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Will 'Interior Designers' do the trick?

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THE good thing about the financial crisis is that it is at its tail-end - at least in Asia. The sad thing is that despite the depth of the crisis and its length - more than 18 months - nothing concrete on the much talked about new international financial architecture has emerged.

It is heartening to note that internationally renowned personalities like US President Bill Clinton and President Jacques Chirac of France have joined the bandwagon of proponents for a new financial architecture. But the swelling chorus of support for the ambitious design has a tinge of stale rhetoric to it, and the plan has not made any substantial headway.

There are plenty of proposals for a new financial architecture. The growth in interest has brought about an increase in 'architects,' eager to have a say in the new financial structure. Almost everybody who is somebody in international finance has come out with an idea.

The International Monetary Fund, the Bank of International Settlement (BIS) and the World Bank have their own views on the matter. Then there are groupings like the Asia Pacific Economic Co-operation (Apec), G-22, G-15, G-10 and G-7.

Apec leaders decided that the plan should be discussed at the G-15 level. Prime Minister Datuk Seri Dr Mahathir Mohamad recently attended the G-15 meeting in Jamaica where there was a debate on the proposed new financial architecture and Malaysia's experience of imposing selected capital control measures.

The US-sponsored G-22, which was set up by Clinton in April last year, counts among its members some distressed victims of the financial crisis. In the eyes of the United States, the grouping is the unofficial back-room for reform of the financial architecture. It has proposals to increase transparency and strengthen the financial sector, but nothing has been put into practice yet.

The G-10 is a group of central bank governors and finance ministers from 11 industrialised countries. The grouping is closely linked to BIS. In 1996, it prepared a comprehensive report on the solution to the financial crisis; nothing has come of it.

The phrase 'new international financial architecture' was coined by the club of G-7 in 1995. But, sad to say, the G-7 just about stopped its efforts there. It is undeniable that the grouping of seven industrialised countries - the United States, France, Japan, Britain, Canada, Italy and Germany - must set the wheels in motion if a new architecture is to become a reality.

But as time passes, it is becoming possible that the ambitious designs for a new financial architecture could lead merely to 'decor' changes to the existing structure.

There are several reasons for this. History suggests that financial architectures evolve over time. Since the Bretton Woods conference in 1944, there have been numerous calls for change, especially when a financial crisis crops up. But when the crisis recedes, everything is quickly forgotten.

For instance, when the fixed exchange rate regime broke down in the early 1970s, several conferences and debates were held centering on a new structure. But nothing came of that. During the debt crisis of the 1980s, again there were calls for a new structure, without any resultant significant change.

What happened, however, was that several 'fine-tuning' measures or practices were put in place to 'plug the holes' in the existing system. When the fixed exchange rate system broke down, the IMF was charged with monitoring the floating exchange rate system, particularly in the emerging economies.

When the Cold War thawed and the communist economic system broke down during the early 1990s, the IMF was the chief architect and financier in rejuvenating the affected countries.

It also acted quickly by providing funds to shore up confidence when the Mexican peso crashed in 1994. More recently, the IMF acted in similar vein to bail out crisis-stricken countries like Indonesia, South Korea and Thailand. But the bitter IMF prescriptions are now under fire and it is believed to be toying with new ideas and remedies in resolving future crises.

A lot of rules and regulations also evolved over time. The Basle Capital Accord, a set of minimum standards for banks, came about in the mid-1980s to further regulate banks, especially those operating on the international scene. This accord is now an accepted norm and has played its part in changing the international financial landscape.

Since the beginning of the crisis, several radical changes have occurred to the international financial structure. For instance, Malaysia has adopted selected capital controls to insulate its currency from manipulation by hedge funds. Although it was criticised, selective currency controls is now being looked at by other developing countries as a cover against speculative activities by hedge funds.

Changes are also on the drawing board for hedge funds themselves. The United States's President Working Group on Financial Markets is looking into the possibility of regulating hedge funds, said to be the cause of the financial crisis, to improve transparency and disclosure about their risk profile. This development, one year ago was considered out of this world.

More proposals, amidst objections, can be expected this June when the G-7 holds a forum to discuss the proposed new financial architecture. The forum's objective is to look into the vulnerability of the global financial system and to identify and oversee the actions needed to address the weaknesses.

Proposed by Hans Tietmeyer, president of Germany's Bundesbank, and driven by the BIS, the forum will meet twice a year to look at issues affecting the international financial system. How effective it will be is moot as it has no formal clout and has, at the very start, left out the views of the developing nations.

Australia has protested that any international financial architecture should include a wide array of participants and not confined to the G-7 members and the IMF, World Bank and BIS.

In this connection, President Chirac has proposed a summit for head of states and governments to be held at the end of the year that would gather the views of developing nations on the issue. An invitation has been extended to Dr Mahathir.

Only time will tell if the various proposals that have spun off from the present financial crisis, including the forum organised by G-7, will shape the new financial landscape. But whatever form the proposed new financial architecture takes, it must be better than the status quo.

To emerge better than the present system, the new architecture has to address several important issues. One of them is an exchange rate policy which is suitable for developing countries and which allows them to achieve a balance between maintaining economic sovereignty and maximising the benefits of globalisation.

The crisis has shown that countries which have a fixed exchange rate regime like Argentina and Hong Kong have withstood the speculative attacks on their currencies. But this comes at a price as the government has no control over its fiscal policies and has to raise interest rates sky-high just to defend the currency. Consequently, the high cost of funds sinks the country into recession.

On the other hand, countries that adopted a crawling peg linked to a major currency like the US dollar easily fell prey to speculative attacks on its currencies.

Some economists feel that the kind of exchange rate regime is not important as long as the country adopts one that fits its economic strengths and strategies for growth.

Another issue that the new financial architecture has to tackle is how countries can extract the maximum benefit of globalisation and, at the same time, keep control of its economy by regulating the flow of funds. The crisis has shown that countries like South Korea and Indonesia would not have fallen if their governments had not allowed easy access of foreign funds for the private and public sectors.

But if there were regulations on the flow of funds, foreign investors would not have poured in funds in the first place. And this will defeat the purpose of globalisation and hamper growth of developing nations.

A tricky job is in store for the advocates and drivers of the proposed new financial architecture. Perhaps they would eventually settle for a 're-decoration job' instead of a new structure altogether.

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