

# Report of the Task Force on International Financial Reform

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*In October 1998 the Prime Minister established a Task Force, comprising senior figures from the private and public sectors and chaired by the Treasurer, to make some constructive and practical suggestions on how Australia could contribute to strengthening the international financial system and achieving greater stability in global capital markets. The Task Force completed its report and presented it to the Prime Minister on 21 December 1998. This article reproduces the key principles and elements of the Report.<sup>1</sup>*

## INTERNATIONAL FINANCIAL REFORM KEY PRINCIPLES

### Reform will require a global response

What was originally seen as an Asian financial crisis is now recognised as a global one, affecting not only a number of the emerging markets, but also threatening the stability of financial markets in developed countries. While, with the benefit of hindsight, much has been learnt about the causes of the crisis, it is premature to draw definitive conclusions. Many saw the problem as stemming from policy shortcomings and structural problems in the emerging markets, although there were always concerns about contagion. Others focused on the potentially devastating effects of vast flows of short-term capital, as well as the inadequate risk assessment by the private sector. Some saw the response of the international financial institutions (IFIs) as inadequate and, indeed, contributing to the depth of the crisis. Attention has also focused on deficiencies in the financial supervisory arrangements in the developed economies. No doubt all factors played a role and, as such, highlight that there is not a single solution to the crisis, nor a single measure that will achieve greater stability in global capital markets. Reform will require progress across a wide range of fronts, much of it focused on sound policies at the national level: countries pursuing appropriate macroeconomic and regulatory policies were much less affected by the financial turmoil that affected others.

*The volatility in international markets was the result of policy shortcomings in both emerging and developed markets, along with inappropriate risk assessments and investment decisions by the private sector. The required policy adjustments*

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<sup>1</sup> A full copy of the Task Force Report can be found on Treasury's home page, <http://www.treasury.gov.au>

*do not rest solely with the emerging markets. Achieving greater stability in the international financial system will ultimately depend on the extent to which all countries pursue sound economic and regulatory policies. While reform will depend on policy responses by every government, the increasing internationalisation of financial systems emphasises the need for a coordinated response.*

### **The objective: Soundly based and more stable capital flows**

Volatile cross-border capital flows can be particularly unforgiving for emerging markets that do not have in place strong financial institutions supported by an appropriate supervisory and governmental framework. But the movement towards increasingly open international trade in goods, services and capital can bring, and has brought, substantial benefits. The more open economies have achieved a stronger economic performance and, consequently, higher living standards than the more inward looking, closed economies. However, the size, volatility and complexity of capital flows have increased dramatically, partly as a result of the increase in the breadth and depth of international derivative markets. Cross-border capital flows can fuel a boom and magnify a crash. Consequently, while technology has increased the potential benefits that can be derived from open, competitive markets, it has also increased the volatility of financial markets. Moreover, they do not always work as desired and appropriate supervision is required — not to impede financial markets, but to increase their stability and efficiency.

*Support should be given for the continuation of the movement towards open international capital markets. For those countries which lack the macroeconomic and regulatory arrangements necessary for dealing with large flows of mobile capital, liberalisation will need to be gradual and consistent with the development of a country's financial infrastructure. In some cases, there may be a need for temporary measures to ensure stability and to protect the domestic financial system from potential disruption from large short-term capital flows until the foundations are in place. Emerging economies may need to use such measures while developing mature regulatory arrangements. At the same time, they should be encouraged to continue to put in place the necessary conditions for further gradual moves towards liberalisation. The overall aim of efforts to reform the international financial system should not be to restrict capital flows, but to make them more soundly based and more stable.*

### **International groupings to pursue reform**

There is presently wide acceptance of the need for reform in order to achieve greater stability in global capital markets. The problems caused by the recent financial market turbulence remain vivid. Crises are not new, nor are calls for,

and talk of, reform. History shows that the momentum for reform can wane as the immediacy of the crisis passes. For example, after the Mexican crisis in 1994-95, many said this was the last time such a crisis would occur.

The G22 Working Group Reports are the most comprehensive step to date in considering what needs to be done to achieve greater stability in global capital markets. The strength of the G22 is its wide representation, from both developed and emerging markets, and being newly formed to address some specific issues, it has not been handicapped by procedural conventions or institutional rigidities. It also has strong representations from the Asian region.<sup>2</sup> The recent APEC Leaders' Meeting in Kuala Lumpur called for the establishment of appropriately constituted task forces to progress some of the issues covered in the three G22 reports, and highlighted the importance of including the 'systemically significant' economies in this process. Reforms are required in economies at different levels of development, across different regions, at the international and national levels, and across both the private and public sectors. While small international groupings can contribute to the process of reform, success in driving them forward will depend on the involvement of a wide cross-section of countries. And the process for reform needs to be driven. It will require political will, along with the cooperation and support of the private sector. The G22 reports are a start, and the endorsement of the issues covered in these reports by the G7 and the APEC Leaders' Meeting is welcome. But the momentum for reform will only be maintained if the work continues to be developed by a representative group of countries.

*Reform will need to be progressed through an international grouping with a wide representation, such as the G22, and will require the active involvement of the private sector. The continuation of the G22 process should be supported, for it has been a constructive step towards reforming the international financial system. Maintaining the momentum for reform is crucial.*

## **Australia's contribution**

Australia clearly has a stake in supporting reform of the international financial system. It has a particular interest in renewing investor confidence and restoring sustainable private capital flows in the troubled Asian economies. From the start of the crisis, Australia has played an active role in international support efforts, participating in financial support arrangements, providing technical assistance, and being heavily involved in the various international forums working on reform.

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<sup>2</sup> Details on G22, G7 and G10 membership are contained in the list of abbreviations at Appendix C of the Report.

Australia can continue to make an effective contribution to the process of reform. In the past, we have experienced some of the problems of volatile international capital flows, but the Australian economy and financial system are now very sound and stable. Australia has a considerable amount of expertise to offer and compares favourably against the recommendations in the G22 reports. We have well-developed links with the Asian economies, along with other economies. These links extend across the public and private sectors; the involvement of the latter will be an integral part of the reform efforts. Australia is in a strong position to continue to work with the Asian economies to resolve problems at the domestic and international level.

*Australia has the experience, the expertise, the opportunity and the will to continue to be an important contributor in efforts to reform the international financial system. We should work towards ensuring that the momentum for reform is maintained, and that consideration is given to the position of the emerging markets, particularly those in Asia. The private sector should be encouraged to participate as appropriate in progressing reform.*

## **INTERNATIONAL FINANCIAL REFORM KEY ELEMENTS**

### **Improving transparency**

There is a clear consensus in the international community that greater transparency (openness) is required by corporations, governments and IFIs. More (accurate and useable) information should lead to better investment decisions by the private sector and better policies on the part of governments. However, efforts to strengthen the international financial system must go beyond calling for improved transparency on the part of borrowers in emerging markets. Attention must be directed at the reasons for inadequate risk assessments on the part of lenders and investors. Appropriate risk assessments by these parties, and the resulting pricing outcomes, should be a major incentive towards ensuring that the required level and quality of information is available.

The lesson from the crisis is not only that there was insufficient information, but also that the information that was disclosed was apparently not incorporated into investment and lending decisions. An important factor that may have contributed to the failure of investors and lenders to adequately use the information available was the existence of explicit or implicit guarantees. This could take the form of the belief that a commercial entity had the support of a government, the assumption that a managed exchange rate removed any foreign exchange exposure on foreign currency denominated loans, the belief that domestic financial institutions were protected by governments, or the perception that foreign lenders would not suffer losses on their loans because funds would be available through the IFIs. Such perceptions of 'moral hazard'

weaken the incentives for lenders and investors to seek or use information on the financial performance of the borrower. Nevertheless, while improved transparency alone will not avoid a crisis, better information can play an important role in limiting the magnitude and extent of a crisis. The lack of timely and relevant information makes it difficult for investors to distinguish between countries, firms and financial institutions that are healthy and those that are not. However, there is no one initiative that will facilitate greater transparency and the use of information. It will require action by governments, the private sector and the IFIs.

*Improved transparency by corporations, governments and IFIs is needed. However, the focus should not merely be on calling for borrowers to disclose more information. It is important to ensure that the incentives are there for information to be used and incorporated in appropriate risk assessments, which will, in turn, result in more soundly based investment decisions. In particular, this will involve minimising implicit or explicit guarantees on the part of governments. Increasing the incentives for the use of information by the investor or lender will increase the market demand for greater transparency.*

## **The role of standards**

Internationally accepted standards with respect to transparency — such as those covering accounting, economic data, and fiscal and monetary policies — allow market participants to compare disclosure practices against agreed benchmarks of good practice. For example, the G22 reports noted the advantages of national authorities implementing and enforcing the accounting standards developed by the International Accounting Standards Committee, or equivalent national standards. But any standard for the disclosure of information must always be pragmatic and relevant, and the cost of its implementation and enforcement has to be considered. Furthermore, the emphasis should not only be on developing international standards, but also on recognising the needs of the emerging markets in gaining the necessary resources, expertise and frameworks to successfully implement standards. Attention has to be paid to the quality of information being released, for poor information may be more misleading than no information.

*Internationally accepted standards and codes of conduct with respect to transparency need to be improved, extended and implemented. Australia should continue to play an active role in their development and ensure that they are practical and meet the needs of the private sector. For this reason, direct input by the private sector in the development of standards is important.*

*Appropriate technical assistance should be provided to the emerging markets to allow standards to be implemented, if necessary, on a phased basis. In addition to Australia's own efforts, including the major package of bilateral assistance*

*recently announced by the Prime Minister, we should promote the need for the international community to better coordinate the provision of assistance. It is important to ensure that assistance is directed to areas that will achieve maximum effectiveness and that the interrelated and reinforcing nature of steps towards transparency and improved corporate governance is recognised. The World Bank, in close cooperation with other IFIs, could take the lead in improving the coordination of technical assistance.*

## **Transparency reports**

If the impediments to the use of information are removed, then the benefits inherent in greater transparency, such as lower borrowing costs and larger and more stable flows of portfolio and direct investment, should be the strongest incentive for compliance with disclosure standards. However, monitoring can play a role, and there is merit in the G22 proposal that the International Monetary Fund (IMF) prepare a 'Transparency Report' for each country in the context of its Article IV consultations. Nevertheless, countries, like companies, can force the pace in terms of what the market expects as the desired level of transparency. For example, Australia's Charter of Budget Honesty has been recognised as best practice in terms of fiscal policy transparency.

*The benefits from greater transparency should be the strongest incentive for compliance with standards. However, monitoring has a role to play. To this end, the IMF should prepare a Transparency Report for each country but, in addition, countries could prepare and publish a report on the extent to which they meet recognised disclosure standards. Australia could take the lead in the preparation of a Transparency Report and provide a format for other countries to follow.*

## **Strengthening supervision of financial systems**

The turbulence in capital markets has exposed shortcomings in the supervisory arrangements for financial institutions, not only in the emerging markets but also in the developed markets. The immediate task facing many of the crisis economies is the recapitalisation of their banking systems; thereafter, the priority will be to ensure that they maintain a sound financial system. Enhancing prudential supervision is a critical element toward achieving sounder financial institutions and, in turn, greater stability in global capital markets. The standards developed by the Basle Committee on Banking Supervision (BCBS) have provided a useful benchmark against which to measure the adequacy of national supervisory systems, and all countries should be encouraged to meet these standards. It is necessary, however, to review these standards on an ongoing basis to ensure that they remain commensurate with the demands of an increasingly integrated and complex financial system. In addition, it is important to ensure that there are no unintended consequences from the

supervisory requirements that may result in adverse market distortions or instability.

*All countries should be encouraged to meet BCBS standards for banking supervision, particularly in the area of capital adequacy, loan valuation and provisions. However, these standards need to be regularly reviewed and this should be conducted in a collaborative manner with non-G10 countries. This review should consider how the standards could be modified to encourage supervised institutions to maintain and apply adequate risk management procedures. Australia should remain at the forefront of the development of bank capital standards and could offer to act as a regional coordinator for submissions to a BCBS review of capital standards.*

### **Peer reviews of supervisory arrangements**

There is a role for enhanced external surveillance of the adequacy of countries' prudential supervisory arrangements. Rating agencies are already beginning to assess the adequacy of supervision in order to calculate governments' contingent liabilities for possible banking failures; incorporating this into country ratings adds a commercial incentive to ensure appropriate prudential supervision. The IMF has indicated that it intends, as part of its country assessment work, to review the extent to which the supervisory framework in individual countries complies with the BCBS Core Principles. The G22 reports also propose a system of peer reviews by other supervisors/regulators.

*External surveillance of a country's supervisory arrangements should be encouraged, and this could be part of the IMF's Article IV consultations. There is, however, a role for more targeted and in-depth surveillance, and the concept of peer reviews should be developed. This could be facilitated by a new international secretariat, perhaps jointly sponsored by the IMF and the World Bank and other international organisations, with detailed expertise in monitoring supervisory arrangements.*

### **Provision of technical assistance by governments and the private sector**

The Australian supervisory system and its supervisory expertise are internationally held in high regard. Australia can, and has, made an important contribution to enhancing financial supervision in the regional economies. This has involved conducting training courses; seconding staff, both inward (overseas staff to work in Australia) and outward (Australian staff to work overseas), and sponsoring and providing internships for overseas staff; and organising and participating in regional conferences and seminars. Australia has provided assistance to the economies in the region in terms of the

supervision of financial ‘markets’ as well as institutions. For example, through its membership of the East Asian and Oceanic Stock Exchange Federation (EAOSEF), the Australian Stock Exchange (ASX) provides assistance to stock exchanges in the region to meet the benchmark standards that are desired by large investors.

*As announced by the Prime Minister at the recent APEC Leaders’ Meeting, Australia is providing substantial technical assistance and training to countries in the region that are looking to develop their financial systems and supervisory arrangements. This is an important contribution to the recovery of these economies. Australia should also call for improvements in the coordination of such assistance to the emerging markets. While Australian financial institutions’ exposure and business in Asia may be reduced as the economies recover, many have found it commercially useful to take a long-term view of providing technical assistance in the region. Consideration could be given to increasing the level of cooperation between the Government, Australian financial institutions and private sector organisations in the provision of such assistance.*

## **Supervision of highly leveraged hedge funds and large institutional investors**

The emergence of highly leveraged macro and other hedge funds along with other large institutional investors has created a new source of systemic instability. These institutions pose a risk to market integrity, through their potential to distort prices in the markets where they operate, as well as posing a risk to the stability of these markets and, in turn, the solvency of other institutions. The recent APEC Leaders’ Meeting called for a task force to examine the appropriate transparency and disclosure standards for private sector financial institutions involved in international capital flows, such as investment banks, hedge funds and other institutional investors. This work will require the involvement of banking and securities market regulators, and needs to address a range of issues, including whether action should be limited to requiring disclosure, as called for by the G22 reports, what form that disclosure should take and whether it would be preferable to regulate these institutions directly. At a minimum, disclosure should include the size of balance sheets and the extent of off-balance sheet exposures. Consideration will also need to be given to the suitability of present methods of market supervision for managing the degree of leverage that these institutions have used and the counterparty exposures and risks this leverage entails.

An important issue is how to ensure compliance by these institutions, which often operate out of international ‘havens’ where regulation is minimal or non-existent. A solution might be to impose more stringent requirements on creditors and counterparties to undertake more rigorous risk management in their dealings with hedge funds. It would be very difficult, and most likely



ineffective, to attempt to extend market misconduct provisions in relation to exchange traded financial products to cover the activities of hedge funds in over-the-counter markets.

*Steps are necessary to ensure adequate disclosure by hedge funds and other highly leveraged institutions and to ensure appropriate risk management on the part of creditors and counterparties in their dealings with such investors. In particular, supervisors will need to ensure that banks and other regulated bodies have adequate systems for managing exposures to hedge funds. Higher capital weights or exposure limits on dealings with hedge funds may be necessary when systems or practices are inadequate to deal with those who do not meet adequate disclosure standards. A suitably constituted task force, as recently called for by the APEC Leaders' Meeting, should progress this matter as soon as possible.*

### **Facilitating private sector involvement in improved crisis management**

While every effort needs to be made to avoid crises, they will occur. Recent events highlight that the management of crises could be improved with the effective involvement of the private sector at an early stage. There is a need to have more flexible mechanisms to deal with 'fire sales' and the resulting rapid depletion of reserves and/or depreciation of currencies. In particular, it would be desirable if an improved mechanism could be developed for a country to consult with creditors and reschedule repayments and, in dire circumstances, implement a temporary payments suspension (standfast) while rescheduling arrangements are put in place. In practice, this is likely to require some involvement of the IMF to reassure creditors that the action is genuinely necessary. It may, in fact, become inevitable that provision of official support through IMF programs will be tied to the successful restructuring of existing debts to eliminate 'funding gaps'. Some form of cooperative standfast, accompanied by the involvement of creditors at an early stage of program negotiation, would facilitate such an outcome.

Effective crisis management requires creditors to be quickly identified and contacted. This is becoming increasingly difficult given the number and variety of creditors. The introduction of 'majority voting' or 'collective action' clauses would, however, provide an incentive for creditors to 'register' with a suitable forum so as to ensure that they would have input into any proposal to vary payment terms. Such clauses would be included in loan documentation and there would be advantages if they were to become the accepted norm for sovereign foreign borrowings. In doing so, this would provide some degree of protection to creditors in terms of their fiduciary obligations to their shareholders and beneficial owners, which may be necessary if creditors are to become willing participants in debt standfasts.

While improved arrangements are necessary for handling sovereign foreign debt, the problem in Asia was banking and other private debt rather than sovereign. Insolvency regimes should provide the mechanism for the handling of private debt; however, in a crisis situation there may be a need for government intervention to facilitate negotiations between private creditors and debtors. Bank debt is best handled through a cooperative rescheduling, which would be facilitated with the early establishment of a 'contact group' of bank creditors. This could be achieved if, when a country approached the IMF, it also appointed a suitable commercial bank with a large exposure to coordinate a bank creditor contact group. Such a contact group could facilitate the provision of information to creditors, as well as facilitating a rescheduling, if required. In return for including bank creditors at an early stage of the negotiations, agreement could be sought for them to maintain existing exposures, including through the endorsement of letters of credit for financing trade, for a fixed period during which negotiations can be finalised. The fact that a creditor contact group has been established should not be seen as signalling that a country is likely to be rescheduling its debts, thereby adversely affecting the supply of new capital. Rather, the formation of such contact groups should become the normal procedure for countries seeking an IMF program and the renegotiation of existing debts could, where appropriate, become a condition of the program.

While the successful early involvement of private sector creditors and the use of temporary standfasts could facilitate future crisis management, there are a number of difficult issues which would need to be resolved. One concern is that an arrangement to facilitate standfasts would act as a disincentive to lend (especially to new lending at the onset of a crisis). However, any such arrangement should be similar in concept to domestic insolvency systems, which are well accepted and do not act as a disincentive to lenders in national markets. That said, the advantage of domestic insolvency regimes is that there is an institutional and legal structure over and above the borrowers. In contrast, sovereign borrowers can control the ability to call a standfast without any apparent independent arbiter.

The standard use of collective action clauses and improved procedures for creditor-debtor consultations will depend on developing arrangements that are acceptable to private sector lenders. This will require extensive consultation between sovereign borrowers and private sector lenders. Some of the issues that will need to be considered include the specification of collective action clauses, such as the rules for majority voting; the legal status of such clauses and actions taken; the mechanism for central registration of contact groups to speed implementation of debt restructuring; the relationship between any new arrangements for restructuring with the Paris and London Clubs; the procedures for a standfast; and the role of the IMF and other IFIs in a standfast.

*While crisis prevention through the application of appropriate policies and proper risk assessments is the prime objective, mechanisms for improved crisis*

*management are also necessary. The APEC Leaders' Meeting endorsed the establishment of a properly constituted working group to develop suggestions for improved crisis management, including through involving the private sector at an early stage. Such a working group should comprise sovereign bond issuers, private sector lenders and the IFIs. It should aim to explore the adoption of collective action clauses, arrangements for debt standfasts and other mechanisms to facilitate early consultations between creditors and debtors. The focus of this group should be a practical one, seeking, in particular, the input from lenders as to the practicality of such arrangements and the details that need to be considered.*

*Since most sovereign borrowers in international markets are emerging economies, they need to play an integral role in any discussions on this issue. A G22 grouping would provide the appropriate degree of representation although an APEC working group would also maintain the momentum for reform. Australia should play an active role in advancing the work of such a group. APEC Leaders welcomed the Prime Minister's offer for Australia to chair a working group, if it was formed in an APEC context.*

## **Maintaining trade finance**

One common casualty of financial crises is the withdrawal of trade finance to the crisis-affected countries. This hampers a country's recovery, limiting its ability to import raw product and intermediate goods as well as directly limiting its capacity to earn foreign exchange from exports. Under normal arrangements, trade finance should be insulated from any restructuring or standfast, and lenders would be encouraged to continue providing trade finance even when unwilling to provide other loans to borrowers in the country concerned. Some mechanism for differentiating the credit risk in trade finance from that in other lending will be required to achieve this. This differentiation might be, for example, in the form of third-party guarantees provided by IFIs or by countries. It will also require action by the government of a crisis economy to ensure that trade finance is differentiated and supported.

Australia has been active in improving the availability of trade finance to crisis-affected countries, with increased export insurance coverage provided by the Export Finance and Insurance Corporation for exports to Indonesia and Korea. Further, Australia is in the process of finalising its membership of the Multilateral Investment Guarantee Agency, the arm of the World Bank which seeks to promote economic development by providing insurance coverage against non-commercial risks for investments in developing countries.

Central to improving trade finance in the crisis economies will be accelerating the pace of bank and corporate restructuring. The 'Asian Growth and Recovery Initiative' recently proposed by the United States and Japan is focused on

accelerating the pace of bank and corporate restructuring in the crisis economies, as well as providing increased trade finance.

*It is important to support trade finance during a period of crisis management so as to preserve the ability of a country in crisis to maintain trade. Ultimately, ensuring a solvent banking system is the key to facilitating the flow of finance to importers and exporters. Encouragement should be given to international efforts to increase trade financing for the crisis economies, as well as to accelerating the pace of bank and corporate restructuring. An important contribution Australia can make is providing technical assistance to facilitate bank and corporate restructuring.*

### **Strengthening national insolvency regimes**

Effective national insolvency regimes are an important element of crisis prevention and management. An effective national insolvency framework would address the issue of financial difficulties of troubled firms accumulating into an economy-wide crisis. The absence of a national insolvency regime can see pressure for foreign liabilities of insolvent corporations being taken up by the public sector. Strong insolvency regimes are also an important element of orderly and cooperative crisis management.

The development of a model law on insolvency in an appropriate international forum could assist with the adoption of effective national insolvency regimes in the emerging markets. Well-targeted technical assistance would also be required. Monitoring progress of actions towards adopting the model framework may also be appropriate.

*Australia could propose, and actively encourage, that the United Nations Commission on International Trade Law undertake the development of an international model law on insolvency and participate in monitoring implementation. Australia should continue to provide targeted regional technical assistance on insolvency matters.*

### **Improving the composition of capital flows**

Heavy reliance on short-term capital flows increases the vulnerability of the emerging economies to a sharp withdrawal of such finance. Where the domestic financial system may have difficulty coping with large short-term inflows and outflows, market-based restrictions, such as reserve requirements on short-term overseas borrowing, may assist in promoting greater stability for domestic institutions. Where short-term overseas borrowing reflects a lack of domestic borrowing opportunities, countries should be encouraged to develop domestic bond markets (which may require technical assistance) to help achieve a more

appropriate balance in the composition of their domestic and foreign currency exposures.

Attention has focused on whether incentives can be introduced to encourage long-term capital inflow rather than short-term flows. Foreign direct investment is not only more stable than short-term flows but has the advantage of bringing with it technology and expertise. Countries should also be encouraged to remove any distortions, such as tax incentives, undue restrictions on foreign direct investment, and poor corporate governance (which discourages the development of local equity markets and inflows of portfolio investment), favouring short-term capital flows. The impact on the composition of capital flows resulting from the low weights for short-term interbank borrowings under the BCBS capital requirements should be reviewed.

*Australia has extensive experience in developing and managing a sovereign bond market and could extend technical assistance in terms of the supervision of markets and provision of efficient registry and settlement systems. Australia could also propose a working group (G22 or APEC) to consult on issues relating to debt management in emerging economies. This could draw on the outcome of the Organisation for Economic Cooperation and Development (OECD)/World Bank Workshop on the Development of Fixed-Income Securities Markets in the Emerging Market Economies.*

*To enhance the environment for foreign direct investment, consideration could be given, perhaps within APEC, as to how greater transparency with respect to foreign investment laws and policies can increase a country's attractiveness to foreign direct investment.*

*To facilitate a larger proportion of stable portfolio investment and foster the development of domestic share markets, Australia should promote general improvements in corporate governance, including through its current work in the APEC Finance Ministers context, and through bilateral assistance.*

## **The role of international financial institutions**

Criticism has been directed towards the way the IFIs, particularly the IMF, have handled the crisis. With the benefit of hindsight, the IFIs could have done better, and they have acknowledged this and acted to improve their effectiveness in the management of crisis situations, particularly in terms of the nature of IMF-supported programs. Nevertheless, the IMF and multilateral development banks continue to have legitimate roles and will remain integral players in crisis prevention and management. In this context, the IFIs have implemented more innovative financing techniques, in cooperation with the private sector, to assist crisis countries.

*Support should continue to be given to efforts by the World Bank and IMF to achieve closer collaboration, especially as it relates to reforming national financial systems. More innovative and flexible financial support packages should be encouraged, and proposals for an enhanced IMF facility to provide a contingent short-term line of credit to countries pursuing appropriate policies should be supported. The World Bank, in close consultation with other IFIs, should be the basis for improved international cooperation (that is, a clearing house) for the provision of technical assistance.*

## **Enhanced international cooperation on financial sector policy issues**

Recent financial market developments have highlighted the need to improve international cooperation on financial sector issues. It is telling, for example, that there is not an established international forum to address a number of the issues raised in the G22 reports. The international financial system consists of a series of national systems linked through cross-border capital flows. A cooperative and coordinated response by national authorities is necessary to attain stable global capital markets. We do not know where the future pressures on the stability of the international financial system will come from, but one lesson from recent events is that we should have some mechanism by which to assess developments in global markets as they occur and to quickly develop an appropriate policy response when needed. The Joint Forum on Financial Conglomerates, established in 1996, has been a successful innovation in improving international cooperation in relation to the supervision of financial conglomerates and there will clearly continue to be a need for dealing with cross-sector supervisory issues. Australia is an active participant in the Joint Forum, and an Australian is the current Chair. However, this forum's mandate is limited, as is its membership, which comprises financial supervisors from 13 developed economies.

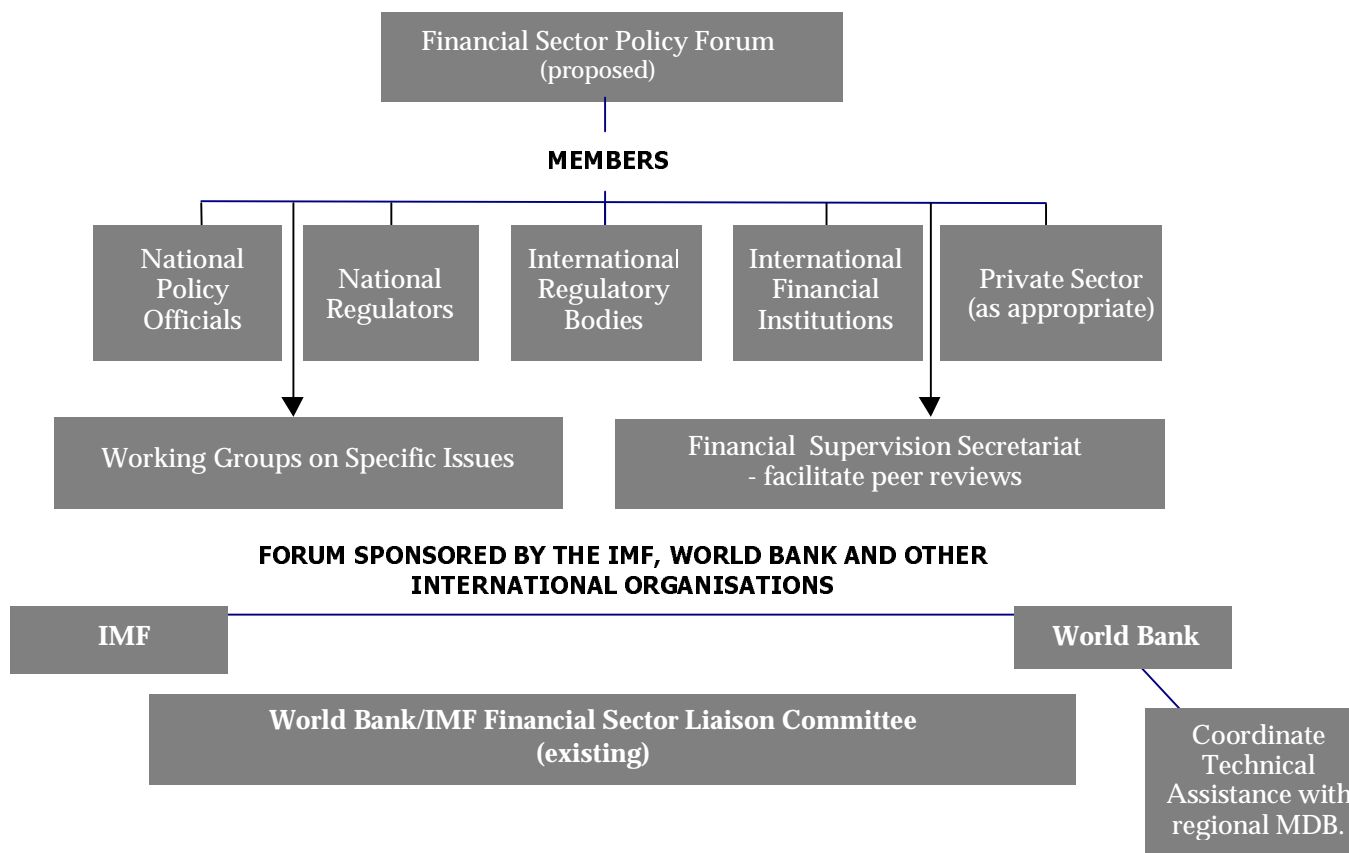
The G22 proved an effective vehicle in considering issues of major reform to the international financial system, and it is an appropriate vehicle to carry forward many of its recommendations. The *G22 Report of the Working Group on Strengthening Financial Systems* did note, however, that there was merit in 'institutional innovations', such as the establishment of a new policy forum, to enhance the discussion of international financial sector policy issues. There would be advantages in a forum or group, with an appropriately wide representation similar to the G22, being established on a standing basis to promote the continuous adjustment of policies to meet the demands of rapidly changing and increasingly integrated financial markets and institutions. Such a standing forum or group could also be an appropriate body for facilitating the coordination of peer reviews of a country's supervisory arrangements.

The following diagram outlines suggested arrangements for enhanced international efforts on financial supervision and coordination of financial policy issues.

*To enhance international cooperation and provide a standing mechanism to respond to future international financial issues, consideration should be given to convening a Financial Sector Policy Forum. This forum, which would have a wide representation similar to that of the G22, would facilitate financial sector policy discussions between officials from national authorities, international regulatory bodies, the IFIs and, as appropriate, representatives from the private sector. Consideration should be given to the forum coordinating peer reviews of countries' financial sector supervisory arrangements.*

*This new forum would, like the G22, include representatives from the IMF, World Bank and BIS, but would not form part of any of these institutions. These bodies could, however, sponsor the establishment of the forum and its work could provide a valuable input into the activities of the IMF and World Bank, which are both enhancing their country specific work in the area of financial markets and supervision.*

**Figure 1: Enhanced international efforts on financial supervision/policy**





## Regional cooperation on financial issues

As noted previously, reform will need to be advanced through international groupings with a wide representation, such as the G22. However, the regional organisations, such as APEC, the Executive Meeting of East Asia-Pacific Central Banks (EMEAP) and the Manila Framework Group, can play an important role in promoting enhanced cooperation on financial policy issues and provide a possible forum for advancing action to strengthen the international financial system. For example, the Manila Framework Group is a regional forum with a membership that covers developed and emerging markets, but its size is such that it has the advantage of flexibility and, possibly, providing more rapid responses.

*Australia should continue to work actively in regional economic forums, such as APEC, EMEAP and the Manila Framework Group, to advance reform initiatives and cooperation on financial policy issues. Such a grouping as the Manila Framework also provides the capacity to be convened at relatively short notice in order to address 'hot issues'. Australia's hosting of the Manila Framework Group meeting in the first half of 1999 provides the opportunity to advance some of the reform proposals, such as the concept of countries preparing Transparency Reports and improving the composition of capital flows.*