

Recent developments in international co-operation

This article highlights recent developments in international co-operation, focusing on efforts in crisis prevention. It shows that the scope and nature of international co-operation have changed significantly over the last two decades in response to new policy challenges associated with rapidly increasing cross-border private capital flows and the emergence of new economies participating in the globalisation process. As a result, international co-operation has shifted away from a predominant focus on exchange rate matters among major industrialised economies to the design of optimal policy frameworks for both mature economies and systemically important emerging market economies (EMEs). The new scope and nature of international monetary and financial co-operation are aimed mainly at reaching a consensus on best practices in policy formulation (macroeconomic and financial stability policies) and improving the transparency and accountability of policy-making vis-à-vis other relevant policy-makers, market participants and public opinion. The ultimate objective is to prevent currency, external debt or banking crises, by relying increasingly on a set of internationally agreed standards and codes. Prevention and better surveillance are expected to foster global financial stability by enhancing the effectiveness of domestic policy-making through rules-based frameworks and market discipline. While the new scope and nature of international co-operation have contributed to the pursuit of sounder domestic policies than in the past, there are areas in which implementation issues are still open. These include, inter alia, ownership of standards and codes and the assessment of their observance, as well as the need to ensure consistency with well-established IMF surveillance and conditionality procedures.

I Introduction

The scope and nature of international economic co-operation has changed over the past two decades with regard to the relative emphasis placed on the three main areas of international co-operation in the post-Bretton Woods era, namely exchange rate stability, external debt sustainability and systemic financial stability. Whereas international co-operation in the 1980s focused mainly on exchange rate stability among major industrial countries, the external debt and banking crises of Mexico and Asian EMEs in the 1990s brought to the fore the question of external debt sustainability in all emerging market countries coupled with domestic and systemic financial stability concerns.

This article aims to illustrate how this experience led to a shift from a mode of co-operation relying on *ad hoc* and often *crisis-driven* arrangements to one based on the design and implementation of measures aimed

at strengthening the international financial system in a more systematic and preventive manner. Section 2 illustrates recent developments in the global financial system that have determined the shift in the focus of international co-operation, while Section 3 deals with the implications of the changes in the global financial system for the scope and nature of international co-operation. Section 4 reviews the design and implementation of standards and codes, the new key component of international economic co-operation. The final section offers some concluding remarks.

The article does not address current issues relating to crisis management and resolution. As for the effects of recent developments in international co-operation on the ECB's relations with international organisations and fora, the reader may like to refer to the article "The ECB's relations with international organisations and fora", published in the January 2001 issue of the Monthly Bulletin.

2 Changes in the global financial system

The global financial system has undergone profound changes over the past few decades. Countries have increasingly opened their capital accounts, thus allowing market forces to play a major role in determining asset prices and other policy-relevant financial variables (e.g. interest rates) as well as the pattern of capital flows – which is known as the deepening of financial integration. At the same time, a growing number of economies have been participating in the globalisation process, which has widened the scope of financial integration. However, the financial integration process has been accompanied by episodes of severe financial distress with widespread cross-border spillover effects – a corollary of financial globalisation. While these financial crises can be characterised *ex post* as transitory interruptions in the financial integration process, thus not affecting its long-term development, they have significantly contributed to shaping the scope and nature of international co-operation.

Deepening of financial integration

The main force behind the deepening of financial integration has been the shift from a financial system dominated by the official sector to one dominated by market forces.

Under the Bretton Woods regime, exchange rate stability was regarded as the precondition for the success of trade liberalisation, and free capital movements were considered as a potential source of instability. This implied that countries were allowed, and to some extent even encouraged, to impose capital controls to support the system of fixed but adjustable exchange rates. At the domestic level, these controls were instrumental in achieving a wide variety of targets, ranging from industrial policy and sectoral development objectives to the regulation of the domestic banking and financial markets, possibly supporting mechanisms of direct monetary control. As market pressure put the viability

of the Bretton Woods system to the test, the recourse to capital controls became more widespread, involving both “weak” and “strong” currencies. In the post-Bretton-Woods era, a number of industrial countries relaxed, and eventually lifted, capital controls together with domestic credit and financial market regulations and restrictions. Starting in the United States and Germany, the process gathered momentum as the United Kingdom and Japan began liberalising their controls in 1979 and 1980 respectively. In continental Europe, the full liberalisation of capital movements was achieved in the framework of the Single Market, which became effective in 1990 in virtually all EU Member States, marking the first stage of Economic and Monetary Union and fulfilling a precondition for the adoption of the euro.

The progressive dismantling of capital controls was motivated by their declining effectiveness due to continuous technological progress and financial innovation (i.e. the emergence and rapid expansion of Euro-currency markets). Added to this was the growing conviction that the over-regulation of the credit and financial markets that accompanied capital account restrictions distorted the allocation of resources and weakened the ability of economies to adjust to rapidly changing domestic and external conditions, thus resulting in lower than optimal potential output growth. As such, the liberalisation of capital movements was an important element of the move towards market-oriented policies aimed at achieving sustainable non-inflationary growth rates.

As a result of the shift towards a market-dominated financial system, asset prices and other policy-relevant financial variables became more and more market-determined and the relative importance of bank intermediation decreased in favour of capital markets. In addition, diversification opportunities increased substantially, on both the assets and liabilities

sides. For policy-makers, the growth of financial markets facilitated the adoption of market-friendly structural reforms, as in the case of the privatisation of state-owned enterprises. At the same time, policy-makers have been subject to growing scrutiny, as financial markets have been “pricing in” the quality of public policies more effectively, both in terms of formulation and of implementation.

Widening of financial integration

The deepening of financial integration has been accompanied by a widening of the process through the emergence of new participants in globalisation. Two developments are noteworthy in this respect.

First, the increasing importance of emerging markets in the world economy. Asian EMEs have recorded sustained growth over an extended period. For China, Hong Kong SAR, Indonesia, Korea, Malaysia, the Philippines, Singapore, Taiwan – Province of China and Thailand, the average annual growth rates of real GDP, trade and official reserves amounted to 7%, 12%, and 17% respectively in the period from 1980 to 2000. Accordingly, these countries’ average shares in the world totals rose from 5.3% in the 1980s to 6.9% in the 1990s for GDP, from 8.9% to 14.8% for trade and from 8.4% to 22.1% for official reserves. Several Latin American countries were also able to return to a growth path following the “lost decade” of the 1980s. Whereas GDP growth rates in Argentina, Chile, Mexico and Venezuela averaged 1% in the 1980s, they reached almost 4% in the 1990s. Positive developments were also recorded in the growth of trade volume (from 5% to 9%) and reserves (from -2.7% to 17.9%). In terms of world share, these countries jumped from 2.1% in 1990 to 3.2% in 2000 for GDP, from 2.0% to 2.7% for trade and from 2.3% to 3.9% for official reserves.

Second, the adoption of a market-based system by formerly planned economies in central and eastern Europe and Asia. The result of these two developments was that a growing number of countries became integrated in the global financial system, while emerging market debt instruments (e.g. bonds, international banking credits) developed as a new asset class.

Changing volume and structure of international financial flows

The gradual shift from a financial system dominated by the official sector to one dominated by market forces has been reflected in two major financial market trends.

First, the total volume of cross-border capital flows has increased steadily at a remarkable pace. For instance, IMF figures show that (gross) capital flows among industrial countries more than doubled between 1990 and 1998, reaching a peak of almost USD 4.5 trillion in 1997. This increase helped to finance the United States’ growing current account deficits as well as recycle Japanese surpluses, while the EU remained, broadly speaking, in balance.

Second, net *private* capital inflows to EMEs expanded dramatically. According to the IMF, these inflows grew from an average of around USD 15 billion p.a. in the 1980s to USD 123 billion in the 1990s, reaching a peak of USD 234 billion in 1996, i.e. before the Asian crisis. This shift in favour of emerging economies is also reflected in the fact that private capital markets have superseded official finance in covering the external financing requirements of EMEs. Net *official sector* financing of EMEs grew only slightly from an average of USD 28 billion in the 1980s to around USD 30 billion p.a. in the 1990s. Correspondingly, the average share of private financing in the total rose from 35% in the 1980s to 81% in the 1990s.

3 Implications for the scope and nature of international monetary and financial co-operation

In the post-Bretton Woods era, international co-operation has concerned three main areas, namely exchange rate stability, external debt sustainability and systemic financial stability, though the relative emphasis on each of these three components has changed over time.

International co-operation in the 1980s focused mainly on exchange rate stability among major industrial countries and external debt sustainability problems in middle-income countries, while systemic financial stability concerns were less pervasive. With the deepening and widening of financial integration, the question of external debt sustainability in all emerging market countries – not only Latin America but also Asia and Europe – coupled with domestic and systemic financial stability concerns progressively came to the fore. Moreover, a clear asymmetry emerged between the global nature of the financial system and the national nature of policy-making, an asymmetry that has proved capable of endangering international financial stability. The recognition of this led to a shift from a mode of co-operation relying on *ad hoc* and often *crisis-driven* arrangements to one based on the design and implementation of measures aimed at strengthening the international financial system in a more systematic manner.

The main areas of international co-operation

Exchange rate co-operation

The changing scope and nature of policy co-operation can be better understood by briefly recalling the main features of international co-operation in the 1980s. Policy co-operation then took place mainly among industrial countries, and its objective was to stabilise exchange rates. This focus reflected the experience with the floating rate system in the 1970s and 1980s, whose performance did not match that which had been expected

by the advocates of free floating before the demise of the Bretton Woods system. In particular, major exchange rates suffered swings regarded as undesirably large and not in line with developments in economic fundamentals.

From March 1979, exchange rate co-operation in Europe took place within the framework of the European Monetary System (EMS), which built on the experience of the so-called Snake, an early attempt to form a European exchange rate arrangement following the end of the Bretton Woods system. The exchange rate mechanism (ERM) within the EMS aimed to create an area of monetary stability in support of the process of European economic integration.

With a public commitment “to work towards greater exchange rate stability”, the G5 countries set the stage in January 1985 for large-scale co-ordinated intervention in the foreign exchange markets. Intervention operations were carried out jointly in the following months with the aim of reversing an excessive US dollar appreciation. These operations were put in a broader context with the Plaza Accord in September 1985, in which the G5 governments declared themselves ready to co-operate more closely to achieve the goal of further dollar depreciation. As such, the Plaza Accord was a basis for further co-operation, which delineated the respective roles of intervention and underlying domestic policy adjustments. Exchange rate co-operation continued with the Louvre Accord in February 1987, when participating countries agreed “to intensify their economic policy co-ordination efforts” and “to co-operate closely to foster stability of exchange rates around current levels.” In the 1990s, the G7 countries’ exchange rate policy co-operation moved gradually away from *ad hoc* market reactions and policy actions at times of tension to a medium-term policy orientation towards stable domestic macroeconomic

frameworks broadly consistent with one another. They recognised that the pursuit of sound macroeconomic and structural policies at home is a necessary though insufficient condition for exchange rate stability. They also came to the conclusion that the more systematic approach of minimising the risks of potential instability rather than suppressing its market outcomes might be more effective over the medium term.

External debt sustainability

International co-operation in the 1980s also addressed the external debt sustainability issue, with the Baker and Brady Plans aiming to restore the balance of payments viability of middle-income countries that were hit by the debt crisis of the early 1980s. In particular the Brady Plan, adopted in 1989, reflected the widespread recognition that a lasting solution of the debt crisis required a centralised co-ordination of the creditors-debtors relationships under the aegis of the IMF. However, it made no attempt to implement reforms that could have helped to prevent the emergence of similar problems later on. Thus the Brady Plan, in spite of its widespread implementation both in Latin America and in South-East Asia, should be regarded as an example of ad hoc one-off international co-operation. It was only after the debt crises suffered by Mexico and Asian EMEs in the 1990s that the international community started strengthening the international financial system in a more systematic and preventive manner.

Systemic financial stability

In the 1980s, international co-operation in this area was organised among industrial countries and related almost exclusively to banking supervision matters. The Basel Committee on Banking Supervision was created in 1974 following the Herstatt bankruptcy, which highlighted growing international systemic risks arising from rapidly developing foreign exchange operations

and related cross-border settlements. The Committee introduced its Capital Accord in 1988, in line with its objective of fostering co-operation among the major industrial countries in order to regulate and supervise an increasingly global banking industry and largely in reaction to the external debt problems of middle-income countries in the 1980s. By raising the amount of capital prudential authorities were to require of individual institutions to enable them to withstand potential risks (e.g. market, credit), this agreement helped create a level playing field among internationally active banks. Although the Capital Accord reflected the recognition that increased cross-border linkages among domestic financial institutions, markets and infrastructures called for minimum common standards, the mutually agreed rules were initially designed and applied by industrial countries only. The Committee, however, has from the outset encouraged and provided leadership for non-G10 countries on a wide range of banking issues. This was ultimately reflected in the “Core Principles for Effective Banking Supervision”, agreed following political impulse and guidance from the G7 Summit of Heads of State and Government in Halifax in 1995.

The changing paradigm underlying international co-operation

The international co-operation activities in the 1980s were accompanied by an emerging paradigm of medium-term stability-oriented policies among policy-makers in industrial countries based on the desirability of internally stable currencies and sound public finances. As a result, the policy focus shifted away from activist and short-term-oriented demand management policies to stability-oriented macroeconomic policies as a precondition for attaining sustainable non-inflationary growth.

The new policy paradigm is based on the following principles:

- The exchange rate is an asset price determined by market participants' perceptions of actual and expected economic performances and policies. Exchange rate movements thus reflect the market assessment of countries' fundamentals and consistency across domestic policies. At the policy level, this means that exchange rates can be regarded as the outcome, rather than an objective, of policies.
- It is essential for each individual country to "put its own house in order". In an environment of free capital flows, market-determined asset prices and other policy-relevant financial variables are expected to penalise flawed domestic policies. As a result, sound policy frameworks at the national level are required to improve countries' economic and financial performances, thereby helping to stabilise global financial developments.
- The assignment of objectives to policy areas should follow an "optimal" framework, which includes three main elements: (i) maintaining price stability is the primary objective of monetary policy; (ii) determining the level and composition of public expenditures and revenues is the task of fiscal policy. Within that context, fiscal policy may contribute to smoothing economic activity over the business cycle, mainly through the operation of automatic stabilisers, in a manner consistent with sound and sustainable public finances; and (iii) enhancing potential output growth is the main objective of structural policies, which should foster efficient allocation of resources – in product, labour and financial markets – and strengthen the resilience of economies to shocks.

This policy paradigm emerged only gradually as a crystallisation of the experience of individual industrial countries. The adoption by most mature economies of increasingly rules-based policy frameworks reduced the scope for policy discretion at the domestic level, enhancing policy predictability,

reducing the risk of inconsistency among domestic policies and improving domestic fundamentals. The outcome was viewed as a lessening of the need for co-ordination of actual policy decisions at the international level, since the possibility of negative externalities attributable to unsound national performances and/or policies was considered to have been reduced.

As stated above, the focus of international co-operation changed in the aftermath of the financial crises which affected EMEs in the 1990s. The abruptness and size of cross-border private capital reversals that triggered financial crises in EMEs confirmed that the orderly integration of these countries into the global financial system is a crucial element of international financial stability. It became apparent that the experience gained by industrial countries of best practices in domestic policy-making needed to be transmitted to the EMEs. Following the Mexican crisis in 1994/95, the G7 Summit of Heads of State and Government in Halifax in June 1995 highlighted the need for effective crisis prevention and, thus, the importance of sound policies and improved transparency. Likewise, in the area of supervision and regulation, the competent institutions were asked to develop and enhance standards to contain risk. The Asian crises in 1997 and 1998 gave further momentum to these initiatives. Work was stepped up in the relevant international institutions and fora on internationally agreed standards and codes aimed at enhancing transparency and accountability in the traditional domains of macroeconomic policy and ensuring the soundness of domestic financial institutions, markets and infrastructures.

The remainder of the article will illustrate why standards and codes can be considered a new key component of international co-operation. While enhanced surveillance and prevention, based on this new approach, can make a major contribution to greater global financial stability, exchange rates and external debts remain of relevance. Recent experience has shown that appropriate

domestic policy frameworks and measures may not always be sufficient. As for EMEs, the Asian crisis has highlighted the importance of consistency between any given exchange rate regime and associated macroeconomic and structural policies for global financial

stability. In addition, since the risk of external debt crises will continue to exist, an improved policy framework for crisis management and resolution is also required, especially with respect to the involvement of the private sector.

4 A new key component of international co-operation: standards and codes

Main characteristics of standards and codes

While not new in nature, the number and scope of standards and codes have increased substantially over the past few years together with the number of institutions and fora supporting this process. Three layers may be broadly distinguished in the process.

First, the political impulse is provided by international fora. These include the G7, the G10, the G20 – an informal forum established in 1999 to enhance dialogue between major industrial countries and EMEs – and the Financial Stability Forum (FSF), which was set up in April 1999 to promote international financial stability through international information sharing and co-operation in financial supervision. Second, the task of setting standards is performed by different institutions, ranging from public sector entities such as the IMF, the World Bank, the OECD and central bank committees (i.e. the Basel Committee on Banking Supervision and the Committee on Payment and Settlement Systems) to private sector bodies such as the International Accounting Standards Board and the International Federation of Accountants. Third, the role of standards-enforcer is mainly played by the IMF and the World Bank, in close consultation with the respective standard-setting body. However, the activity of enforcing standards has to take into account the fact that the observance of standards and codes remains voluntary.

The FSF has identified 12 standards and codes as key for financial stability. A description of these, and of the bodies which set them,

is given in Table I in the annex. Using the typology suggested by the FSF, standards and codes can be grouped into three broad areas: (i) macroeconomic policy and data transparency; (ii) financial regulation and supervision; and (iii) institutional and market infrastructure.

The three standards subsumed under the first category – i.e. the IMF's "Code of Good Practices on Transparency in Monetary and Financial Policies", "Code of Good Practices in Fiscal Transparency" and "Special Data Dissemination Standard" – are based on the recognition of the benefits of rules-based and transparent policy frameworks and, to a certain extent, render the policy paradigm referred to above operational. An example is the Code of Good Practices on Transparency in Monetary and Financial Policies, where the term "financial policies" refers to the regulation, supervision and oversight of financial and payment systems, including markets and institutions, with a view to promoting financial stability, market efficiency and consumer protection. The four main principles of this code, which also apply to the companion code on fiscal transparency, are: (i) clarity of roles, responsibilities and objectives of the central bank and financial agencies; (ii) an open process for the formulation and reporting of policies by the central bank and financial agencies; (iii) the provision of reliable information to the markets and public at large; and (iv) accountability of, and assurances of integrity by, the central bank and financial agencies.

The second category includes standards that can be seen as a continuation and broadening

of the endeavours to improve international co-operation in banking supervision which started with the first Capital Accord mentioned above. The three standards – “Core Principles for Effective Banking Supervision”, “Objectives and Principles of Securities Regulation” and the “Insurance Core Principles” – set out principles considered essential for effective supervision and regulation in the three areas concerned.

The standards listed in the third category concern mainly market infrastructure, such as the “Core Principles for Systemically Important Payment Systems”, and microeconomic issues, such as corporate governance, accounting and auditing, but also criminal justice and law enforcement which are covered in the Forty recommendations of the Financial Action Task Force (FATF) regarding money laundering. These standards can also be considered as elementary building blocks in countries’ endeavours to develop sound domestic financial systems, as they represent the micro foundation of their institutional and market infrastructure.

The IMF and the World Bank prepare “Reports on the Observance of Standards and Codes” (ROSCs) that evaluate exclusively the extent to which countries observe internationally recognised standards in 11 areas which have been deemed useful for the operations of the IMF and the World Bank. In addition, in 1999 the two institutions started the joint Financial Sector Assessment Program (FSAP), which provides for comprehensive “health checks” of countries’ financial sectors. This includes the observance of relevant international standards and codes. The assessments are usually composed of modules that cover individual standards and codes, an approach that allows flexibility regarding the areas to be assessed. In line with the voluntary nature of the observance of standards, participation in ROSCs and FSAPs and the publication of the outcome of the two exercises remains voluntary.

So far, only a limited – but growing – number of countries have participated in ROSCs and

FSAPs. As of end-September 2001, 169 ROSC modules had been produced for 57 countries, of which 109 modules for 36 countries had been published. The ECB also participated in the process. In November 2001, a ROSC, covering the transparency of monetary and financial policies and the Core Principles for Systemically Important Payment Systems, was published together with the 2001 IMF Article IV staff report on the monetary and exchange rate policies of the euro area. The IMF found that overall the Eurosystem maintains a high level of transparency in all aspects of its operations and a high degree of observance of the relevant Codes. As regards the FSAP, 62 countries have volunteered to participate in the programme, of which 22 assessments have been finalised and four of these published. However, this limited participation in ROSCs and FSAPs reflects not only the voluntary nature together with the relative newness of the process, but also the resource-intensive character of the initial assessments and their regular updates. Despite the decision to step up the process by setting a target of 24 FSAPs per year, it will take a number of years before ROSCs and/or FSAPs are drawn up for all IMF/World Bank member countries.

Open issues

Despite growing agreement on their importance and merits, the process of developing and implementing standards and codes as well as assessing countries’ observance of them has given rise to questions and challenges, most of which are related to the early stage of the exercise and to its voluntary nature.

Ownership

Given the voluntary nature of the process, a widespread implementation of standards and codes is dependent on the acceptance of them. There has been criticism from some quarters that the first standards and codes have been developed in fora encompassing

only industrial countries (G7 or G10) and that emerging market and developing countries have been largely excluded from the process, although they are supposed to implement the standards and codes as well. In order to address this problem the IMF and the World Bank have initiated “outreach programs”, in which external consultation procedures have been an integral part of the preparations for more up-to-date standards and codes. By increasing the involvement of their entire membership as well as private sector institutions and academics, the two Bretton Woods institutions have improved the acceptability of standards and codes. Other standard-setters with smaller memberships than the IMF and the World Bank have also increasingly opened up their preparation process to extensive external consultation involving EMEs and in some cases the private sector and academics (e.g. Basel Core Principles and Core Principles for Systemically Important Payment Systems). Such a dialogue with national authorities and representatives of the private and academic sectors needs to be continued in order to enhance awareness, acceptance and ownership. Open processes for preparing standards and codes are also likely to provide useful feedback and may lead to an improvement of existing standards.

Self-assessment

Some countries have resorted to self-assessment, i.e. conducted by their own national authorities. Self-assessment can be regarded as an important contribution to countries’ ownership of standards and codes. It is a useful first step for identifying weaknesses and setting priorities in the implementation process, thereby also constituting an initial basis for external assessment. In view of its possible limited objectivity, self-assessment cannot be considered as a substitute for external assessment by the relevant international institutions. In addition, only external assessors are able to ensure the consistency of assessments across countries.

Modes of implementation

Ideally, standards and codes should be regarded as universal instruments to be applied consistently across countries since they reflect an international consensus on what constitutes best practices in a given policy area. However, economic and institutional conditions differ between countries. Consequently, some observers argue that standard-setters should adopt a multi-track approach to the design of standards, i.e. they should envisage different benchmarks for countries at different stages of development. This approach has been partially followed for the codes on data dissemination, where two sets of standards with different requirements have been developed (General and Special Data Dissemination Standards). However, the key feature and the main benefit of the standards and codes approach is the agreement on and the use of consistent definitions across countries. Therefore, there is a clear trade-off between universality of design and consistency in the application of standards and codes. As compliance with standards should inter alia reassure markets that countries are “good risks”, it seems inappropriate to apply differentiated standards to individual countries. An alternative avenue through which to take account of different conditions at country level is to set credible timetables for the full implementation of standards and codes. Likewise, it seems inevitable that differences in institutional capacity and level of development should lead countries to prioritise among standards.

Surveillance and conditionality

The elaboration of best policy practices has considerable potential to help the IMF be more focused in its bilateral surveillance activities and to guide its conditionality policies. In addition, the new emphasis on standards and codes redefines the IMF as the institution responsible not only for crisis management but also for crisis prevention. However, partly as a result of the voluntary

nature of compliance and the still limited country coverage, there are no formal links at present between the observance of standards and codes and the IMF's main instruments of international co-operation, i.e. surveillance and financial assistance combined with conditionality.

As for surveillance, the assessment of a country's observance of standards can help detect potential deficiencies in domestic policy areas and is therefore recognised by the IMF Executive Board as an important element of its surveillance exercise. ROSCs are currently circulated to the Executive Board in the context of the discussions on countries' Article IV consultations. The Executive Board may encourage countries to participate in voluntary ROSCs or FSAPs if potential weaknesses are detected during the Article IV consultation process and the country had not so far volunteered to participate.

Regarding the terms of the provision of financial assistance (conditionality), there might be a case for setting incentives to encourage countries to step up their efforts to comply with standards and codes and thus improve their resilience to crisis. Therefore, over time, the IMF and the World Bank should explore ways to promote a more direct link between standards and conditionality following the example provided by the IMF's Contingent Credit Line. The eligibility requirements for this credit facility list the observance of standards and codes as one element used to ascertain whether a country's policies can be considered "first class".

Role of the private sector

Ideally, country compliance with standards and codes should feed into market

participants' risk assessments and related investment decisions and terms. However, this channel of market incentives is not yet effectively working. This might be due to the relative newness of the process and the fact that awareness of standards is not widespread among market participants, including rating agencies. According to market participants, several aspects of the assessment of compliance could be improved, including the expansion of country coverage, mandatory publication of ROSCs, regular updates and improved user-friendliness through streamlined and standardised formats. Pushed to the limits, these recommendations would lead to the release of ratings. However, the IMF and the World Bank remain wary of providing quantitative ratings on compliance, as this would change the very nature of these organisations.

A small number of private sector firms have also started preparing assessments of individual countries' compliance with standards. In principle, such private sector assessments can be considered helpful as they may play a useful role in bridging the gap between the largely qualitative assessments provided by the official sector and the quantitative information requested by the private sector. Objectivity and accuracy of the assessments are, however, necessary ingredients of the exercise. Concerns about the quality and independence of evaluations would undermine the integrity of the standards and codes approach. On these counts, for the time being, these assessments cannot be considered as a substitute for the work undertaken by international financial institutions. At a later stage, if more firms were to enter this market, competitive market forces might help to ensure a more adequate level of quality.

5 Conclusions

The article has tried to show that international economic co-operation has been flexibly adapted as a response to the changing

circumstances of the 1990s, as well as to the new policy paradigm stressing the importance of rules-based and transparent policies. The

new scope and nature of international co-operation are embodied in internationally agreed standards and codes which aim to enhance transparency and accountability in the traditional domains of macroeconomic policy and ensure the soundness of domestic financial institutions, markets and infrastructures. One important feature is an attempt to address the asymmetry between the global nature of the financial system and the national nature of policy-making. This is done through the adoption of rules-based and transparent policy frameworks that narrow down the scope for policy discretion at the domestic level, thus reducing – in principle – occurrences of a need for co-ordination of actual policy decisions at the international level.

Significant progress has been made in developing and implementing standards and codes as well as assessing countries' observance of them, even if a number of open questions and challenges remain, most of which are related to the voluntary nature of compliance and to the early stage of the exercise. To ensure consistency in the whole process, the institutions and fora involved in standard setting and standard enforcement, respectively, should step up co-operation. On the one hand, standard-setters have to be involved in the development of assessment methodologies to ensure consistent interpretation. On the other, the IMF and the World Bank, given their leading role as standard-enforcers, must also participate in the evaluation of experiences and the possible future development of standards and codes.

Table**Key international standards for sound financial systems, as identified by the FSF**

Subject area	Title of standard	Standard-setting body	Main features
I. Macroeconomic policy and data transparency			
Monetary and financial policy transparency	Code of Good Practices on Transparency in Monetary and Financial Policies (September 1999)	IMF http://www.imf.org	The Code identifies desirable transparency practices for central banks in their conduct of monetary policy and for central banks and other financial agencies in their conduct of financial policies.
Fiscal policy transparency	Code of Good Practices in Fiscal Transparency (April 1998)	IMF http://www.imf.org	The Code contains transparency requirements regarding the structure and functions of government, fiscal policy intentions, public sector accounts and fiscal projections.
Data dissemination	Special Data Dissemination Standard (SDDS) (March 1996)/ General Data Dissemination System (GDDS) (December 1997)	IMF http://www.imf.org	The SDDS is mainly designed for countries having or seeking access to international capital markets. Countries subscribing to the SDDS undertake to follow good statistical practices in four dimensions: (i) coverage, periodicity and timeliness of the data disseminated; (ii) dissemination of advance release calendars; (iii) integrity of the data; (iv) quality of the data. The GDDS is mainly designed for countries that do not have or seek access to international capital markets. The GDDS takes into account, across the broad range of countries, the diversity of their economies and the developmental requirements of many of their statistical systems.
II. Financial regulation and supervision			
Banking supervision	Core Principles for Effective Banking Supervision (September 1997)	Basel Committee on Banking Supervision (BCBS). The BCBS, established by the G10 central banks, provides a forum for regular co-operation among its member countries on banking supervisory matters. http://www.bis.org	The document, prepared in close co-operation with non-G10 supervisory authorities, provides a comprehensive blueprint for an effective supervisory system and is intended to serve as a basic reference for supervisory and other public authorities internationally. It contains 25 basic principles that are considered essential for any supervisory system to be effective. To facilitate implementation and assessment, in October 1999 the Committee developed the "Core Principles Methodology".
Securities regulation	Objectives and Principles of Securities Regulation (September 1998)	International Organisation of Securities Commissions (IOSCO). IOSCO promotes co-operation among national regulators of securities and futures markets. http://www.iosco.org	The document sets out three objectives (protection of investors; ensuring that markets are fair, efficient and transparent; reduction of systemic risk) and 30 principles upon which the regulation of securities markets is based. The document also provides some examples of current practices, acknowledging that these practices will and should change as the markets evolve and as technology and improved co-ordination among regulators makes other strategies available.
Insurance supervision	Insurance Core Principles (September 1997, revised October 2000)	International Association of Insurance Supervisors (IAIS). The IAIS, established in 1994, is a forum for co-operation among insurance regulators and supervisors from more than 100 jurisdictions. http://www.iaisweb.org	The Insurance Core Principles comprise essential principles that need to be in place for an insurance supervisory system to be effective. They set out the framework for insurance supervision and identify areas that should be addressed in legislation or regulations in each jurisdiction.

Subject area	Title of standard	Standard-setting body	Main features
III. Institutional and market infrastructure			
Insolvency	To be developed	World Bank http://www.worldbank.org	
Corporate governance	Principles of Corporate Governance (May 1999)	OECD. http://www.oecd.org	The Principles are aimed at improving the legal, institutional and regulatory framework for corporate governance in OECD and non-OECD countries. They are organised under five headings: (i) the rights of shareholders; (ii) the equitable treatment of shareholders; (iii) the role of stakeholders; (iv) disclosure and transparency; (v) responsibilities of the board.
Accounting	International Accounting Standards – IAS (on an ongoing basis)	International Accounting Standards Board (IASB). The IASB is a private sector organisation which aims to harmonise accounting principles used by businesses and other organisations for financial reporting around the world. http://www.iasc.org.uk	The Standards contain principles to be observed in the preparation of financial statements. A total of 41 IAS have been issued to date.
Auditing	International Standards on Auditing – ISAs (on an ongoing basis)	International Federation of Accountants (IFAC). IFAC is a private sector organisation which aims to develop and enhance the accountancy profession to enable it to provide services of consistently high quality in the public interest. http://www.ifac.org	The national standards on auditing and related services published in many countries differ in form and content. The International Auditing Practices Committee (IAPC) takes account of such documents and differences and is thus in a position to issue ISAs which are intended for international acceptance. ISAs have to be applied in the audit of financial statements and, if necessary in an adapted form, to the audit of other information and to related services.
Payment and settlement systems	Core principles for systemically important payment systems (January 2001)	Committee on Payment and Settlement Systems (CPSS). The CPSS, established by the G10 central banks, provides a forum for regular co-operation among its member central banks on issues related to payment and settlement systems. http://www.bis.org	The document sets out core principles for the design and operation of systemically important payment systems. It also provides guidance on how the principles can be implemented, and describes the role of central banks in ensuring that the principles are observed.
Market integrity	Forty recommendations of the Financial Action Task Force (FATF) (initially developed in 1990; revised in 1996)	FATF. The FATF was established by the G7 Summit in Paris in 1989 and comprises 26 member countries. It monitors members' progress in implementing measures to counter money laundering. http://www.oecd.org/fatf	The forty recommendations set out the basic framework for anti-money laundering efforts. They cover the criminal justice system and law enforcement, the financial system and its regulation, and international co-operation.

Sources: Financial Stability Forum (<http://www.fsforum.org>) and the relevant institutions.