried out with development and transition economies is clearly welcome, it is no substitute for appropriate and formal representation. Developing countries could be included in these fora on a rotational basis, without significantly increasing the size of these groups and therefore not jeopardising their effective working methods.

Specifically on the Basel Committee and its recent work on the New Basel Accord, it would appear that the lack of systematic representation from developing countries, has impacted negatively on the nature of their analysis and their recommendations. The proposals in the New Accord - particularly those related to the switch to the use of bank's internal risk management systems - would seem to be driven largely by the wishes of the major G-10 international banks. However, what is good for these banks is not necessarily good for the stability of the international financial system in general, nor the developing world in particular. Many specifically negative impacts on developing countries of recent proposals has not been properly considered, due to lack of developing countries participation.

Beyond these changes needed to address the very real democratic deficit in the current global governance arrangements, developing countries could also increase their influence through enhanced co-operation and by strengthening regional arrangements.

In the case of the Fund Executive Board, for example, developing and transition economies are under-represented. However, these countries are not totally powerless if they are able to formulate joint positions on Fund policy and act together either through voting or in the formulation of consensus. For example, as Evans and Finnemore highlight, if the major developing countries share a position, they can block proposals requiring an 85 per cent super majority. Even decisions requiring small majorities could be influenced by developing countries if those represented through constituencies headed by G10 Executive Directors are included. This is important, but would require developing a stronger sense of shared goals. As Evans and Finnemore state: 'If it could be done, the power of the South even measured formally in terms of votes would become significant' (2001:13).

Developing countries could also benefit from strengthening their own regional arrangements for financial governance.

Institutional mechanisms at the global level need to be complemented at the regional level, for at least three reasons (see Ocampo, 2001a). The first is growth of intra-regional trade and capital flows, which increases macroeconomic linkages. As a result certain functions can be better carried out at least partly at a regional level, such as surveillance and consultation of macroeconomic policies, as well as mutual surveillance for national prudential regulation of the financial system. Secondly, contagion of crises often starts within regions; therefore a complement to global mechanisms, particularly for liquidity provision, can be provided by regional mechanisms; such a mechanism is currently being seriously discussed within Northeast Asia, and has existed for several decades within the European Union. Thirdly, for smaller countries, the access to a broader alternative of institutions for crisis management, including regional ones, may be particularly valuable as they have relatively less influence and bargaining power with global institutions. More generally, the creation and strengthening of regional developing country mechanisms and institutions will also help increase developing countries' ability to negotiate for a fuller global financial architecture.

However significant regional arrangements may become, it is important to stress that they should be perceived as a complement and not a substitute for global institutions (such as the IMF, World Bank and the BIS). These are particularly important in a world where finance is becoming increasingly globalised.

Macroeconomic consultation and surveillance among regional neighbours, then, can provide a very useful complement to consultation carried out at the global level. In fact, the regulation and supervision of the financial sector and the definition of best practice and minimum standards could arguably be dealt with more adequately at the regional and sub-regional level. With regard to the BIS, for example, developing countries may wish to organise, probably on a regional basis, BIS like arrangements/meetings, beyond those that already exists. Such arrangements/sets of meetings amongst regional regulators could be strongly linked to – but be broadly autonomous from – the BIS and its committees. An advantage of such complementary arrangements would be that they could draw more and better on common regional issues in – and features of – financial systems, within regions.

Regional arrangements can also play a useful role in managing balance of payments and financial crises. The regional reserve funds and swap arrangements that have sprung up in recent years could be further developed and expanded in order to complement the crisis response traditionally managed by the IMF. Interesting initiatives of recent years have included the swap arrangements agreed among the Asian countries in 2000. Regional liquidity mechanisms, especially in Asia, could be very significant, given the very high level of foreign exchange reserves in that region; they could also be important, though less so given lower levels of reserves, in the Latin American region. They are more difficult to establish in Sub-Saharan Africa, given these countries' low levels of foreign exchange reserves.

Developing countries should clearly be better represented in the major international decision-making fora on economic and financial issues. Developing countries can also do much by forging common positions amongst themselves and by developing regional initiatives. Both would help ensure an international financial system, that would not only serve better developing countries, but also developed countries.

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