



Economic Commission
for Africa

Policy Research Paper

Reform of the International Financial Architecture and the Policy Implications for Africa



No. 1

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Acronyms

AACB	Association of African Central Banks
ACB	African Central Bank
ACP	The African, Caribbean and Pacific Group of States
AIB	African Investment Bank
AMCP	African Monetary Cooperation Programme
AMF	African Monetary Fund
ASEAN	Association of Southeast Asian Nations
AUC	African Union Commission
BIS	Bank for International Settlements
BWS	Bretton Woods System
CIFs	Climate Investment Funds
CPIA	Country Policy and Institutional Assessment
CRER	Constant Real Exchange Rate
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
ECF	Extended Credit Facility
ESF	Exogenous Shocks Facility
FSB	Financial Stability Board
FSF	Financial Stability Forum
FSI	Financial Stability Institute
GDDS	General Data Dissemination Standard
DGP	Gross Domestic Product
GECC	Global Economic Coordination Council
GTLP	Global Trade liquidity Programme
HIPC	Highly Indebted Poor Country
IaDB	Inter-American Development Bank
IAIS	International Association of Insurance Supervisors
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMFC	International Monetary Fund Committee
IOSCO	International Organization of Securities Commissions
LDCs	Least Developed Countries
LICs	Low Income Countries

LTCM	Long Term Capital Management
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MIGA	Multilateral Investment Guarantee Agency
NPV	Net Present Value
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
OTC	Over-the-Counter
PPP	Purchasing Power Parity
PRGT	Poverty Reduction and Growth Trust
RCF	Rapid Credit Facility
RECs	Regional Economic Communities
SALs	Structural Adjustment Loans
SCF	Standby Credit Facility
SDDS	Special Data Dissemination Standard
SDRs	Special Drawing Rights
SECALs	Sectoral Adjustment Loans
SMEs	Small and Medium Enterprises
SOEs	State-owned Enterprises
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organisation

Abstract

This paper undertakes an analysis of the emerging international financial architecture from the perspective of its implications for Africa. It highlights the evolution of the international financial architecture following the Great Depression (the Bretton Woods System). It further examines the international financial architecture after the collapse of the Bretton Woods System through to the Asian financial crisis in 1998 and provides an assessment of the global financial crisis of 2007-2009, a critique of the international financial architecture, and the issues for reform. After considering various alternative proposals that have been offered for a radical and incremental reform of the international financial architecture, the paper examines the case for a pan-African financial architecture.

Executive Summary

The 2007-2009 Global financial crisis has brought about renewed calls for a reform of the existing International Financial Architecture (IFA). These same calls for reform were made in the aftermath of the 1997-1998 Asian Financial Crisis. In fact, the core of the current International Financial Architecture has its roots in another crisis, the Great Depression of the 1930s. Following the Great Depression and the ensuing economic and financial crisis, the United Nations Monetary and Financial Conference was held in 1944 at Bretton Woods, New Hampshire, (USA) to put in place an international financial architecture. The outcome was the establishment of the International Monetary Fund (IMF) and World Bank. At the center of the Bretton Woods regime was the IMF, which was expected to perform three important functions:

- Regulatory (administering the rules governing currency values and convertibility)
- Financial (advance credits to countries with short-run balance of payment difficulties), and
- Consultative (providing a forum for cooperation among governments)

By 1971, the Bretton Woods System (BWS) had collapsed and a new regime of floating exchange rates begun. The breakdown of the Bretton Woods System left the International Financial Architecture, which had been put in place at the end of World War II, in disarray. It led to the creation of the G7, the informal group of the world's seven leading economies to coordinate their economic policies.

The end of the Bretton Woods System unleashed two decades of financial globalization, encouraged by the deregulation of both currency markets and banking and investment rules. This led to increased flows of private money to rich and poor countries alike, which helped boost growth but also created greater instability.

The international financial architecture exercise has since gone through several phases, focused on different issues, as the international community has sought to apply the lessons learned from the many crises that followed, e.g. the Mexican crisis of 1995, the Asian crisis of 1997, the Russian crisis of 1998, the Brazilian and Ecuadorian crises of 1999 and, the Turkish and Argentine crisis of 2001-02.

Following the 2007-2009 global financial crisis, the international financial architecture has come under renewed attack with many calls for reform.

Critique of the emerging international financial Architecture

The emerging international financial architecture has been criticized on a number of grounds including:

The Underlying Development Model

The theoretical underpinning of the new IFA is a view of the world predicated on the efficient functioning of a free market economy (the neo-classical model). Under this framework, there is a drive to fashion a unique world system where every economy basically looks alike. However,

Keynesian models after the Great Depression have shown quite clearly why in the presence of uncertainty and market failure for example, the neoclassical model will not only be inefficient but can exacerbate rather than prevent financial crisis.

Dealing with global imbalances

A key factor in the 2007-2009 global financial crisis has been attributed to increasing global imbalances and the attendant problem of unwinding these imbalances in an orderly manner. As was noted earlier, the Bretton Woods Conference in 1944 rejected Keynes' proposal to formally agree on the sharing of adjustment burdens by current account deficit and surplus countries.

The problem of global imbalances was amplified after the Asian crisis by the decision of many emerging market countries in Asia and Latin America to respond to the financial crises in the 1990s by adopting policies to strengthen their external balances. This was to prepare a defense against instability due to volatile external financial flows. Countries with insufficient reserves had paid high economic and political costs in the East Asia and global liquidity crises at the end of the previous decade. The absence of alternative means for self-protection may not only impair a robust and sustainable recovery, but also lead, in the long run, to further instability.

Supervision and regulation of the international financial system

A lesson from the Great Depression was the need for strong financial sector regulation as the market could not be relied upon to self-regulate. Ensuring global financial stability to support economic stability is a global public good and therefore there is a need for global coordination. However, this should not mean the imposition of one set of regulatory standards by the developed countries on the developing countries. In existing global regulatory bodies, concerns of developing countries are often unrepresented or under-represented. For Africa, the issue of voice and representation on international regulatory bodies like the Financial Stability Board is important.

All G20 countries have also committed to adopt the Basel II Capital Framework by 2011. The Basel Committee has also initiated proposals for a Basel III capital framework. However, the policy process leading to Basel-II and Basel III largely excluded inputs from developing countries. Basel II especially affects the cost of international bank financing for African countries and could reduce their access to external financing.

In the area of regulation of offshore financial centres, while particular attention has focused on offshore financial centres in developing countries, so far the principal sources of tax evasion, tax secrecy, money laundering, and regulatory arbitrage have been through on-shore tax havens in developed countries' financial centres.

Governance of the international financial architecture

The emerging international financial architecture has also been criticized for not being sufficiently representative of all countries in the governance of its respective institutions. Neither the G-7 industrialized countries nor the G-20 represents a sufficiently inclusive global steering group for addressing global systemic challenges. While the G-20 is more broadly based, there is still no representation of the remaining 170 countries.

Any future governance format must therefore ensure inclusiveness and adequate representation of developing countries, including least-developed countries (LDCs). This inclusive response will require the participation and the involvement of the entire international community.

Alternative reform proposals for the new international financial architecture

Various proposals have been put forward on the reform of the international financial architecture. The key issues that have to be addressed by the emerging international financial architecture include i) global imbalances and reserve accumulation, ii) the role of the US dollar as a reserve currency, iii) the exchange rate regime, iv) regulation of the financial system and v) governance of the international financial institutions. The proposals can generally be classified under two broad categories: i) Proposals that seek to replace the existing architecture with a new one (radical reform) and ii) proposals that seek to incrementally reform the existing international financial architecture. The radical reform proposals proposed by Professor Stiglitz for example, seeks to make the United Nations and not the IMF and World Bank as the center of the new international financial architecture and give developing countries more clout in the system. The incremental reform proposals on the other hand are currently being driven by the G20 with proposals to reform the existing institutions of the international financial architecture.

What are the implications of the emerging international financial architecture for Africa? Which path of reform should Africa opt for? The paper makes a number of recommendations.

Recommendations

For Africa, the choice between gradualist reform and radical reform must be a pragmatic choice between short and long term objectives. While the radical reformers like the Stiglitz Commission have very sound arguments, the practical and political reality is that there is no support from the major powers for such radical reforms. The process of incremental reform has begun and while the ultimate goal may be the architecture set out by the Stiglitz Commission, it is important that in the short term Africa injects itself into the incremental reform process as quickly as possible.

In the immediate term, African countries should push for the full implementation of all the commitments to Africa at the 2009 G20 Summits in the areas of:

Increased resources from the international financial institutions

- Follow through on the speedy implementation of the commitment to increase lending to multilateral development banks by \$100 billion with a commitment to increase this to \$300 billion over the next three years;
- Speedy implementation of the IMF review of the restrictive Debt Sustainability Framework of the IMF and World Bank;
- Clarification on the modalities of access for the \$50 billion set aside for low-income countries (LICs) at the London Summit;
- Implementation of reaffirmation of aid commitments. The G20 need to be held to their promises;

- The G20 should urge and support the IMF to ensure that African countries continue to have increased and flexible access with relaxed conditions to IMF facilities to support their economies in the period of recovery and beyond;
- IMF and World Bank should submit specific reports to the IMFC and Development Committee at the Spring and Annual Meetings on how flexible they have made these funds available to low income countries.

Strengthening financial supervision and regulation

- The policy process leading to Basel-II and Basel III has largely excluded inputs from developing countries. It is therefore important that Africa's voice be heard as the modalities for implementing the Basel II capital framework and other prudential regulations are finalized and implemented;
- At this relatively early stage, it is important that Africa's representation on the Financial Stability Board be reviewed. At the very least, the Association of African Central Banks (AACB) or some other representation for central banks in Africa should also be part of the process;
- Influence at institutions like the Financial Stability Board (FSB) depends on the perceived value of the intellectual contribution to the discussion. So it will be important for African countries to be represented by respected technical experts, with the latitude to participate in discussions;
- The issue of access to financial services by the poor and SMEs should be placed at the top of the agenda. African countries should have voice and participation in the proposed G-20 Financial Inclusion Experts Group.

Reform of the international financial institutions

- Africa should continue to argue for increased voice and representation (additional Chairs) on the IMF and World Bank Boards;
- Africa should also argue for the introduction of a requirement that a majority of countries as well as a majority of voting power is required to pass some measures (as is required for amendments to the Articles) so as to create an incentive for the small number of rich and powerful members to consult with and persuade the large number of vote-poor member;
- There is therefore a need for speedy follow-through on the decisions reached at the summits to reform the IMF and the World Bank.

Resisting protectionism and promoting global trade and investment

- The significant new money (at least \$250 billion) for trade finance is welcome and Africa should press for a clarification of the sources of funds and the speedy implementation of the decision;
- For many African countries, the issue is one of increased market access to enable them to expand their exports. This can be accomplished by inter alia, continuing the demands for a relaxation of rules of origin requirements, lowering non-tariff barriers, and aid for trade;
- African countries need to decide on their main priorities for the WTO negotiations so that they can push through their main interests;
- African countries should continue to press developed countries to open up their markets for trade and live up to their promise to make the Doha Round the "Development Round".

The issuing of special drawing rights as the world's reserve currency

Africa should support the continued issue of new special drawing rights (SDRs) as an alternative world reserve currency. However, new SDR issues should be aligned with support for development, giving larger allocations to those with the highest demand for reserves.

Regional financial architecture

To complement efforts at the global level, African countries should quicken the process of putting in place a regional financial architecture to deal with future financial crises, as the East Asians did following the 1997-1998 Asian financial crisis.

African countries should inter alia:

- Aggressively regulate and supervise financial systems to ensure that banks manage risks prudently to ensure accountability, transparency and responsibility in banking operations. The African regional networks should aim to improve the existing regulatory and supervisory approaches in order to refine and strengthen further liquidity and capital adequacy regulations, thereby adjusting them to new products and developments in the financial system in Africa;
- Undertake financial reforms to improve bank competitiveness as well as to enhance mechanisms for crisis prevention, management and resolution at the regional or continental level.
- Erect an incentive structure for sound corporate finance to avoid high leverage ratios and excessive reliance on foreign borrowing;
- Develop and formalize the role of microfinance institutions and rural financial markets, as part of the new financial architecture in African economies. This is because these institutions are capable of offering more outreach than commercial banks and capital markets. This requires developing legal as well as technological frameworks for the financial transactions in these institutions and markets.

Furthermore, the Pan-African financial institutions that have been established by the AU (the African Monetary Fund, African Investment Bank and the African Central Bank) should become operational as soon as possible through the pursuit of appropriate policies for macro-economic convergence and ratification of the various agreements and the contribution of the required capital by member States.

Resource mobilization as part of the pan-African financial architecture

A regional financial architecture for Africa should support the mobilization of resources within Africa for growth. African countries should therefore increasingly focus on domestic and regional mobilization of resources to complement external sources. The implementation of a carbon tax on petroleum consumption of for example 5 cents per litre Africa-wide will yield some \$9 billion per annum into a Fund that can be used to finance infrastructure investment and at the

same time contribute to the fight against global warming. Other alternatives to raise domestic resources include banking the unbanked and issuing diasporan bonds,

Ultimately, African countries must place themselves in an economic and financial position to benefit from the emerging international financial architecture. The recent experience of Greece, with the financial markets is a reminder that African countries should avoid the temptation to run persistent fiscal deficits along with loose monetary policy (inflation tax) while attempting to borrow externally (on commercial or concessional terms) to finance the deficit. It will be soon obvious that the government is engaged in a ponzi game and therefore not sustainable. To the extent that the Pan-African institutions are able to enforce this discipline, there would be macroeconomic stability.

Longer- term recommendations

In the longer term, African countries should align themselves with some of the key recommendations of the Stiglitz Commission for a more fundamental and inclusive reform of the international financial architecture. This would include:

A new global reserve system

The “Triffin dilemma” was one of the problems of the Bretton Woods System, as confidence eroded in the dollar as an international reserve currency with increased US deficits. More recently, the problem of global imbalances has also highlighted the weaknesses of the international reserve system. The current reserve system could be eliminated by creating a supranational international reserve currency as Keynes suggested. Responsibility for managing the global reserve system could be given to the IMF, which currently issues the only global currency, SDRs, on which the system could be built.

A global reserve currency

The new multilateral reserve system should have its own reserve currency based on the SDR. This is the only way to overcome the inequities and instability inherent in a global reserve system based on a national currency, that is, the dollar. The global reserve currency could be allocated to countries on the basis of some formula (“quota”) based on their weight in the world economy (GDP) or their needs (demand for reserves). Since developing countries hold reserves which are, in proportion to their GDP, several times those of industrial countries (26.4% of GDP in 2007 vs. 4.8% for high-income OECD countries), to manage the trade and capital account volatility they face, a formula that would allocate the currency according to some definition of demand for reserves would result in larger proportional allocations to these countries. The allocation can and should have built into it incentives and/or penalties to discourage maintaining large surpluses. Countries that maintain excessive surpluses could lose all or part of their quota allocations if they are not utilized in a timely manner to increase global demand.

Coordination of global macro-economic policies:

Given the specific institutional purposes of the IMF, the World Bank, and other international institutions, there is a need for better coordination and political accountability and for a forum for consensus building to broaden and guide their policy agendas. A Global Economic Coordi-

nation Council (GECC), at a level equivalent with the United Nations General Assembly and the Security Council that addresses areas of concern in the functioning of the global economic system in a comprehensive and sustainable way must be created. The GECC would meet annually at the summit level, to assess and coordinate development policies and lend leadership in socio-economic and environmental fields.

Introduction

The succession of financial crises that started with the crisis in the European Exchange Rate Mechanism in 1992-93 and continued with the Tequila crisis of 1995 and within two years, the Asian, Russian crisis of 1998, the Argentine economic crisis of 2001-2002 and the recent global financial crisis that began in 2007 have given bold relief to the shortcomings in the international financial architecture. While there is no generally-agreed definition of what is meant by the term “International Financial Architecture”, it basically comprises three elements: first, the basic economic model by which international financial relations are conducted; second, the network of institutional arrangements that are put in place to manage these relations; and third, how decision-making power in the system is distributed among individual countries (Crockett, 2009).

The 2007-2009 global financial crisis has brought about renewed calls for a reform of the existing international financial architecture. The international financial architecture has been criticized on a number of grounds including the theoretical underpinning of the underlying development model, the lack of voice and representation of the developing countries in the shaping of the emerging architecture, inadequate representation of developing and African countries in the governance of the international financial institutions, exchange rate regime, the role of the dollar as a reserve currency, and the absence of an agreed framework to deal with global imbalances.

This paper undertakes an analysis of the emerging international financial architecture from the perspective of its implications for Africa. To this end, the rest of the paper is organized as follows: Section 2 highlights the evolution of the international financial architecture following the Great Depression (the Bretton Woods System). Section 3 examines the international financial architecture after the collapse of the Bretton Woods System through to the Asian financial crisis in 1998. Section 4 examines the global financial crisis of 2007-2009, a critique of the international financial architecture, and the issues for reform. Section 5 examines various alternative proposals that have been offered for a radical and incremental reform of the international financial architecture. Section 6 examines the case for a pan-African financial architecture. Section 7 is the conclusion.

The Evolution of the International Financial Architecture

The Great Depression

To understand the evolution of the IFA, it is instructive to go back to the Great Depression of 1929-1939. The Great Depression began with a catastrophic collapse of stock-market prices on the New York Stock Exchange in October 1929. Many banks were consequently forced into insolvency. The failure of so many banks, combined with a general and nationwide loss of confidence in the economy, led to much-reduced levels of spending and demand and hence of production, thus aggravating the downward spiral.

Almost all nations sought to protect their domestic production by imposing tariffs, raising existing ones, and setting quotas on foreign imports. The effect of these restrictive measures was to greatly reduce the volume of international trade. The Great Depression was eventually to cause a complete turn-around in economic theory and government policy. Keynes argued that the Great Depression spread rapidly around the world because the responses made by governments were flawed. When faced with falling export earnings they overreacted and severely increased tariffs on imports, thus further reducing trade. Moreover, since deflation was the only policy supported by economic theory at the time, the initial response of every government was to cut their spending. As a result, consumer demand fell even further.

Bretton Woods Conference and the post-war international financial architecture

The Bretton Woods Conference is the name commonly given to the United Nations Monetary and Financial Conference, held (July 1–22, 1944) at Bretton Woods, New Hampshire, USA. Delegates from 44 countries met in the midst of World War II to reshape the world's international financial system¹. It was the first attempt in the history of the modern world to put in place an international financial architecture (Bloch, 1977).

The delegates at the Bretton Woods Conference focused on two key issues: how to establish a stable system of exchange rates, and how to pay for rebuilding the war-damaged economies of Europe. To accomplish these objectives, two international financial institutions (IFIs) were established. The International Monetary Fund (IMF) was set up to promote international monetary cooperation and to enforce a set of fixed exchange rates that were linked to the dollar. Countries in balance of payments difficulties could receive short-term help from the IMF to avoid devaluation. The IMF could also sanction changes in exchange rates when necessary.

The International Bank for Reconstruction and Development (the World Bank) was set up to make long-term loans “facilitating the investment of capital for productive purposes, including

¹ The countries represented were: Australia, Belgium, Bolivia, Brazil, Canada, Chile, China, Colombia, Costa Rica, Cuba, Czechoslovakia, Dominican Republic, Ecuador, Egypt, El Salvador, Ethiopia; the French Delegation; the Governments of Greece, Guatemala, Haiti, Honduras, Iceland, India, Iran, Iraq, Liberia, Luxembourg, Mexico, Netherlands, New Zealand, Nicaragua, Norway, Panama, Paraguay, Peru, Philippine Commonwealth, Poland, Union of South Africa, Union of Soviet Socialist Republics, United Kingdom, United States of America, Uruguay, Venezuela, and Yugoslavia.

the restoration of economies destroyed or disrupted by war and the reconversion of productive facilities to peacetime needs”.

The Architecture of the Bretton Woods System

Design of the Bretton Woods System

Negotiators generally agreed that as far as they were concerned, the interwar period had conclusively demonstrated the fundamental disadvantages of unrestrained flexibility of exchange rates. The floating rates of the 1930s were seen as having discouraged trade and investment and to have encouraged destabilizing speculation and competitive depreciations. Yet in an era of more activist economic policy, governments were at the same time reluctant to return to permanently fixed rates on the model of the classical gold standard of the nineteenth century (Eichengreen, 1996).

What emerged was the “pegged rate” or “adjustable peg” currency regime. Members were required to establish a parity of their national currencies in terms of gold (a “peg”) and to maintain exchange rates within plus or minus one percent of parity (a “band”) by intervening in their foreign exchange markets (that is, buying or selling foreign money). In theory, the reserve currency would be the “bancor” (a World Currency Unit), suggested by John Maynard Keynes. Keynes’ proposals would have established a world reserve currency (which he thought might be called “bancor”) administered by a central bank and vested with the possibility of creating money and the authority to take action on a much larger scale (Bloch, 1977).

In case of balance of payments imbalances, Keynes recommended that both debtors and creditors should change their policies. As outlined by Keynes, countries with payment surpluses should increase their imports from the deficit countries and thereby create foreign trade equilibrium. Thus, Keynes was sensitive to the problem that placing too much of the burden on the deficit country would be deflationary (Bordo and Eichengreen, 1993). However the United States, as a likely creditor nation, and eager to take on the role of the world’s economic powerhouse, objected and their request was granted, making the “reserve currency” the U.S. dollar. This meant that other countries would peg their currencies to the U.S. dollar, and—once convertibility was restored—would buy and sell U.S. dollars to keep market exchange rates within plus or minus 1% of parity. Thus, the U.S. dollar took over the role that gold had played under the gold standard in the international financial system (Bloch, 1977).

To bolster faith in the dollar, the U.S. agreed separately to link the dollar to gold at the rate of US\$ 35 per ounce of gold. At this rate, foreign governments and central banks were able to exchange dollars for gold. The Bretton Woods System was thus a monetary regime joining an essentially unchanged gold exchange standard, supplemented only by a centralized pool of gold and national currencies, with an entirely new exchange rate system of adjustable pegs (Eichengreen, 1996). At the centre of the regime was to be the IMF, which was expected to perform three important functions: i) regulation (administering the rules governing currency values and convertibility), ii) financial support (supplying supplementary liquidity), and iii) consultation (providing a forum for cooperation among governments).

Shortcomings of the Bretton Woods System

While the Bretton Woods Conference was historic, it nonetheless contained two major shortcomings:

Exchange rate rigidity and asymmetry of adjustment to global imbalances

The Bretton Woods System gave the US currency - which was linked to gold - the dominant position in the world economy and allowed the US to run a trade deficit without having to devalue. However, the question of what constituted a fundamental disequilibrium in exchange rates was not clear. How could governments be expected to change their exchange rates if they could not even tell when a fundamental disequilibrium existed? And if they were inhibited from re-pegging rates, then how would international payments equilibrium be maintained?

The heaviest weight on exchange rates at the time was on the persistent payments imbalance between the United States and the surplus countries of Europe and Japan. Each side blamed the other for the disequilibrium (Bloch, 1977).

With hindsight, the problem of the responsibility for adjustment may not have arisen if countries had accepted the Keynes proposal to place the burden on both surplus and deficit countries, so that countries with big surpluses would have to revalue their currencies, and those in deficit would be forced to devalue. Unfortunately, this is still an unresolved issue today. In this regard, the Bretton Woods Conference was a missed opportunity to deal with the issue of global imbalances.

Breakdown of the Bretton Woods System

After 1958, however, America's persistent deficits began to take on a different coloration. Following a brief surplus in 1957, owing to special circumstances, the US balance of payments plunged to a US \$3.5 billion gap in 1958 and to even larger deficits in 1959 and 1960 (Bordo and Eichengreen, 1993). This was the turning point. In 1958, Europe's currencies returned to convertibility. Subsequently, the former eagerness of European governments to obtain dollar reserves was transformed into what seemed an equally fervent desire to avoid excess dollar accumulations. Before 1958, less than 10 per cent of America's deficits had been financed by calls on the U.S. gold stock (the rest being financed with dollars). During the next decade, almost two thirds of America's cumulative deficit was transferred in the form of gold, mostly to Europe. Bretton Woods was clearly coming under strain (Bordo and Eichengreen, 1993).

By the 1970s, the US currency was under pressure from a combination of factors, including the cost of the Vietnam War and the growing trade deficit.

In 1971, the US under President Nixon unilaterally went off the gold standard and devalued the dollar, a move ratified by the Smithsonian Agreement later that year. This led to the abandonment of fixed exchange rates and the introduction of floating rates, where the value of all the main currencies was determined by market trading. Attempts to forge a new Bretton Woods agreement on currencies in the 1970s failed, although the IMF still retained its role of helping countries cope with major currency crises - including Britain in 1976.

The International Financial Architecture after Bretton Woods: From the 1980s Debt Crisis to the Asian Financial Crisis

The end of the Bretton Woods System unleashed two decades of financial globalization, encouraged by the deregulation not just of currency markets, but also of rules about banking and investment. This led to increased flows of private money to rich and poor countries alike, which helped boost growth but also created greater instability. The rapid reversal of such private sector flows when currencies were threatened with devaluation was the central cause of many of the financial crises.

The 1980s debt crisis

The “petrodollar recycling” of the 1970s gave rise to increased indebtedness by many developing economies, especially in Latin America. During that period, the price of oil rose dramatically. Oil-exporting countries in the Middle East deposited billions of dollars in profits they received from the price hike in U.S. and European banks. Commercial banks were eager to make profitable loans to governments and state-owned entities (as well as private companies) in developing countries, using the dollars flowing from the Middle Eastern countries. Developing countries, particularly in Latin America, were also eager to borrow relatively cheap money from the banks (Carrasco, 2009).

The “frenzied” lending and borrowing came to a halt with the global recession in the early 1980s. The significant drop in debtor countries’ exports, combined with a strong dollar, (the value of the dollar increased relative to the value of other currencies) and high global interest rates, depleted foreign exchange reserves that debtor countries relied upon for international financial transactions. Debtor countries consequently began to feel the strain of having to make timely payments on their foreign debt, which became much more expensive to pay off because the loans carried floating interest rates that increased along with global rates. These problems were compounded by massive capital flight - outward transfers of money by private individuals and entities in developing countries.

In August 1982, Mexico stunned the financial world by declaring that it could no longer continue to pay its foreign debt. Not long after Mexico’s declaration came similar announcements from other Latin American debtor countries, such as Brazil, Venezuela, Argentina, and Chile. The prospect of massive defaults posed grave problems for creditor countries, such as the United States. Government regulators discovered that commercial bank creditors, particularly the big U.S banks, had dangerously low levels of capital that could be used to absorb losses resulting from massive loan defaults. Policymakers were also worried that there was no central authority or forum that could oversee an orderly resolution of the crisis, such as a global bankruptcy system.

Debt restructuring negotiations and the international financial system

The principal players in the crisis - governments, banks, the IMF and the World Bank - averted a collapse of the international financial system by resorting to case-by-case debt restructuring negotiations, popularly known as the “muddling through” approach. The approach entailed engaging in a series of work-outs with hundreds of commercial bank creditors throughout the world via bank advisory committees or steering committees, which were composed of banks with the greatest exposures to debtor countries. (Work-outs for government-to-government lending took place under the auspices of the Paris Club, a forum open only to sovereign States.)

Under this approach, commercial banks agreed to (i) provide new loans to debtor countries, and (ii) stretch out external debt payments. In return, debtor countries agreed to abide by IMF and World Bank stabilization and structural adjustment programmes intended to correct domestic economic problems that gave rise to the crisis. IMF stabilization programmes typically included drastic reductions in government spending in order to reduce fiscal deficits, a tight monetary policy to curb inflation, and steep currency devaluations to increase exports. World Bank structural adjustment programmes focused on longer-term and deeper “structural” reforms in debtor countries.

After a few years of repeated restructuring deals, “debt fatigue” began to appear. New loans to debtor countries plummeted as commercial bank creditors contemplated the possibility that debtor countries were facing insolvency rather than a temporary drop in their ability to pay back the foreign debt.

In October 1985, U.S. Treasury Secretary James Baker proposed a strategy, dubbed the Baker Plan that attempted to alleviate the debt fatigue. The plan was designed to renew growth in fifteen highly indebted countries through \$29 billion in new lending by commercial banks and multilateral institutions in return for structural economic reforms such as privatization of state-owned entities and deregulation of the economy. The strategy failed, however, because the projected financing did not materialize and, when it did, the new lending merely added to debtor countries’ already crushing debt burden. During this period, Latin American debtor countries were making massive net outward transfers of resources.

In light of what appeared to be an intractable problem, government officials, academics and private entities began to propose plans that would provide debtor countries with debt relief rather than debt restructuring. In the meantime, various debtor countries suspended debt payments and fell out of compliance with, or otherwise refused to adopt, IMF adjustment programmes. This eventually prompted the big creditor banks to admit publicly (by adding to “loan loss reserves”) that many of the loans to debtor countries would not be repaid.

The Brady Initiative

The Brady Initiative, announced in March 1989 by U.S. Treasury Secretary Nicholas F. Brady, marked a change in U.S. policy towards the debt crisis. Given the persistently high levels of foreign debt, the Initiative shifted the focus of the strategy from increased lending to voluntary, market-based debt reduction (reduction of outstanding principal) and debt service reduction (reduction of interest payments) in exchange for continued economic reform by debtor countries.

Debtor countries obtained significant (but not massive) debt relief under the Brady Initiative through: (i) direct cash buybacks; (ii) exchange of existing debt for “discount bonds” (bonds issued by the debtor country with a reduced (discounted) face value but carrying a market rate of interest); (iii) exchange of existing debt for “par bonds” (bonds that carry the same face value as the old loans but a below-market interest rate); and (iv) interest rate reduction bonds (bonds that initially carry a below-market interest rate that rises eventually to the market rate). Commercial bank creditors that did not wish to participate in a debt or debt service reduction option could choose to give debtor countries new loans or receive bonds created from interest payments owed by debtor countries. Debtor countries sweetened the deals by providing “enhancements,” such as principal and interest collateral (U.S. Treasury bonds).

Commercial bank creditors agreed to Brady deals with a good handful of countries, including Argentina, Brazil, Costa Rica, Mexico, Nigeria, the Philippines, Uruguay and Venezuela. In the meantime, Latin American countries implemented substantial economic reforms. In 1991, the region registered capital inflows that exceeded outflows for the first time since the onset of the debt crisis. This led some observers to proclaim that the debt crisis was over for major Latin American debtor countries.

Stabilization and adjustment programmes

The IMF stabilization programmes applied short-term “emergency” measures intended to reduce domestic demand for goods and services (IMF stand-by arrangements). The World Bank engaged in policy-based lending through structural adjustment loans (SALs) and sector adjustment loans (SECALs), medium- to long-term loans that supported structural changes to improve supply and prevent the recurrence of a crisis. Both programmes carried “conditionality,” releasing funds in instalments and requiring recipients to meet performance criteria for each instalment.

The idea behind stabilization is that a drop in demand will result in a reduction of the current account deficit (more imports than exports), which the IMF believed was one of the major causes of the financial crises in debtor countries. In most cases, governments reduced demand by cutting public expenditures, devaluing the country’s currency, and reducing the money supply. The expenditure-cutting included drastic cuts in infrastructure (e.g., roads, bridges, and dams), freezing state employees’ wages or laying off state employees, reducing consumer subsidies, and cutting health and education expenditures. Central banks devalued the currency in part to reduce imports and increase exports. Authorities reduced the money supply to check inflation.

World Bank structural adjustment programmes complemented stabilization efforts by seeking to increase economic efficiency, which, in turn, would increase the domestic supply of goods and services. Although such programmes differed among countries, they shared two themes: liberalization of domestic and foreign trade, and privatization of often large and inefficient public enterprises. Domestic liberalizations included abolishing price controls, freeing interest rates, ending credit rationing, and establishing a capital market. Liberalization of external trade typically included reduction of high tariffs, elimination of quotas on imports and import licenses, abolition of export duties and licenses, devaluation of the currency, and product diversification. Public enterprises were also subject to market discipline via privatizations, reduction or abolition of subsidies, and other streamlining measures.

The Asian financial crisis and the international financial architecture

The 1990s was a decade riddled with major financial crises in Argentina, Asia, Mexico, Russia, and Turkey, which threatened the global financial system and brought to the fore, the search for a new international financial architecture that would be able to prevent and resolve such financial crises. As Kenen (2002) has noted, the architecture exercise has gone through several phases, focused on different issues, as the official community has sought to apply the lessons learned from the many crises that followed the 1995 Mexican crisis – the Asian crisis of 1997, the Russian crisis of 1998, the Brazilian and Ecuadorian crises of 1999 and the Turkish and Argentine crisis of 2001-02. This exercise has been described as “reform on the run” (Kenen 2001).

The 1995 G7 Halifax summit agreed a series of reforms with the IMF and World Bank, as a response to the experience of Mexico. The G7 leaders agreed a four-point plan, which was rapidly adopted by the IMF and World Bank. The four elements were: stronger IMF surveillance for all countries, based on better data; a new emergency financing mechanism, backed by extra funds; better cooperation between regulators of financial institutions; and exploring procedures for countries, comparable to the insolvency for firms.

The implementation of the Halifax agreement was slow however, and before much could be accomplished, the Asian financial crisis erupted in 1997.

The Asian financial crisis of 1997–98 was triggered by massive reversals of capital flows and contagion. Kawai (2009) notes that while the deeper, structural causes of crises may vary, there were common factors across crisis-affected countries. Domestic financial firms that were inadequately regulated and supervised over borrowed from abroad and over extended loans to domestic corporations and projects of dubious credit quality. Furthermore, a currency crisis that initially appeared to be benign evolved into a full-blown economic crisis due to the mutually reinforcing impacts of currency depreciation, financial sector deterioration, and corporate sector distress.

The crisis-affected countries in Asia had liberalized controls over their domestic financial systems and international capital flows and, as a result, had been integrated — partially at least — with global capital markets by the first half of the 1990s. In the years leading to the crisis, they had received large inflows of capital to the financial and corporate sectors, particularly in the form of foreign currency-denominated short-term capital, which was not hedged (Rodrik, 1999). As a result, the ratios of short-term external debt to foreign exchange reserves had risen to levels greater than unity. When market perceptions changed rapidly in 1997, these economies saw rapid outflows of capital and the consequent large downward pressures on currencies. The currency crisis was triggered by the sudden reversal of capital flows. Regional contagion of the crisis was spectacular. The impact of the Thai baht devaluation quickly spread to Malaysia, Indonesia, the Philippines, and eventually Korea within a matter of months.

The IMF response to the Asian crisis

The IMF response to the Asian financial crisis was very different from the Mexican crisis and served to exacerbate the crisis (Kenen, 2002). The core of the problem in the Mexican case was the large stock of short-term dollar-indexed government debt. Mexico could not redeem them,

given its small foreign-currency reserves, and could not roll them over, because foreign investors knew that Mexico could not redeem them. But the amount of official financing for Mexico was sufficiently large to redeem that debt and rebuild Mexico's reserves.

In the Thai case by contrast, the amount of official financing was smaller than the stock of short-term foreign-currency debt owed by the Thai banks – and that was also true for the Korean case. In this respect, Kenen (2002) argues that the Mexican case was unique. It was the only case where the IMF acted in a manner resembling a lender of last resort seeking to stem creditor panic. It supplied enough financing to convince nervous creditors that there was no need for them to rush for the exit.

In the case of the Asian financial crisis, IMF conditioned its assistance on a very long list of wide-ranging economic and financial reforms - more than one hundred requirements in the Indonesian and Korean cases, some of them only remotely related to the immediate causes of those countries' problems. It believed that swift implementation of those reforms would lead to a rapid revival of confidence (Rodrik, 1999).

In the event, political resistance blocked the speedy adoption of many financial-sector reforms, and some of other the reforms as well. Confidence was not restored, and the amounts of official financing proved therefore to be too small.

The urgency to put a new international financial architecture in place increased sharply after the Asian and Russian crises in August 1998 and its ripple effects in Wall Street in the form of the collapse of Long Term Capital Management (LTCM). Emerging-market crises were no longer just distant events but were seen to have repercussions which could affect major financial markets in industrialized countries (Ahluwalia, 2000).

The 1999 Cologne reforms of the international financial architecture

The Cologne measures built on the Halifax programme and greatly expanded it. The agreed measures included:

- Establishing an enhanced IMF facility to provide a precautionary line of credit that could be drawn on if needed by countries pursuing strong IMF approved policies, accompanied as appropriate by bilateral finance, on a case by case basis, and with appropriate private sector involvement;
- Agreement to establish a new World Bank emergency facility, which will provide at times of crisis vital support for the most vulnerable groups and support for critically needed financial sector restructuring and the increased use of financing tools to catalyze private flows.
- Strong global action to promote greater openness in the financial operations of individual countries, financial and corporate institutions and the international financial institutions, and through internationally agreed codes of good practice to increase the transparency of government fiscal and monetary policy, and strengthen corporate governance;

- The need to strengthen the global financial system by enhancing the surveillance of national financial and regulatory systems, with better cooperation among national authorities and key international financial and regulatory institutions;
- The importance of an orderly and progressive approach to capital account liberalization;
- The importance of developing and implementing measures to ensure the orderly and cooperative resolution of future crises, in particular, mechanisms to involve the private sector;
- The need for general principles of good practice in social policy, to protect the most vulnerable groups in society. These should be drawn upon in developing adjustment programmes in response to crises.

The HIPC debt initiative

The Highly Indebted Poor Country (HIPC) Initiative was launched by the IMF and the World Bank in the fall of 1996 to provide a permanent exit from repeated debt rescheduling of HIPCs. There is broad agreement that the removal of a “debt overhang” is a pre-condition for growth and sustainable development. Three years after the start of the HIPC initiative, it was clear that the original HIPC framework was not sufficient to provide HIPCs with a permanent exit, and at the 1999 G-8 Cologne Summit, the HIPC initiative was enhanced.

The HIPC initiative is in two stages. The first stage is a three-year period during which HIPC coordinates with the World Bank and IMF to establish a record of good economic policies and sustained poverty reduction. At the end of this three-year period, the World Bank and IMF determine whether a country’s debt level is sustainable. For those countries whose debt burden remains unsustainable after full use of traditional debt relief mechanisms, a package of debt relief is identified. This is known as the decision point. While full HIPC debt relief will be provided at the completion, some creditors might provide interim debt relief (the period between the decision point and the floating completion point). Under the enhanced framework, the completion point is “floating”, as it is tied to the implementation of key structural reforms and poverty reduction policies.

The principal objective of the HIPC Initiative is to bring a poor country’s debt burden to a sustainable level. The HIPC framework is limited to external debt that is public and publicly guaranteed; hence it excludes all domestic debt and all private debt that is not publicly guaranteed. The criterion for being “poor” is to be an “IDA-only” country, which is defined as a country that relies on highly concessional financing from the World Bank’s concessional lending-arm, the International Development Association ((IDA).

The enhanced HIPC Initiative considers a country’s debt to be sustainable if the net present value (NPV) 2 debt-to-export ratio is maximal 150 percent, based on the debt sustainability analysis at the enhanced HIPC decision point. In cases where a country has both (a) an export-to-GDP ratio of at least 30 percent and (b) a government revenue-to- GDP ratio of at least 15 percent, the enhanced HIPC framework considers also a fiscal window, whereby it is assumed that a country’s debt is sustainable if the NPV debt-to-government revenue ratio is maximal 250 percent.

For HIPC countries with unsustainable debts, the enhanced HIPC Initiative provides debt relief calculated on the basis of debt sustainability analysis made at the decision point, to be delivered irrevocably at the HIPC completion point, though some creditors provide interim debt relief in the period between decision and completion points. The enhanced HIPC Initiative retains flexibility to review a country's debt conditions at the completion point if unforeseen events beyond the debtor's control justify additional debt relief (so called completion point "topping-up" of debt relief).

Multilateral Debt Relief Initiative (MDRI)

At the July 2005 G8 Summit in Gleneagles, Scotland, to help accelerate progress toward the United Nations Millennium Development Goals (MDGs) G8 leaders pledged to cancel the debts of the world's most indebted countries, many of them in Africa. At their annual meetings in September 2005, the Board of Governors of both the IMF and World Bank endorsed the principles of the 100 percent debt cancellation deal, formally called the Multilateral Debt Relief Initiative (MDRI). MDRI was finalized by the IMF in December 2005 and by the World Bank and African Development Fund in April 2006. The agreement provides 100 percent debt cancellation on eligible multilateral debts to countries that have completed the Highly Indebted Poor Country (HIPC) Initiative process. In 2007, the Inter-American Development Bank (IaDB) also decided to provide additional ("beyond HIPC") debt relief to the five HIPC countries in the Western Hemisphere.

At the time of the March 2009 G20 Summit in London to deal with the global financial crisis, 24 qualified HIPC countries had received debt cancellation through the MDRI, 20 of them in Africa (Benin, Burkina Faso, Burundi, Cameroon, Ethiopia, Gambia, Ghana, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Sao Tome & Principe, Senegal, Sierra Leone, Tanzania, Uganda, and Zambia) had reached their completion points.

For the 24 completion point countries that qualified, MDRI has resulted in the cancellation of \$43.3 billion over the life of the loans. This is in addition to \$45.3 billion in HIPC relief. Combined, the two debt relief initiatives are currently providing approximately \$88.6 billion in relief to completion point countries, of which \$73 billion is for the 20 African completion point countries.

Once all 41 HIPC countries have reached completion point, MDRI will result in the cancellation of \$48.9 billion over the life of the loans and HIPC will provide approximately \$99 billion in relief. If all 41 potentially eligible countries complete the process, the two initiatives will provide roughly \$147 billion in relief.

Each of the participating institutions set individual policies with their Boards for implementation of MDRI.

Establishment of the Financial Stability Forum

At the 1999 Cologne Summit, surveillance over the international financial system was strengthened not only by new standards for data but also by codes of conduct prescribing greater transparency in monetary, fiscal and social policies. A missing element in the global financial architecture was the lack of an effective representative forum for overseeing the functioning of

the financial system as a whole. A limited step towards establishing a mechanism which could oversee the functioning of international financial markets in an integrated fashion was taken by the establishment of the Financial Stability Forum (FSF). The FSF was established at the official level in June 1999 as a 33-member body comprising three representatives from each of the G-7 countries and two representatives each from the IMF, World Bank, Basle Committee, Bank for International Settlements (BIS), the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO). Membership was subsequently expanded to include the Netherlands, Australia, Hong Kong and Singapore. No developing countries were included.

The Financial Stability Forum decided on 12 international codes and standards for sound financial systems (Table 1). The IMF developed and promulgated standards for the compilation and dissemination of economic and financial data, enabling market participants, as well as the Fund and other official institutions, to readily assess the problems and prospects of individual countries. Standards and codes were also drafted to aid in assessing the quality of national financial systems: Core Principles for Banking Supervision prepared by the Basel Committee on Banking Supervision, Objectives and Principles of Securities Regulation prepared by IOSCO, Insurance Core Principles prepared by IAIS, and Principles of Corporate Governance prepared by the Organisation for Economic Cooperation and Development (OECD), as well as accounting and auditing standards and codes designed to foster transparency in the conduct of monetary and fiscal policies.

Table 1: Financial stability forum codes and standards for a sound financial system

CODE	ISSUING BODY
Code of Good Practices on Transparency in Monetary and Financial Policies	IMF
Code on Good Practices on Fiscal Transparency	IMF
Special Data Dissemination Standard (SDDS) and General Data Dissemination Standard (GDDS)	IMF
Principles and Guidelines on Effective Insolvency and Creditor Rights Systems	World Bank
Principles of Corporate Governance	Organization for Economic Cooperation and Development
International Accounting Standards	International Accounting Standards Board,
International Auditing Standards	International Federation of Accountants
Core Principles for Systematically Important Payment Systems	Committee on Payments and settlement Systems
Forty Recommendations of the Financial Action Task Force on Money Laundering	Financial Action Task Force
Core Principles for Effective Banking Supervision	Basel Committee on Banking Supervision
Objectives and Principles of Securities Regulations	International Organization of Securities Commissions
Insurance Core Principles	International Association of Insurance Supervisors

The IMF and World Bank have been assigned the key task of monitoring and evaluating country compliance with many of these standards.

The reform of the international financial architecture following the Asian financial crises was thus generally limited to the enhanced HIPC Initiative, the creation of the Financial Stability Forum, whose representation excluded developing countries and the promulgation of international codes and standards for financial markets. The G7 side-stepped key issues such as the governance of the IFIs and regulation of hedge funds. The recent (2007-2009) global financial crisis has however injected fresh impetus into the reshaping of the international financial architecture.

The 2007-2009 Global Financial Crisis, Critique of the International Financial Architecture, and Issues for Reform.

What began as a sub-prime mortgage problem in the United States in 2007 quickly metamorphosed into a global financial crisis with a fall in global output and increasing unemployment. Virtually no country has been left unscathed by the crisis.

Many economists agree that while the proximate cause of the 2007-2009 financial crisis is attributed to the sub-prime mortgage market in the United States, at the fundamental level, the crisis could be ascribed to the persistence of large global imbalances, meaning imbalances between savings and investment in the major world economies reflected in large and growing current account imbalances (Obstfeld and Rogoff, 2009).

Substantial imbalances in savings and investment emerged after 2000, and were reflected in growing current account imbalances within major world economies. Rising U.S. deficits and increasing surpluses in emerging East Asian economies (especially China) and oil-exporting countries in the Middle East developed. In turn, the savings and investment imbalances gave rise to the so-called savings glut in developing countries and spawned sizable net flows of capital from developing to advanced countries, with the United States being the primary recipient of these flows. The savings glut helped to reduce world interest rates. At the same time, the substantial rise in demand, especially by East Asian and Middle Eastern economies, for official reserve assets crowded out private demand for such high-quality, low-risk assets. Consequently, a scramble by private investors for other higher-yielding but relatively low-risk assets contributed to the financial excesses that finally culminated in the present turmoil in world financial markets.

The debate however soon turned to the nature of the international financial architecture that allowed these global imbalances to persist, with the existing architecture coming under attack.

Critique of the international financial architecture

The international financial architecture has been criticized on a number of grounds, including:

The underlying development model

The theoretical underpinning of the new international financial architecture is a view of the world predicated on the efficient functioning of a free market economy (the neo-classical model). Under this framework, there is a drive to fashion a unique world system where every economy basically looks alike. It is assumed that markets are efficient, and the best way to organize economic activity, free trade and unfettered mobility of financial resources (through capital account liberalization) are the best guarantees to broadly shared global prosperity. Foreign investment is key to growth, employment generation and technological progress in developing countries (Stiglitz, 2009). Furthermore, by enhancing the work of the market, it is assumed that the proposed reforms of the international financial architecture would prevent future financial crises. From

this perspective, the challenge facing the international community is to deepen globalization through the reforms of the international financial architecture while the task of national economies is simply to adapt to the emerging architecture.

It has been argued that the neoclassical approach is not necessarily the most efficient model to underpin the international financial architecture (Soludo and Rao, 1995). The Keynesian models, after the Great Depression, have shown quite clearly why in the presence of uncertainty and market failure for example, the neoclassical model will not only be inefficient but can exacerbate rather than prevent financial crisis. The Keynesian position is that no unique fundamentals exist in any market since the correct asset price depends on the distribution of income, political power, etc. making multiple equilibria possible. Economists such as Stiglitz and Akerlof have also shown that in the presence of imperfect information or incomplete markets, the market equilibria will not be Pareto efficient. For these reasons, in the presence of asymmetric information, adverse selection and moral hazard, herding behaviour and contagion, and excessive volatility in asset prices would cause financial activity to be inherently vulnerable to instability.

Notwithstanding the apparent underlying problems and applicability of the neoclassical model to the emerging international financial architecture, it is still the core approach of the IFIs and the goal of the international financial architecture reforms to create perfectly competitive markets by removing all “distortions” preventing the efficient functioning of the free market. It is this view that guided the prescriptions of the IMF that followed the Asian crisis of 1997-1998, which was perceived to have been caused by distortions such as crony capitalism, inadequate rule of law, weak financial regulation, lack of transparency, poor corporate governance and an insufficiently open capital account to the market economy. The IMF rescue package for South Korea was thus conditioned on over 50—80 detailed conditions covering everything from deregulation of garlic monopolies to taxes on cattle feed and new environmental laws.

Rodrik (1999) has described the conditionalities as entailing “a remolding of the Korean economy in the image of a Washington economist’s idea of a free market economy. If Korea, a mid-size country with an exemplary development record, is subject to such intrusive conditionality, one can imagine what is in store for small countries with more checkered economic histories.... The reality is that our prescriptions often go considerably beyond what can be supported by careful theoretical reasoning or empirical demonstration”.

Korea also had to agree to an unprecedented number of 60 policy conditions in summer 2001. For economists like Rodrik and Stiglitz, the Asian financial crisis was not because of the presence of distortions in the market (economy as diagnosed by the IMF) but rather the result of the excessively rapid capital account liberalization, and inadequate financial regulation, noting that some countries with the weakest financial sectors, and greatest lack of transparency were unaffected by the Asian financial crisis. However, the fact that the world recovered so quickly from financial crises such as the East Asian crisis of 1997-1998 and the global liquidity crisis of August 1998 induced false confidence in the self-correcting nature of market processes as happened after the Great Depression and its impact faded from memory. More generally, the historical role of government intervention in recovery and stability was forgotten.

Dealing with global imbalances

A key factor in the 2007-2009 global financial crisis has been attributed to increasing global imbalances and the attendant problem of unwinding these imbalances in an orderly manner. As

noted earlier, the Bretton Woods Conference in 1944 rejected Keynes' proposal to formally agree on the sharing of adjustment burdens by current account deficit and surplus countries.

Since the Bretton Woods System was established, three of its features have worked at times to delay adjustment in current account imbalances (Crockett, 2009). First, a country that issues reserve assets can finance current account deficits for an extended period. Secondly, a country facing upward pressure on the value of its currency can manage its exchange rate to resist such pressure and delay adjustment in its balance of payments for an extended period. A third feature that can provide incentives to delay adjustment emerged as a consequence of the shift to flexible exchange rates that began in the 1970s. For countries with floating exchange rates, a depreciating currency can provide a sheltering effect that can diminish pressures for structural adjustment.

Rather than simply cushioning one-off shocks, as proponents of floating rates envisage, currency depreciation can also enable policymakers to ignore enduring structural challenges. The United States has taken advantage of its position as the primary issuer of reserve assets to finance a growing current account deficit during the 2000s. East Asian emerging market economies in general and China in particular, have taken advantage of the second feature of the system. They have resisted upward pressure on their currencies and run large current account surpluses.

The Stiglitz Commission (2009) notes that, for several reasons, many emerging markets strengthened their external accounts, to the extent that foreign reserves grew to US \$4.5 trillion by October 2008. The first was to prepare a defence against instability due to volatile external financial flows. Countries with insufficient reserves had paid high economic and political costs during the East Asia and global liquidity crises at the end of the previous decade. The loss of economic sovereignty, coupled with the imposition of pro-cyclical macroeconomic conditionality (as well as other forms of conditionality) as part of IMF-support programmes, has also been a source of particular concern to many countries. In addition, some countries had adopted exchange rate stabilization as part of their policies to ensure external balance and stability; some of these countries built up substantial reserves as a result of attempts to prevent exchange rate appreciation, with its adverse effects on economic development.

Also, while it is rational for individual countries to “insure” against another crisis through the build-up of external surpluses and foreign reserves, doing so weakens global aggregate demand. This can be seen as the international equivalent of the paradox of thrift. The absence of alternative means for self-protection may not only impair a robust and sustainable recovery, but also lead, in the long run, to further instability. The implication is that a reform of the global reserve currency system that provides an acceptable means of risk mitigation is imperative.

Reserve currency status of the US dollar

Closely linked to the issue of global imbalances is that of the reserve currency status of the US dollar. Historically, reserve currencies are only as good as the state of the economies of the currency issuing countries. Unfortunately, even from as far back as the Athenians of the 5th century BC, every reserve currency issuer, has ultimately abused this privilege. Every reserve currency issuer has over-issued its currency and eventually found trust in its credit withdrawn by the rest of the world. For a reserve issuer, the temptation to run large deficits, with loose monetary policy and external borrowing is one that is difficult to resist.

The United States, as the main engine of growth for the world economy and the country issuing the primary reserve currency, runs a current account deficit and augments the world supply of dollars. The fiscal stimulus and bank rescues in response to the recession have already caused the deficit to balloon to record levels, dramatically increasing the volume of debt issuance. This high deficit could trigger a crisis of confidence in the dollar. There is reasonable concern that the United States may be approaching the tipping point at which over-issuance leads to the world community withdrawing its unquestioning faith in the dollar and dollar assets (the Triffin Dilemma) – and such a loss in confidence would damage the scope for the dollar to continue acting as the dominant reserve currency (Nugée, 2010). As the largest holder of US dollar assets, China has expressed this concern and would like to see a move away from the dollar as the primary international reserve currency.

Supervision and regulation of the international financial system

A lesson from the Great Depression was the need for strong financial sector regulation, as the market could not be relied upon to self-regulate. The aftermath of the Great Depression therefore saw a more stringent financial sector regulatory regime. Over time, however, the neoclassical model regained prominence and the IFIs pushed for a regime of deregulated financial markets across the world. They argued that the inherent efficiency of unfettered financial markets would contribute to the overall efficiency of the economy or at least, “lighter” regulation would improve economic performance. Given the pervasiveness of deregulated financial markets, the 2007-2009 global financial crisis represents a repudiation of the vision of free-market fundamentalism. The externalities resulting from the failure of financial institutions and the attendant costs presents a strong case for regulation of the financial sector.

Ensuring global financial stability to support economic stability is a global public good. In a world of financial and economic integration, failure in the financial system of one country can exert large negative externalities on others. This was brought home in the 1997-1998 global financial crisis as fears of “contagion” became widespread. Such contagion was, indeed, evident as the crisis in East Asia led to problems in Russia, and the crisis in Russia in turn spread to Brazil. However, the present crisis has made these “cross-border spillovers” particularly evident, as the failure of the US to regulate its financial markets adequately has had global consequences. That is why a discussion of regulation is not just a matter that can or should be left to national authorities. There is a need for global coordination. However, this should not mean the imposition of one set of regulatory standards by the developed countries on the developing countries. In existing global regulatory bodies, concerns of developing countries are often unrepresented or under-represented.

For Africa, the issue of voice and representation on international regulatory bodies is paramount. For example, membership of the Financial Stability Board (FSB) includes all G20 countries, The European Commission, European Central Bank, International Financial Institutions and International supervisory and regulatory bodies. The number of seats assigned to member jurisdictions in plenary meetings reflects the size of the economy, financial market activity and national financial stability arrangements (see Annex 1)).

The membership list indicates that representation on the FSB is dominated by the industrialized economies (Financial Stability Board, 2009). Europe, for example, has representation at Plenary Meetings from the United Kingdom (3), France (3), Germany (3), Spain (2), Italy (3), Switzerland (2), Russia (3) the European Central Bank (1) and the European Commission (1).

Africa, on the other hand (with 1 billion people and a GDP in PPP terms equivalent to that of France) is represented only by South Africa (1). The membership of the FSB and the associated representation of the members is a reflection of the marginalization of Africa in the discussion of the reforms of banking supervision and regulation. Africa and Indonesia, for instance, have equal representation on the FSB.

While Africa's voice has been marginalized in this process, it will eventually have to impose its policies and regulations on their financial systems, although it has not been involved in their formulation. Furthermore, they could be at variance with their own economic interests at this stage of their development.

Governance of the international financial architecture

The emerging international financial architecture has also been criticized for not being sufficiently representative of all countries, in the governance of its respective institutions. The underlying challenge to effective global economic governance originates from the absence, in a world of sovereign states, of an adequate body or bodies as a locus of coordination and accountability, and the fact that there is no way to enforce transparency and elicit compliance. Neither the G-7 industrialized countries nor the G-20 represents a sufficiently inclusive global steering group for addressing global systemic challenges. While the G-20 is more broadly based, there is still no representation of the remaining 170 countries. IFIs such as the IMF and World Bank do not have sufficient representation from developing countries. The inconsistency between the economic and financial weight of developing countries in the world economy and their role as recipients of IMF and World Bank funds, on the one hand, and their representation in these institutions, on the other, is one of the factors behind the loss of legitimacy and relevance of those organizations in addressing systemic issues.

Any future governance format, therefore, must ensure inclusiveness and adequate representation of developing countries, including least-developed countries (LDCs), promote complementarity and coherence, and establish links between existing and new forums. Although informal groups such as the G-7 and G-20 can play a useful role, they should not be allowed to undermine the functioning of formal institutional arrangements and the discharge of their respective mandates. This inclusive response will require the participation and involvement of the entire international community. Apart from the G-7, G-8, or G-20, it must encompass representatives of the entire G-192". This implies that the United Nations is the most legitimate forum for addressing the pressing needs of global collective action facing the world today (Stiglitz Commission, 2009).

Exchange rate regime and capital controls

Following the Asian crisis, the debate on exchange rate policies in developing countries has focused on the issue of connections between exchange rate regimes and financial crises. Pegged or fixed exchange rates have fallen out of favour on the grounds that financial and currency crises in emerging markets have often been associated with such regimes. Accordingly, developing countries are increasingly being advised to choose one of two extremes - either to float freely or to lock in their exchange rates to one of the major currencies, through such arrangements as currency boards, or even simply to adopt the dollar as their national currency (Fischer, 2001).

The issue of unwinding global imbalances is linked to the exchange rate regime. The IMF has placed the blame for global imbalances squarely on the apparent government policy in Asia (especially China) to undervalue their exchange rates as part of an export-led growth strategy.

“For the world to succeed in its rebalancing efforts, exchange rates must be allowed to reflect medium-run fundamentals. Based on our analysis, many Asian currencies are still undervalued related to those of their major trading partners, while the euro is somewhat overvalued on this basis. So long as this remains the case, the price signals sent about the returns from tradable goods compared to those from nontradable goods will continue to be skewed—thus delaying the rebalancing across countries, and more specifically the necessary recalibration of Asia’s growth model.” Dominique Strauss-Kahn (2009)

The issue of the exchange rate regime raised by the IMF Managing Director has bedeviled the international monetary system since Bretton Woods. How do you get countries with surpluses on their current accounts to allow their currencies to appreciate if they do not want to or do not see the need to do so?

Yilmaz (2002) argues that contrary to some perceptions, countries with flexible exchange rates are no less vulnerable to financial crises than those with pegged or fixed exchange rates. Differences among pegged, floating and fixed regimes lie less in their capacity to prevent damage to the real economy and more in the way damage is inflicted: for instance, in real terms Argentina and Hong Kong (China) – both economies with currency boards – have suffered as much and even more than their neighbours, who are experiencing sharp declines in their currencies. Rather, he argues, “there now appears to be a growing consensus that better management of exchange rates in developing countries requires targeting real exchange rates in combination with the control and regulation of destabilizing capital flows”.

Furthermore, UNCTAD (2010) notes that while the World Trade Organization was established to help countries coordinate and manage the multilateral trading system, and the Basle Accords set global standards for banking, the global monetary system has no such agreed regulatory system for enabling trading partners to avoid distortions stemming from financial shocks and, most importantly, exchange rate misalignments. Such a framework for limiting the degree of exchange rate deviations from the fundamentals would provide the missing link in dealing with the crucial but neglected source of imbalance and instability in the globalized economy. It proposes the adoption of: a “constant real exchange rate rule” in a multilateral context, and adjusting nominal exchange rates for inflation differentials between countries to maintain a constant real exchange rate (CRER).

New thinking on the exchange rate regime at the IMF may be emerging. Tsangarides et al (2010) present compelling evidence that that ‘intermediate regimes’—currencies that are pegged to baskets or within bands, or floated but with significant government intervention – offer advantages of higher economic growth because they “represent a happy balance between pegs and free floats.”

On the issue of capital controls, the IMF Articles of Agreement recognize that members generally may exercise such controls as are necessary to regulate international capital movements (Article VI, Section 3). However, the general right of members to regulate international capital movements is qualified by members’ obligations subject to IMF surveillance under Article IV.

Again however, new thinking appears to be emerging at the IMF (though not yet IMF official policy). Ostry et al (2010) after examining the experience of governments that have regulated capital flows, note “that the use of capital controls was associated with avoiding some of the worst growth outcomes associated with financial fragility.” A key conclusion is that, if the economy is operating near potential, if the level of reserves is adequate, if the exchange rate is not undervalued, and if the flows are likely to be transitory, then use of capital controls—in addition to both prudential and macroeconomic policy—is justified as part of the policy toolkit to manage inflows. Such controls, moreover, can retain potency even if investors devise strategies to bypass them, provided such strategies are more costly than the expected return from the transaction: the cost of circumvention strategies acts as “sand in the wheels.” The authors find that GDP fell less sharply during the financial crisis in countries that already had such policies in place.

There is also an argument for doing nothing. Driffill (2010) argues that the world has slowly been learning to live with floating exchange rates for more than three decades and individual countries have worked out a variety of arrangements for monetary policy, exchange rates and financial stability to suit their own individual perceived circumstances and needs. Failed attempts to fix or manage exchange rates and unsuccessful experiments with policy coordination have shaken people’s confidence in concerted action – we have been there before! Driffill suggests that the ‘fall-back option’ – ‘business-as-usual, laissez-faire, muddling through’ – is not such a bad thing.

Towards an Africa-Inclusive International Financial Architecture

What is clear from the foregoing is that there are a number of key issues that have to be addressed by the international financial architecture, whatever form it takes. These key issues include i) global imbalances and reserve accumulation, ii) the role of the US dollar as a reserve currency, iii) the exchange rate regime, iv) regulation of the financial system and v) governance of the international financial institutions

The various proposals for the reform of the international financial architecture can basically be classified in two main categories: i) radical reform, i.e., a new architecture, and ii) incremental reform of the existing financial architecture.

As the debate on reform of the international financial architecture continues, it is clear that Africa as a region does not have a comprehensive view or approach to the type of international financial architecture that should emerge. Should there be a radical reform or should the reform be incremental? What is likely to be achieved?

After the Asian financial crisis for example, ASEAN set out its own view of the evolution of the international financial architecture (Appendix II) in 1999. The ASEAN view included its position on issues such as development priorities, reform of the IFIs, exchange rate regime, capital account liberalization, supervision of the financial system, transparency and dissemination of information and monitoring short-term capital flows.

Africa, on the other hand, has for a long time basically gone with the flow, with no coordinated position.

Radical reform proposals –replacing the existing international financial architecture

There are a number of proposals, on the other hand, which call for a radical overhaul of the existing international financial architecture, including its underlying model. Most of the proposals for radical reform are captured in the report by the United Nations expert panel on the reform of the international financial architecture (the Stiglitz Commission)

The Stiglitz Commission

The United Nations Expert Panel on the Reforms of the International Monetary and Financial System under the chairmanship of Professor Stiglitz makes the following key recommendations:

A new global reserve system

The “Triffin dilemma” was one of the underlying problems of the Bretton Woods agreement. Excessive U.S. deficits would erode confidence in the value of the U.S. dollar, which would no

longer be accepted as an international reserve currency. . More recently, the problem of global imbalances has also highlighted the weaknesses of the international reserve system. The current reserve system could be eliminated by creating a supranational international reserve currency. Indeed, the idea of an international reserve currency issued by a supranational bank is not new. It was broached more than 75 years ago by John Maynard Keynes in his 1930 Treatise on Money and refined in his Bretton Woods proposal for an international clearing union.

Responsibility for managing the global reserve system could be given to the IMF, which currently issues the only global currency, Special Drawing Rights (SDRs), on which the system could be built. The Commission recommends the creation of a new global reserve system with the SDR as its anchor. Since the entire system will be based on the SDR, its issue on a once-for-all basis, as recommended by the G-20, will not suffice. The new system must be based on a greatly expanded SDR with regular or cyclically regulated emissions calibrated to the size of reserve accumulation. This is precisely what was recommended in the Keynes Plan.

A global reserve currency

The new multilateral reserve system should have its own reserve currency based on the SDR. This is the only way to overcome the inequities and instability inherent in a global reserve system based on a national currency, that is, the dollar. The global reserve currency could be allocated to countries on the basis of some formula (“quota”) based on their weight in the world economy (GDP) or their needs (demand for reserves). Since developing countries hold reserves which are, in proportion to their GDP, several times those of industrial countries (26.4% of GDP in 2007 vs. 4.8% for high-income OECD countries), to manage the trade and capital account volatility they face, a formula that would allocate the currency according to some definition of demand for reserves would result in larger proportional allocations to these countries. One possibility is, of course, to give developing countries all allocations. Note that the current SDR allocation is based on a particular “quota” system, that of the IMF, which continues to be subject to heated debate because richer countries, on average, get a larger share of new allocations—i.e., the opposite of what a criterion based on need would suggest. The allocation should have built incentives and/or penalties into it to discourage maintaining large surpluses. Countries that maintain excessive surpluses could lose all or part of their quota allocations if they are not utilized in a timely manner to increase global demand.

The role of counter-cyclical issues of SDRs to finance world liquidity and official support to developing countries during the current crisis was recognized by the G-20, in its decision to issue the equivalent of \$250 billion in SDRs. However, this decision also illustrates the problems associated with tying SDR issuance to IMF quotas, as less than \$100 billion of the proposed emissions would benefit developing countries, with an even lesser amount (about \$20 billion) going to low-income countries.

Regional monetary arrangements

The international reserve system should rely broadly on regional monetary arrangements, while developing countries should actively cooperate to put such arrangements in place. This seems to be in direct line with the suggestion made by the well-known economist, Triffin in the late sixties, that the international monetary system should be based on regional monetary systems, including regional reserve funds and reserve currencies, e.g. the Chiang Mai Initiative of the ASEAN Plus 3 (China, Japan, and Korea).

Strengthening the lending capability of multilateral development banks

It is well-known that the World Bank and regional development banks do not have adequate resources for financing development in the developing countries at the desired level. They have not proved effective in raising resources from the commercial market for on-lending at concessional rates to the developing countries. The question of restructuring and reforming these multilateral development banks to enable them to adequately discharge their statutory functions has been long pending. In the context of the current crisis, the Commission has recommended that a large-scale programme for commercial lending to the developing countries should be launched; and for this, a new credit facility under the umbrella of the World Bank and regional development banks should be created.

The creation of a global financial regulatory authority and a global competition authority:

While the effective regulatory system must be national, there should also be a global regulatory framework to establish minimum standards and to govern the global operation of systemically relevant global institutions as well. Movements towards this will be enhanced by taking steps to lay the groundwork for a global financial authority and a global competition authority. The purpose of the global competition authority will be to prevent financial institutions from growing to sizes that generate systemic risks and make them too big to fail. These global institutions should be democratically constituted. The idea of a financial regulatory mechanism and a mechanism to curb monopolistic practices of the multinational corporations is not new to the United Nations system. The IMF itself was created as a financial regulatory mechanism at the global level.

Coordination of Global Macro-Economic Policies:

The World Bank, IMF and more recently, WTO are three key post-war international economic institutions that were expected to work together to promote sustained economic recovery and growth, and full employment, leading to economic welfare and reconstruction and development of economic capacities and capabilities.

The variety of international institutions and organizations with specific mandates requires an overarching, inclusive body with an integrated view of the economic problems confronting the world and the adequacy of existing institutional arrangements and institutions, including their mandates, policies, instruments, and governance for addressing the economic challenges facing the world today.

In this regard, the United Nations is the most legitimate forum for addressing the pressing needs of global collective action facing the world today. It can, for instance, play a central role in achieving greater coherence among different actors. Given the specific institutional purposes of the IMF, the World Bank, and other international institutions, there is a need for better coordination and political accountability and for a forum for consensus building to broaden and guide their policy agendas. They therefore recommend the establishment of the Global Economic Coordination Council (GECC) a globally representative forum, at a level equivalent to the United Nations General Assembly and Security Council that addresses areas of concern in the functioning of the global economic system in a comprehensive and sustainable. The GECC would meet annually at the summit level, to assess and coordinate development policies and lend leadership in socio-economic and environmental areas.

Unlike the G20 recommendations, which have sought to enhance the role of the IMF in the surveillance of the global economy, the Stiglitz Commission argues that the IMF has not implemented its surveillance mandate consistently and even-handedly. In recent decades, it has largely ignored its mandate to sustain growth and employment and has focused almost exclusively on curbing inflation. It has also promoted financial (including capital account) liberalization, although its Articles of Agreement clearly allow governments to use capital controls. Before the current crisis, the IMF also failed to provide early warnings. They therefore recommend that the GECC, supported by an International Panel of Experts should take over the role of surveillance from the IMF.

A price-based incentive to adjust to global imbalances

There have also long been worries (articulated by Keynes at Bretton Woods) about asymmetric pressure to adjust to payment imbalances by deficit and surplus countries. Eichengreen (2009) proposes the establishment of an automatic process that creates incentives for surplus countries to adjust. A country that had run a current account surplus in excess of 3 percent of GDP for three years, for example, might be required to transfer additional resources to the Fund at the end of every year in which that excess persisted.

A critique of the radical reform path

For most developing countries, the Stiglitz Commission proposals are instinctively appealing. If implemented, it will mean a new world order in which developing countries have a voice. How feasible is this in the short to medium term however? Cohen (2010) for example argues that reform of the system is unlikely to come in a one fell swoop. In the absence of broad consensus among key governments; calls for a grand global bargain – a ‘New Bretton Woods’ – “are naive at best”. Change, if it is to come at all, will emerge from a gradual process of incremental adjustment and adaptation.

Julius (2010) points out that while the current international financial architecture is inadequate, it cannot be easily or quickly reformed or replaced, as the options currently available are either normatively undesirable or politically problematic. Any change to the current system and their implementation will take a long time. In the meantime, however, it is critical to ensure the sustainability of the old system and avoid its collapse – with all the related shocks and costs that this might entail. The lesson from history is that the governance and voting structures of the IMF are exceedingly difficult to change even though they are ill-suited to the current pattern of global production or other measures of economic power. It is generally easier to graft new arrangements onto the old.

For Africa, the choice between gradualist reform and radical reform must be a pragmatic one, between short and long-term objectives. While the radical reformers like the Stiglitz Commission have very sound arguments, the practical and political reality is that there is little support from the major powers for such radical reforms. The process of incremental reform has begun, and while the ultimate goal may be more ambitious (e.g. the architecture set out by the Stiglitz Commission), it is important that in the short term Africa injects itself into the incremental reform process as quickly as possible.

Proposals for incremental reform of the international financial architecture

This G20 has taken the position, as reflected by its actions (at the London and Pittsburgh Summits in 2009), that the reforms of the international financial architecture would proceed on an incremental basis. Africa's pragmatism on this issue was demonstrated in the 2009 G20 meetings in London and Pittsburgh, which saw the articulation of an African position by President Meles Zenawi of Ethiopia (ECA, 2009).

Africa's position at the G20 London summit revolved around two key issues:

- (i) What new policies or reforms can help Africa deal with the financial crisis?
- (ii) What changes in the international financial system are necessary to avoid a similar crisis in the future and provide African countries the necessary policy space?

What new policies or reforms can help Africa deal with the financial crisis?

Africa's position at the Summit was that:

- As the developed countries implement various fiscal stimulus packages, there is the need for Africa to be fully integrated into the coordinated effort to increase global aggregate demand. The developed countries' fiscal stimulus will be a lot less effective if not accompanied by similar fiscal stimulus in the developing world;
- Developed countries should meet their existing aid and debt reduction commitments to Africa ;
- G20 should urge and support the IMF to put in place a new facility to support African economies during this crisis; this should be a special facility with relaxed conditions to be based on outcomes.
- An early general capital increase for the African Development Bank is needed to enable it to further scale up its interventions in support of countries in Africa.
- Some \$13 billion should be raised through the sale of some 15 percent of IMF gold reserves to help developing countries deal with the financial crisis;
- The IMF should issue a new \$250 billion SDR to provide resources for developing countries.

What changes in the international financial system are necessary to avoid a similar financial crisis in future and give African countries the necessary policy space?

Africa's position at the Summit was that:

- There should be a redesign of the joint IMF/World Bank Debt Sustainability Analysis (DSA) framework to take into account the shortcomings of the methodology and eliminate the judgmental element of what constitutes good policies and institutions;
- At a minimum, the new regulatory reforms in the financial sector should encourage efforts to provide financial services to the poor in developing countries who are excluded from access to banking and financial services;
- Africa should have meaningful voice and representation at the Financial Stability Forum and increased representation on the IMF and World Bank Boards;
- Developed countries should open up their markets for trade and live up to their promise to make the Doha Round the "Development Round".

G20 commitments to reforming the international financial architecture

To what extent did the agreements reached at the G20 Summits reflect Africa's aspirations for a more inclusive international financial architecture? The G20 specifically committed to:

Increase financial resources of international financial institutions

The summit announced a \$1.1 trillion unprecedented fiscal expansion for the world economy made up of:

- Trebling the resources of the IMF to \$750 billion, through a combination of immediate financing from member governments;
- At least, an additional \$100 billion in lending by the multilateral development banks was agreed, with a commitment over the next three years for this to rise to \$300 billion. This will go to all developing countries (low and middle income);
- \$250 billion for trade finance was announced, which is to be provided over two years for all countries. As part of the \$250 billion, there will be a World Bank Global Trade Liquidity Pool that should provide \$50 billion over the next three years.

The G20 Communiqué also included a number of important measures of significance for African countries. The leaders:

- Reaffirmed their historic commitment to meeting the Millennium Development Goals and to achieving their respective Official Development Assistance (ODA) pledges, including commitments on aid for trade, debt relief, and the Gleneagles commitments, especially to sub-Saharan Africa;
- Agreed to provide \$50 billion to support social protection, boost trade and safeguard development in low income countries, as part of the significant increase in crisis support for these and other developing countries and emerging markets;
- make available resources for social protection for the poorest countries, including through investing in long-term food security and through voluntary bilateral contributions to the World Bank's Vulnerability Framework, including the Infrastructure Crisis Facility, and the Rapid Social Response Fund;
- Committed to how sales of IMF gold will be used, together with surplus income, to provide \$6 billion additional concessional and flexible finance for the poorest countries over the next 2 to 3 years. We call on the IMF to come forward with concrete proposals at the Spring Meetings;
- Agreed to review the flexibility of the Debt Sustainability Framework and call on the IMF and World Bank.

Response of international financial institutions to the global financial crisis and the G20 Summit

In terms of quantity and quality, the response of the international financial institutions (IMF, World Bank and the African Development Bank) to the 2007-2009 global financial crisis has been from the response following the Asian financial crisis, with lessons apparently learnt.

International Monetary Fund response

With increased resources and direction from the G20 Summit and a re-evaluation of its own policies, the IMF has provided increased resources on more flexible terms and moved away from hard structural conditionality, in response to the crisis.

From 1 May 2010, structural performance criteria were discontinued for all IMF loans, including for programmes with low-income countries. Structural reforms will continue to be part of IMF-supported programmes, but only when they are seen as critical to a country's recovery. The monitoring of these policies will be done in a way that reduces stigma, because countries will no longer need formal waivers if they fail to implement an agreed measure by a specific date (IMF, 2010).

Moving away from its traditional one-size fits all approach, the IMF has also decided to increase the flexibility of its programming by tailoring programmes to specific country circumstances rather than adherence to dogma. It is in this context that for example, the November 2008 Fund-supported programme in Iceland allows for a high fiscal deficit in 2009, to avoid exacerbating the ongoing collapse of economic activity, while taking measures (including capital controls) to stabilize the exchange rate and restructure the banking sector. Also, the September 2008 IMF-supported programme in Costa Rica uses expansionary fiscal policy to mitigate the adverse effects of the drop in private demand during 2009, including increases in the wage bill and infrastructure spending

Because of the crisis, fiscal targets have been loosened in close to 80 percent (18 out of 23) of African countries that have an active IMF programme. On average for all sub-Saharan Africa, in 2009, fiscal deficits were widened by 2 percent of GDP, and up to 7.5 percent if oil producers are included (IMF, 2010).

The IMF has also overhauled its concessional financing facilities to make them more flexible and address the diverse needs of low-income countries, as many are being hard hit by the global crisis. The new framework includes increased resources, a doubling of borrowing limits, zero interest rates until the end of 2011, and more flexible terms (IMF, 2010). The IMF support package includes:

- **Mobilization of additional resources**, including from sales of an agreed amount of IMF gold, to boost the Fund's concessional lending capacity to up to \$17 billion through 2014, including up to \$8 billion in the first two years. This exceeds the call by the Group of Twenty for \$6 billion in new lending over two to three years;
- **Interest relief**, with zero payments on outstanding IMF concessional loans through end-2011 to help low-income countries cope with the crisis;
- **Permanently higher concessionality** of Fund financial support, with annual interest rates regularly reviewed, so as to preserve a higher level of concessionality than previously.
- Doubling of average loan access limits for low-income countries;
- **A new set of financial instruments** tailored to the diverse needs of low-income countries and better suited to meet the crisis challenges:
 - 1) An Exogenous Shocks Facility (ESF) was established in 2008, to provide concessional financing to Poverty Reduction and Growth Trust (PRGT)-eligible coun-

tries facing balance of payments needs caused by sudden and exogenous shocks. The ESF has been superseded by the Standby Credit Facility (SCF);

- 2) **A Standby Credit Facility** to address short-term and precautionary needs;
- 3) **An Extended Credit Facility (ECF)** to provide flexible medium-term support; and
- 4) **A Rapid Credit Facility (RCF)**, offering emergency support with limited conditionality

Review of the low-income country Debt Sustainability Framework

Following the call by African countries and others for the review of the Debt Sustainability Framework (DSF) and the agreement reached by the G20 leaders calling on the IMF for such a review, the IMF has subsequently obliged. In a decision by the Executive Board in September 2009, the DSF was modified to include:

Greater recognition of the impact of public investment on growth. Directors agreed that analyzing the investment-growth nexus required a country-specific approach, using a broad range of indicators, supplemented with model-based approaches, where appropriate. The financial programming model of the Fund did not factor in the impact of public investment on growth but rather the impact of such investment on budget deficits. This constrained the capacity of countries to borrow. The recognition of this basic fact in the framework represents a sea change.

More explicit consideration of workers' remittances in debt sustainability analyses (DSAs). Noting the increased significance of remittances as a source of external financing in LICs in recent years, greater flexibility should be applied in taking account of the size of remittances when assigning risk ratings.

More flexible treatment of external debt of state-owned enterprises. In this regard, the IMF would exclude from DSAs the debt of state-owned enterprises (SOEs) that pose a limited fiscal risk for the government and can borrow without a government guarantee.

An approach to reduce the effects of fluctuations in Country Policy and Institutional Assessment (CPIA) scores on debt distress thresholds and ratings.

World Bank response

In response to the global financial crisis and the increased demand for resources from member countries, the World Bank has also stepped up its assistance to developing countries to mitigate the impact of the crisis. From July 2008 to January 2010, the Bank provided a record \$89 billion in support to developing and middle-income countries. The assistance includes:

- US\$53.1 billion by the International Bank for Reconstruction and Development (**IBRD**), which provides financing and technical assistance to middle-income countries, which account for 70 percent of the world's poor;
- \$18.3 billion committed by the International Development Association, which provides interest-free loans and grants to the world's 79 poorest countries;
- \$15.5 billion by the **IFC**, the Bank Group's private sector development arm, which also launched an array of crisis response initiatives, including a \$3-billion fund to strengthen banks, a \$5-billion Global Trade Liquidity Programme, and a US\$2.4 billion Infrastructure Crisis Facility;

- US\$1.9 billion in guarantees by the Multilateral Investment Guarantee Agency (**MIGA**), the Bank Group's political risk insurance agency. The majority of the guarantees support continued lending by banks in response to the financial crisis;
- Assistance to countries designed to maintain **long-term infrastructure investments** and sustain potential for private sector-led growth and job creation.
- A tripling of support for **safety net programmes** (school feeding, nutrition, conditional cash transfer, and cash for work).
- A new Global Food Crisis Response Programme, which has approved \$710 million for 21 African countries.

In response to the crisis, and to improve its efficiency and flexibility, the Bank has developed a range of financing innovations to meet pressing development priorities in 2010 and beyond. For example:

- **Climate Investment Funds (CIFs)**. The Bank has raised approximately \$6 billion to support development in areas of forestation, energy efficiency and technology, and has leveraged these funds almost 10-fold;
- **Equity Funds**. In March 2010, the first round of an equity fund of \$500 million is expected to close. The fund was launched with investors from some sovereign funds and a pension fund, through the IFC.

African Development Bank Response

In response to unprecedented requests for financing from its members, on 4 March 2009, and prior to the G20 summit in London, the AfDB adopted four initiatives to assist African countries deal with the global financial crisis. These were:

- An Emergency Liquidity Facility, with a US\$ 1.5 billion budget
- A Trade Finance Initiative: a US\$ 500 million investment in the Global Trade Liquidity Programme (GTLP) as the second phase of its Trade Finance Initiative. The first phase, approved in March 2009 was US\$ 500 million in lines of credit to support trade finance by African banks, bringing the combined ceiling for both phases 1 and 2 to US\$ 1 billion. The initial US\$ 500 million investment by the Bank makes the Global Trade Liquidity Program the single-largest contributor to African trade finance. The Bank's presence helped increase the share of GTLP resources specifically targeted for Africa.
- A Framework for Accelerated Resource Transfer of African Development Fund resources to eligible countries.
- Enhanced policy advisory support.

The Bank more than doubled its portfolio in its regional member countries in 2009, increasing project and programme approvals to US\$12 billion, from US\$5.4 billion in 2008. Recipient countries welcomed the speed and flexibility with which the AfDB made this funding available during the crisis.

From the point of view of developing countries in general, and African countries in particular, the London G20 summit agreement was a step in the right direction. The agreement to: (i) set aside US\$50 billion for low-income countries; (ii) sell IMF gold reserves to provide additional US\$6 billion concessional and flexible finance to the poorest countries; (iii) issue new SDRs and review the flexibility of the DSF applied by the IMF and the World Bank to restrict the capacity

of African countries to borrow); and (iv) protect the poor and vulnerable were all consistent with Africa's demands from the summit and on paper, represent significant wins for Africa. However, the devil is in the details of the implementation of these decisions. Even though there has been a review of the DSF for example, it is yet to be operationalized in specific country contexts to properly assess the difference it has made.

The US\$250 billion allocation of SDRs for example, is to be done according to quotas rather than need. This means that 60% of this issue will be allocated to a few developed economies while Africa as a whole will be allocated 5.4 percent (some 13.5 billion or an average of some \$250 million per country). This is not exactly what Africa called for in the demand for the issue of new SDRs; it implies that the resource flows expected from the new SDR issue has fallen short of what was expected.

Also, the agreement to increase lending to multilateral development banks by US\$100 billion with a commitment to increase this to US\$300 billion over the next three years could be particularly significant for Africa. How much of this will be lent to the African Development Bank and when? It is important for Africa to demand that the G20 follow through on this commitment expeditiously.

Similarly, the agreement to provide \$250 billion in trade finance is potentially significant. However, neither the details of where the money would come from nor the modalities for access have been laid out. It is therefore necessary that Africa holds the G20 to these commitments and demands the detailed framework for delivery.

The G20's reaffirmation of aid commitments is most welcome. However, the Gleneagles commitments are being significantly downgraded in the face of the recession. Responding to the lower GDP figures in developed countries, the OECD has downgraded the annual extra amount rich countries need to provide to meet their commitment, from the original \$50 billion to \$41 billion – a loss of \$9 billion for poor countries (Oxfam, 2009). Nevertheless, the G20's reaffirmation of its aid commitments will provide further means to hold governments to their promises. However, evidence to date shows that many G20 members are way off track, and some, such as Italy, are even cutting their aid budgets.

To what extent did the G20 financial commitments in London meet Africa's financing requirements? Various estimates have been made on the size of the financing gap that Africa faces in meeting its development policy objectives in critical areas such as infrastructure, agriculture health, education, agriculture, and ICT:

In their 2008 report, the MDG Steering Group notes the following financing requirements:

- Overall external public financing for development in Africa needs to rise to \$72 billion per year to support the achievement of the MDGs;
- To achieve a Green Revolution in Africa, the international community needs to increase external financing of agriculture from the current US\$1-2 billion to \$8.0 billion by 2010;
- Approximately \$8.3 billion is required annually to achieve the education MDGs;
- Some US\$25-30 billion annually is required to meet health goals
- Some US\$52.2 billion per year will be required in private and public investment finance to resolve critical infrastructure bottlenecks in Africa (particularly in Energy,

ICT, roads, water and sanitation). Of this amount some US\$23.5 billion will need to be mobilized as external public financing;

- World Bank and IMF (2006) estimate additional requirements of US\$23-28 billion per annum for improvements in infrastructure and human resource development;
- World Bank (2008) Africa Infrastructure Country Diagnostic estimates that, after savings from reducing operating inefficiencies and improving cost recovery, Africa's infrastructure gap is \$13 billion per annum.

The estimated resource requirements would accelerate growth, meet the MDGs, and also enhance the ability of African economies to withstand or quickly recover from external shocks such as the global financial crisis. In this context, while the commitment by the G20 to set aside US\$50 billion of additional resources for low income countries is a significant development, a considerable financing gap still remains.

The G20 stimulus package has resurrected and significantly empowered the International Monetary Fund, through which most of the stimulus funds will be channelled to developing countries in the form of loans. The concern of African countries is that the IMF may continue to impose procyclical conditions on African countries that are currently forced to borrow from it. However, the G20 communiqué states inter alia that:

“It is essential that these resources can be used effectively and flexibly to support growth. We welcome in this respect the progress made by the IMF with its new Flexible Credit Line (FCL) and its reformed lending and conditionality framework which will enable the IMF to ensure that its facilities address effectively the underlying causes of countries' balance of payments financing needs, particularly the withdrawal of external capital flows to the banking and corporate sectors”.

It has however been argued that for African countries, the extent to which the IMF lending and conditionality framework has really been reformed is highly questionable (Woods, 2009). Only a few developing countries (that are already deemed to have sound finances) are eligible for the new flexible credit line, which is to have little or no conditionality.

Adam, Collier and Vines (2010) however argue that the Fund responded to the financial crisis decisively and much more rapidly than expected to the emerging problems in low-income countries. This response was made both through the exogenous shocks facility and the SDR allocation approved by the G20 at the London summit in April 2009. As a result of IMF funding, as well as a degree of 'frontloading' by the World Bank of its highly concessional lending through its International Development Association (IDA) window, many low-income countries were able to avoid the painful real exchange rate adjustment that might otherwise have been required. This, they argue, represents a shift by the Fund away from a presumption that countries in external difficulty must always adjust to this problem, and do so rapidly, to one that sees financing as a possible alternative to short cuts and rapid adjustment, providing such actions are part of a coherent policy response.

Strengthening financial supervision and regulation

Major failures in the financial sector and in financial regulation and supervision were identified as fundamental causes of the global financial crisis of 2007-2009. The G20 set up two working groups on the financial system regulation and financial market issues: enhancing sound regula-

tion and strengthening transparency and reinforcing international co-operation and promoting integrity in financial markets. The G20 leaders, following the recommendations of these working groups, agreed to measures to strengthen the supervision and regulation of the financial system.

These included agreement to:

- Establish a new Financial Stability Board (FSB) with a strengthened and broader mandate to promote financial stability, as a successor to the Financial Stability Forum (FSF), including all G20 countries, FSF members, Spain, and the European Commission;
- Request that the FSB should collaborate with the IMF to provide early warning of macroeconomic and financial risks and the actions needed to address them;
- Reshape their regulatory systems so as to be able to identify and take account of macro-prudential risks;
- Extend regulation and oversight to all systemically important financial institutions, instruments and markets. This will include, for the first time, systemically important hedge funds;
- Endorse and implement the FSF new principles on pay and compensation and support sustainable compensation schemes and the corporate social responsibility of all firms;
- Take action, once recovery is assured, to improve the quality, quantity, and international consistency of capital in the banking system. In future, regulation must prevent excessive leverage and require buffers of resources to be built up in good times;
- Take action against non-cooperative jurisdictions, including tax havens. They declared that the era of banking secrecy is over;
- Call on the accounting standard setters to work urgently with supervisors and regulators to improve standards on valuation and provisioning and achieve a single set of high-quality global accounting standards;
- Extend regulatory oversight and registration to credit rating agencies to ensure they meet the international code of good practice, particularly to prevent unacceptable conflicts of interest;
- Adopt the Basel II Capital Framework by 2011.

The G20 communiqué did not provide the specific details of how these agreements on the financial regulation measures are to be operationalized. The FSB has been asked to work out the details and is already hard at work to implement the Action Plan. This work is taking place under various working groups formed by the FSB. For Africa, the issue of voice and representation in this process is paramount.

Membership of the FSB includes all G20 countries, The European Commission, the European Central Bank, International Financial Institutions and International supervisory and regulatory bodies. The number of seats assigned to member jurisdictions in plenary meetings reflects the size of the economy, financial market activity and national financial stability arrangements (see Annex 1).

The membership list indicates that representation on the FSB is dominated by the industrialized economies. Europe, for, example has representation at plenary meetings by the United Kingdom (3), France (3), Germany (3), Spain (2), Italy (3), Switzerland (2), Russia (3) the European Central Bank (1) and the European Commission (1). Africa on the other hand (with a population

of one billion and GDP in PPP terms equivalent to that of France) is represented only by South Africa (1). The membership of the FSB and representation of the members is a reflection of the marginalization of Africa in the discussion of the reforms of banking supervision and regulation. Africa and Indonesia have equal representation on the FSB for example.

Africa's voice has been marginalized in this process even though African countries tend to bear a disproportionate share of the burden of financial crises. Many African countries are thus compelled to impose on their financial systems, policies and regulations which they have not been part of formulating and which could be at variance with their own economic interests at this stage of their development.

Adoption of the Basel II Capital Framework

All G20 countries have committed to adopt the Basel II Capital Framework by 2011. This will make the Basel II framework the operational one in the supervision and regulation of financial systems across the globe.

Many African central banks have expressed the intention to adopt the Basel II framework in due course. A Financial Stability Institute (FSI) survey in 2006 reported that 12 out of 17 African countries surveyed intended to adopt Basel II.

Claessens et al (2008) point out that as with the other international financial standards, the policy process leading to Basel-II largely excluded inputs from developing countries. Nevertheless, although initially, the accord was formally only applicable to internationally active banks of the industrialized countries, it is likely to become the global norm, thereby affecting the costs of domestic and international financial intermediation. Basel II especially affects the cost of international bank financing for African countries and could reduce their access to external financing. This is because:

- Being institutionally further from the norm, the costs of implementing many of the new standards are high for many African countries;
- The hallmark of Basel I was its simplicity, at the cost of some insensitivity in terms of credit risk. The hallmark of Basel II may be its complexity. Satisfying this complexity raises relative compliance costs more for smaller and less sophisticated banks, erecting barriers to entry and hindering competition. Again, this especially affects banks in African countries that tend to be smaller and less sophisticated, putting them at a competitive disadvantage relative to large banks from developed countries, although the risks are not necessarily higher;
- Under Basel II many African sovereigns would attract a 100 per cent (BB+ to B) or a 150 per cent (below B) capital charge, and under the rules no unrated bank or corporate client could have a charge lower than the weighting of the sovereign in which they were incorporated. For otherwise creditworthy entities within those countries, capital costs are thus set to rise relative to Basle I;
- The differential risk weightings of Basel II compared to Basel I led to a significant increase in capital requirements for loans to lower rated borrowers which tend to be developing country sovereigns or banks and firms in those economies, likely reducing the quantity of lending to these borrowers

- Basel II enhances the procyclicality of lending because it relies on market signals (in the form of both asset prices as well as ratings) than Basel I. If a wide range of banks responds simultaneously and in the same way to perceived risks – as reflected in prices and ratings in the market – downturns and upturns may be reinforced as banks downgrade or upgrade clients on a large scale. For African and other developing countries whose asset prices and ratings are already more volatile than those of developed countries. It could make emerging markets’ external financing more volatile and domestically lead to more severe business cycles.

Basel III

The latest Basel proposals for the banking sector require far more capital to be raised. For many banks, capitalization under Basel II is deemed very weak. Under the proposals – which have been dubbed ‘Basel III’ – banks will have to maintain a so-called core capital ratio of at least 6%.

The Committee’s “Basel III” proposal covers the following key points:

Tier 1 capital base

This proposal raises the quality, consistency and transparency of the capital base. Some of the existing Tier 1 capital will be disqualified under the new rules. The new rules are intended to ensure that the banking system is in a better position to absorb losses on both a going concern and a gone concern basis. In addition to raising the quality of the Tier 1 capital base, the Committee is also harmonising the other elements of the capital structure.

Minimum liquidity standard

This proposal introduces a global minimum liquidity standard for internationally active banks that includes a 30-day liquidity coverage ratio requirement underpinned by a longer-term structural liquidity ratio. The framework also includes a common set of monitoring metrics to assist supervisors in identifying and analysing liquidity risk trends at both the bank and system level. Banks are required to hold significantly more government bonds on their books. The new liquidity coverage ratio aims to ensure adequate liquidity in the event of another market dislocation. It is meant to require a bank to maintain an adequate level of unencumbered, high quality assets that can be converted into cash to meet its liquidity needs for a 30 day time horizon under an acute liquidity stress scenario.

Leverage ratio

This proposal introduces a leverage ratio as a supplementary measure to the Basel II risk-based framework with a view to migrating to a Pillar 1 treatment based on appropriate review and calibration. The leverage ratio will help contain the build-up of excessive leverage in the banking system, and introduce additional safeguards against model risk and measurement error. To ensure comparability, the details of the leverage ratio will be harmonised internationally, fully adjusting for any remaining differences in accounting.

Counterparty credit risk - derivatives, repos and securities

This proposal strengthens the risk coverage of the capital framework. In addition to the trading book and securitisation reforms announced in July 2009, the Committee is proposing to

strengthen the capital requirements for counterparty credit risk exposures arising from derivatives, repos and securities financing activities. The strengthened counterparty capital requirements will also increase incentives to move Over-the-Counter (OTC) derivative exposures to central counterparties and exchanges. The Basel Committee will also promote further convergence in the measurement, management and supervision of operational risk.

Countercyclical Capital Buffers

This proposal introduces a series of measures to promote the build-up of capital buffers in good times that can be drawn upon in periods of stress. A countercyclical capital framework will contribute to a more stable banking system, which will help dampen, instead of amplify, economic and financial shocks. In addition, the Basel Committee is promoting more forward-looking provisioning based on expected losses, which captures actual losses more transparently and is also less pro-cyclical than the current “incurred loss” provisioning model.

It is important that Africa’s voice be heard as the modalities for implementing the Basel II and Basel II capital frameworks and other prudential regulations are finalized and implemented. Otherwise, the world risks being divided into a two-tier financial jurisdiction with countries whose financial systems meet the FSB regulations in one tier and those which do not (the majority of African countries are likely to fall into this category) in another. This could have an adverse effect on capital flows and investments through the banking system on Africa.

African countries, like all other countries, need high-quality regulatory environments, not only to avoid financial crises but also for financial development. That said, one should be cautious about the emergence of a one-size fits-all approach from the FSB deliberations that ignores the peculiarities of the risks financial systems in low income countries and could therefore stifle their development.

At this relatively early stage, it is important that Africa’s representation on the FSB should be reviewed. At the very least, the Association of African Central Banks (AACB) or some other representation for central banks in Africa should also be part of the process. However, African countries need to be clear on their objectives. A first question is to identify the bodies that are likely to be most influential in shaping the global financial architecture. The FSB will be the forum that develops the regulatory structure of a reformed financial system, and makes recommendations about international harmonization of regulatory standards. Also of key importance will be the various committees established under the umbrella of the BIS, which will also participate in the FSB. These include, in particular, the Basel Committee on Banking Supervision, the Committee on the Global Financial System, and the Committee on Payment and Settlement Systems.

Crockett (2009) notes that it is not a question of voting power, since there is no voting structure in the committees. Rather, influence depends on the perceived value of the intellectual contribution to the discussion. It will therefore be important for African countries to be represented by respected technical experts, with the latitude to participate in discussions.

A second step is to develop a strategy for achieving more “clout” in these bodies. A third is to work out what it is African countries want, in a substantive sense, in the model of international financial relations.

It is also noteworthy that while the FSB has moved with lightening speed to address the issue of regulation and supervision of the international financial system, the issue of the access to financial services by the poor and SMEs which is very dear to African countries has been relegated to the background with a promise to launch a G-20 Financial Inclusion Experts Group to identify lessons learned on innovative approaches to providing financial services to the poor. For African countries, the issue of capital flight and illicit financial flows is as important as that of tax havens to the developed countries, which should make greater effort to address the problem. .

Reform of the international financial institutions

The original role of the IMF at its founding was to monitor the fixed exchange rate system. After the collapse of the Bretton Woods System, the main tasks of the IMF turned to surveillance, lending, and technical assistance. The World Bank has also changed its focus since 1944 and added the International Development Association (IDA) concessional loan window, the International Finance Corporation, its private sector arm, and MIGA, a loan guarantee facility against political risk. They have moved into adjustment lending to preserve the environment, lending for education, health and so on. Nevertheless, the financial crises of the 1990s saw increasing demand, especially on the part of the emerging economies and developing countries, for reforms of the IFIs, particularly in the area of governance, voice, representation and conditionality.

IMF/World Bank governance reforms refer to changes in quotas and voting rights, and executive board representation and the management selection process. The current distribution of quotas and the relative voice of members within the IMF and World Bank raised questions about its legitimacy among its shareholders and other stakeholders. IMF/World Bank governance reforms are deemed by emerging and developing countries as necessary to restore their legitimacy, to afford them the authority and credibility needed to carry out their mission.

Most significantly, the distribution of votes and voice in the IMF and World Bank has not kept up with changes in the global political economy. For example, Belgium has more votes in the IMF than Brazil; and sub-Saharan African countries, which actually use the services of the World Bank, currently have two representatives on its Board, while Western Europe has eight.

Furthermore, developing countries complain (as was the case during the Asian crisis) that the conditions attached to IMF and World Bank funding are too onerous. For example, the IMF has historically required member States facing financial crisis to cut public expenditures, unlike the strategy currently adopted by the US and Europe.

The G20 leaders at the London Summit also agreed to a number of governance reforms at the International Monetary Fund and the World Bank to “reflect changes in the world economy and the new challenges of globalisation, and the fact that emerging and developing economies, including the poorest, must have greater voice and representation”.

An agreement to treble basic votes

This tripling of basic votes — the first such increases since the Fund’s establishment in 1944 - will enhance the voice and participation of low-income countries. Until early 2008, each IMF member had 250 “basic votes” plus one vote for each SDR 100,000 of its assigned quota. The effect of an increase in basic votes is increased voting power of those members, whose voting power

is below the average for Fund membership as a whole, thereby allowing the smallest members to have an increased measure of influence in the Fund's decision-making process. Successive general increases in quotas had reduced the share of basic votes to 2 percent from 11 percent, when the Fund was established. This has led to a weakening of the voice of African countries within the Fund. The trebling of the basic votes increases the number of basic votes of each member to 750.

A new quota formula of ad hoc quota increases, based on the new formula

G20 leaders also agreed to shift the IMF quota share by at least 5 percent from under-represented countries to over-represented countries. African leaders have also demanded representation on the Board of the World Bank as well. A third chair is to be added to SSA. There would be an increase of 3 percent voting power for developing and transition countries, in addition to an earlier 1.46 percent increase under the first phase of the adjustment. These reforms are necessary to reflect a changing world and to ensure that developing countries such as those in SSA have greater voice and representation.

An agreement that each of the two Executive Directors representing African members can appoint one additional Alternate Executive Director

Furthermore, the large number of countries represented by the two African chairs and the heavy workload that flows from the Fund's engagement in these countries called for further steps to strengthen the operations of these offices. Consequently, the Executive Board also recommended that each of the two African Executive Directors representing African constituencies should be allowed to appoint an additional Alternate Executive Director.

It is however difficult to see how the appointment of two Alternate Directors can change anything in terms of voice and representation for African countries. Rather, African countries should argue for the introduction of a requirement of a majority of countries and a majority of voting power to pass some measures (as is required for amendments to the Articles). This would create an incentive for the small number of rich and powerful members to consult with and persuade the large number of vote-poor members. The Directorate General for External Policies of the European Parliament (2009) has argued that without such a measure, it is unclear that the new African Alternate Directors included in the package of reforms will have much scope for effectiveness.

The G20 also agreed that:

- Consideration should be given to greater involvement of the Fund's Governors in providing strategic direction to the IMF and increasing its accountability;
- The heads and senior leadership of the international financial institutions should be appointed through an open, transparent, and merit-based selection process.

The agreements reached by the G20 on the reform of the IFIs represent a long overdue first step in the right direction even though the reforms fall far short of what is needed. However, priority should be given to the ratification of the April 2008 measures, since it is a first step towards improving the distribution of quota and voting shares. It is imperative that African countries quickly reach agreement as to which country/countries will take the newly created positions at the IMF and the World Bank. Africa should continue to argue for Increased voice and representation (additional Chairs) on the IMF and World Bank Boards and for the introduction of a requirement that a majority of countries as well as a majority of voting power is required to pass

some measures (as is required for amendments to the Articles) so as to create an incentive for the small number of rich and powerful members to consult with and persuade the large number of vote-poor members.

Resisting protectionism and promoting global trade and investment

On world trade, the G20 leaders noted that reinvigorating world trade and investment is essential for restoring global growth and vowed not to repeat the historic mistakes of protectionism of previous eras. To this end, they agreed to:

- Reaffirm the commitment to refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing inconsistent World Trade Organisation (WTO) measures to stimulate exports
- Minimize any negative impact on trade and investment of our domestic policy actions including fiscal policy and action in support of the financial sector, and avoid measures that constrain worldwide capital flows, especially to developing countries
- Ensure availability of at least \$250 billion over the next two years to support trade finance through our export credit and investment agencies and through the MDBs
- Remain committed to reaching an ambitious and balanced conclusion to the Doha Development Round

The commitment by the G20 to avoid protectionism has so far had little impact as 17 of twenty G20 members have introduced protectionist measures since the 2008 G20 meeting in Washington (Oxfam, 2009).

The EU announced new export subsidies on butter, cheese, and milk powder. Less obviously, both China and India have increased the rebate on the duty drawback system for exporters, and, although the subsidy component is a matter for discussion, the timing of these measures raises questions. Subsidies proposed for the auto industry have proliferated and total some \$48 billion worldwide, mostly in high-income countries (\$42.7 billion). In addition to the US direct subsidy of \$17.4 billion to its three national companies, Argentina, Brazil, Canada, China, France, Germany, Italy and the UK, , , , have also provided direct or indirect subsidies – not including Australia’s support to its car dealers and South Korea’s and Portugal’s support to their component suppliers (Oxfam, 2009).

The significant new money (at least \$250 billion) for trade finance is welcome – the collapse in trade finance and “letters of credit” has played a critical part in the slump in world trade. This was also the main mechanism of transmission of the global financial crisis to African countries. However, there are no details as to the breakdown of the headline figure between G20 export credit agencies and the multilateral development banks, or the extent to which it will really benefit African countries.

While the G20 has committed to concluding the Doha Round, it is not clear how such a conclusion will benefit Africa. Multiple memberships of different groups within WTO and cross-country alliances illustrate the fact that no clear “African view” exists on what the best achievable Doha outcome should look like (Meyn, 2008). The African Group at WTO covers 41 countries. African countries are further represented in the African, Caribbean and Pacific (ACP) group,

mirroring their special trade relationship with the EU, and the G-90 Group, which combines the African and the Least Developed Countries (LDC) Group. Reflecting their special interests and development status, various subsets of the African Group are also members of the Commodities Group, the Cotton-4 Group, the Developing Country Grouping, the G-20, which fights for improved agricultural market access, G-33 (“friends of special products”, which pursues mainly defensive agricultural interests), Non-Agricultural Market Access (NAMA), which fights for tariff cut commitments for developing countries’ non-agricultural products, and the LDC Group itself.

African LDCs that are exempt from tariff concessions at WTO do not have the same interests as emerging African economies, such as Egypt or South Africa. In addition, conflicting objectives among different stakeholders in African countries make it even more difficult to achieve a compromise that satisfies all parties.

Most African countries are uncompetitive suppliers of agricultural products on the world market (Stevens et al., 2007; Meyn, 2007). To make international exports worthwhile, it is argued that they require a protected market and a price level above world market. The EU is therefore the main export destination for African agricultural exports, combining preferential access to a high-priced market with high protection rates against third party developing countries. Reducing the price or protection level towards other countries would have immediate negative consequences for African and Caribbean exporters by reducing the export prices they would receive, and exposing them to increased competition. For many African countries therefore, the issue is one of increased market access to enable them to expand their exports. This can be accomplished by inter alia, relaxing rules of origin requirements, lowering non-tariff barriers, and aid for trade.

While no single African view exists on what pro-developmental outcome is desired at WTO, it seems that African countries need to decide on their main priorities so that they can push through their main interests. It is important to reconcile their opposition to the stance taken by developed countries by forging strong links with other allies in the developing world. WTO negotiations are all about bargaining and having a set of clear and united objectives.

An inclusive and balanced agreement must contain progress on the reduction of agricultural subsidies in developed countries, an expansion of market access for goods from Africa, a new financial commitment towards aid-for-trade. The Doha round must allow sufficient policy space for SSA to undertake trade policies that support growth and development.

Alternative world reserve currency

While the dollar as the world’s reserve currency may have problems, it is not clear that are credible alternatives to replace it at this point in time amongst the major currencies like the yen, euro or renmimbi. A couple of alternatives have been proposed:

The issuing of SDRs as the world’s reserve currency

China has proposed a new issuance of SDRs and the expansion of the SDR basket to include the currencies of all the major economies weighted in terms of GDP. The basket should be backed by real assets such as a reserve pool that would allow subscription and redemption by investors as desired. As D’Arista and Erturk (2010) have pointed out however, among the major limita-

tions is the fact that the SDR is not liquid; it cannot be openly traded for national currencies and buying or selling SDRs for national currencies requires the consent of the countries issuing those currencies. Thus, SDR reserves cannot be used to counter a run on a country's currency or buy needed imports in the event of an economic downturn or natural disaster. Proposals to increase liquidity include establishing a settlement system between the SDR and other currencies and encouraging countries to peg to and invoice in SDRs, and encouraging, promoting and/or subsidizing private sector use of the SDR.

A multicurrency reserve system

Nugee (2010) proposes the development of a multicurrency reserve system that is appropriate for a world of regional trading blocs – Europe, Asia, the Americas – alongside a still pre-eminent dollar. While increasing the number of currencies used to acquire international reserve assets would add diversity and stability, it will require deep and liquid financial markets for added currencies, their wide use in private sector transactions and the willingness of the issuing countries to allow investments in national financial assets on a scale necessary to accommodate the demand for reserves.

China seems to favour this shift. However, it has to be gradual so as to avoid undermining the value of existing dollar reserves. Others oppose shifting to a multicurrency system, arguing that, in addition to increasing exchange rate volatility, international reserves denominated in any national currency couples reserve accumulation to the deficit position of a reserve currency country and is therefore inherently unsustainable (Greenwald and Stiglitz 2008; Ocampo 2009).

Taxing financial transactions or institutions

Tobin tax

The idea to tax cross-border financial transactions was presented by the late James Tobin, a Nobel-prize winner in economics, as far back as the early 1970s [Tobin (1974)]. The Tobin tax may serve two purposes, namely to discourage short-term financial transactions and generate tax revenues that may be used for financing global public goods. However, the more the tax succeeds in reducing short-term capital flows, the less revenues would be raised. The fund-raising function of the Tobin tax would also suffer if donor countries regarded tax revenues as a substitute for traditional sources of development aid. The allocative function of the Tobin tax may be compromised by administrative problems and tax evasion. However, these arguments do not provide sufficient reason to dismiss the idea. No tax whatsoever could be levied if all loopholes had to be known and closed in advance. Moreover, tax evasion remains unlikely unless the tax burden exceeds the costs of evasion. A more important counter-argument is that the suggested Tobin tax rates of up to one percent of financial transactions would not have prevented any of the major financial crises in recent years. For instance, the currency attacks on Asian currencies in the late 1990s offered short-term capital gains of around 50 percent. Consequently, the Tobin tax would not have made much of a difference. The Tobin tax may even increase the probability of crises if policymakers stick to inconsistent economic policies in the erroneous belief that they are effectively protected against speculation and currency attacks (Nunemkamp, 2009).

IMF financial stability and financial activity taxes

Following the direction from the G20, the IMF (2010) has proposed two taxes a “financial stability contribution”, a flat rate levy on all financial institutions (including hedge funds by private equity firms, and mutual fund houses) , and a “financial activities tax”, levied on their profits and remuneration. The total sum raised could be equivalent to 2-4 per cent of each country’s gross domestic product, or 20 per cent of the financial sector’s pre-tax profits. The taxes are designed to help pay for future financial clean-ups and reduce systemic risk by shrinking the size of the financial sector. A recent (June 2010) meeting of the G20 finance ministers in South Korea has ruled out a global tax on financial institutions or transactions, leaving countries to pursue their own policies in this regard.

Global Glass-Steagall

Eichengreen (2009) argues that the Global Credit Crisis resulted from deregulation that permitted banks to branch into new lines of risky business and that ratcheted up competitive pressure, which induced gambling to survive. That deregulation and intensification of competition occurred both at the national level, as with the elimination of Regulation Q (interest rate ceilings) and Glass-Steagall restrictions in the United States, and internationally, as capital controls were removed, restrictions on the activities of foreign banks relaxed and cross-border bank activity expanded.

One conceivable response would be to re-impose Glass-Steagall-like restrictions, dividing the banking and financial system into two components. In one component (what we used to call commercial banking) liabilities would be limited to retail deposits, while assets would be limited to low-risk instruments: cash, short-term treasuries, commercial paper, adequately-collateralized small business loans, and conforming mortgages. The other component of the system would be allowed to invest in riskier assets. Investment banks would provide loans to sub-investment-grade borrowers and take companies public. In a financially integrated world such reforms will be feasible only if coordinated internationally. Either through being incorporated into the Basle Committee’s Core Principles for Effective Banking Supervision or make them an obligation of IMF members.

A Pan-African Financial Architecture for Africa

As the discussion over the design of the new international financial architecture proceeds, it is a sad fact that Africa ultimately has little control over what will eventually emerge. It is for this reason, and to complement efforts at the global level that Africa should also begin the process of putting in place a regional financial architecture that can help African countries better deal with financial crises in future as the East Asians have done following the 1997-1998 Asian financial crisis. In the aftermath of the Asian financial crisis, the ASEAN countries together with China, Japan and South Korea (ASEAN + 3) began the process towards an Asian regional financial architecture as they were convinced that they could not rely on the IMF in times of crisis. IMF critics argued that the IMF initially interpreted the crisis incorrectly, it forced countries to adopt macroeconomic and structural policies that did not support confidence and recovery, it was rigidly ideological in its analysis of hedge funds and initial dismissal of the possibility of destabilizing speculation in financial markets, and it was not able to garner the support of the United States and Europe in dealing with the crisis at critical stages in 1997 and 1998.

There was a profound sense in much of East Asia that international financial policymaking and cooperation can only proceed on the global level. It must be complemented by strong, well-designed regional financial arrangements. These financial arrangements encompass strengthened policy dialogue, financial cooperation and perhaps common currency arrangements in East Asia (Kawai, 2009).

The onset of the global financial crisis in Africa has seen a quick response from African policy makers and institutions. The African Development Bank has provided much needed funds to many countries and has in the process assumed the position of the largest lender to Africa, ahead of the World Bank.

Furthermore, coordination and assessment of policies is taking place at the level of the Committee of African Finance Ministers and Governors of Central Banks, with intellectual leadership provided by the Economic Commission for Africa, the African Development Bank and the African Union Commission. A common African position was for example, presented at the G20 meetings.

Moving from the short to the medium term it is important that African countries individually and collectively implement the following (Murinde, 2009):

- Aggressively regulate and supervise financial systems to ensure that banks manage risks prudently, to ensure accountability, transparency and responsibility in banking operations. The African regional networks should aim at improving the existing regulatory and supervisory approaches in order to refine and strengthen further liquidity and capital adequacy regulations, thereby adjusting them to new products and developments in the financial system in Africa
- Undertake financial reforms to improve bank competitiveness as well as enhance mechanisms for crisis prevention, management and resolution at the regional or continental level

- Erect an incentive structure for sound corporate finance to avoid high leverage ratios and excessive reliance on foreign borrowing
- Develop and formalize the role of microfinance institutions and rural financial markets, as part of the new financial architecture in African economies. This is because these institutions are capable of offering more outreach than commercial banks and capital markets. This requires developing legal as well as technological frameworks for the financial transactions in these institutions and markets.

Establishment of the Pan-African financial institutions

The Constitutive Act of the African Union (signed in Lome in 2000) approved the establishment of three pan-African financial institutions; the African Central Bank (ACB), the African Monetary Fund (AMF), and the African Investment Bank (AIB) to be hosted by the Federal Republic of Nigeria, the Republic of Cameroon, and the Libyan Arab Jamahiriya, respectively. These three institutions were considered by the Heads of State and Government of the AU as critical building blocks of a pan-African financial architecture to underpin Africa's economic development.

The African Monetary Fund

The African Union Commission (AUC, 2009) has argued that under there is an urgent need for greater co-operation among African central banks in the conduct of monetary policy. This means, in part, pooling their international reserves to create an institution, the purposes of which will be to: (1) correct imbalances in the balances of payments of the regional economic communities (RECs) of the African Union with the rest of the world; (2) contribute to the removal of restrictions on current payments between member States; (3) settle current payments between member States in order to promote intra-African trade; and (4) coordinate the position of member States on international monetary issues.

To achieve these objectives, AMF will provide short-term and medium-term loans to member States (or to the RECs) for the financing of their overall balance of payments deficits with countries outside Africa, resulting from trade in goods and services, transfers and capital movements. The AMF will also issue guarantees in order to strengthen the borrowing capabilities of member States or the RECs from other financial sources for the purpose of financing the overall deficits in their balances of payments (AUC, 2009).

The African Investment Bank

According to the Agreement establishing the Bank, its purpose is to foster economic integration and balanced development of the member countries in line with the broad objectives of the African Union medium-term strategic plan. The functions of the Bank (in accordance with sound banking principles) include:

- Finance public and private sector physical assets intended to advance regional economic integration of member countries
- Assist in the modernization of the rural sector in low-income countries
- Strengthen private sector activities and the modernization of the rural sector in low-income member countries

The Bank would also provide technical assistance to member countries, as may be needed, for the study, preparation and implementation of investment projects.

The African Central Bank

The AU also decided on the establishment of a common African central Bank to be hosted by Nigeria. Prior to this decision however, work towards the African central bank was ongoing under the African Monetary Cooperation Programme (ACMP). The African Monetary Cooperation Programme (AMCP) involved the adoption of collective policy measures to achieve a harmonized monetary system and common management institution. It envisaged the harmonization of the monetary cooperation programmes of the various sub-regional groupings as building blocks with the ultimate aim of evolving into a single monetary zone by the year 2021, with a common currency and a common Central Bank at the continental level. The AU, however, decided to quicken the pace of progress towards the establishment of the African Central Bank (ACB) and has therefore brought down the ACB time-line from 2021 to 2018, under the ACMP.

While these Pan-African institutions are important, they would not by themselves be a panacea to Africa's development issues and participation in the international monetary system. The fundamental issues have to do with pursuing sound economic policies and obtaining sufficient resources for the necessary investment in infrastructure and human capital. To what extent can a regional financial architecture promote these objectives?

The recent experience of Greece, with the financial markets is a reminder that African countries should avoid the temptation to run persistent fiscal deficits along with loose monetary policy (inflation tax) while attempting to borrow externally (on commercial or concessional terms) to finance the deficit. It will be soon obvious that the government is engaged in a ponzi game and therefore not sustainable. To the extent that the Pan-African institutions are able to enforce this discipline, there would be macroeconomic stability. Ultimately, African countries must place themselves in an economic and financial position to benefit from the emerging international financial architecture.

To spur growth however, there should be major investments in infrastructure, human capital, agriculture, ICT, etc. At the continental level, this requires the mobilization of significant resources that have thus far not been provided by the international monetary system.

Regional resource mobilization as part of the pan-African financial architecture

For Africa to be able to withstand external shocks like the global financial crises, she must build a strong, dynamic and resilient regional economy. Consequently, policies should be put in place to ensure macroeconomic stability. This implies that all economic fundamentals must not only be robust but also move in the right direction. Fiscal and monetary policy must be coordinated in a manner that will ensure sustainable growth, employment and development. However, macroeconomic stability by itself is not enough.

The continent has serious infrastructural challenges; except for a few countries, all SSA economies have inadequate hard and soft infrastructure. The current global crisis provides another chance for quality expenditure switch in favor of infrastructural development. Africa needs good roads, railways, power, water and sanitation, ICT etc. It should also address the wide gap in terms of human capacity development. Investment in these areas would yield positive results. The quantum of the resources required can be provided externally or internally and through the public and private sectors. Realistically a mixture of both is required.

While external flows (aid, debt relief, FDI and portfolio flows) have an important role to play in closing Africa's resource gap, they are insufficient and cannot also be relied on as the current financial crisis has demonstrated. Rather, Africa should focus on generating additional resources internally to undertake the type of development that will better position African countries to weather future financial crisis. This is by no means a new insight. In fact, the Monterrey Conference on Financing for Development held in 2002 recognized the critical importance of domestic financial resources for development. The AU/ECA Conference of Ministers meeting in Cairo in June 2009 also focused on this issue. The reasons are straightforward (Gayi, 2008):

- Both ODA and FDIs are highly volatile; four times more than domestic revenues for example;
- Domestic resource mobilization would improve countries' fiscal positions;
- Increased reliance on domestic resources would also reduce the probability of accumulating unsustainable external debts;
- With no conditionality associated with domestic resource mobilization, African countries can regain the policy space to pursue their development priorities; The reality of the international development game is that one who pays the piper calls the tune.

The fact remains however that domestic savings in sub-Saharan Africa (projected by the IMF to decline from 24.5 percent of GDP in 2008 to 17.6 percent of GDP in 2009) are the lowest in any region. This compares with 41 percent of GDP savings rate for East Asia and the Pacific. Furthermore, volatility of income sources (primary commodities) in Africa also means higher volatility of savings, and therefore less predictability of investment. Almost all the recorded savings in Africa are in the form of private savings. Public savings are estimated to average 2 percent of GDP over the last decade (Brownbridge, 2007).

One of the major constraints facing many African countries is the small size of their economies (excluding for example Egypt, Nigeria and South Africa). For this reason, it is thought that the potential for generating resources domestically is limited, hence the focus on external sources. The potential for mobilizing funds on a regional level in Africa to finance its development has largely been ignored. This potential is however enormous. The total GDP of all 52 African countries (in PPP terms) in 2008 is just below that of France, making Africa the 8th largest economy in the world if viewed in aggregate.

In the search for additional financial resources to fill the gap, it is time for African countries to recognize that together, and with greater effort, significant amounts of resources can be generated on the continent from both the private and public sectors. Africans must ultimately bear the burden of financing their own development, no matter how painful it may be, and it will not be painless. Africa cannot expect that the burden for its development should be borne by others.

A Region-wide tax

African countries can impose on themselves a tax that will generate sufficient resources into a fund that can be used to finance various critical development initiatives whether in infrastructure, agriculture, ICT or education. These funds can be leveraged to secure private sector participation in relevant initiatives or projects.

A tax on petroleum consumption is one such tax. Africa consumes about 3,000,000 barrels of fuel a day (2007 levels). Five cents per litre tax will yield some \$9 billion per annum (Bawumia, 2010). A guaranteed additional \$9 billion of domestic resources annually, appropriately deployed, can conceivably have a transformational impact in areas such as regional infrastructure investment on the continent. Such a carbon tax is also consistent with contributing positively to the efforts to reduce green house gases and the associated global warming. Africa will also have enhanced credibility at G20 meetings if it is also seen to be putting something additional on the table.

A tax on petroleum consumption has the advantage of being one of the easiest ways of obtaining revenue, and the consumption of fuels as a group is relatively price inelastic and income elastic. The revenue yield is predictable. The burden of the tax is also equally shared across the continent and as a carbon-tax, it is also environmentally friendly. It will also enhance the fiscal/debt sustainability as well as the external payments outlook for the region as a whole.

While petroleum taxes are politically sensitive, it is actually not the case that petroleum products are overtaxed in Africa compared with other regions of the world. The average tax as a share of final prices for premium unleaded in OECD countries in 2009 was 69% while the estimate for Africa is much lower. The tax component of the final price in Ghana averages some 20.4% while that of South Africa is 27.9% and Nigeria is zero (Adenukinju, 2008) . While petroleum taxes are politically difficult to implement, an Africa-wide tax is more likely to be accepted if its uses are specific and explained properly.

With funds from this tax, Africa will also be able to negotiate on a more equal footing with countries like the India and China who are increasingly seeking a foothold on the continent. The management and administration of such a fund can be given to either to a new institution or an existing institution such as the African Development Bank. Details of access to the fund and what initiatives or projects are financed can be worked out in consultation with member countries.

Mobilizing resources from the Diaspora: Diasporan bonds and remittances

A regional/global approach to domestic resource mobilization would also require African countries to pay attention to mobilizing resources through “diasporan bonds” and remittances. “Diasporan bonds” are so named because they are bonds issued with the target market being a country’s citizens in the Diaspora. India and Israel have successfully raised significant amounts of resources (\$11 billion and \$25 billion respectively) through such bonds. About 16 million citizens of SSA are estimated to be living in the Diaspora with 5 million in high-income coun-

tries (Ratha et al, 2008), who estimate that \$5-\$10 billion can be raised annually by tapping into the wealth of this African Diaspora.

Remittance flows have become very important in Africa. Sub-Saharan Africa received almost \$12 billion in remittances in 2007, and the actual amount could be double this if informal flows are taken into account. In small countries such as Lesotho, remittances represent up to a quarter of GDP. (Ratha et al, 2008) have argued that the greatest impediment to increasing the flow of remittances is the cost of remittances to Africa compared to other regions of the world - as high as 25 percent of the amount remitted. Governments should encourage the flow of remittances through formal banking channels as well as reduce the cost of remittances. These mutually reinforcing measures, it is argued, would significantly increase the level of remittance flows which can be leveraged to improve access to the capital markets.

Mobilizing resources from the unbanked

Domestic savings in Africa are mostly held in the form of non-financial assets and therefore outside the formal banking systems. With an estimated 80% of household assets in rural areas held in non financial assets, a significant amount of domestic resources are not available for intermediation. For many SSA African countries (excluding South Africa), only about 20% of the bankable public have access to a bank account. Financial transactions are dominated by cash payments, with some 90 percent of issued currency held by the non-bank public, with one-third of broad money (M2) being held in the form of currency.

To improve domestic resource mobilization, there are the usual recommendations to improve the efficiency of tax collections, through reform of the public financial management system, automation of tax administration, stemming capital flight etc. However, at the heart of the problem of tax collection is the highly informal nature of many economies underpinned and supported by the predominance of cash transactions in an environment of financial exclusion. Unfortunately, many countries have not made the link between financial exclusion on the one hand, and the difficulty of collecting taxes, on the other.

One of the quickest ways to formalizing the economy and therefore to increasing the tax net is to bank the unbanked. This calls for a reform of the payment system in the context of branchless banking models that places the unbanked at the centre rather than at the periphery. This calls for a reform of the payment system in the context of branchless banking models that places the unbanked at the centre rather than at the periphery. For this to be effective, the payment system platform must allow both online and offline electronic payment transactions. The traditional focus on online electronic payments by banks automatically restricts participation and enables the dominance of cash payments.

For Africa, these electronic payment systems should be designed in collaboration with the private sector to work in the rural environment. South Africa, Kenya and Ghana have taken the lead in this direction with smartcard and mobile banking solutions. If undertaken on a comprehensive scale, financial resources locked up in non-financial assets would be brought into the banking system for intermediation and this could be a significant source of resources (representing potentially three to five times what is being currently intermediated in the financial system). Furthermore, to the extent that electronic payment transactions dominate, government can easily collect and assess taxes and therefore enhance domestic resource mobilization.

Conclusion and Recommendations

The foundation of the existing international financial architecture can be found in the Bretton Woods Conference of 1944 where the major world powers gathered under the auspices of the United Nations to put together an architecture for the international monetary and financial system. The IMF and the World Bank were established under a regime of fixed exchange rates, with the U.S. dollar (linked to gold) as the reserve currency. This Bretton Woods System however collapsed as U.S. deficits increased with the Vietnam War and other countries lost confidence in the ability of the U.S. to convert dollars into gold. The Bretton Woods System, as established, was unable to deal with the issue of global imbalances as the burden of adjustment was placed on deficit countries. After the collapse of Bretton Woods, the world entered into a floating exchange rate regime with reform of the international financial architecture driven by the exigencies of the day, usually after a financial crisis. The Mexican crisis (1995) and the Asian Crisis (1997-1998) heightened the calls for reform.

The 2007-2009 global financial crisis has brought about renewed calls for a reform of the existing international financial architecture. This paper has undertaken an analysis of the emerging international financial architecture from the perspective of its implications for Africa.

The emerging international financial architecture following the G20 summits held in London and Pittsburg in 2009 has been criticized on a number of grounds, including the theoretical underpinning of the underlying development model, the lack of voice and representation of the developing countries in the shaping of the emerging architecture, inadequate representation of developing and African countries in the governance of the international financial institutions, exchange rate regime, the role of the dollar as a reserve currency, and the absence of an agreed framework to deal with global imbalances.

The key issues that have to be addressed by the emerging international financial architecture include (i) global imbalances and reserve accumulation, (ii) the role of the US dollar as a reserve currency, (iii) the exchange rate regime, (iv) regulation of the financial system and (v) governance of the international financial institutions

As the debate reform of the international financial architecture has proceeded, it is clear that Africa as a region does not have a comprehensive view or approach to the type of international financial architecture that should emerge.

It has therefore been argued that there should be a more inclusive international financial architecture that takes into account the needs and aspirations of developing countries in general, and African countries in particular.

The various proposals for the reform of the international financial architecture can be classified in two main categories: (i) radical reform i.e., a new architecture, and (ii) incremental reform of the existing financial architecture.

Recommendations on an African position for the international financial architecture

For Africa, the choice between gradualist reform and radical reform must be a pragmatic choice between short and long-term objectives. While the radical reformers such as the Stiglitz Commission have very sound arguments, the practical and political reality is that there is little support among the major economic and political powers for such radical reforms. The process of incremental reform has begun, and while the ultimate goal may be more for example, the architecture set out by the Stiglitz Commission), it is important that in the short term, Africa injects itself into the incremental reform process as quickly as possible.

Short-term recommendations

In the immediate term, African countries should push for the full implementation of all the commitments to Africa at the 2009 G20 Summits and other fora. These include:

Increased resources from the international financial institutions

- Follow through on the speedy implementation of the commitment to increase lending to multilateral development banks by \$100 billion with a commitment to increase this to \$300 billion over the next three years
- Speedy implementation of the IMF decision to review the restrictive Debt Sustainability Framework of the IMF and World Bank and continuing efforts to increase its flexibility
- Clarification on the modalities of access to the \$50 billion set aside for low-income countries at the London Summit
- Implementation of reaffirmation of aid commitments. G20 need to be held to their promises
- G20 should urge and support the IMF to ensure that African countries continue to have increased and flexible access, with relaxed conditions to IMF facilities, to support their economies during the exit from the crisis
- IMF and World Bank should submit specific reports to the IMFC and Development Committee at the Spring and Annual Meetings on how flexibly they have made these funds available to low-income countries.

Strengthening financial supervision and regulation

- The policy process leading to Basel-II and Basel III has largely excluded inputs from developing countries. It is therefore important that Africa's voice be heard, as the modalities for implementing the Basel II and Basel III capital frameworks and other prudential regulations are finalized and implemented;
- At this relatively early stage, it is important that Africa's representation on the Financial Stability Board be reviewed. At the very least, the Association of African Central Banks (AACB) or some other representation for central banks in Africa should also be part of the process;
- Influence at institutions like the FSB depends on the perceived value of the intellectual contribution to the discussion. It will be important for African countries to be represented by respected technical experts, with the latitude to participate in discussions;

- The issue of access to financial services by the poor and SMEs should be placed at the top of the agenda. African countries should have voice and participation in the soon to be launched G-20 Financial Inclusion Experts Group.

Reform of international financial institutions

- Africa should continue to argue for increased voice and representation (additional chairs) on the IMF and World Bank Boards, while ensuring effective representation;
- Africa should also argue for the introduction of a requirement for a majority of countries and a majority of voting power to pass some measures (as for amendments to the Articles) so as to create an incentive for the small number of rich and powerful members to consult with and persuade the large number of vote-poor members;
- There is therefore a need for speedy follow-through by the IFIs and their member governments on the decisions adopted in 2008 and additional measures reached at the summits to reform the IMF and the World Bank.

Resisting protectionism and promoting global trade and investment

- The significant new money (at least \$250 billion) for trade finance is welcome and Africa should press for a clarification of the sources of funds and the speedy implementation of the decision;
- For many African countries, the issue is one of increased market access to enable them to expand their exports. This can be accomplished by measures such as continuing the demands for a relaxation of rules of origin requirements, lowering non-tariff barriers and aid for trade. There should also be capacity building and strengthening to meet requirements;
- African countries need to decide on their main priorities in the WTO negotiations so that they can push through their main interests;
- African countries should continue to argue for developed countries to open up their markets for trade and live up to their promise to make the Doha Round the “Development Round”.

The issuing of SDRs as the world’s reserve currency

Following the \$250 billion issue of SDRs by the IMF, Africa should support the continued issue of new SDRs as an alternative world reserve currency. However, new SDR issues should be aligned with support for development, giving larger allocations to those with the highest demand for reserves. Furthermore, new SDR allocations should be countercyclical and allocations to developed countries without need for additional reserves could be treated as resources that can be loaned to countries in need.

Pan-African financial architecture

To complement efforts at the global level that African countries should quicken the process of putting in place a regional financial architecture that can help them better deal with financial crises in future as the East Asians have done following the 1997-1998 Asian Financial Crisis.

African countries should inter alia:

- Aggressively regulate and supervise financial systems to ensure prudential risk management, accountability, transparency and responsibility in banking operations. The African regional networks should improve the existing regulatory and supervisory approaches in order to refine and strengthen further liquidity and capital adequacy regulations, thereby adjusting them to new products and developments in the financial system in Africa;
- Undertake financial reforms to improve bank competitiveness as well as to enhance mechanisms for crisis prevention, management and resolution at the regional or continental level;
- Erect an incentive structure for sound corporate finance to avoid high leverage ratios and excessive reliance on foreign borrowing;
- Develop and formalize the role of microfinance institutions and rural financial markets, as part of the new financial architecture in African economies. This is because these institutions are capable of offering more outreach than commercial banks and capital markets. This requires developing legal as well as technological frameworks for the financial transactions in these institutions and markets.

Furthermore, the Pan-African financial institutions that have been established by the AU (the African Monetary Fund, African Investment Bank and the African Central Bank) should be operationalized as soon as possible through the ratification of the various agreements and the contribution of the required capital by member States.

While these Pan-African financial institutions are important, they would not by themselves be a panacea to Africa's development issues and participation in the international monetary system. They cannot be an excuse to avoiding difficult economic choices. These institutions should serve to reinforce macroeconomic stability, which will ultimately remain the responsibility of individual countries.

Resource mobilization as part of a regional financial architecture

Africa should increasingly focus on domestic and regional mobilization of resources to complement external sources. The implementation of a carbon tax on petroleum consumption of for example, five cents per litre Africa-wide will yield some \$9 billion per annum into a fund that can be used to finance infrastructure investment and the same time contribute to the fight against global warming. Other alternatives include banking the unbanked and issuing diasporan bonds.

Ultimately, African countries must place themselves in an economic and financial position to benefit from the emerging international financial architecture. The recent experience of Greece, with the financial markets is a reminder that African countries should avoid the temptation to run persistent fiscal deficits along with loose monetary policy (inflation tax) while attempting to borrow externally (on commercial or concessional terms) to finance the deficit. It will be soon obvious that the government is engaged in a ponzi game and therefore not sustainable. To the extent that the Pan-African institutions are able to enforce this discipline, there would be macroeconomic stability.

Longer-term recommendations

In the longer term, African countries should align themselves with some of the key recommendations of the Stiglitz Commission for a more fundamental and inclusive reform of the international financial architecture. This would include:

A new global reserve system

The “Triffin dilemma” was one of the problems underlying the Bretton Woods System as confidence eroded in the dollar as an international reserve currency, with increased U.S. deficits needed to increase global liquidity. More recently, the problem of global imbalances has also highlighted the weaknesses of the international reserve system. The current reserve system could be eliminated by creating a supranational international reserve currency as Keynes suggested. Responsibility for managing the global reserve system could be given to the IMF, which currently issues the only global currency, SDRs, on which the system could be built.

A global reserve currency

The new multilateral reserve system should have its own reserve currency based on the SDR. This is the only way to overcome the inequities and instability inherent in a global reserve system based on a national currency, that is, the dollar. The global reserve currency could be allocated to countries on the basis of some formula (“quota”) based on their weight in the world economy (GDP) or their needs (demand for reserves). Since developing countries hold reserves which are, in proportion to their GDP, several times those of industrial countries (26.4% of GDP in 2007 vs. 4.8% for high-income OECD countries), to manage the trade and capital account volatility they face, a formula that would allocate the currency according to some definition of demand for reserves would result in larger proportional allocations to these countries. The allocation can and should have built into it incentives and/or penalties to discourage maintaining large surpluses. Countries that maintain excessive surpluses could lose all or part of their quota allocations if they are not utilized in a timely manner to increase global demand.

Coordination of global macro-economic policies:

Given the specific institutional purposes of the IMF, the World Bank, and other international institutions, there is need for better coordination and political accountability and for a forum for consensus building to broaden and guide their policy agendas. A Global Economic Coordination Council (GECC), at a level equivalent to the United Nations General Assembly and the Security Council that addresses areas of concern in the functioning of the global economic system in a comprehensive and sustainable way must be created. The GECC would meet annually at the summit level, to assess and coordinate development policies and provide leadership in socio-economic and environmental fields.

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Annex

List of Members of the Financial Stability Board

Country/Institution	List of Members
Argentina	Central Bank of Argentina
Australia	Department of Treasury Reserve Bank of Australia
Brazil	Ministry of Finance Central Bank of Brazil Securities and Exchange Commission
Canada	Department of Finance Bank of Canada Office of the Superintendent of Financial Institutions
China	Ministry of Finance Peoples Bank of China China Banking Regulatory Commission
France	Ministry of Economy, Industry and Employment Bank of France Autorite des Marches Financiers (AMF)
Germany	Ministry of Finance Deutsche Bundesbank Bundesanstalt für Finanzdienstleistungsaufsicht (Bafin)
Hong Kong	Hong Kong Monetary Authority
India	Ministry of Finance Reserve Bank of India Securities and Exchange Board of India
Indonesia	Bank of Indonesia
Italy	Ministry of the Economy and Finance Bank of Italy Financial Services Agency
Japan	Ministry of Finance Bank of Japan Financial Services Commission
Korea	Bank of Korea Financial Services Commission
Mexico	Ministry of Finance and Public Credit Bank of Mexico
Netherlands	Ministry of Finance Netherlands Bank
Russia	Ministry of Finance Central bank of the Russian Federation Federal Financial Markets Service
Saudi Arabia	Saudi Arabian Monetary Agency
South Africa	Ministry of Finance
Spain	Ministry of Economy and Finance Bank of Spain

Country/Institution	List of Members
Switzerland	Swiss Federal Department of Finance Swiss National Bank
Turkey	Central Bank of the Republic of Turkey
United Kingdom	HM Treasury Bank of England Financial Services Authority
United States	Department of the Treasury Board of Governors of the Federal Reserve Securities and Exchange Commission
European Central Bank	
European Commission	
International Financial Institutions	Bank for International Settlements International Monetary Fund Organisation for Economic Cooperation and Development (OECD)
International Standard Setting and Regulatory Bodies	Basel Committee on Banking Supervision Committee on Payment and Settlement Systems Committee on Global Financial System International Accounting Standards Board International Association of Insurance Supervisors International Organization of Securities Commissions

Source: Financial Stability Board (2009)

Common ASEAN Position on Reforming the International Financial Architecture

(Adopted at the Special ASEAN Finance Ministers' Meeting in Manila on 30 April 1999)

- 1) The global effort to resolve the current crisis must recognize the diverse circumstances and priorities of individual economies at different stages of development. Any proposed solution must therefore be sufficiently flexible to accommodate these differences.
- 2) In view of the global nature of today's financial markets, the reform of the international financial architecture must involve the participation of all countries, including the emerging economies.
- 3) ASEAN shall adopt a more proactive role at various international and regional fora to ensure that its interests and priorities are given due consideration in any proposal reform the international financial architecture.
- 4) While the purpose of any international reform is to enhance efficiency and stability in financial markets and to promote global economic activity, such efforts must not lose sight of the overriding objective of improving living standards. Due priority must, therefore, be accorded to measures to protect the poor and most vulnerable segments of society.
- 5) Measures to strengthen the international financial architecture would need to include a review of the roles of the international financial institutions (IFIs), as well as the international regulatory bodies, in order to enhance their capacity and capability to contain and resolve crises.
- 6) Appropriate mechanisms are needed to enhance greater private sector participation in crisis management and resolution.
- 7) Standards of transparency and disclosure must be applied equally to the public and private sectors. In particular, large market participants, such as highly leveraged institutions which have systemic significance, should be subject to regular and timely transparency and disclosure requirements.
- 8) The dissemination of necessary information will help investors to make better decisions and not rely solely on the information of rating agencies. Given the important role that credit rating agencies play in the international financial markets, there should be greater transparency in the rating process.
- 9) There must be closer and more coordinated monitoring of short-term capital flows. In particular, there should be global agreement on the disclosure requirements for such flows and closer collaboration and information sharing among national and international regulators.
- 10) To complement the ASEAN Surveillance Process, ASEAN shall explore options to strengthen regional support activities.
- 11) An orderly and well-sequenced approach to capital account liberalization in tandem with the degree of development of the domestic financial sector and supervisory regime should be supported.
- 12) Sound, consistent and credible macroeconomic policies are fundamental to the sustainability of any exchange rate regime. There is no single exchange rate regime that is suitable for all countries and that countries have a right to choose their own exchange rate regime based on their national objectives and priorities.

