International Finance and Developing Countries in a Year of Crisis

1997 Discussions at the United Nations

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FOREWORD

Dear Reader:

It gives me great pleasure to introduce this volume featuring a number of presentations made to the Second Committee of the General Assembly in the fall of 1997 on global financial issues.

Powerful transnational forces are reshaping world society. Globalization and liberalization have become key features of the world markets in goods, services, technology, labour and, most particularly, capital. This new situation has deepened the interdependence of all nations. It has unquestionably enhanced opportunities for international cooperation and development. At the same time, as the recent events in world financial markets make plain, it carries with it new challenges. The vulnerability of a large number of countries—mostly developing countries—has been heightened. Many of them face the real risk of being excluded from the globalization process and being further marginalized. In brief, globalization and liberalization may also lead to further inequality and poverty within and among countries.

Against this background, the immediate purpose of international cooperation for development is to spread the benefits of globalization to the fullest extent possible while minimizing and controlling its possible adverse consequences. In a longer term perspective, and as reflected in the outcome of the global conferences held in recent years under United Nations auspices, the goal of the international community, through its concerted efforts, is to foster sustained economic growth, social development and justice and environmental protection in a holistic, integrated and comprehensive manner.

In this process and by virtue of its global membership, mandate and impartiality, the United Nations and, most particularly, the Second Committee of the General Assembly have a privileged role in fostering a constructive dialogue and genuine partnership among all countries conducive to the creation of consensual norms and standards as well as internationally agreed policies and goals. There are significant areas of agreement among the actors involved over global financial issues. But some questions remain politically controversial. Others are highly contentious. In brief, the search for a durable consensus is likely to be a lengthy and delicate one. The stakes of this grand debate, however, are high as its implications are global in scope and significance. For this reason alone, it would need to be nurtured and sustained by a vigorous process of intellectual policy reflection and policy analysis. But also, an informed understanding of the complexity and ramifications of current processes of financial integration is essential for those involved in formulating and implementing public policy.

A key *raison d'être* of the United Nations University is to act as a bridge between actors and observers, between scholars and practitioners, between the worlds of knowledge and policy making. It was in this spirit that the University contributed to the planning of the presentations and panel discussions featured in this book, which it is also publishing. The data and information contained in the papers included in this volume together with their concrete and practical recommendations should be of immediate interest to practitioners and scholars as well. It is my hope that these studies will promote the deliberative process now unfolding among scholars and practitioners both within and outside the United Nations.

Hans van Ginkel
Rector
The United Nations University

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PREFACE

This volume represents a successful collaboration about a very important issue and I am happy to see it brought to fruition and in such a timely fashion. It also reflects well on the reforms that the General Assembly introduced in 1996 and that have been carried forward in the Assembly's 1997 session. The reforms provided an opportunity for the Assembly to be better informed about views held outside the halls of the United Nations and, in this case, provided a mechanism to consider a breaking issue, the deepening and spreading currency and financial crises in the "emerging markets". As Ambassador Oscar de Rojas explains in his contribution, the Assembly responded to the gravity of the situation with resolutions that, *inter alia*, have set in motion an intergovernmental process that can make an important contribution to improving the operation of the international financial system for development.

This book was prepared in the Department of Economic and Social Affairs, but it is the product of cooperation between the delegations of the Member States of the United Nations to the General Assembly, the staff of the Department and United Nations University (UNU). Under the leadership of Ambassador de Rojas, as Chairman of the Second Committee of the Fifty-second Session of the Assembly, along with his bureau in the Committee, a programme of lectures, briefings and panels was organized by the Secretariat with the support of United Nations University. We very much appreciate the effort of UNU to become more closely involved in the intergovernmental processes of the United Nations and to publish this book.

The contributors to this volume have all given generously of their time and effort. We offer their views to the international community for reflection and as an input to the intergovernmental process of analysis and dialogue on the crisis in the financing of development.

Nitin Desai
Under-Secretary-General
for Economic and Social Affairs

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We would like to thank several people who provided assistance in the preparation of this book. Our appreciation goes to Ian Kinniburgh, Director of the Development Policy Analysis Division of the Department of Economic and Social Affairs, who was central to organising the panel of experts. We also wish to thank Henk-Jan Brinkman, Leo Buencamino, Simon Cunningham, Judith Goss, Sam Jan, Hiroshi Kawamura, Ramachandra Kurup, Valerian Monteiro and Ann Orr (all of whom work at the Department of Economic and Social Affairs of the United Nations Secretariat) for their assistance in the production of this book. In addition, we are grateful to United Nations University, and in particular Jacques Fomerand, for agreeing to publish the book in a very short time. The views advanced in this book belong to us and the other contributors. In addition, we, the editors, take full responsibility for any errors.

Barry Herman and
Krishnan Sharma

New York, February 1998

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INTRODUCTION

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In 1996, the General Assembly adopted a new mode of operation for considering economic and social questions so that experts and officials from outside the United Nations could contribute directly to its deliberations. As the Assembly was to take up aspects of the financing of development in the 1997 session, the Department of Economic and Social Affairs of the Secretariat, working with the Chairman of the Second Committee of the Assembly and supported by the United Nations University, arranged some lectures and a panel on this subject. Meanwhile, the international financial and currency crisis that burst on the scene in Asia in July 1997 continued to fester, deepen and spread. As of early January 1998, as this is written, it was unclear how it would finally be resolved. This volume examines the international financial crisis, reviews the results of the Assembly's deliberations on the financing of development in 1997 and makes available to a wider audience the perceptions and analyses of the external experts who contributed to the General Assembly's work.

1 The views expressed herein are those of the authors and not necessarily the views of the United Nations.

Given the situation in Asia, the Assembly discussions on international financial matters were intense and the inputs from the external speakers were particularly opportune. One result was that the Assembly agreed by consensus to set in motion an intergovernmental preparatory process for a "systematic, comprehensive and integrated high-level international intergovernmental consideration on financing for development" (General Assembly resolution 52/179, paragraph 1).[2] This represents an agreement to discuss how developing countries interface with the international financial system, as well as other dimensions of finance for development. It suggests a recognition that the changing nature of international financial markets warrants a high-level review of finance for development in a political forum.

This result, coupled with the Assembly's assessment of "global financial flows and their impact on the developing countries" (resolution 52/180), emerged from the new process of formal and informal discussion. While the Assembly does not generally hold hearings, it increasingly arranges to hear and question experts through the new mechanism of holding panels and lectures during informal meetings of the main Assembly Committees for economic and social matters.[3] In the autumn of 1997, programmes of informal sessions were arranged in the light of the items of the Assembly's agenda that were allocated to the two Committees.[4]

One item allocated to the Second Committee was "Macroeconomic policy questions: financing of development, including net transfer of resources between developing and developed countries" (Agenda item

2 The text of this and other resolutions referred to in this book may be found in annex B, below.

3 These are the Second Committee (Economic and Financial Questions) and the Third Committee (Social, Humanitarian and Cultural Questions).

4 Besides the presentations included in this book, other panels discussed poverty eradication, international migration and new challenges for the international trading system. Invited speakers addressed a range of issues including the Initiative for the Heavily Indebted Poor Countries (HIPC), financing international development cooperation, the role of public policy in a globalizing environment, children and development, human rights and development, and implementation of the Agenda for Development.

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95(a) of the Fifty-second Session of the General Assembly). In addition to the traditional "formal debate", in which Governments stated their views under the agenda item, based in part on the documentation prepared by the Secretariat, the Managing Director of IMF, Mr. Michel Camdessus, addressed the Committee in informal session on 31 October 1997. The Committee also invited Professor Gerald K. Helleiner of the University of Toronto, who coordinates the research project of the United Nations Conference on Trade and Development to assist the Intergovernmental Group of 24 on International Monetary Affairs. Professor Helleiner addressed the Second Committee on 15 October 1997. Finally, the Second Committee hosted a panel on "Financial and Development Issues in Emerging Markets" on 4 November 1997. The panel was chaired by Mr. Rafeeuddin Ahmed, Associate Administrator of the United Nations Development Programme, and heard presentations by Mr. Ariel Buira, Member of the Board of Governors of the Banco de México; Professor Linda Lim of the University of Michigan Business School; and Mr. Arjun Sengupta, Member of the Indian Planning Commission.

* * * * *

This book, which grew out of these presentations, begins with the editors' analysis of the international financial crisis in some of the "emerging-market" economies in Asia. The crisis is seen in the context of the surging private flows to a group of the developing countries in the 1990s and stagnating official flows, and its implications for policy-makers are assessed. The chapter finds that, after the pressures built up that eventually forced the devaluation of the Thai baht, a crisis of confidence of varying intensity spread to other emerging-market countries. Two kinds of contagion are identified, one based on similarities with the domestic situation in Thailand (which provoked its crisis) and the other on international factors that other countries might have had in common with Thailand. Policy prescriptions for all countries hit by the crisis are seen to be quite similar, based on a model of what is needed to restore the confidence of financial investors. Questions are also raised about policies that might reduce the vulnerability of countries to future crises and in particular about the sequencing and timing of steps to liberalize international capital flows in developing countries. A further issue is the future role of the IMF as its credibility with international financial markets as well as with national policymakers is seen to be a function of how quickly the affected countries are able to recover.

The chapter by Ambassador Oscar de Rojas emphasizes the opportunity that the United Nations now has to make a major contribution to international policy for development. In addition to the newly agreed intergovernmental process that was noted above, Ambassador de Rojas describes other important initiatives, including the initiation of a high-level dialogue between the intergovernmental committees of the Bretton Woods institutions and the Economic and Social Council of the United Nations. The first dialogue is expected to take place in April 1998, following the spring meetings in Washington, D.C. He also reviews the state of international consensus, as reflected in the 1997 General Assembly resolutions, on international financial volatility, the external debt problems still faced by some—especially the lowest-income—developing countries, and the recent reductions in official development assistance flows. Indeed, the intensified international consideration of financing for development in the United Nations reflects a measure of dissatisfaction with the current situation in each of these problem areas. Ambassador de Rojas couches his concern for the urgency of the issues on the agenda in terms of a call for justice, "for the duty of those who have more means towards those who have less" and for "authentic human solidarity, without which it is impossible to construct either development or peace".

The Managing Director of IMF, Mr. Michel Camdessus, discusses lessons arising from developments in Asia for both national policymakers and the international community. He argues that policymakers in individual countries need to have a "more acute and far-reaching" idea of national responsibility. He mentions three important aspects of this responsibility. First is a responsibility to neighbours and partners, which would lead countries to ensure that their policy fundamentals are sound in order to reduce the risk of sparking a crisis which then spreads to other economies. Second, Governments need to get their policy priorities right; for example, in Asia, priority should be given to improving current account positions and strengthening financial sectors rather than boosting growth at unsustainable rates. Third, according to Mr. Camdessus, countries need to be responsible in their dealings with private capital flows by passing sound and transparent policies that gain the confidence of financial markets and enable them to allocate resources efficiently. These efforts by individual countries will need to be supported by their neighbours, by advanced economies and by multilateral institutions like the IMF. One method would be for countries in a region to complement IMF surveillance by voluntarily undertaking mutual surveillance with their neighbours. Another method of support would be for the international community to assist, through foreign aid and other measures, the poorest countries that are struggling to attract foreign investment even though some of them have made significant progress on economic reform. Finally, multilateral institutions like the IMF, which can help countries to cope with the risks of globalization as well as to take advantage of its opportunities, need to be suitably strengthened.

Mr. Ariel Buira analyses various issues raised by capital flows to emerging markets. While recognizing the benefits accruing from these flows, he stresses the need for Governments and the international community to be able to manage their volatility. In Mexico, for example, the December 1994 devaluation triggered what Mr. Buira called "a run on the country". Part of the problem lies with policies that accommodate the build up of a pool of potentially "hot money". Measures, such as imposing a limit on foreign-currency denominated deposits that domestic commercial banks can accept, may discourage "hot money". At the international level, he sees new challenges posed by global financial integration and calls for international financial institutions to act as overseers and, in some cases, as regulators of international capital flows. Mr. Buira also argues that the risks arising from the volatility of capital fall largely on recipient countries and need to be shared by investors. For instance, national authorities, together with the IMF, could ensure that creditors also accrue some losses by, for example, imposing certain limitations on capital withdrawals out of a country. Another important requirement is for massive financial support to be provided to countries facing speculative attacks *before* they fall prey to a crisis rather than after the event. Such support should be available to countries with good fundamentals and sound policies; in other cases, financial support would be provided together with an agreement to adopt economic policies that improve a country's fundamentals.

Professor Linda Lim addresses the role of foreign capital, and especially of capital-market liberalization, in economic development, focusing on the experience of south-east Asia. She argues that capital-market liberalization is beneficial in the long run to economic growth in developing countries but needs to be "accompanied by proper institutional and skill development and underlying political, administrative and private sector capacity to manage both liberalization and growth". Professor Lim argues that foreign capital alone is not to blame for the currency crisis that has enveloped the region. Economic and political fundamentals led to the fall in the Thai currency and she expresses surprise that lenders and equity investors did not withdraw their money from the country sooner. She points out that other south-east Asian currencies exhibited weak fundamentals, albeit to a lesser extent. However, while these factors may have warranted an exchange rate depreciation, Professor Lim is also surprised by the magnitude of the decline. The policy implications of these developments, in her view, entail sound macroeconomic management accompanied by sufficient regulation, supervision and disclosure of information by the financial sector. In addition, private financial and industrial companies need to improve credit evaluation and management expertise. Financial markets also need better information which would enable them to allocate resources more efficiently.

Mr. Arjun Sengupta focuses on what developing country Governments can do to attract external financial resources and absorb them most effectively, especially in the light of the Asian financial crisis. Thus, he reviews the essential macroeconomic and institutional elements of an enabling environment for efficient use of external resources, while he also comments on how private sector involvement can be mobilized in a traditionally public sector domain, namely infrastructure investment. He delves into the 1997 Thai crisis to understand better the interaction between structural issues in trade and production, on the one hand, and financial sector fragility, on the other hand. In the realm of international cooperation, he recalls a proposal of developing country Governments to establish a substantial, new, compensatory financing facility at IMF, in order to help fight speculative attacks on eligible country currencies. He also sees opportunities for leveraging official development assistance with private external finance, a technique that might help bring additional financial resources to low-income countries that are largely by-passed by most forms of private flows.

In the final chapter, Professor Gerald Helleiner calls for an intergovernmental conference on finance and development. He argues that the current system of global economic governance does not adequately represent developing economies. This needs to be changed since the increasing integration of these countries into the global economy not only raises risks to them but also to the world economic system. Professor Helleiner states that the principal global monetary institutions are dominated by the developed economies and he advocates that the governance of the World Bank and the IMF should be reconstituted to reflect their global membership more accurately. But since, according to him, these institutions show so little sign of making the necessary changes in the near future and given the urgent need for a stronger multilateral framework under which international finance can operate, the Second Committee needs to examine ways in which such events could be moved forward.

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