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Workshop "Towards a sustainable finance"

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The aim of this note is to examine some basic issues related to the functioning of the international monetary and financial systems. Also, it puts forward some few proposals related to these systems. Issues and proposals are dealt with from the viewpoint of the South. More specifically, one takes the perspective of a developing country with a deep and wide insertion in the world financial system and a high degree of dependency on the performance of the international monetary system. Besides, the underlying approach of the analysis is the international political economy.

This note is divided into three sections. The first one (Regulatory System) examines some operational issues such as transparency, standards and surveillance, as well as financial regulation and supervision. A key policy issue for developing countries – capital and exchange controls -- is also discussed in this section. The second section (International Money) presents analyses and proposals related to the three basic functions of the international monetary system, that is, international liquidity, exchange rate stability and balance-of-payments adjustment. The last section (Development Finance) focus on central issues like the external debt of developing countries, development lending and institutional changes at the international level.

1. Regulatory system

1.1. Transparency, standards and surveillance

There is a consensus regarding the development of standards for improving the quality of information on international capital flows, the balance sheet of firms, banks and financial institutions, and macroeconomic variables of the countries. On the other hand, there is a fear that the greater public disclosure of information may increase further the instability of the international financial system.

Regardless of this perception, greater transparency of banks, financial institutions, multilateral organisations (IMF and IBRD) and countries (central banks accounts, government budgets, external accounts, loans contracts, clauses of securities, performance indicators, etc) should be a basic guideline for the international financial and monetary systems. Governments should giver high priority to the works of the standard-setting bodies regarding accounting, auditing, bankruptcy, corporate governance, payment and settlements systems and market regulations.

The idea that the IMF and other institutions should have privileged access to “confidential” information on the situation of a country (for instance, level of international reserves) should be rejected for, at least, two reasons. First, there is no guarantee that the information given to, say the IMF or the BIS (Bank for International Settlements), is not transmitted to other governments and financial institutions. Second, it is unthinkable that a national government (a minister of Finance or a governor of Central Bank) may give privileged information to non-residents (even a multilateral organisation) at the expense of citizens (including the Congress) of the country in question. Thus, all documents delivered by national governments to the Board of the IMF or other institutions should be immediately available to citizens of the country.

1.2. Financial regulation and supervision

The Basle Capital Accord has standards that are not sufficient to capture the credit risks associated with financial globalisation. Also, there is a strong feeling that private rating agencies are not efficient regarding the evaluation of country-specific risks and firm-specific risk. There are highly-leveraged financial institutions (for instance, hedge funds), as well as the off-shore centres (fiscal heavens), that are outside the capital requirements of the Basle Accord.
As a result, there is an urgent need to develop new mechanisms for further regulation of the international operations of banks and to extend and develop stronger regulations to funds. Besides, the World Social Forum, which took place in Porto Alegre, Brazil, by the end of January 2001, has reached a basic consensus with respect to the proposal to make illegal the off-shore centres.

1.3. Capital and exchange controls
One of the fundamental problems of the international economy is that liberalisation of the capital account is a basic guideline of the IMF and a component of foreign policy of developed country governments. However, the problems caused by financial globalisation require a standstill and a rollback of the present process of financial liberalisation. Greater restrictions on international capital inflows and outflows would tend to reduce the volatility of the international financial system. Even though developed countries will loose the profits and rents related to international financial operations, the reduction of the instability and volatility of the international economy will bring about benefits on a world scale.
As far as developing countries are concerned, besides capital controls, exchange restrictions should be applied to limit the conversion between domestic currency and foreign currencies. Here, it is not only stricter controls on the capital account the balance of payments (foreign direct investment, portfolio investments and loans). It is also necessary greater restrictions on the factor-services account (remittance of profits and payment of interests) and on the trade account (for instance, imports of superfluous goods and services, payments for technology). In developing countries, marked by great external vulnerability and a high social cost of foreign currency, capital controls and foreign restrictions should be related to both outflows and inflows.

2. International money

2.1.International liquidity

More than half of the transactions in the world trading system and in the global security markets are denominated in North-American dollars. As a matter of fact, the most important financial asset of the world is the U.S. Treasury bond, whereas the most important monetary asset is the U.S. dollar. In this regard, international liquidity is, to large extent, determined by the deficit of the U.S. balance of payments, which has reached record levels in the last few years. Of course, the size of the domestic capital markets and the strength of the firms in the United States are powerful determinants of the monetary hegemony of this country. The U.S. economy has huge benefits derived from the privilege to issue the currency mostly acceptable in the world. As result, there is an asymmetry in the world economy.
To prevent this asymmetry the alternative is a truly global monetary institution, with the power to issue money and create credit. This global monetary authority would behave in way to control the level of international liquidity. Nevertheless, the creation of this kind of institution is much closer to the Kant's dream of a "perpetual peace" than to reality. In this regard, a proposal would be the U.S. government to share with other countries the benefit derived from seigneuriage. Inflation in the North-American economy implies a loss of purchasing power of the U.S. currency in the hands of non-residents. As a result, the U.S. Treasury could contribute to a global fund (International Development Fund) on the basis of this seigneuriage. This fund could be used for development finance in the South.

2.2. Balance-of-payments adjustment

The creation of mechanisms to finance countries with temporary balance-of-payments difficulties is seen as a function of the international monetary system. More specifically, the IMF has played the role of lender of last resort. There are two basic problems related to this function of the IMF: the system of negative conditionality and the creation of moral hazard. Basically, the IMF has failed because its conditionality system creates more problems than it solves. After all is said and done, the historical experience shows that IMF-supported programs tend to put developing countries in a path of instability and crises. By and large, crises transcend the economic dimension and cause social unrest and bring about political and institutional ruptures in developing countries.

With respect to the creation of moral hazard, the basic point is that the bailout mechanism provided by the IMF, in the form of credit facilities, tends to be an incentive to governments to behave in an irresponsible way. In developing countries, the promotion of deregulation and liberalisation, required by the IMF, tends to involve degrees of openness which are not compatible with the real economy. In this regard, if it is not possible to eliminate the liberalisation requirements of the IMF and control the behaviour of governments, it seems that financing facilities at the IMF are a problem, not a solution. In this regard, the idea is not to strengthen the IMF, but to weaken or, better, to abolish its role as a lender of last resort.

The proposal to create a tax on international capital flows may also contribute to reduce the volatility of the international monetary system and the instability of the world financial system. Regardless of the operational problems, this tax requires to make illegal the off-shore centres. Also, this tax may provide funding for development projects in the South.

2.3. Exchange rate stability

After the rupture of the Bretton Woods system in 1971 exchange rates became more volatile. Major reserve currencies remain highly unstable and exchange rates depend on the moods market as well as the intervention of the key players of system (U.S., Europe and Japan). This combination of market forces (usually, under speculative attacks) and discretionary mechanisms (via the G-3) shows that the IMF has no word to say regarding this key aspect of the international monetary system. IMF lost the function of stabilising the exchange rate system.

With respect to developing countries, the basic guideline should be to avoid the trap put forward in the recent past regarding the choice of exchange rte regimes. The conventional wisdom is oriented to recommend fixed exchange rate regimes (for instance, currency boards) or flexible exchange rates. The managed floating regime does provide a greater degree of manoeuvre for developing countries. Of foremost importance is to keep control of key policy variables such as exchange rate, capital flows, money base and interest rates. Only a system of managed floating allows developing countries this flexibility. External vulnerability tends to increase with both fixed exchange rates and purely flexible exchange rates. Developing countries should reject the new conventional wisdom regarding exchange rate regimes.

3. Development finance

3.1. Foreign-currency debt

External debt is a major constraint for development in the South. It implies a stock disequilibrium, which involves the outflow of huge resources. Besides, it increases external vulnerability insofar as developing countries have to orient all main economic policies to solve the balance-of-payments problems created by the service of external debt. This debt is an unbearable burden on many developing countries and a critical uncertainty for most of them. Mechanisms for debt relief and debt work-out have to be created or developed further. This is a key priority for developing countries. Developed countries governments should be persuaded to carry out bilateral and multilateral debt reduction.

At the same time, the National Plebiscite on the External Debt in Brazil, which involved more than 6 million people, has clearly showed the need to raise social consciousness regarding the issue. A world campaign has to be carried out to put definitively the external debt of developing countries in the political agenda of international institutions and developed-country governments. The international Jubilee South campaign has to have a world-wide support: Life before debt!

3.2. Development lending

Developing countries have to become less vulnerable with respect to the international monetary and financial systems. Besides the reversal of financial liberalisation, these countries have to promote strategies aimed at rooting capital locally. In this regard, there should be the creation of local credit unions, cooperatives and other mechanisms.

As regards international financial institutions, development finance should not involve conditionality, except those related to the economic and financial feasibility of the projects. Another set of criteria should be the environmental and social impact of the projects. Structural adjustment lending, related to the promotion of liberal reforms, should be abolished from the work programs of the international institutions.

3.3 Institutional changes

The IMF and the World Bank are powerful instruments of foreign policy of developed countries, mostly, the United States. In this regard, these institutions create more problems for developing countries than they are supposed to solve. Even in the developed countries there is an increasing perception that these instruments are quite inefficient. The immediate consequence is to abolish the IMF and the World Bank.

The capital of both institutions could be used to the creation of an International Development Fund oriented to finance social, economic and environmental projects in developing countries. Governments, from developed and developing countries alike, should not participate in the decision-making process of this Fund. The Board of this Fund should be composed by representatives of the international civil society chosen by a voting and democratic process on a world scale.