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Follow-up to and implementation of the outcome of the 2002 International Conference on Financing for Development and the preparation of the 2008 Review Conference

Recommendations by the Commission of Experts of the President of the General Assembly on reforms of the international monetary and financial system

Note by the President of the General Assembly

1. The outbreak of the financial crisis in 2008 originated in the advanced developed countries, but has spread quickly to become a world economic crisis that affects all countries, including the emerging economies and less developed countries.

2. To review the workings of the global financial systems and to explore ways and means to secure a more sustainable and just global economic order, I have convened a Commission of Experts, chaired by Professor Joseph Stiglitz, 2001 Nobel laureate Prize winner in Economics, and comprised of a outstanding economists, policy makers, and practitioners drawn from Japan, Western Europe, Africa, Latin America, South and East Asia. These experts were chosen based on their comprehensive understanding of the complex and interrelated issues raised by the workings of the financial system. The Commissioners are also individuals recognized for their strong grasp of the strengths and weaknesses of existing multilateral institutions as well as their sensitivity to the particular challenges facing countries from different regions of the world and at different levels of economic and social development.

3. I now have the pleasure to transmit the preliminary recommendations of the Commission for your consideration. These recommendations and the analysis that underlies them will figure prominently in the interactive thematic dialogue on "The World Financial and Economic Crisis and its Impact on Development", which I will convene from 25 to 27 March 2009 at United Nations Headquarters in New York. It is my hope that Members of the General Assembly will find these recommendations, and the dialogue next week, useful as they prepare for the United Nations Conference on World Economic and Financial Crisis and Its Impact on Development, which will be convened in little more than two months time in accordance with General Assembly resolution 63/239 of 24 December 2008.

THE COMMISSION OF EXPERTS ON REFORMS OF THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEM

Recommendations
19 March 2009

I. Preamble

1. The rapid spread of financial crisis from a small number of developed countries to engulf the global economy provides tangible evidence that the international trade and financial system needs to be profoundly reformed to meet the needs and changed conditions of the 21st century. Past economic crises have had a disproportionate adverse impact on the poor, who are least able to bear these costs and that can have consequences long after the crisis is over.

2. While it is important to deal with the structural changes to adapt the international system to prevent future crisis, this cannot be achieved without significant measures to promote recovery from the current crisis whose impact may be even worse than in the past. The International Labour Organization estimates that the rise in unemployment in 2009 compared to 2007 of 30 million could reach more than 50 million if conditions continue to deteriorate. Some 200 million people, mostly in developing economies, could be pushed into poverty if rapid action is not taken to counter the impact of the crisis on developing countries. Even in some advanced industrial countries, millions of households are faced with the threat of losing their homes and access to health care, while economic insecurity and anxiety is increasing among the elderly as they lose their life-time savings in the collapse of asset prices.

3. The welfare of developed and developing countries is mutually interdependent in an increasingly integrated world economy. *Short term measures to stabilize the current situation must ensure the protection of the world's poor, while long term measures to make another recurrence less likely must ensure sustainable financing to strengthen the policy response of developing countries.* Without a truly inclusive response, recognizing the importance of all countries in the reform process, global economic stability cannot be restored, and economic growth, as well as poverty reduction worldwide will be threatened.

4. This inclusive global response will require the participation of the entire international community; it must encompass more than the G-7 or G-8 or G-20, but the representatives of the entire planet, from the G-192. It was to respond to this need that the President of the General Assembly created the present Commission of Experts to address the measures needed to meet the crisis and recommend longer term reforms. Recognising work being undertaken by the G-8 and the G-20, and other

bodies, the Commission sees its own work as complementary, seeking to focus on impacts of the crisis and responses to the crisis on poverty and development.

5. Reform of the International system must have as its goal the better functioning of the world economic system for the global good. This entails simultaneously pursuing long term objectives, such as sustainable and equitable growth, the creation of employment in accordance with the "decent work" concept, the responsible use of natural resources, and reduction of greenhouse gas emissions, and more immediate concerns, including addressing the challenges posed by the food and financial crises. As the world focuses on the exigencies of the moment the long standing commitments to the achievement of the Millennium Development Goals and protecting the world against the threat of climate change must remain the overarching priorities; indeed, appropriately designed global reform should provide an opportunity to accelerate progress toward meeting these goals.

II. Responding to the Global Financial Crisis

6. Sustainable responses to the crisis require identifying the factors underlying the crisis and its rapid spread around the world. Loose monetary policy, inadequate regulation and lax supervision interacted to create financial instability. The results were manifest in the large global imbalances whose disorderly unwinding in the absence of prompt countercyclical measures may aggravate the crisis.

7. Part of the reason for inadequate regulation was an inadequate appreciation of the limits of markets—what economists call "market failures." While such failures arise in many markets, they are particularly important in financial markets and can have disproportionately large consequences as they spill over into "real" economic activity.

8. The conduct of monetary policy can be traced in part to an attempt to offset an insufficiency of global aggregate demand, aggravated by increasing income inequality within most countries. Monetary conditions were also influenced by the accumulation of foreign exchange reserves by some emerging market countries seeking protection from global instability and onerous conditions traditionally attached to assistance from the multilateral financial institutions.

9. The current crisis reflects problems that go beyond the conduct of monetary policy and regulation of the financial sector. It also involves deeper inadequacies in areas such as corporate governance and competition policies. Many of these failings, in turn, have been supported by a flawed understanding of the functioning of markets, which also contributed to the recent drive towards financial deregulation. These views have been the basis for the design of policies advocated by some of the international economic institutions, and for much of the architecture of globalization.

10. More generally, the current crisis has exposed deficiencies in the policies of some national authorities and international institutions based on previously fashionable economic doctrines, which held that unfettered markets are, on their own, quickly self-correcting and efficient. Globalization too was constructed on these flawed hypotheses; and while it has brought benefits to many, it has also enabled defects in one economic system to spread quickly around the world, bringing recessions and impoverization even to developing countries that have developed good regulatory frameworks, created effective monetary institutions, and succeeded in implementing sound fiscal policies.

11. The Principles and Recommendations outlined in this Report seek to address the underlying problems. They focus both on feasible interim steps that can and should be taken immediately, and the deeper medium and longer term reforms that are necessary if we are to make another such crises less likely, and if we are to strengthen the international community's capacity to respond to a crisis, should one occur.

12. In analyzing appropriate national and global responses to the crisis, the Commission noted the following principles:

13. Failure to act quickly to address the global economic downturn inevitably would increase its depth and duration and the eventual cost of creating a more balanced robust recovery.

14. In a globally integrated world, the actions of any one country have effects on others. Too often these *externalities* are not taken into account in national policy decisions. Developed countries in particular need to be aware of the adverse consequences of these externalities, and developing countries need frameworks to help protect themselves from regulatory and macro-economic failures in systemically significant countries.

15. Developing countries should have expanded scope to implement policies and create institutions that will allow them to implement appropriate counter-cyclical policies.

16. Advanced industrial countries should observe their pledges not to undertake *protectionist* actions, and even more importantly insure that stimulus packages and recovery programs do not further distort the economic playing field and further increase global imbalances.

17. Measures to restore domestic financial markets in developed countries through *subsidies* to financial institutions have been accompanied by a sharp reduction in flows of capital to developing countries. It is important to ensure that these measures do not create a new form of financial protectionism. Financial subsidies can be just as detrimental to the efficiency of a free and fair trading system as tariffs. Indeed, they

may be far more inequitable, because rich countries have more resources to support subsidies.

18. Greater transparency on the part of all parties in responding to the crisis is necessary. More generally, democratic principles, including inclusive participation in decision making, should be strengthened and respected.

19. The crisis is, in part, a result of excesses in deregulation of financial markets and in international trade. Restoring the global economy to health will require restoring a balance between the role of the market and the role of the state.

20. In responding to this crisis, it is imperative that actions to improve conditions in the short term do not result in structural changes which increase instability or reduce growth in future.

21. It is essential that governments undertake reforms that address some of the underlying factors that contributed to the current economic crisis if the world is to emerge from the crisis into sustainable, balanced growth. It is not enough simply to return to the status quo *ex ante.*

22. Appropriately designed short run measures may be complementary to long term goals, especially those related to climate change and the environment.

III. Immediate Measures

23. The current crisis must be met with rapid and effective measures, but it must also lay the basis for the long-run reforms that will be necessary if we are to have a more stable and more prosperous global economy and avoid future global crises.

24. Ten immediate measures are essential for global recovery.

1. All developed countries should take strong, coordinated, and effective actions to stimulate their economies.

25. Stimulus should be timely, have large "multipliers," help address the strains posed by the economic downturn on the poor, help address long run problems and prevent instability. While the decision on stimulus is national, it should be judged on its *global impacts;* if each country looks only at the national benefits versus costs, e.g. an increased national debt, the size of the global stimulus will be too small, spending will be distorted, and the global impact will be eviscerated.

26. *National stimulus packages should thus include spending measures to be undertaken in developing countries to offset the impact of the decline in world trade and financial market disintermediation. Industrialised countries should thus dedicate 1.0 per cent*

of their stimulus packages, in addition to traditional official development assistance commitments.

2. **Developing countries need additional funding**

27. More permanent and stable sources of funding for developing countries (See Section IV.10 below) that could be activated quickly and are not subject to inappropriate conditionality are necessary. Indeed, additional funding would be required just to offset the imbalances and inequities created by the massive stimulus and bail-out measures introduced in advanced industrialised countries. Such funding could be provided by an issuance of Special Drawing Rights approved by the IMF Board in September 1997 through the proposed Fourth Amendment of the Articles of Agreement to double cumulative SDR allocations to SDR 42.8 billion and through the issuance of additional SDRs through standard procedures.

28. In addition regional efforts to augment liquidity should be supported. For instance, extension of liquidity support under the Chiang Mai initiative without an IMF program requirement should be given immediate consideration. Regional cooperation arrangements can be particularly effective because of a greater recognition of cross-border externalities and greater sensitivities to the distinctive conditions in neighbouring countries.

29. These additional sources of funding should be in addition to traditional official development assistance. Failure to maintain the levels of official assistance will have long-term effects. There will be an increase in poverty and malnutrition and the education of many young people will be interrupted, with life-long effects. The sense of global social solidarity will be impaired, making agreement on key global issues, such as responding to the challenges of climate change, more difficult. Failure to provide such assistance can be counterproductive even in a more narrow sense: it can impair the global recovery.

30. *Developed countries must make a renewed effort to meet the commitments made in the Millennium Declaration, the Monterrey Consensus, the 2005 Global Summit, and the Doha Declaration by 2015.*

3. **Mobilizing Additional Development Funds by the Creation of a New Credit Facility**

31. The creation of a new credit facility is thus a matter of urgency. If such a facility could be created in a timely way, it could be a major vehicle for the disbursement of the requisite additional funding.

32. Given the need for rapid response, the new credit facility might be more quickly established under the umbrella of existing institutions, such as the World Bank, where

efforts are underway to remedy existing inadequacies in governance and lending practices, or in Regional Development Banks where developing countries have more equitable representation.

33. Or alternative institutional arrangements that create competition amongst institutions providing financial assistance might be envisaged. Such competition might not only increase the efficiency of disbursement, but also reduce the application of procyclical conditionality linked to financial support.

34. Whatever form is chosen, the new facility should have governance more reflective of democratic principles, with strong representation of developing countries and those countries contributing to the facility. These new governance arrangements might provide lessons for the reform of existing institutions.

35. Administration of the Facility could be done by staff seconded from existing multilateral financial institutions or central banks. The new facility could draw upon financial contributions from all countries. It could leverage any equity funds contributed by borrowing, including on the market or from those with large reserves or Sovereign Wealth Funds. Its ability to borrow could be enhanced through guarantees provided by governments, especially those of the advanced industrial countries. These alternative arrangements should be seen as a complement to expanded financial support from existing institutions,

4. Developing Countries need more policy space

36. There are asymmetries in global economic policies—countercyclical policies are pursued by developed countries, while most developing countries are encouraged or induced to pursue pro-cyclical policies. While this is partly due to the lack of resources to pursue countercyclical policies, it is also due to misguided policy recommendations from international financial institutions. Conditionality attached to official lending and support for international financial institutions has often required developing countries to adopt the kinds of monetary and regulatory policies which contributed to the current crisis. In addition, these conditionalities contribute to global asymmetries, disadvantage developing countries relative to the developed, and undermine incentives for developing countries to seek support funding, contributing to global economic weakness. While the IMF initiatives to reduce conditionalities are to be commended, they might be insufficient, while in many cases countries are still required to introduce pro-cyclical policies.

5. The lack of coherence between policies governing trade and finance must be rectified.

37. Policy space is circumscribed not only by a lack of resources, but also by international agreements and by the conditionalities that often accompany assistance.

Many bilateral and multilateral trade agreements contain commitments that circumscribe the ability of countries to respond to the current crisis with appropriate regulatory, structural, and macro-economic reforms and rescue packages, and may have exposed them unnecessarily to the contagion from the failures elsewhere in the global economic system. *Developing countries especially need policy frameworks that can help protect them from regulatory and macro-economic failures in systemically significant countries.* Developing countries have had imposed on them not only deregulation policies akin to those that are now recognized as having played a role in the onset of the crisis, but also have faced restrictions on their ability to manage their capital account and financial systems (e.g. as a result of financial and capital market liberalization policies); these policies are now exacting a heavy toll on many developing countries.

6. Crisis response must avoid protectionism

38. Overt protectionism includes tariffs and domestic restrictions on procurement contained in some stimulus packages. Because of complex provisions and coverage of international trade agreements, seemingly "symmetric" provisions (e.g. exceptions of the application of provisions to countries covered by particular WTO or other international agreements) can have markedly asymmetric effects. Subsidies, implicit and explicit, can, as has been noted, be just as distorting to open and fair trade. There may, in some cases, be pressure for banks receiving large amounts of government assistance to focus on lending domestically. While the temptation that gives rise to such measures is understandable, efforts need to be made to finance additional support to developing countries to mitigate the impact of the crisis as well as of both open and hidden subsidies (i.e. state assistance through lending programs and guarantees) in order to avoid further distortions.

7. Opening advanced country markets to least developed countries' exports

39. While a successful completion of the Doha trade round would be welcome, its impact on the crisis and its development dimension are still unclear (see IV.9, below). There are, however, a number of measures that have already been agreed in multilateral trade negotiations which could be implemented rapidly to support developing countries impacted by the crisis. These include implementation of duty-free, quota-free market access for products originated from LDCs. In addition, the agreement reached at the WTO´s Hong Kong Ministerial session in 2005 provided for the elimination of all forms of developed country export subsidies, at the latest by 2013, should be implemented immediately. There is no reason to await a general agreement before implementing these measures. In addition, domestic support for cotton subsidies should be abolished immediately, as they distort prices to the detriment for African countries. More generally, in all trade negotiations, the long recognized principle of special and differential treatment of developing countries should be preserved.

8. Learning from Successful Policies to undertake Regulatory Reforms.

40. The financial crisis is widely viewed to be the result of the failure of regulatory policies in the advanced industrial countries. While full regulatory reforms (discussed more extensively in section IV.6 below) will take time, it is imperative that work on regulatory reform begin now. The collapse in confidence in the financial system is widely recognized as central in the economic crisis; restoration of confidence will be central in the recovery. But it will be hard to restore confidence without changing the incentives and constraints facing the financial sector. *It is imperative that the regulatory reforms be real and substantive, and go beyond the financial sector to address underlying problems in corporate governance and competition policy, and in tax structures, giving preferential treatment to capital gains, that may provide incentives for excessive leverage.* While greater transparency is important, much more is needed than improving the clarity of financial instruments. Even if there had been full disclosure of derivative positions, their complexity was so great as to make an evaluation of the balance sheet position of the financial institutions extraordinarily difficult. Still, there is need for much greater transparency, including forbidding off balance sheet transactions and full expensing of employee stock options.

41. Well regulated economies have to be protected from competition from economies with inadequate or inappropriate regulatory systems. The problems of regulatory arbitrage and tax evasion are closely linked. Tax havens and financial centers in both developed and developing countries *that fail to meet basic standards of transparency, information exchange and regulation should be given strong incentives to reform their practices*, e.g. by restricting transactions between financial institutions in those jurisdictions and those in more highly regulated countries. Institutional arrangements for improving harmonisation and transparency should be strengthened, including the United Nations Committee of Experts on International Cooperation in Tax Matters as proposed in Paragraph 16 of the Doha Declaration. Also other international arrangements and conventions such as United Nations Convention against Corruption should also be strengthened.

9. Coordinating the Domestic and Global Impact of Government Financial Sector Support

42. Government bail-outs have substantial redistributive consequences that must be analysed in assessing their impact on recovery. In addition, because of the urgency of the situation they often fail to observe principles of good governance and especially of democratic transparency. This may lead to the introduction of inappropriate incentives, as well as failure to recognise possible adverse effects on other countries, especially on developing countries that lack equivalent financial resources.

Developed countries should undertake their financial support policies recognising that even symmetric policies can have asymmetric effects because guarantees by developing country governments are likely to be less meaningful than those by developed countries.

43. Failure to recognise these wider domestic and global consequences of financial support measures have often meant that the costs to the government and to developing countries have been higher than necessary. Funds have often been redistributed to those with higher incomes, and have created distorted incentives. Support measures for financial institutions that are implemented by Central Banks risk imposing high costs on the public purse, without adequate parliamentary oversight of appropriations. *Greater transparency on the part of all parties would facilitate a more effective response to the crisis.*

10. Improved coordination of global economic policies

44. There is a need for substantial improvement in the coordination of global economic policy. Global economic integration has outpaced the development of the appropriate political institutions and arrangements for governance of the global economic system. Remedying this lacuna is a matter of urgency, discussed at greater length in section IV.3, but this will not happen overnight.

45. In the short term, there should be an appropriate mechanism within the United Nations System for independent international analysis on questions of global economic policy, including its social and environmental dimensions. Following the successful example of the Intergovernmental Panel on Climate Change (IPCC), a similar panel could be created to offer consultancy to the General Assembly and ECOSOC, but also to other international organizations to enhance their capacity for sound decision-making in these areas. At the same time, such a panel would contribute to foster a constructive dialogue and offer a regular venue for fruitful exchange between policy makers, the academic world and key international organisations. The panel should comprise well respected academics from all over the world, appropriately representing all continents, as well as representatives of international social movements. Being made up of outstanding specialists, the panel should be able to follow, analyse and assess long-term trends, key developments and major dynamics for global change affecting all people around the globe, identify problems in the global economic and financial architecture, and jointly provide options for coherent international action and recommendations for political decision-making processes.

IV. Agenda for Systemic Reforms

46. There is an equally important agenda of deeper systemic reforms to the international system, that should begin now, if we recovery is to be sustainable.

1. A New Global Reserve System

47. The global imbalances which played an important role in this crisis can only be addressed if there is a better way of dealing with international economic risks facing countries than the current system of accumulating international reserves. Indeed, the magnitude of this crisis and the inadequacy of international responses may motivate even further accumulations. Inappropriate responses by some international economic institutions in previous economic crises have contributed to the problem, making reforms of the kind described here all the more essential. To resolve this problem ***a new Global Reserve System***—what may be viewed as a greatly expanded SDR, with regular or cyclically adjusted emissions calibrated to the size of reserve accumulations—could contribute to global stability, economic strength, and global equity. Currently, poor countries are lending to the rich reserve countries at low interest rates. The dangers of a single-country reserve system have long been recognized, as the accumulation of debt undermines confidence and stability. But a two (or three) country reserve system, to which the world seems to be moving, may be equally unstable. The new Global Reserve System is feasible, non-inflationary, and could be easily implemented, including in ways which mitigate the difficulties caused by asymmetric adjustment between surplus and deficit countries.

2. Reforms of the Governance of the International Financial Institutions

48. There is a growing international consensus in support of reform of the governance, accountability, and transparency in the Bretton Woods Institutions and other non-representative institutions that have come to play a role in the global financial system, such as the Bank for International Settlements, its various Committees, and the Financial Stability Forum. These deficiencies have impaired the ability of these institutions to take adequate actions to prevent and respond to the crisis, and have meant that some of the policies and standards that they have adopted or recommended disadvantage developing countries and emerging market economies. Major reforms in the governance of these institutions, including those giving greater voice to developing countries and greater transparency are thus necessary.

49. The reform of the World Bank's governance structure should be completed swiftly. For the second stage of the reform, focussing on the realignment of shares, three criteria could be taken into account: economic weight, contribution to the development mandate of the World Bank (for example, measured in terms of contributions to IDA and trust funds), and the volume of borrowing from the Bank.

50. For the IMF, serious consideration should be given to restoration of the weight of basic votes and the introduction of double or multiple majority voting.

51. Elections of the leaders of the World Bank and the International Monetary Fund should take place under an open democratic process.

3. A Global Economic Coordination Council.

52. A globally representative forum to address areas of concern in the functioning of the global economic system in a comprehensive way must be created. At a level equivalent with the General Assembly and the Security Council, such a Global Economic Council should meet annually at the Heads of State and Government level to assess developments and provide leadership in economic, social and ecologic issues. It would promote development, secure consistency and coherence in the policy goals of the major international organisations and support consensus building among governments on efficient and effective solutions for issues of global economic, governance. Such a Council could also promote accountability of all international economic organizations, identify gaps that need to be filled to ensure the efficient operation of the global economic and financial system, and help set the agenda for global economic and financial reforms. It would be supported intellectually by the work of the International Panel discussed in III.10. Representation would be based on the constituency system, and designed to ensure that all continents and all major economies are represented. At the same time, its size should be guided by the fact that the council must remain small enough for effective discussion and decision making All important global institutions, such as the World Bank, IMF, WTO, ILO and members of the UN Secretariat dealing with economic and social issues would provide supporting information and participate in the Council. It could thus provide a democratically representative alternative to the G-20.

4. Better and more balanced surveillance.

53. The surveillance of economic policies should be especially focused on systemically significant countries, those whose bad performance is most likely to have global consequences. Such surveillance should focus not just on inflation, but on unemployment, financial stability, systemic stability related to the presence of built in stabilizers or destabilizers, and systems of social protection.

5. Reforming Central Bank Policies to promote Development

54. Whereas price stability is desirable in support of growth and financial stability, it is not sufficient. Central Banks should therefore aim to ensure price stability in the context of delivering long-term sustainable growth, while being sensitive to the risks to financial stability, capital flows and exchange rates. Central banks also need to give consideration to financial market and asset price developments. This may entail Central Banks using a wider range of instruments, including prudential instruments. A distinction may need to be made between the roles of Central Banks in maintaining financial stability under normal circumstances and during crisis periods. Central

Bank governance arrangements may need to differ depending on their precise role. In particular, in any actions which may impose serious risks on a country's fiscal position, such as those now being implemented in many countries as part of financial institution resolutions, should be subject to coordination.

6. Financial Market Policies

55. Financial policies, including regulation, have as their objective not only ensuring the safety and soundness of financial institutions and stability of the financial system, but protection of bank depositors, consumers and investors and ensuring financial inclusion - such as access to all banking services including credit, and the provision of financial products which help individuals and families manage the risks they face and gain access to credit at reasonable terms. It is also imperative to make sure that the sector is competitive and innovative.

56. Financial institutions have been allowed to grow to be too big to fail, imposing enormous risk on the global economy. And while there has been innovation, too much of the innovation was aimed at regulatory, tax, and accounting arbitrage, and too little at meeting the real needs of ordinary citizens. Too little was done to help developing countries and ordinary homeowners manage the risks which they face, with consequences that have been repeatedly apparent. Financial regulation must be designed so as to enhance meaningful innovation that improves risk management and capital allocation.

57. The current crisis has made it apparent that there are large gaps and deficiencies in the regulatory structures in place in many systemically significant countries. It is also apparent that while effective regulatory system must be national there must be some global regulatory framework to establish minimum national standards and also govern the global operations of systemical relevant global financial institutions. The Report of the Commission will identify a number of key aspects of regulatory reform, emphasizing the need for deep and pervasive reforms and highlighting the risks of merely cosmetic changes in regulations. The following items are among the key aspects of needed reform.

(*a) Financial Product Safety*

58. Sustainable recovery will depend on appropriate regulations (across countries, products, and institutions). Regulations should be based on what things are, not what they are called, i.e. insurance products should be regulated the same way, whether called insurance or not. Financial regulators should be mandated to ascertain the safety and appropriate use of various financial instruments and practices, including through the creation of a Financial Products Safety Commission.

59. Core depository institutions should be restricted from undertaking excessively risky activities and tightly regulated. There also needs to be close oversight over all highly levered and all systemically significant institutions. But there should be oversight over all financial institutions. Institutions can quickly change into systemically significant.

(b) Comprehensive Application of Financial Regulation

60. The fact that correlated behavior of a large number of institutions, each of which is not systemically significant, can give rise to systemic vulnerability makes oversight of all institutions necessary. There needs to be tighter regulation of incentives, especially in the core institutions; part of the current problem is a result of distorted incentives which encouraged short sighted and excessively risky behavior. It may be easier to regulate incentives than every manifestation of perverse incentives. There need to be restrictions on leverage, with automatic countercyclical capital adequacy and/or provisioning requirements.

61. Although the activities of private investment funds, equity funds and hedge funds did not trigger the financial crisis, their regulation is not globally uniform, creating the potential for regulatory arbitrage and the potential for gaps in regulation. Funds should be registered in the countries of their operations and provide appropriate regulation to regulatory authorities. In addition, banks must define limits for transactions with hedge funds.

62. There should be no retreat from mark to market accounting for institutions with short-term funding in order to provide full transparency for investors and regulators. Other institutions may be encouraged to supplement mark-to-market accounting with valuations that are more appropriate to the maturity of their liabilities. In addition, steps should be taken to enforce transparency norms and public accountability for all public companies.

(c) Regulation of derivatives trading

63. The large scale use of unregulated, unsupervised OTC derivatives has resulted in undue complexity, opacity, and mis-pricing of these instruments, and facilitated capital avoidance by financial institutions. These practices have weakened our financial system significantly and made resolution of failing firms extremely difficult.

64. Where appropriate steps should be take to develop regulated exchanges for trading standardized contracts of systemically significant derivative contracts, with the associated regulatory restrictions including limits on non-commercial traders. Regulations should insure that derivative instruments are held on balance sheets, valued at independently audited real transaction prices, with appropriate capital provisioning, and clarity of purpose. The use of over the counter contracts by core

institutions should, in general, be discouraged, but whenever used, there should be ample and adequate margin.

(d) Regulation of Credit Rating Agencies

65. Other needed reforms, including for Credit Rating Agencies and systems of information provision are addressed in an Appendix.

(e) Towards global institutional arrangements for governing the global economy: a Global Financial Regulatory Authority; a Global Competition Authority.

66. The Financial Stability Forum was created in the aftermath of the 1997-8 financial crisis in order to promote international financial stability, improve the functioning of financial markets and reduce the tendency for financial shocks to propagate from country to country, and to enhance the institutional framework to support global financial stability. It is now apparent that the reforms that it has proposed, although important, have not been sufficient to avoid major global financial instability. If it is to become the main instrument for the formulation of reforms of the global financial system it must take into consideration the importance of financial stability for the development of the real economy. In addition it must increase the representation of developing countries to adequately reflect the views and conditions in these countries and be made accountable to a democratically representative institution such as the Global Economic Coordination Council proposed above.

67. The development of financial institutions that are too big to fail has played an important role in the development of the crisis and has made the resolution of the crisis both difficult and costly, both for taxpayers and for the global economy. It is imperative not only that is adequate oversight of these large institution but that efforts be made to limit their size and the extent of their interactions, to limit the scope of systemic risk. This will require more effective global cooperation in financial and competition regulation. Movement towards this goal might be enhanced by taking steps to lay the groundwork for a Global Financial Regulatory Authority and a Global Competition Authority. With so many firms operating across borders, it is difficult to rely on national regulatory authorities. There may be large externalities generated by the action (or inaction) of national authorities. A potential, but partial, remedy to this difficulty is the proposal for a College of Supervisors to oversee systemically relevant global financial institutions. This could provide a basis for a more comprehensive Global Authority.

(f) Host Country regulation of foreign subsidiaries

68. In the absence of adequate global coordination, financial sector regulation will need to be based on the host country, not the home country, and may entail requiring the establishment of subsidiaries, rather than relying on branches.

(*g*) *Regulatory institutions*

69. While inadequate regulations are partly to blame for the current crisis, in some cases good regulations were not effectively applied and enforced. This highlights the need for reforms in regulatory structures, including reforms that make the possibility of regulatory capture less likely. The weaker is the system of global regulation, the more segmented will financial markets have to be to ensure global stability.

7. Support for Financial Innovations to Enhance Risk Mitigation

70. The absence of global systems of risk bearing and the absence of—and in some cases resistance to—innovations that would facilitate efficient risk bearing, such as GDP indexed bonds and mortgage products which better manage the risks associated with home ownership must be remedied. Governments and the international financial institutions need to explore meaningful innovations that would enhance risk management and distribution and how markets might be encouraged to do a better job. In particular, while there have been some expansion in capital markets in domestic currencies in developing countries, developing countries still bear the brunt of exchange and interest rate fluctuations. IFI lending in (possibly baskets of) local currencies and the provision of exchange and interest rate cover might be important steps in improving international risk markets.

8. Mechanisms for handling Sovereign Debt Restructuring and Cross-border Investment Disputes

71. There is an urgent need for renewed commitment to develop an equitable and generally acceptable Sovereign Debt Restructuring Mechanism, as a well as an improved framework for handling cross border bankruptcies. One way by which this might be done is through the creation of an independent structure, such as an International Bankruptcy Court. The United Nations Commission on International Trade Law provides a model that could be extended to the harmonization of national legislation on cross border disputes dealing with trade in financial services.

72. A number of countries may face difficulties in meeting their external debt commitments as the crisis worsens and debt rescheduling becomes more and more difficult due to an increase in creditors not represented in the Paris Club. The current crisis has already seen a number of bankruptcies of companies that operate across national borders, and their number is likely to increase. The absence of a formal mechanism for dealing with the impact of cross border bankruptcy and insolvency,

especially when related to financial institutions, transmits the adverse economic effects to the global economy.

73. It is especially important to achieve a uniform approach to financial and investment disputes on bankruptcy and insolvency, given the fact that the regulations dealing with these matters included in bilateral free trade agreements often transcend existing multilateral treaties and national legislation.

9. Completion of a Truly Development-Oriented Trade Round

74. There is a need for a true development round, to create an international trade regime which truly promotes growth in the developing countries. It is essential, that in all trade negotiations, the long recognized principle of special and differential treatment of developing countries be preserved.

10. More Stable and Sustainable Development Finance

75. The need for more and more stable sources of finance for development, including for the investments needed to address the long run challenges of responding to climate change, and new institutions for disbursement of funds, is discussed in Section III.4 above.

76. In the absence of better systems of risk mitigation, it is especially important for developing countries to be wary of measures that expose them to greater risk and volatility, such as capital market liberalization. Developing countries should use all the tools at their disposal, price interventions, quantitative restrictions, and prudential regulations, in order to help manage international capital flows.

77. Market-driven international capital flows are of a magnitude and volatility that they can offset any formal mechanism to provide additional finance for development. Thus, an active management of foreign capital inflows will be required to ensure that they are supportive of government counter-cyclical policies. The Articles of Agreement of the International Monetary Fund provided to members the facility of controlling capital inflows and expressly excluded the use of Fund resources to meet imbalances resulting from capital account disequilibrium. The Fund should thus be encouraged to return to its first principles and support countries that attempt to manage external flows in support domestic counter cyclical policy.

78. The international community needs to explore a variety of mechanisms of ***innovative finance,*** including regular emissions of a new global reserves (SDRs), revenues generated from the auction of global natural resources (such as ocean fishing rights and pollution emission permits), and international taxes (such as a carbon tax, which would simultaneously help address problems of global warming, or a financial

services tax, which would simultaneously help stabilize international financial markets.)

79. The receipts could be directed to support the developing countries costs of reducing greenhouse gas emissions in the context of their national policies to promote sustainable development. The effective implementation of national systems of taxation form a crucial part of domestic development finance. Measures must be taken to preserve national autonomy in the selection of the sources and methods of government financing while ensuring that national differences do not create incentives to evade responsibility of contributors to the support of government policies. An efficient method of achieving this result would be the acceptance by all countries of an amendment of Article 26 of the United Nations Model Double Taxation Convention between Developed and Developing Countries to make the exchange of information automatic.

Information on the Commission of Experts is available in: http://www.un.org/ga/president/63/commission/financial_commission.shtml.