



Ministerial Conference on the Financial Crisis

BRIEFING NOTE 2

The Current Financial Crisis and the International Financial Architecture

**Ramada Plaza Hotel, Tunis, Tunisia
November 12, 2008**

I. Introduction

The growing integration of the world economy has increased the vulnerability of countries to external shocks and provided ample evidence that multilateral and coordinated actions are needed. Financial markets are global in scope; however the current crisis has demonstrated that supervision and regulation at national and international levels have not kept up with the pace of financial innovation. Nor do the underlying governance structures in the International Financial institutions reflect adequately the changing economic weights in the global economy. There is now intensive discussion about reform. The G20 will meet in Washington on 15 November, and are expected to focus primarily on restoring financial stability, unlocking credit markets and restoring confidence in the international system. From an African perspective this is a first necessary step, but international discussions must be broadened to include the longer term issues of growth and development. This paper provides a brief overview as context for discussion by Ministers and Governors.

II. The Global Picture

Firstly, earlier crises, such as in Mexico (1994-95) and East Asia (1997-98) as well as the current one have brought to light weaknesses in existing supervisory and regulatory framework and in the way banking and financial markets operate. Secondly, while there has been an increase in the role of developing countries in world production and trade, these countries are still underrepresented in decision making organs of international institutions set-up to regulate the functioning of the international financial system. Thirdly, the growing current account imbalances in some developed countries and the fear that such imbalances are not sustainable, are also a motivation for reform. So far, attempts to correct these imbalances through coordinated actions have not been very successful and so there are calls for new mechanisms to deal with these issues and reduce the potential impact on the world economy.

In the words of the British Prime Minister Gordon Brown, a new international architecture, or Bretton Woods II, is required to capture '*the new realities -- open not sheltered economies, international not national capital markets, global not local competition*' (October 13, 2008). One of the issues that have to be addressed in the new international architecture is the need to pay more attention to crisis prevention. Good surveillance creates an incentive for the adoption of policies and practices that are conducive to financial and real stability. It especially helps countries avoid accumulating unsustainable private and public debt during boom periods, thus reducing the likelihood of turbulences in international currency and financial markets.

In that regard, the role played by the International Financial Institutions (IFIs) and the Financial Stability Forum are crucial. Their work should be guided by a number of core principles:

- (i) Strengthen transparency (enforcement of internationally agreed accounting standards, and credit insurance market standards);
- (ii) Enhance sound regulation, prudential oversight and risk management;
- (iii) Promote integrity in financial markets and encourage sound banking practices (protecting against speculative bubbles);
- (iv) strengthen cross-border supervision and crisis management;
- (v) improve early warning systems; and
- (vi) reinforce international cooperation.

They need to reflect better current economic weights but also take fully into account the interests of the poorer countries which, whilst not systemically important, are nonetheless impacted by global developments. There have been some recent improvements, for example, recent reforms of the International Monetary Fund (IMF) have led to quota increases, the tripling of basic votes, and the decision to add a second alternate director for constituencies of 19 members or more. Similar reforms are underway at the World Bank. While these reforms are welcome many argue that further changes are needed.

Current events have shown the need also to have appropriate instruments. When a systemic financial crisis occurs, rapid response is needed to avoid a complete collapse of the system. Even countries with sound macroeconomic fundamentals, as it is in some emerging markets, are no longer immune from the negative spillover effects of financial crisis. In that regard, the IMF's creation on October 29, 2008 of a new Short-Term Liquidity Facility (SLF) which channels funds quickly to emerging markets is welcome.¹ The Exogenous Shocks Facility for low-income countries is also a welcome addition. The IMF will also strengthen its short-term preventive response capacity with its Contingent Credit Lines, which is a precautionary line of defense readily available to countries with strong economic policies designed to prevent future balance of payments problems that might arise from international financial contagion.

The reforms should provide an opportunity for African countries to increase their voice. It is also critical for African countries engage in the key policy debates in the IFIs but also in forums that set-up and negotiate accounting and corporate governance standards, such as the Basel Committee. This would ensure that regulations and banking requirements would take into consideration Africa's specificities.

¹ See IMF <http://www.imf.org/external/pubs/ft/survey/so/2008/POL102908A.htm> Accessed on November 1, 2008.

The ultimate objective of reforms is to enhance the efficiency of global and regional financial markets in lowering transaction costs, improving liquidity and facilitating financial intermediation and these objectives are central to the development of African countries.

III. A Pan-African and Country Response

A global solution is not one unless it is inclusive. This crisis has shown that contagion affects all. Therefore, Africa wants its voice to be heard and its concerns addressed. However, it is not practical for all African countries to participate in all forums. For this, the pan-African institutions, the African Development Bank, African Union Commission, and Economic Commission for Africa are well positioned to play this role in line with their pan-African mandate. This role would complement activities performed both by Regional Economic Communities and national governments.

In addition, the financial crisis has also demonstrated the critical role of effective regulations for the stability of the financial sector. In particular, enforcement of rules of transparency is essential to allow authorities to minimize the exposure of the banking sector to systemic risk. The transnational nature of some financial institutions and the increasing interdependence of markets also call for cross-border regulation of financial markets.

V. Conclusion

The G20 meeting on November 15th must be seen as a beginning of a process that is all inclusive. It is imperative that the African position is taken into account. At the international level, we need standards that (1) provide adequate regulation, (2) do not stifle financial development and innovation, and (3) that can adapt to country-specific circumstances. The views of Ministers and Governors will be brought to the attention of the participants to the G20 meeting in Washington on November 15, 2008.

Suggested issues for discussion

1. Do Ministers and Governors agree on the core principles outlined in this note?
2. What actions should be taken at national and regional level?
3. How can the emerging financial architecture take fully into account Africa's concerns?