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001. Paper	RE: Global Leaders' Meeting on Financial Architecture (partial) (1 page)	3/16/99	P6/b(6)

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Jimmie Purvis

jp4

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1998-SE-014128

1998-SE-014128

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.
December 14, 1998

INFORMATION

UNDER SECRETARY

for Tim Geithner
Robert Rubin

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Timothy Geithner TFG
Under Secretary (International Affairs)

SUBJECT: NEC Deputies Meeting on the Architecture

Caroline Atkinson and I attended an NEC Deputies meeting today to discuss the Architecture issues. Steinberg, Eizenstat, Yellen, Fuerth and others attended. They were very complimentary of the Rubin/Summers/Atkinson papers.

I thought it would be useful to share with you a few of the more substantive points that were made.

First, they suggested that we needed to give slightly more thought to several issues than was indicated in the paper.

- More emphasis and profile to the social safety net concerns with a suggestion that well-designed social policies be considered an integral part of "good" policies in normal times, and that social safety nets be addressed up front in crises along side the development of the IMF programs. I agree
- More consideration of issues related to the design of IMF conditionality needed to be explored, including the appropriate level of ambition on the structural front, à la the Feldstein/Kissinger critique. I'm [illegible] to
- More work on the various types of insurance schemes. Seems to me questionable, conceptually. I'm [illegible]

Second, they suggested we needed to define sooner rather than later what specific proposals were most promising. It is hard for people to extract from what is a relatively long list of ideas where we think real progress can be made. Important to have comprehensive paper: proposals on some can be relatively rapid; some may take a long time.

Third, the President is apparently interested in devoting a significant part of the State of the Union Address to the global financial crisis and architecture agenda. The White House would like us to begin to draft some points for the State of the Union that outline the objectives for the reform of the system and, to the extent possible, any new proposals we have for achieving those objectives. I said I wasn't sure that we were going to have any new specific proposals ready at that point, but they are likely to continue to press us on this point.

I'm inclined to think did about the right things, but hard to argue against review.

cc: Ted Truman, Bob Boorstin, Stephanie Flanders

No, but this stuff is new to everyone but a few focused people around the world. We could do a very thoughtful and interesting draft — and I suspect even make news. Need specifics on process or substance.

EXECUTIVE SECRETARIAT

EXECUTIVE SECRETARIAT CORRESPONDENCE MEMO COVER SHEET

Tuesday, December 15, 1998

PROFILE #: 1998-SE-014128

DATE CREATED: 12/15/1998

ADDRESSEE: Robert E. Rubin
Secretary

AUTHOR: Geithner, Timothy F.
US, International Affairs

SUBJECT: NEC Deputies Meeting on the Architecture

ABSTRACT: NEC Deputies meeting on the Architecture.

RM 3419

TO REVIEWERS

IN:

TO EXECUTIVE SECRETARY

IN:

TO THE SECRETARY

To DI 12/15/98

DATE SIGNED:

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DI to RER (READING) 12/15/98
DI to LS

cc: MF
SS
NC/DI/PA/AK

The Secretary of the Treasury

NOTE FOR TIM GEITHNER

FROM: BOB RUBIN

Page 1 -- First Bullet Point
I agree.

Second Bullet Point
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Third Bullet Point
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Fourth Paragraph
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Last Paragraph
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Attachment

1998-SE-014128

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.
December 14, 1998

UNDER SECRETARY

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cc: Ted Truman, Bob Boorstin, Stephanie Flanders

1998-SE-014129

DEPARTMENT OF THE TREASURY
Washington

December 15, 1998

TO: Secretary Rubin
Deputy Secretary Summers

FROM: Timothy Geithner TFG

SUBJECT: Miyazawa's Speech on the Architecture

Miyazawa's speech is worth reading. It is quite thoughtful and well organized. The objectives are more sensible than the specific prescriptions. Note in particular the proposal for a general SDR allocation and his proposal for regional currency support mechanisms.

Caroline Atkinson and her team are doing a more detailed analysis.

cc: Ted Truman
Caroline Atkinson

12/15/98
Geithner
Truman
Atkinson
Sisters
Goodman

MINISTRY OF FINANCE

THE JAPANESE GOVERNMENT

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MINISTRY OF FINANCE

THE JAPANESE GOVERNMENT

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MINISTRY OF FINANCE

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Director, International Finance
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United Kingdom

Dr. Lawrence Summers FAX: 1-202-622-0081
Deputy Secretary of the Treasury
U.S.A

From: Eisuke Sakakibara FAX: 81-3-5251-2144
Vice Miniser of Finance for International Affairs
Ministry of Finance, Japan

Remarks: Please find attached a letter from Dr. Sakakibara, Vice Minister of Finance For International Affairs.

Thank you.

VICE-MINISTER FOR INTERNATIONAL AFFAIRS
THE MINISTRY OF FINANCE
THE JAPANESE GOVERNMENT

December 15th, 1998

Dear Colleagues,

I attach herewith the text of the speech that Minister Miyazawa made today at the Foreign Correspondents Club in Tokyo. The speech spells out Japan's thoughts on three fundamental issues facing the international financial architecture, namely risks posed by short-term capital flows; appropriate exchange rate system; and liquidity provision to crisis countries.

I hope that this will be of any interest to you. I look forward to holding further discussion with you on these, and other, critical issues concerning the architecture.

Yours sincerely,

Eisuke Sakakibara

Cc: G22 countries

Towards a New International Financial Architecture

Speech by Mr. Kiichi Miyazawa, the Minister of Finance,
At the Foreign Correspondents Club of Japan
December 15, 1998

I. Experiences of the Recent Past

II. Risks Posed by Short-Term Capital Movements, and Measures to Cope with Them

III. The Exchange Rate Regime

IV. Providing Liquidity to Crisis Countries

V. Conclusion

Towards a New International Financial Architecture

Speech by Mr. Kiichi Miyazawa, the Minister of Finance,
At the Foreign Correspondents Club of Japan
December 15, 1998

Ladies and gentlemen, it is my great honor and pleasure to have an opportunity to speak at this distinguished gathering.

Today, I wish to speak about the challenges facing the current international financial system and about ways to reform and improve its workings. These are very important issues, and unless we resolve them correctly, the world economy might not develop in a sound way in the next century.

In order to look to the future, one should begin by looking back at recent experiences of the international financial system.

I. Experiences of the Recent Past

Since the Mexican peso crisis in late 1994, there has been much discussion about reform of the international financial architecture. Beginning immediately after that crisis, various opinions were expressed, and the importance of transparency and disclosure emerged as the most important issues to be tackled, along with the need to reinforce IMF resources. It has been argued that if investors had known the true economic situation in Mexico, they would have been able to make rational investment decisions, and probably they would not have invested in that

country in the first place. Following this line of reasoning, the IMF has decided to promote disclosure of each country's policies by compiling the SDDS (Special Data Dissemination Standard). In addition, it has been argued that IMF surveillance should be strengthened, and efforts accordingly have been made for that purpose.

Then, last year, there came the crises in Asia. In contrast with previous crises, especially those in Latin America, where the main problems were ones of large fiscal deficits and over-consumption, the most significant aspects of the Asian crises were that they basically stemmed from heavy borrowing by private sector borrowers from private overseas creditors, and from excessive and/or inefficient investments made possible by such borrowing. The Asian crises revealed the weakness of financial sectors and the lack of proper financial sector supervision in these countries. This experience led to discussions about establishing appropriate financial supervision systems, and about the need for involving private-sector creditors in preventing and resolving the crises. Still, the sense of crisis did not seem to be shared evenly throughout the world: I suppose that this was because some observers attributed the Asian crises to specific deficiencies in the economic management of the Asian countries, including seemingly opaque and improper relationships between governments and businesses.

However, when turmoil also took place in Russia and Brazil this year, it became very clear that crises such as those experienced in Asia are more general phenomena. One cannot help but realize that these successive crises stemmed not only from specific problems in particular economies, but also from general problems inherent in today's global economic system.

The risks involved in large and abrupt movements of short-term capital are now keenly recognized, as shown in the crises in Asia as well as

in Russia and Brazil. We have also been reminded that appropriate exchange rate regimes are clearly the key to the stability of the international financial system. It is now widely acknowledged that maintaining a virtual peg to the U.S. dollar was one of the main reasons for the crises in the emerging economies in Asia. The problems were made more serious because the U.S. dollar had greatly appreciated vis-à-vis the Japanese yen and other major currencies since 1995, which caused a loss of those economies' trade competitiveness.

Against this background, active discussions are now underway on how to improve the international financial architecture. These include a variety of proposals, such as renewed appeals to strengthen standards for transparency and good governance in both the private and public sectors, and to improve the supervision of the financial sector, and new ideas about organizational realignment of the IMF, the World Bank, and others.

Today, however, I wish to focus on what I think are the most fundamental issues underlying the present international financial architecture: they are (1) how to cope with short-term capital movements; (2) how to determine an appropriate exchange rate regime; and (3) how to provide liquidity to crisis countries. I strongly believe that these three issues are what we must tackle first and foremost, in order to effectively prevent and resolve crises.

I am convinced that these questions must be urgently discussed and dealt with by the G7, while securing the involvement of key emerging economies. Japan, as a country in the Asian region where the people have been experiencing the very serious impact of the crises, would like to play an active and constructive role in dealing with such system-wide issues.

II. Risks Posed by Short-Term Capital Movements, and Measures to Cope with Them

The first fundamental issue is how to cope with large-scale short-term capital movements.

It is true that the free movement of capital has often been a driving force behind economic growth in developing and emerging countries. Recently, however, a great leap in financial technological development has enabled international investors to invest and divest in the most exotic markets with ease. It is said that at present approximately $1.5 trillion worth of currencies are traded every day. If we assume that there are 250 business days in one year, currency transactions could total as much as $375 trillion per year. Considering the fact that the size of world trade for one year as a whole is merely $11 trillion, one has to recognize what a great influence capital movements could have on any country.

The free movement of capital is supposed to provide optimum allocation of resources: in reality, this might not be the case, especially for short-term capital flows, because investors make their decisions based on imperfect and asymmetrical information, and they therefore tend to follow what other investors are doing. This phenomenon, known as "herding", could trigger abrupt movements of short-term capital, without major changes in the economic fundamentals. Excessive capital inflows can lead to overheating of an economy, including increases in unproductive investments, asset price "bubble", and inflation. And if outflows start, torrents of outgoing funds could ruin a nation's economy.

Based on this recognition, first, even in an emerging or developing economy where capital account liberalization is an appropriate and necessary strategy for promoting further growth and efficiency in light of its stage of economic development, it is critical that such liberalization is

implemented as and when certain appropriate conditions exist, such as a robust financial sector and a capable supervision system. Furthermore, the capital account liberalization should proceed in a well-sequenced manner. In particular, the need for prudential regulations cannot be exaggerated. Through them, for instance, risks associated with foreign exchange exposures and maturity mismatches should be properly monitored.

Second, the monitoring of the movements of capital, particularly of short-term capital, needs to be enhanced. In conducting surveillance and in formulating programmes, the IMF should urge national authorities, and give assistance when appropriate, to compile and to monitor more detailed data concerning inflows and outflows of capital — in terms of maturity, currency, form (direct investment, bank borrowing, securities investment, etc.), and borrower (sovereign, quasi-sovereign, financial institution, private corporation, etc.). Obviously, capital account liberalization has made it more difficult to collect data on capital transactions. However, the reporting obligations of both financial institutions and corporations that are borrowing from overseas creditors must be strengthened as needed.

Third, an emerging or developing economy, in its process for capital account liberalization, might want to keep capital inflows to a manageable level, according to its economic size and the stage of development of its financial sectors. In such a case, maintaining market-friendly controls that would prevent turbulent capital inflows should be justified. Such measures have already been adopted by some Latin American countries, making best use of prudential regulations such as reserve requirements for foreign borrowing.

Fourth, as for reintroduction of measures to prevent capital outflows, there are strong views against it. It is true that some measures might hamper useful capital inflows, such as direct investment, by eroding investor confidence. Some are either so discretionary or arbitrary that

they might undermine the efficiency of the national economy. I fully understand the hesitation shown by people who, pointing out these problems, call for caution in approving the introduction of such measures.

I believe, however, that there might be some cases that would justify the reintroduction of such measures, for instance, when preventing IMF loan proceeds from being used to bail-out foreign investors' money, and when preventing capital flight by residents. Of course such controls should not be the norm: they must be exceptions. Also, such measures need to be carefully designed, so that they will not adversely affect inflows of stable and useful long-term investment. I look to the IMF "to review the experience with the use of controls on capital movements, and the circumstances under which such measures might be appropriate" as instructed by the communiqué of the Interim Committee meeting held this October.

Lastly, industrial countries can also contribute to the mitigation of risks posed by turbulent short-term capital movements, through strengthened monitoring on the lenders' side. We need sophisticated supervision systems to cope with various forms of investment, from simple portfolio investments to exotic off-balance-sheet derivatives. In particular, the authorities in such countries must pursue ways to address issues related to internationally active institutional investors, including hedge funds. In my view, we should examine the scope for measures including appropriate prudential rules or reporting requirements for financial institutions investing in or lending to hedge funds, especially those established in the offshore centers where regulations are deemed loose, and appropriate disclosure or reporting requirements for hedge funds themselves.

In addition, in order to make the whole exercise effective, coordination among national and international regulators should be reinforced. For this purpose, it is worth considering the creation of a

forum where major international regulatory bodies such as the Basle Committee of Banking Supervision and IOSCO (International Organization of Securities Commissions), together with the IMF, the World Bank, and also national regulators, can discuss important issues of the time.

III. The Exchange Rate Regime

The second fundamental issue facing today's international financial system concerns the exchange rate regime.

After the collapse of the Bretton-Woods system, all of the major countries and many others opted for a floating exchange rate regime, because it was believed at that time that a floating rate would shield a country from external shocks, including high inflation overseas, and that it had a built-in mechanism for rectifying current account imbalances among countries. These objectives have been achieved only partially at best.

Under the floating rate regime, we have experienced problems of volatility and misalignment: exchange rates have sometimes shown large fluctuations; they have deviated, for a long period, at levels inconsistent with economic fundamentals; and large imbalances among the major countries have continued to exist. Moreover, as the movements of capital have increased in size and frequency, the fluctuations in exchange rates have become even greater, resulting in serious adverse effects on the real sectors of even large economies. Needless to say, violent effects of large-scale, short-term capital flows are felt more by smaller economies. They are not just adversely affected by volatile fluctuations of exchange rates: it has become more apparent that an emerging economy might face risks of default, due to difficulty in rolling over foreign currency loans, or to a run by international investors, even if it adopts a fully flexible exchange rate regime.

A variety of efforts has been made to stabilize the exchange rates of the currencies of major industrial countries. In the late 1980s, macroeconomic policy coordination was pursued, but it did not result in as much stability of exchange rates as had been expected. In addition, the coordination of fiscal or monetary policies is not as easy a task as theories assume, because of constraints resulting from domestic concerns and political sensitivities. Nowadays, it is often argued that exchange rate stability would be better achieved through efforts by each industrial country towards sustainable low-inflation growth. The question still remains, however, if this would be sufficient.

Some suggestions are reportedly being made in Europe concerning the need for greater stability among the major currencies. I agree that greater stability is desirable. It is our task to examine the possibility of creating an exchange rate regime that will bring about greater stability on the one hand and needed flexibility on the other, among the yen, the U.S. dollar, and the euro. Although it is a difficult challenge, we have to work hard to attain this "managed flexibility" among the three currencies.

With regard to the currencies of emerging and developing countries, it is crucial what exchange rate regime we advise each country to adopt. Of course, the most appropriate exchange rate regime might differ from country to country, due to differences in the size of a nation's economy, the composition of its trade partners, the composition of its major trade items, the degree of its capital account liberalization, the nation's past experience with inflation, and other factors.

At the same time, however, the recent experiences in Asia apparently revealed the risks of pegging a country's currency to a single foreign currency. Doing that often causes disregard of exchange risks by foreign investors as well as by domestic borrowers, and sustained

misalignment of exchange rate level with economic fundamentals, and consequently leads to a bubble economy that later bursts. No country can afford a mistake in selecting an exchange rate regime, on which all economic policies hinge.

It might be generally appropriate that emerging or developing countries peg their rates to a currency or to a basket of currencies of the developed countries with which they have the closest trade and investment interdependence, while adjusting the peg periodically so as to reflect developments in relative real effective exchange rates, unit prices, and current and capital account balances. Having said that, I would like to repeat that there is no simple set formula, and that case by case perusal of a country's specific situation is essential.

IV. Providing Liquidity to Crisis Countries

The third fundamental issue is how to provide liquidity to countries hit by crisis.

According to the IMF World Economic Outlook (September, 1998), Asian countries attracted $28.8 billion of net private capital inflows in 1996, a trend that was brutally reversed in 1997, when there was a net outflow of $44.3 billion of private capital from these countries. Regardless of the health of a country's economic fundamentals, no country can weather such an onslaught.

Also, Asian countries' access to capital markets has all but disappeared. In January of this year, for instance, Indonesia's sovereign risk was deemed so high that the premium for its sovereign bonds reached about 1,000 basis points above that of U.S. Treasury bonds. It rose as high as 1,800 basis points following the Russian turmoil during this past

summer, although it came down again to about 1,000 basis points by November. Such a prohibitive premium was applied to many other sovereign bonds issued by emerging economies. Even if such countries were able to borrow in the market, such high interest payments would not be sustainable.

There is much talk these days about loss of market confidence. This is actually a different way of saying that the crises of today are often essentially crises of liquidity. Overseas creditors pull out funds even from countries with appropriate policies and from otherwise solvent local institutions and corporations. The most appropriate response to this type of crisis is to provide liquidity. This would provide an economy with breathing space that could be used to calm the market, and that would make it possible to consider necessary policy measures to be taken after the crisis, according to the specific circumstances of each country. This also would mitigate panic among overseas creditors: knowing that there were sufficient funds, they would not have to rush to try to gain as big a slice as possible of a small pie.

Incidentally, trying to calm the market by presenting policy adjustments that are too ambitious might at times become counterproductive: a very tight monetary policy in the absence of history of high inflation, and a very stringent fiscal policy in a country with a good track record concerning fiscal soundness could simply result in a contraction of the real economy and further deterioration of market confidence. In this regard, it might also be advisable for the IMF to refrain from requiring too broad or too ambitious structural reforms at a time of crisis, because such targets very likely will be missed, particularly amid the political confusion experienced during a crisis, and they could lead to even further erosion of market confidence. Of course, that is not to say that we should disregard necessary macroeconomic adjustments. But measures should be implemented with full awareness of the ongoing crisis.

Likewise, much-needed structural policies should be addressed as mid- to long-term challenges.

In sum, to prevent panic among investors and to restore confidence as quickly as possible, the international community needs to enhance its capacity to provide liquidity. The IMF, as the central institution of the international financial system, has to play an important role in this endeavor by assuming some role as the lender of last resort in an appropriate situation. In this regard, the coming into effect of the New Arrangement to Borrow and the progress being made towards the IMF quotas increase, both of which contribute to reinforcing IMF resources, are important steps.

I now wish to spell out some concrete ideas about mechanisms for providing quicker and greater liquidity, in line with the views I have just presented.

First, in order to provide liquidity to member countries hit by a crisis, the IMF could create a new facility that would be precautionary as well as quick in disbursement when needed. Such a facility would differ from the precautionary facility currently being discussed, in that my proposal would not require pre-agreed arrangements, but would base itself primarily on good track records certified through regular surveillance. This new facility would aim only at overcoming present difficulties; policy requirements should be limited to a minimum for serving this objective. Once a crisis has passed, necessary reforms could be implemented in the context of longer-term programmes of the IMF or the World Bank.

Second, in order to enhance the IMF's capacity to provide large-scale, short-term liquidity, it is conceivable to allow the IMF to borrow in the market as the institution is granted the capacity to do so by its Articles. Such borrowed funds would be used exclusively for the existing SRF

(Supplemental Reserve Facility), a precautionary facility currently under discussion, and the above-mentioned new facility. This is logical, inasmuch as such borrowing by the IMF would be a means to recycle private funds that have stopped flowing into, or have indeed flowed out from, emerging economies.

Third, the IMF can augment countries' foreign reserves through a new general allocation of SDRs. Member countries agreed last year to carry out a special allocation that was intended to achieve a fair allocation of SDRs between the original members and new members of the IMF. However, considering the fact that there is a global need to supplement reserves, especially in the emerging economies, and that risks of inflation are low, the case for a new general allocation is very strong.

Fourth, in order to complement the role and function of the IMF, I think that it is appropriate to consider establishing regional currency support mechanisms. The recent experience regarding Brazil has reinforced our conviction that, in order to strengthen the international community's capacity to provide liquidity at a time of crisis, it would be appropriate to complement IMF loans through some kind of regional mechanism that is anchored in a sense of solidarity and mutual dialogue among the countries in a region.

These mechanisms, which could be established in each region such as Asia, Latin America, and Eastern Europe, would be funded by countries in the region that are strongly interdependent on each other in the fields of trade, investment, and so on, and that are conducting continuous dialogue with each other on their policy directions. Nonregional countries with economic or political interests in the stability of the region also could participate.

Under the initiative carrying my name, the Japanese government

has proposed a variety of financing schemes, totaling $30 billion, for Asian countries. I am hoping that this initiative could lead to further discussions towards a regional currency support mechanism of the type that I just mentioned.

V. Conclusion

Talks about reforming the international financial architecture should not be just a passing fancy. They are indispensable for creating a better environment in which the world economy will operate.

In 1926 John Maynard Keynes said,

> Many of the greatest economic evils of our time are the fruits of risk, uncertainty, and ignorance. ... I believe that the cure for these things is partly to be sought in the deliberate control of the currency and of credit by a central institution, and partly in the collection and dissemination on a great scale of data relating to the business situation, including the full publicity, by law if necessary, of all business facts which it is useful to know.

Based on this observation, he continued,

> For my part, I think that capitalism, wisely managed, can probably be made more efficient for attaining economic ends than any alternative system yet in sight.
>
> (*The End of Laisser-Faire*)

As is usual, his foresight applies even today.

It is the responsibility of all of us, who have a common stake in the stability and sound development of the international financial system, to work to create a new international financial architecture for the next century. And I firmly believe that Japan should play a leading role in this important task of preparing for the new century, which is only two years

away.

Thank you very much.

1999-SE-000285

12/28/98 to: T. i

Gene: Here not cc's only

Ron: B.L This is kind of an old memo. Where we stand on process for carrying forward, for Treas/Fed, and internationally

cc: Summers Rubin.

TO:

FROM: Caroline Atkinson
Senior Deputy Assistant Secretary

SUBJECT: International Architecture: Organization and Work Plan.

The work on architecture will continue to require involvement of people within and outside Treasury, and action in a number of policy areas, ranging from IMF reform to development of regulatory rules for hedge funds. The following sets out a suggested organizational framework for the renewed effort needed over the next six months, until the Cologne summit in June 1999.

Task Force on Architecture:

A "double" layer task force is envisaged, in order to involve closely a number of key people who are not able to work full-time on these issues, but nevertheless have much to contribute. There would be an inner core group of four full-time people and one (Fed) part-timer at Treasury under a task force leader who would report to me. The outer group would comprise Stephanie Flanders, Karin Lissakers, Nouriel Roubini and Jeff Frankel from CEA, and Lewis Alexander ~~and David Howard from the Fed Board~~ whose close involvement, in particular in developing ideas, would be sought.

The internal Treasury team would work full-time on international architecture for the six months beginning December 7. The team, to be headed by [Mary Goodman/Louellen Stedman] will initially comprise Steve Backes, Brad Setser, [Mark Jaskowiak], [Anthony Marcus], and a part-time Federal Reserve Board secondee [Jane Haltmaier]. It will be primarily responsible within Treasury for taking forward the work in this area, for ensuring the involvement of other relevant people and coordination domestically and internationally. A number of other offices also have a major substantive role in developing policy in some areas of the architecture work, notably Bill Murden's Office of International Banking and Capital markets (Bill is also the OASIA person on the team working on hedge funds for Gary Gensler/Lee Sachs). These offices, covering IMF, World Bank, debt, hedge funds, will also nominate contact points for liaison with the task force.

In addition, other offices in Treasury have a broad interest in the work, and their advice will be needed, including notably Public Affairs, Legislative Affairs and General Counsel. A contact person from each has been designated as follows: Public Affairs--Michelle Smith; Legislative Affairs--Linda Robertson or Rick Sinkfield; General Counsel--Anna Gelpern. We would also

hope that Bob Boorstin (and/or Eli Kaplan) would stay in close touch with the work. Finally, we would also plan to consult informally with a broad range of outside experts on specific policy issues, including Daniel Tarullo, David Lipton, Barry Eichengreen, Morris Goldstein, Kenneth Rogoff, Richard Cooper, Carmen Reinhard, Rudi Dornbusch.

The Secretary of the Treasury

January 4, 1999

NOTE FOR TIM GEITHNER and CC's **Only**

FROM: BOB RUBIN

This is draft of an old memo. Where do we stand on process for carrying forward, at Treasury/Fed, and international)?

Attachment

Copy to: L.Summers
M.Froman

1999-SE-000381

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

January 15, 1999

MEMORANDUM FOR THE PRESIDENT

FROM: Robert E. Rubin
Lawrence H. Summers

SUBJECT: Soros' Recent Proposal for a Global Central Bank

You have asked about the George Soros' proposal to transform the IMF into a global lender of last resort, which appeared in last Monday's *Financial Times*. Soros' current proposal is an evolution of his earlier proposal for a global credit insurance scheme. It represents part of his continued search for a global solution to current international financial problems.

Soros' proposal has three main components:

Transforming the IMF into more of an international lender of last resort by creating a huge standing capacity to lend with little or no conditionality to countries that pre-qualified for such protection by adopting sound policies.

- Mandatory losses for the bankers and other investors who lent to countries that failed to qualify for the protection offered by the lender of last resort if such countries got into trouble.

- Turning the revamped IMF into a forum for greater coordination among existing national central banks over global monetary conditions.

Certain of Soros' ideas are conceptually attractive, such as developing a system for crisis response that provides incentives for countries to pursue better policies. Greater monetary and financial stability is also a worthy goal. But there are important practical problems with Soros' specific proposals.

- Soros proposes a very severe set of criteria that a country would have to meet in order to be eligible for the protection provided by the international lender of last resort. Indeed, his criteria are so tight that most countries that did qualify would be unlikely to ever need assistance, while many important countries would not qualify in the foreseeable future.

- The international community may want to help systemically significant countries that get into trouble even if they have not qualified for the lender of last resort protection. This would undermine the scheme's credibility.

- If a country that did qualify in advance nonetheless got in trouble, it is likely that the country would need both remedial steps to improve its policies and international assistance to get back on track, not just money.

- Any global lender could be accused of "bailing out" the private sector. It would also need access to a potentially huge pool of official finance. This raises a key question: would we in the United States ever want either to give greater authority to a global body, like the IMF, to create money and credit by itself or to contribute large sums of our money (e.g. though IMF quota increases) to fund the "last resort lending."

Automatically imposing losses on private creditors every time the IMF helps countries that have not qualified for the lender of last resort protection, as Soros proposes, would also create real difficulties. Private creditors who knew they faced mandatory "losses" would have a strong incentive to rush for the exits at the first hint of financial distress in unprotected countries, augmenting risks of contagion and panic. We have been in the lead in developing better ways to involve the private sector, but it is critical to find the right way.

Finally, Soros argues that a revamped IMF could provide a forum for greater coordination among existing national central banks, including our own Federal Reserve. However, creating greater global governance over international monetary and credit conditions implies an erosion of our own national monetary sovereignty.

For these reasons, Soros' specific proposals do not look all that appealing, even if many of the ideas he highlights contain elements we think are useful. We have tried to design proposals in our own work that pick up on the attractive elements of the ideas in play while not getting ensnared in potential disadvantages by:

- Pressing for the creation of an IMF precautionary facility, to provide a line of credit to help countries with strong policies ward off destabilizing market contagion.

- Developing new ways to involve the private sector in crisis response.

- Proposing a major effort to develop new international codes and standards in a broad range of areas that will set targets and create incentives to help improve policies around the globe.

To avert the next crisis

The IMF should be transformed into an international central bank so that it can act to prevent financial crises as well as be the lender of last resort to distressed countries

So will it be business as usual in 1999? The recent dramatic volatility in financial markets is but a distant memory. The miseries of Russians and Indonesians seem far away. But the global financial system still has fundamental flaws. Unless these problems are addressed and we learn the lessons of the past year, the system is liable to collapse.

Booms and busts are endemic in financial markets. Instead of moving like a pendulum, markets can move like a wrecking ball, knocking over one economy after another. The swings cannot be avoided altogether, but they need to be brought under control. International financial institutions, nobably the International Monetary Fund and the World Bank, were designed for a world devoid of large-scale capital flows. In the recent crisis, the IMF proved part of the problem rather than the solution.

The primary mission of the IMF is to preserve the international financial system. Its task is to ensure that a debtor country will be able to meet its international obligations, if not right away, then within the foreseeable future. The conditions it imposes on the debtor country include punitively high interest rates, which serve the dual purpose of stabilising exchange rates and creating a trade surplus by precipitating a recession. Both developments indirectly benefit lenders because they facilitate the repayment of debts.

This method of operation has given rise to what is now recognised as a moral hazard. In case of trouble, lenders can count on the IMF to bail them out; this has supposedly encouraged sloppy lending practices. Actually, the moral hazard is better described as an asymmetry in the treatment of lenders and borrowers.

There is another asymmetry in the way the IMF currently operates. It can intervene only in times of crisis; it has no authority to prevent a crisis from developing. Yet experience shows busts can be prevented only by moderating the booms that precede them.

These two asymmetries, taken together, explain why the IMF has become part of the problem. In the most recent crisis, the IMF imposed punitive interest rates and the countries concerned were plunged into deep recession. But when the crisis threatened the US, the Federal Reserve lowered interest rates and the US economy escaped unscathed.

The IMF is now under severe attack. There are voices calling for its abolition. Others want to cripple it by imposing all kinds of conditions. I believe these attacks are misconceived. If global financial markets are inherently unstable we need a stronger regulatory framework rather than the dismantling of existing institutions. To be specific, we need to convert the IMF into something resembling an international central bank.

The new IMF would eliminate the imbalance between prevention and cure. The emphasis would be on prevention

I do not have in mind an institution like the Federal Reserve or the European Central Bank. I am talking about empowering the IMF to act as lender of last resort with regard to a select group of countries that are eager to obtain such protection. The countries concerned would have to follow sound macroeconomic policies; have a sound banking system, with appropriate supervision; provide adequate information both to the IMF and to the markets; maintain flexible exchange rates with appropriate measures for the control of excessive capital flows; have proper corporate governance and bankruptcy laws; respect certain basic human rights and abide by the rule of law. In return, the IMF would stand by as a lender of last resort and provide an adequate supply of capital when financial markets were unwilling to do so.

Those countries that cannot or will not meet these conditions would continue to have access to the IMF on terms similar to those that are available currently with one important difference: in a crisis the IMF would impose conditions not only on the country concerned but also on the creditors. By putting would-be creditors on notice, the IMF would prevent excessive capital inflows from developing. If it still became necessary to impose a moratorium or a compulsory debt-to-equity conversion scheme, the international financial system would not be disrupted because it would be an isolated case. The threat of contagion, inherent in the current arrangements, would be eliminated.

Empowering the IMF to act as lender of last resort would radically change the mission of the IMF and the way it operates. It would eliminate the current imbalance in favour of creditors.

The new arrangement would also eliminate the imbalance between prevention and cure. The emphasis would be on prevention, where it properly belongs. Booms and busts would not be banished altogether; but the IMF, in its new incarnation, could also act as a kind of international central bank, regulating the environment for international capital flows in order to obviate the need to intervene as lender of last resort.

This is not an utopian ideal but an idea that could and should be implemented right now.

It is implicit in a recent G7 communiqué, which proposed preventative actions and a contingency fund, and in the speeches of Bill Clinton, the US president, Gordon Brown, the UK Chancellor of the Exchequer, and other statesmen.

I would not like to pretend that it would be easy to establish the rules by which a reconstituted IMF would operate. An international regulator of credit and money supply would have to consider not only the countries at the periphery but also those at the centre of the global capitalist system. It would be improper for either the US Federal Reserve or the European Central Bank to allow its autonomy to be infringed by an international body; but both institutions would be represented on the governing body of the reconstituted IMF, and, in that context, they would be better able to co-ordinate their global responsibilities.

Most global financial crises have been precipitated by a rise in interest rates. That was true in 1929, in 1982, and again in 1992 when the reunification of Germany destroyed the European Exchange Rate Mechanism. It was not the case in 1997-8, but it may well be the case in the next crisis. The ability to inject or restrict liquidity not only at the centre but at the periphery would open up policy options not now available. Something resembling an international central bank could provide the cornerstone of the financial architecture around which a new Bretton Woods conference could be organised.

In the US, a task force of the Council on Foreign Relations and others are studying the subject; there ought to be similar initiatives in Europe. But it is even more important that the countries that could benefit from a lender of last resort – in South-east Asia, Latin America and the rest of the world – should address the issue. After all, if the new architecture is to correct the asymmetry between centre and periphery, countries at the periphery should have an important say in its design.

George Soros is chairman of Soros Fund Management and of the Open Society Institute and author of The Crisis of Global Capitalism

day of 1999, I made retail history. After a long quest across European frontiers, I finally did what no one had done before.

One packet of tea bags, one pair of wool-mix socks and a thermal vest – 21 euros. Three shop assistants watched in awed silence as I filled out my cheque. These were the first euros to cross the counter of Marks and Spencer in Brussels' Rue Neuve.

"Non, non," interrupted the supervisor. A hitch. I had put the wrong symbol in the currency box. One ripped-up cheque later, the transaction was completed and I left the store triumphant.

Had it not been for this success, I might have started to New Year dream.

My hunt for the euro, not yet circulating as note or coin but up and running for non-cash transactions, had begun appallingly. At the Extra Super Stark hypermarket in Eschweiler, Germany, there was not a euro in sight. The line of people at the checkout was getting twitchy. Who was this mad woman trying to pay for her bratwurst, sauerkraut and Riesling in euros?

"Noch nicht," insisted the long-suffering lady holding my cheque. "You have to fill it out in D-Marks. We haven't even changed our tills yet."

I retreated to McDonald's. "Euros?" said Herr Gafoor, who

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Soros wants IMF to be world central bank

By Peter Marsh in London

The International Monetary Fund should be converted into a global central bank to reduce the risks of new world economic crises, George Soros, the billionaire financier and philanthropist, says today in the Financial Times.

The newly constituted IMF would act as a lender of last resort to member countries believed to have sound banking systems and economic policies.

It would also regulate the international flow of credit to reduce the chances of outbreaks of economic turmoil such as those triggered in the past 18 months by events in Asia and Russia.

Mr Soros says his proposal is needed to tackle what he perceives as the "inherently unstable" nature of global financial markets.

But he concedes that reaching the international consensus to establish such a powerful institution would not be easy.

In the article, Mr Soros implies a two-tier membership system for the reformed IMF. The top tier – a "select group" of the 182 existing members – would accept "protection" from the world economic system by agreeing that the IMF take over as lender of last resort, even if financial markets were unwilling to do so.

Although most large, developed countries would qualify for the top tier of membership, an important group of developing nations could join in, if they "choose to accept the discipline" of having the IMF operate in this way.

In a controversial part of his proposal, Mr Soros holds out the prospect of the newly empowered IMF punishing institutions that lent to countries that later got into financial difficulties. Punishments could include compulsory conversion of debt into equity or enforced repayment delays.

"By putting would-be creditors on notice [of potential sanctions] the IMF would prevent excessive capital inflows from developing," according to Mr Soros, who in the past year has lost hundreds of millions of dollars through positions taken in Russia and Malaysia, and who has been a severe critic of IMF policies.

As well as requiring agreement by central banks such as the new European Central Bank and the US's Federal Reserve – which might prove reluctant to share some of their powers – Mr Soros's new scheme would require a large increase in the "quotas" or membership fees paid by the IMF's member countries. This would almost certainly run into political difficulties.

Officials from the Group of Seven leading industrialised countries are discussing a relatively small step toward reforming the architecture of the global financial system: a merger of the ministerial committees that oversee the IMF and World Bank.

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EXECUTIVE SECRETARIAT CORRESPONDENCE MEMO COVER SHEET

Wednesday, January 13, 1999

PROFILE #: 1999-SE-000381

DATE CREATED: 01/13/1999

ADDRESSEE: Robert E. Rubin
Secretary

AUTHOR: Atkinson, Caroline
Senior DAS, International Affairs

SUBJECT: Memo to the President on Soro's Proposal for a Global Central Bank

ABSTRACT: Memo to the President on Soro's proposal for a global central bank.

RM 3419

TO REVIEWERS

IN:

TO EXECUTIVE SECRETARY

IN:

TO THE SECRETARY

DATE SIGNED:

DISTRIBUTION: AS, INTERNATIONAL AFFAIRS

LS ok per David Fischer

NCC cc to MF

NCC ready for MER (signature)

1/14/99

01/13/1999 03:44:14 PM

1999-SE-000381 Brad Setser

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

January 13, 1999

MEMORANDUM FOR SECRETARY RUBIN

FROM: Caroline Atkinson CA
Senior Deputy Assistant Secretary
International Banking and Monetary Affairs

SUBJECT: Memo to the President on Soros' proposal for a global central bank.

You have asked that we prepare a memo on Soros' proposal for the President. A draft memo from you and Deputy Secretary Summers to the President is attached. It reflects some comments from Deputy Secretary Summers.

ATTACHMENTS: Tab A: Memo on Soros' proposal for a global lender of last resort
Tab B: Soros' *Financial Times* article

Signed by RER + LHS 1/15/99
Original to AK for delivery to WH. 1/15/99

1999-SE-001617

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

February 16, 1999

UNDER SECRETARY

ACTION

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Timothy F. Geithner CA for
Under Secretary (International Affairs)

SUBJECT: Memorandum to the President on Work on International Financial Architecture

Action Forcing Event:

In advance of President Clinton's meeting with President Chirac this Friday, we thought it would make sense for you to send the President an update on our work on the international financial architecture.

Recommendation:

That you send the attached memorandum to the President

Agree _____ Disagree _____ Let's Discuss _____

Background:

The attached memo brings the President up to speed on our progress to date in implementing measures in international financial architecture and summarizes what we want to achieve at the G-7 meetings this weekend. An attached paper sets out new ideas we want to move forward with before the Köln Summit. That paper is structured along the lines of the cover note that we recently sent to you along with our "book" of policy proposals in financial architecture.

cc: Knight, Gensler, Sachs, Boorstin, Flanders, Robertson, Smith

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

MEMORANDUM FOR THE PRESIDENT

FROM: Robert E. Rubin
Secretary of the Treasury

SUBJECT: Work on the International Financial Architecture

In advance of your meeting with President Chirac, I want to bring you up to date on where we are in our work on the international financial architecture. This memo summarizes our progress in implementing measures already in train and notes the things we hope to tie up when Alan Greenspan and I meet with our G-7 counterparts this weekend in Frankfurt. I also want to lay out some of the ideas that we want to move forward with in the next few months before the Köln Summit. The attached paper on "Policy Proposals on International Financial Architecture" describes our ideas in the framework I set out in the more detailed paper I sent you in December.

Progress to Date

We have been making progress on a number of issues where the U.S. has been pushing for change (Tab A). We will use this weekend's G-7 meetings to bring some of them to closure.

- *Pro-Growth Stance*: Since last fall we have argued that the balance of risks in the world economy had shifted, and that a commitment to sound, growth-oriented policies was needed in all of the G-7 countries, not just the U.S. We expect this message to be an important part of the Communique from this weekend's meetings. We will argue that better fundamentals are needed to encourage exchange rate stability -- not exchange coordination, as Germany, France, and Japan favor.

- *Disclosure*: We expect to reach agreement among the G-7 on important improvements to the IMF's Special Data Dissemination Standard (SDDS) to give a full picture of countries' reserve positions – enabling the markets to assess countries' financial position. We plan to "overcomply" by reporting reserves on a weekly, rather than monthly basis.

- *Financial Stability Forum*: Bundesbank President Tietmeyer has been working on a proposal to improve policy coordination among national financial authorities, the international financial institutions and international regulatory bodies, an idea that we floated in the G-22 last year. Tietmeyer's proposal needs some modifications, but we hope to agree on an approach the G-7 can endorse this weekend.

- *IMF Contingent Credit Line*: We hope to resolve soon with our G-7 partners remaining issues so that the IMF can move quickly to finalize the contingent credit line we agreed to establish in October. This would enable the IMF to agree with a member country - before

a crisis occurs - on the terms for substantial amounts of IMF assistance should a crisis hit. Such agreements should encourage countries to act sooner to forestall crisis, building confidence in a way that not only helps prevent a crisis in the country itself, but also helps stem market contagion before it spreads.

- *Broad International Outreach on Architecture*: Starting with the G-22 process a year ago, we have been pressing forcefully to have an inclusive dialogue. Our G-7 colleagues have now agreed to hold two seminars by Köln involving senior finance officials from over 30 countries on key architecture issues. Germany will host a meeting in mid-March, and we will host a second one in the U.S. in April, around the spring IMF Meetings.

Work Going Forward

Our approach has been to put proposals on the table, work to get others to agree to them, lock that in, and then to push out the frontier and begin working to reach a new goal. I plan to continue that process at the G-7 meetings this weekend. I will focus on sensible measures to reduce risk in the system. I want to give a push to the work that FRBNY President MacDonough has been doing to improve the Basle Capital Accord to better reflect the spectrum of financial risks in today's global markets. I also believe, based on our own work on Highly-Leveraged Institutions (HLIs), that there is scope for more disclosure and reporting requirements for these firms and for an agreement to raise the bar on such requirements in other countries. I also want to put some new ideas on the table and start working to get them in place by the Köln Summit.

- *Crisis Response*: This is near the top of the G-7's agenda. The key will be to strike the right balance in involving the private sector in the resolution of crises but not spark contagion. Our actions over the past year have begun to correct the perception that private creditors don't bear the risk of their decisions. I also want to look at innovations to help make private sector involvement work more smoothly.

- *International Financial Sector Standards*: We have a proposal that would put much greater emphasis on the international standards in over 20 areas critical for financial stability. We are thinking of a "code of codes" for the financial sector that countries would subscribe to, along with institutional changes to monitor countries' compliance, and possible market incentives to encourage countries to comply. This should focus public attention on key standards and prompt emerging markets to implement them.

- *Flexible Exchange Rates for Emerging Markets:* The crisis has shown the serious limitations of fixed or pegged exchange rate regimes for emerging market economies. We need to work on ways to encourage flexible rates in emerging markets, and I want to look at limiting the funds the IMF provides to countries defending a fixed exchange rate.

The note at Tab B sets out these ideas and others that need more work between Treasury, the Fed, and others. I would like to discuss these with you to get your input as we go forward.

Attachments: Tab A: Implementation of Financial Architecture Measures
Tab B: Policy Proposals on International Financial Architecture

IMPLEMENTATION OF FINANCIAL ARCHITECTURE MEASURES

Measures Put in Place Since October

Strengthened disclosure: Strong international standards for disclosure of critical economic and financial data through the IMF's Special Data Dissemination Standard (SDDS) have been in place since January 1, 1999 and are being widely used. This will allow for more informed investment decisions and will help promote sound policies. U.S. should be in full compliance by end-February.

Development of internationally agreed accounting standards: Recent events have shown the need for immediate improvements in accounting around the world to set standards for private sector disclosure, a critical element of modern financial markets. In December, the IASC approved accounting standards on financial instruments – an important milestone.

Improving private-sector risk management: Treasury has supported a private sector initiative to improve private sector risk management and reporting of key risk management practices to regulator and supervisors. In January, a group of 12 major internationally active commercial and investment banks announced the formation of the "Counter-party Risk Management Policy Group" to promote enhanced best practices in credit and market risk management.

Lending to highly leveraged institutions: The near-collapse of LTCM revealed shortcomings in certain bank risk management practices. In January, the Basle Committee on Banking Supervision published a report from the Working Group on Highly Leveraged Institutions. The report outlines possible supervisory steps to reduce risks to banks that invest in such entities.

International guidelines for national insolvency and debtor-creditor regimes: Strong insolvency regimes are important both to crisis prevention and rapid crisis resolution. Following the G-22 endorsement of a set of key principles of effective insolvency and debtor-creditor regimes, the IMF and UNCITRAL have jointly prepared a paper on the best insolvency practices.

Improving social safety net protection in countries affected by crisis: To protect the most vulnerable during times of crisis, the World Bank announced in November that it plans to triple its assistance to the most vulnerable in Asia. The Asian Development Bank is doubling its assistance. In January, governments, NGOs, private donors, and IFIs met in Bangkok to share best practices in crafting effective social safety net protection for the poor and others affected by the crisis.

Measures to be Agreed at G-7 Ministerial Meetings 2/20/99

Strengthened Disclosure: We expect to reach agreement on improvements in countries' reporting of their reserves and related liabilities under the IMF's Special Data Dissemination Standard (SDDS). This will enable markets to assess countries' financial position more accurately. The U.S. will lead by example in reporting reserve data on a weekly basis (the standard is monthly).

Financial Stability Forum: Bundesbank President Tietmeyer has been working on a proposal to improve policy coordination among national financial authorities, the international financial institutions and international regulatory bodies, an idea that we floated in the G-22 last year. Tietmeyer's proposal needs some modifications, but we hope to agree on and endorse the *Financial Stability Forum* proposal this weekend.

IMF Contingent Credit Line: We are working to resolve remaining issues with our G-7 partners so that the IMF can move quickly to finalize the contingent credit line we agreed to establish in October. This would enable the IMF to agree with a member country - before a crisis occurs - on the terms for substantial amounts of IMF assistance should a crisis hit. Such agreements should encourage countries to act sooner to forestall crisis, building confidence in a way that not only helps prevent a crisis in the country itself, but also helps stem market contagion before it spreads.

Broad International Outreach on Architecture: Starting with the G-22 process a year ago, we have been pressing forcefully to have an inclusive dialogue. Our G-7 colleagues have now agreed to hold two seminars by Köln involving senior finance officials from over 30 countries on key architecture issues. Germany will host a meeting in mid-March, and we will host a second one in the U.S. in April, around the spring IMF Meetings. The seminar discussions will cover the main areas of work that we set for ourselves in the October 30th statement of G-7 Finance Ministers and Central Bank Governors.

Treasury
February 14, 1999

POLICY PROPOSALS ON INTERNATIONAL FINANCIAL ARCHITECTURE

This paper outlines the policy choices in international financial architecture that we believe will make sense over the next few months. Most of the proposals have broad continuity with current policies, although some of these go beyond the present consensus between Treasury, the Fed, and others.

I. IMPROVED POLICIES IN DEVELOPING COUNTRIES

A core objective is to get emerging markets to focus on and adhere to stronger policies -- particularly in the financial sector. We propose pulling together **a comprehensive set of international standards and practices into an integrated framework, or code of codes,** perhaps to be called the *Financial Sector Standards Accord (FSSA)*. The FSSA would combine the over 20 international codes and standards that already exist or are being developed in areas critical for financial stability like bank capital, securities regulation, corporate governance, with the codes that the IMF is developing on fiscal, and monetary and financial transparency. The idea is that a country that subscribed to the FSSA and implemented the standards would have laid the foundation for the basic financial infrastructure for today's world. The financial crisis has also demonstrated the dangers of poor debt management, and we want to propose developing principles of good practices in this area.

II. MEASURES TO INDUCE DEVELOPING ECONOMIES TO UNDERTAKE SOUND POLICIES

We still believe that disclosure and transparency are key vehicles to focus markets' attention on how country risks differ. Subscription by countries to our proposed *Financial Sector Standards Accord* should help. Stronger IMF surveillance and conditionality will be important as well. Three new measures to create incentives may make sense.

(1) Linking the terms of IFI finance to stronger policies *ex ante* through a **modest prequalification mechanism**. Countries' performance against a matrix of the FSSA and, perhaps, other important indicators of macroeconomic performance, would be taken into account in determining the terms of countries' access to IMF resources, including interest rates charges and possibly the amounts.

(2) Finding ways to **link countries' adherence to international standards to their access to major markets** by tying foreign financial institutions' right to establish in U.S., UK and other markets to adherence to the FSSA, and encouraging foreign sovereign bond issuers in the U.S. and other important markets to disclose their compliance with the FSSA. We also could press key European exchanges to make countries that wish to issue sovereign Eurobonds increase the information they disclose to a level closer to what we require for foreign bonds in the U.S.

(3) **Creating new institutions to strengthen international surveillance** in the financial sector. We are exploring options, including creating a new semi-independent agency to draw on private sector expertise or a new "joint venture" IFI, perhaps under the aegis of the IMF and World Bank, to monitor country compliance with financial sector standards.

III. Measures to Induce Creditors and Investors in Industrial Countries to Analyze and Weigh Risks Appropriately

Drawing on the work under way domestically, we would like to support internationally a set of changes that could comprise an important **improvements in the international financial regulatory system**. Many would improve disclosure and reporting, including by hedge funds and financial institutions that do business with them. In part, this would raise the bar on reporting and disclosure requirements in other countries. For banks, we will work in the next few months to fix the worst problems with the Basle Capital Accord, and in the longer term we should aim at a comprehensive overhaul of the Accord. And, to contain the risk that stronger regulation in major financial centers is undercut by a move to offshore centers, we will look at ways to improve supervision of internationally active financial firms and have proper risk controls and country limits in place for firms that deal with offshore centers. We also want to explore imposing regulatory capital surcharges on bank lending to countries and offshore centers that don't subscribe to our proposed FSSA.

IV. Limitations on the Flow of Capital

Today's problems are centered on an excessive withdrawal of capital from emerging markets. However, capital inflows to emerging markets probably were excessive as well, raising the issue of whether emerging market economies should consider restraints on capital inflows. **We propose developing a set of principles for policies on capital account openness**. This could allow leeway for some types of restrictions on capital inflows for a limited time. Note that we are not proposing any public statement of support for controls on capital outflows.

V. Exchange Rate Regimes

Exchange rate regimes will be a central part of the G-7 dialogue on the financial architecture. We do not support the proposals that Germany and others will press for coordination to moderate swings in exchange rates of the **major currencies**. We believe they come down on the wrong side of a fundamental choice between sustaining and reinforcing a market-based system for the global economy, on the one hand, and trying to manage and control markets, on the other. We believe strongly in the market-based approach.

For developing countries, there are two key questions – whether it is feasible for countries to occupy a middle ground between fixed and floating rates, and how much official support to provide to a country that chooses fixed rates. **There should be a presumption in favor of floating rates for developing countries**. We want to explore limiting the amount of assistance the IMF would provide to countries defending a fixed exchange rate. This could create strong

incentives for countries to float, though it would not prevent countries that wanted to fix their rates from doing so, since they could still use normal IMF facilities.

VI. Crisis Response

One of the most difficult questions is how to **involve the private sector** in the resolution of crises. We need to strike the right balance between involving the private sector appropriately, and steps that would prompt creditors to rush for the exits at the first hint of financial distress, augmenting risks of contagion. Our actions over the past year have built up important precedents, i.e. in Korea, in the Paris Club for Pakistan, and now in the case of Brazil. This is a good start at changing perceptions, and we should continue to make such case law and look at ways to encourage use of "collective action clauses" in bonds and incentives to facilitate rollover, restructuring or provision of new money by private creditors. There will be other times when we may want to provide large amounts of official finance to prevent contagion. Coercive efforts to involve the private sector would not be appropriate in these cases.

The new IMF precautionary facility will allow large-scale lines of credit with appropriate conditionality. Questions raised by some observers about whether the IMF should act more like a domestic lender of last resort turn on the scale of the resources which the IMF can marshal, the terms it provides – lending freely at a penalty rate of interest or tying money to negotiated conditionality – and prequalification. We believe that the **negative aspects of having the Fund act as a true lender of last resort outweigh its benefits**. However, we will continue to explore options to secure more resources for the Fund on a contingency basis.

VII. Social Sector

We are **developing a set of principles of good practices in social policy** to protect the most vulnerable segments of society against economic shocks and provide a guide for policy choices that contribute to longer-term growth and development. We should work to have these adopted, including as part of conditionality in MDB lending, and we should ensure that social programs are not cut disproportionately when governments undertake fiscal adjustment.

VIII. Institutional Reforms to Carry Forward the Agenda

We also need to make sure that the IFIs can operate effectively and implement the changes we have outlined. One important gap is bringing together the worlds of the IFIs and the financial regulators. We have called for creation of a ***Financial Stability Forum*** to better coordinate the work of the international regulators, the IFIs and national financial authorities. Bundesbank President Tietmeyer has recommended this basic approach to the G-7. We also want to make sure that proposals to redraw the lines between the IMF and World Bank or strengthen the Interim and Development Committees strike the right balance between shooting for a clean, rational structure and preserving our ability to achieve our objectives. Finally, we want to look at spinning off the financial sector development activities of the IFIs into a separate new joint venture entity to enhance surveillance.

1999-SE-002633

1999-SE-002633

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ACTION

UNDER SECRETARY

March 16, 1999

ACTION

MEMORANDUM FOR SECRETARY RUBIN

FROM: **Timothy F. Geithner** TFG
Under Secretary (International Affairs)

SUBJECT: **Global Leaders' Meeting on Financial Architecture**

ACTION FORCING EVENT:

At your meeting with the President to prepare for the visit of President Chirac, he asked us to prepare a proposal for a leaders' meeting on financial architecture issues.

RECOMMENDATION:

That we forward the attached proposal to NSC/NEC.

Agree ✓ Disagree ____ Let's Discuss ✓

~~Approved~~

Don't we need recommendation

BACKGROUND/ANALYSIS:

The attached paper, put together by the task force, considers several options for timing and venue and participation. It proposes a three part agenda: building political support for implementation of reforms, human and social aspects of financial crises, and economic relations between industrial and developing nations. Even if hosted by the U.S., the meeting could be co-chaired by the chairs of the G-7, the Interim Committee, and the Development Committee (Germany, Italy and Thailand).

cc: D/S Summers

EXECUTIVE SECRETARIAT

Global Leaders' Meeting

Issue: A meeting of worldwide leaders would provide political support and oversight of the financial architecture process, and be an important stimulus to the implementation phase.

Recommendation: That there should be a meeting, with agenda, timing and venue, and participation selected from the options delineated below. Regardless of who hosts the meeting, it could be co-chaired by the chairs of the G-7, the Interim Committee, and the Development Committee (Germany, Italy and Thailand, respectively). The discussion might focus on building political support for implementation of reforms, on the human and social aspects of financial crises, and on development and economic relations between industrial and developing nations, with one of the co-chairs handling each issue. order?

Discussion: While the meeting would make a valuable contribution to the architecture process, it might be seen by some as disproportionate to the kinds of changes that we will be making. It will therefore be important to avoid creating expectations of dramatic new announcements, or of inadvertently signaling that the process is over, rather than moving into a new (and perhaps even more difficult) phase -- implementation. There have been several other proposals for a leaders' meeting, including one by French President Chirac, who has offered to host. We would want to manage the structure and outcome of any meeting, however, which would be easier if we organize it.

Options: If a meeting is to be held, interrelated decisions need to be made on three dimensions: agenda, timing and venue, and -- perhaps the trickiest -- participation.

Agenda. We recommend three main agenda items, on the overall theme of making globalization work:

- building political support for reform during non-crisis times -- particularly the reforms agreed to at June's G-8 Summit in Cologne;
- ameliorating the human and social impact of crises; and
- development issues and advancing economic relations between industrial and developing nations, e.g. by promoting trade and investment.

reverse the order?

These would allow the meeting to provide impetus to the implementation phase, to discuss broader concerns, and to provide appropriate attention to the special problems of the poorest. Other items that could also be discussed include:

- further steps to promote development;
- lessons to be learned from adjustment under crisis; and
- capital flows and their effects.

? Any better wording? Something neutral in my view.

Timing/Venue. The meeting should take place after the Cologne summit, at which the G-8 leaders will announce most of the substantive decisions on architecture. This suggests three basic possibilities, one during the summer and two in September:

Withdrawal/Redaction Marker
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. Paper	RE: Global Leaders' Meeting on Financial Architecture (partial) (1 page)	3/16/99	P6/b(6)

This marker identifies the original location of the withdrawn item listed above. For a complete list of items withdrawn from this folder, see the Withdrawal/Redaction Sheet at the front of the folder.

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b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

- *During the Summer, with Germany hosting in its role as G-7 chair (in Germany):* both the timing and venue for this option would link the meeting most directly to the Cologne summit, thereby most effectively building on its momentum and perhaps providing the strongest impetus to implementation. Leaders would need to make an extra trip, however, and German organization might be overstretched.

- *Immediately following the September 12/13 APEC Leaders' Meeting (in New Zealand):* APEC participants could invite additional leaders to join them to discuss architecture. This would obviate the need for an additional architecture element within APEC, although it would detract somewhat from that summit. It would also eliminate the need for additional travel by APEC leaders, but the logistical challenge of hosting both meetings could place a heavy burden on New Zealand. The need to invite all APEC members would constrain participation choices.

- *Around the time of the September 28-30 IMF/World Bank annual meetings (in the U.S.):* this timing best justifies a U.S. site, allowing us to host and better control the meeting -- although at the same time probably exacerbating concerns about U.S. domination of the process. The meeting could be held either in Washington or at a pleasant, more intimate site. Leaders would have to make a special trip.

Participation. A successful meeting should include the world's largest economies, the major debtor and creditor countries, and those that were at the center of the recent crisis. At the same time, it should be small enough to allow true discussion and should minimize, to the extent possible, the offence caused to uninvited countries. One way to do this would be to invite countries in an existing group, although none is ideal. We see three workable approaches (summarized on the attached chart):

- *"G-33":* The existing dialogue process has produced three groupings of finance ministries and central banks: the original G-22 that met last April, the "G-26" into which it grew (which met in October), and the "G-33" participating in this year's G7-led seminars. This group includes all of the countries that are important for the process. However, its *ad hoc* nature, along with the fact that it was picked by the U.S., reduces its legitimacy. The group is also somewhat larger than optimal.

- *Interim Committee (proposed by France):* The I.C. is built on constituencies, so virtually the entire world is represented either directly or by proxy. The Committee's membership is unappealing in some ways, however: Africa, Europe and the Middle East are overweighted while Asia is underweighted. Conceivably, the mix might be strengthened by inviting each I.C. constituency to send one member, although not necessarily the chair. It is not clear that we could influence these choices, however, so improvements would not be assured -- although fierce internecine conflict surely would.

- *APEC Plus*: If the meeting is held on the fringes of the APEC summit, all of the APEC heads would need to be invited. Combining them with the Interim Committee or G-33 groups yields attendance of 38 or 40, with Asia overrepresented. The inclusion of APEC member Taiwan could pose diplomatic problems.

Country Groupings

	Interim Committee (24)	"Improved IC"* (24)	"G-33" (33)	APEC + IC (38)	APEC + G-33 (40)
Industrial	G-7 Australia Belgium Denmark Netherlands Switzerland	G-7 Denmark Netherlands	G-7 Australia Belgium Netherlands Spain Sweden Switzerland	G-7 Australia Belgium Denmark Netherlands New Zealand Switzerland	G-7 Australia Belgium Netherlands New Zealand Spain Sweden Switzerland
Latin America	Argentina Brazil Venezuela	Argentina Brazil Mexico	Argentina Brazil Chile Mexico	Argentina Brazil Chile Mexico Peru Venezuela	Argentina Brazil Chile Mexico Peru
Asia	China India Thailand	China India Korea Thailand	China Hong Kong India Indonesia Korea Malaysia Singapore Thailand	Brunei China Hong Kong India Indonesia Korea Malaysia PNG Philippines Singapore Taiwan Thailand Vietnam	Brunei China Hong Kong India Indonesia Korea Malaysia PNG Philippines Singapore Taiwan Thailand Vietnam
Transition	Russia	Hungary Poland Russia	Poland Russia	Russia	Poland Russia
Africa/Middle East	Algeria Gabon Saudi Arabia South Africa UAE	Cote d'Ivoire Egypt Morocco Saudi Arabia South Africa	Cote d'Ivoire Egypt Morocco Saudi Arabia South Africa Turkey	Algeria Gabon Saudi Arabia South Africa UAE	Cote d'Ivoire Egypt Morocco Saudi Arabia South Africa Turkey

* Approximation of best possible outcome from allowing each IC constituency to select one representative. Would not be guaranteed, although intra-constituency conflict would.

EXECUTIVE SECRETARIAT CORRESPONDENCE MEMO COVER SHEET

Tuesday, March 16, 1999

PROFILE #: 1999-SE-002633

DATE CREATED: 03/16/1999

ADDRESSEE: Robert E. Rubin
Secretary

AUTHOR: Geithner, Timothy F.
US, International Affairs

SUBJECT: Global Leaders' Meeting on Financial Architecture

ABSTRACT: Global Letters' Meeting on Financial Architecture.

RM 3419

TO REVIEWERS

IN: / to PA 3/16/99

TO EXECUTIVE SECRETARY

IN:

TO THE SECRETARY

PA to NCC 3/16/99

DATE SIGNED:

DISTRIBUTION: AS, INTERNATIONAL AFFAIRS

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NCC to NER (ACTION) (To take home 3/17)

NCC cc to MF
NC/DL/PA/AK

3/17/99

03/16/1999 11:19:44 AM

Global Leaders' Meeting on Financial Architecture

Initiated by: A. Marcus/IM AM

C. Allison CA 3/15

1999-SE-003559

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

April 6, 1999

ACTION

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Caroline Atkinson
Senior Deputy Assistant Secretary (International Affairs)

SUBJECT: Proposal for Special Heads' Architecture Meeting

Attached is a revised version of the heads memo and paper (for an NEC/NSC discussion), following our meeting yesterday afternoon. The paper suggests the five topics you outlined, and lays out three possibilities for attendance, and the two basic structures we discussed, a formal summit and a less formal retreat.

cc: U/S Geithner
A/S Truman
DAS Medish
DAS Zelikow
DAS Schuerch
Bob Boorstin

Exec. Sec. - NC

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

April 7, 1999

MEMORANDUM FOR GENE SPERLING
SANDY BERGER

FROM: Robert E. Rubin R.E.R.

SUBJECT: Proposal for Special Leaders' Meeting on Economic Architecture

The President asked us to prepare a proposal for a leaders' meeting on financial architecture.

The attached paper sets out our ideas for such a meeting. The paper discusses two possible structures -- a formal summit or an informal retreat -- and lays out three possibilities for attendance. It suggests four topics to be discussed:

- reforms of the international financial architecture;
- managing economic integration and the challenges of development;
- the human and social impact of crises; and
- the politics of reform.

If you find these suggestions helpful, this paper might serve as a basis for a broader discussion.

cc: Secretary Albright

Special Heads' Architecture Meeting

Issue: A meeting of representative worldwide leaders on globalization would provide political support and oversight of the financial architecture process, be an important stimulus to implementation of reforms, and provide an important forum to build support for continued efforts towards building openness and market-based solutions.

Recommendation: That the U.S. offer to host a meeting as suggested below.

Discussion: The meeting, perhaps in the fall, could make a valuable contribution to the financial architecture process, as another step in the development and implementation of reforms, and could also address other economic issues of global concern. Broad consultation is needed to promote consensus on how best to manage globalization so as to reap its full benefits for growth, while minimizing the risks. We should, however, avoid creating expectations of dramatic new announcements. Given the complexity and scope of the architecture agenda, some reforms will have already been implemented at the time of the meeting, some will be underway, and some will likely not have begun. The totality of these changes will be substantial.

There have been several other proposals for a leaders' meeting, including one by French President Chirac, who has offered to host. We would want to manage the structure and outcome of any meeting, however, which suggests that we should host it. The meeting could be co-chaired by the President and the chairs of the G-7, the Interim Committee, and the Development Committee (Germany, Italy and Thailand, respectively), with one chairing each session. Decisions need to be taken in three areas: format (whether the meeting should be a formal summit or a less formal retreat, which in turn is connected to the likely outcome and follow-up), agenda, and participation.

Format

We see two possible formats for the meeting, of which we recommend the first:

- **Leaders' Retreat:** leaders could discuss the issues relatively informally, and could issue a short document laying out their vision, perhaps framed as a manifesto for the global economy of the 21st century. This format would probably lend itself to a more interesting discussion, and its relatively *ad hoc* nature would make institutionalization of the meeting somewhat less likely, although some may be frustrated by the lack of an action-oriented outcome.

- **Formal Summit:** this would be a more tightly-controlled meeting, with a designated speaker followed by a period of discussion on each topic. At the end, leaders would release a communique outlining their conclusions, and perhaps including a work plan for addressing the challenges they identify. The formality of the Summit could lead to a more stilted debate and could raise expectations of a dramatic outcome and of follow-up meetings in future.

Agenda

We recommend a four-part agenda:

- reforms of the international financial architecture;
- managing economic integration and the challenges of development;
- the human and social impact of crises; and
- the politics of reform.

Participation

Selecting participants could be quite difficult since we want to keep the group relatively small while still inviting all of the key countries -- the major debtors and creditors, and those that were at the centers of the recent crises. We also want to minimize the offense to those who are excluded; this will be particularly sensitive because of a likely perception that the meeting could become institutionalized rather than be unique.

One way to minimize any resentment is to select members from an existing group, although none is ideal. The constituencies of the IMF and World Bank (whose memberships differ, but only slightly) provide a useful starting point, since virtually the whole world is represented. Using the constituencies as a basis also raises some problems: the structure overweights some regions (Europe, Africa, and the Middle East) and underweights others (Asia and Latin America), and each combination of the constituency chairs (which vary between the organizations, and between their boards and committees) omits some key countries.

The attached table summarizes three possible options:

- ***"G-8 Plus":*** if we choose to keep the meeting to a limited group of the countries that we see as most relevant, we might invite the G-8 leaders along with the heads of eight - twelve important developing nations, which we would select. This would create the tightest meeting, but also probably the greatest discord. It would therefore be important to have our G-7 partners reconciled to the list and concept. This option would avoid reifying the existing IFI structures. One possible list of countries is shown in the attachment.

- **Combined Interim and Development Committees:** a rule-based approach would be easier to justify. One option would be to invite all of the countries that sit on the IMF's Interim Committee and the World Bank's Development Committee. Because of overlaps, this creates a group of 31 (the list based on current memberships is attached). This approach has the advantage of being rule-based, thereby reducing any discord, and of keying off the Development Committee as well as the Interim Committee. Some key countries (Korea, Mexico, and Poland) would be excluded and the weighting problem would remain.

- **Two per Constituency:** another approach would be to invite two members from each constituency that has more than one member (or to invite the constituencies themselves to choose). This creates a larger group, but it partly ameliorates the weighting problem and allows all of the key countries to be included. However, if we were to make the choices it could appear somewhat arbitrary to some.

Country Groupings

	"G-8 Plus" (16-19)	Interim + Development Committees (31)	Two Per Constituency (40)
Industrial	G-7	G-7 Australia Belgium Denmark Netherlands Norway Spain Switzerland	G-7 Australia Belgium Denmark Netherlands Portugal Sweden Switzerland
Latin America	Brazil Mexico	Argentina Brazil Chile Venezuela	Argentina Brazil Chile Colombia Jamaica Mexico Venezuela
Asia	China India Korea	China India Thailand	Bangladesh China India Korea Singapore Thailand
Transition	Russia	Russia	Bulgaria Hungary Poland Russia
Africa/Middle East	South Africa Turkey	Algeria Bahrain Cote d'Ivoire Gabon Lesotho Morocco Saudi Arabia South Africa UAE	Algeria Cote d'Ivoire Egypt Gabon Morocco Nigeria Saudi Arabia South Africa UAE
	Argentina, Nigeria, Poland &/or Thailand		

To NCC 4/7/99

NCC OK to autopen 4/7/99

Osie autopenned + delivered to WH 4/7/99

PA faxed to G. Sperling 4/7/99

PA cc RER
LS
MG
SS
NCDI/PA/AK

Please log in

999-SE-006088

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

June 3, 1999

UNDER SECRETARY

Information

MEMORANDUM FOR: **SECRETARY RUBIN**
DEPUTY SECRETARY SUMMERS

FROM: Timothy F. Geithner TFG
Under Secretary (International Affairs)

SUBJECT: Financial Architecture Report to Leaders

Attached is the draft of the Finance Ministers' Report on Financial Architecture for the Köln Summit. This is the product of several rounds of detailed discussions on language with the G-7 over the past few weeks. Aside from the few items still in brackets, I believe you will be comfortable with it. There are almost no proposals in the agreed text that we did not initiate, and none that we can not live with. As is inevitable, there are some general areas of ambiguity, where it was necessary to preserve some dignity for the defeated.

This report is probably as close as we could have expected to get to the consensus that we have tried to frame through the Leaders' Statement last October, the papers you have circulated to the G-7 and your public statements.

Caroline Atkinson, Mary Goodman, and their team have done a great job in leading this effort. They deserve -- along, of course, with you two -- all the credit for whatever good has come out of this exercise.

There are three issues still outstanding:

- Private sector involvement: My colleagues have all said that their Ministers are prepared to live within the framework we proposed and not press in other venues for a more rigid, rules-based approach. You will still need to make clear in your meetings that we are only prepared to support the text on this basis, and you should elicit a commitment from Ministers on this point.

- Institutional reform: We are still discussing whether there is scope to reach an agreement that secures meaningful participation of key emerging market countries in an ongoing dialogue but does not compromise our objectives on institutional reform in the IFIs.

- Expansion of Financial Stability Forum: We are still exploring whether we can agree to expand the Forum's permanent membership by the September meetings as we have proposed. Main candidates are Hong Kong, Singapore, Australia, Switzerland, and the Netherlands.

cc: Jim Steinberg/NSC
Lael Brainard/NEC
Stuart Eizenstat/State
Al Larson /State

G7FMRev7

02 June, 1999

DRAFT

Strengthening the International Financial Architecture

Report of G7 Finance Ministers to the Köln Summit

Introduction

A well-functioning international financial system is essential to allow an efficient allocation of global savings and investment, and provide the conditions needed to improve world wide growth and living standards in all countries. Recent events in the world economy have demonstrated that a strengthening of the system is needed to maximise the benefits of, and reduce the risks posed by, global economic and financial integration.

Reform of the International financial architecture will also reinforce the open multilateral trading system. Keeping markets open for goods and capital will make the global economy more resilient to shocks. The benefits and economic opportunities derived from open markets have led to a significant improvement in living standards in industrialised and emerging economies. We believe the process of globalisation offers great additional potential to create wealth and employment.

As Finance Ministers of the major economies, we are aware of our special responsibility for improving the conditions for a proper functioning of the international financial and monetary system and, in particular, enhancing sound fundamentals necessary for exchange rate stability. To this end we will maintain strong cooperation to promote stability of the international monetary system and exchange rates among major currencies that are in line with fundamentals.

Following the remit from last year's Birmingham Summit, we have proposed in co-operation with other countries a number of important reforms to the architecture of the international financial system. We believe the initiatives and reforms that have been agreed will make a significant contribution to the stability of the world financial system.

02/08 '99 17:17 FAX 0081333223 ZDF

In this increasingly integrated global economy, in which policy responsibility still lies mainly with sovereign states, the challenge is to promote global financial stability through national action as well as through enhanced international cooperation. All countries, together with the international financial institutions and private sector financial institutions, must share this responsibility.

This does not require new international organisations. It requires that all countries assume their responsibility for global stability by pursuing sound macroeconomic and sustainable exchange rate policies and establishing strong and resilient financial systems. It requires the adoption and implementation of internationally agreed standards and rules in these and other areas. It requires the existing institutions to adapt their roles to meet the demands of today's global financial system: in particular to put in place effective mechanisms for devising standards, monitoring their implementation and making public the results; to have the right tools to help countries to manage crises; and to take steps to enhance their effectiveness, accountability and legitimacy. It also requires the right structure of incentives for all participants in the international financial system – national authorities as well as the private sector.

56. Our overall strategy is to identify and put in place policies to help markets work properly and to provide for the public goods necessary to achieve this objective. This requires public authorities to provide for enhanced transparency and disclosure, improved regulation and supervision of financial institutions and markets, and policies to protect the most vulnerable. It also requires that private creditors and investors bear responsibility for the risks that they take, and are involved appropriately in crisis prevention and crisis management. In these respects, the establishment of internationally-agreed codes and standards for policy-makers serves both as an incentive for better governance and as a yardstick against which to measure country risk.

Last autumn, we identified for leaders the need for concrete actions to strengthen the international financial architecture. This report recommends specific reforms in six priority areas:

- Strengthening and reforming the international financial institutions and arrangements
- Enhancing transparency and promoting best practices
- Strengthening financial regulation in industrialised countries

- Strengthening macroeconomic policies and financial systems in emerging markets
- Improving crisis prevention and management and involving the private sector
- Promoting social policies to protect the poor and most vulnerable.

We believe these proposals will reduce the risk of, and help better manage, future financial crises. We are committed to, and will monitor closely, their implementation, and will continue to report on progress as necessary. Of course, financial markets will continue to evolve and this is likely to require further adaptations of the international financial system in the years ahead.

A. Strengthening and reforming the international financial institutions and arrangements

The development of global economic and financial arrangements to reflect the changing nature of the world economy is a continuous process. Our aim is to promote more efficient international financial institutions and arrangements, in which all relevant interests can be effectively represented.

We agree on a set of principles which should guide this process:

- The IMF and the World Bank have the central role in the international economic and financial system, and in facilitating cooperation among countries in these fields

- The international supervisory and regulatory bodies have a crucial role to play in making the international financial system more robust.

- The accountability and transparency of the IFIs and these bodies should be strengthened

- [A broad range of countries should be involved in discussions on how to adapt the international financial system to the changing global environment.]

The constituency based system is appropriate for the governance of the institutions. [The flexibility offered by the system could be used if needed to take into account developments in the world economy. [We welcome in this context the review of quota formula.]] [The system

should be reviewed to take into account new developments in the world economy and to provide for appropriate representation. [We agreed to review the IMF voting system.]]

A number of steps have been taken to widen the ongoing dialogue on the international financial system to a broader range of countries, including the establishment of the New Agreement to Borrow (NAB) comprising 25 participants; the special meetings involving Ministers and Governors of systemically significant economies that occurred during 1998; the seminars involving 33 industrial and emerging economies held this spring in Bonn and Washington; and this year's Spring meeting of the IMF Interim Committee which was prepared for the first time by a special meeting of deputies.

The new Financial Stability Forum was created to enhance international cooperation and coordination in the area of financial market supervision and surveillance. The Forum met for the first time in April, and agreed to focus initially on three issues: the implications of highly leveraged institutions, off-shore centres and short-term capital flows. This process will include participants from other industrial and emerging economies. We agree that the Forum should, [by the time of the September meeting], [by the end of the year], be broadened to include several key economies with significant financial centres, in a format that provides for effective dialogue.

[A number of proposals have been offered for institutional reform including the proposal for transformation of the Interim Committee into a Council. We are in the process of considering these issues]

We have also agreed to take steps to improve the effectiveness of the IMF and other IFIs, including by:

- pursuing enhanced monitoring of policy commitments while drawings on the Fund remain outstanding but after program conditionality has ended, in order to reinforce incentives for good performance;

- sharpening the focus of the IFIs on sectors where they have a comparative advantage, and broadening their dialogue with other international fora and with the private sector. Special attention needs to be paid to the specific circumstances of the country concerned aiming at encouraging direct ownership of the programs;

02/06 '99 17:18 FAX 069/35322328

- building upon the experience of IMF-supported programmes in the financial crisis, the IMF should explore ways further to improve IMF surveillance and programmes so that they better reflect the changes in the world economy, in particular potentially abrupt large-scale cross border capital movements.

- enhancing the accountability of the IMF by improving transparency, the decision-making procedures and the timely flow of information.

- encouraging the IMF to continue undertaking systematic evaluations both internal and external of the effectiveness of selected operations programmes, policies and procedures.

B. Enhancing Transparency and Promoting Best Practices

The availability of accurate and timely information is an essential ingredient for well-functioning financial markets and market economies. Such information is necessary for market participants and should be used by them to make good decisions. It also provides greater incentives for policy-makers to implement sound economic policies. Improved information will help markets to adjust more smoothly to economic developments, minimise contagion and reduce volatility.

Significant progress has been achieved in a number of areas. The IMF has made substantial progress in promoting enhanced disclosure of economic statistics and indicators, and in developing voluntary codes of good practice and standards to ensure appropriate transparency of the processes by which governments formulate macroeconomic and financial policies:

- The IMF Executive Board approved in March 1999 an expansion of the *Special Data Dissemination Standard* (SDDS) to provide for a more comprehensive and timely disclosure of data on countries' international reserve positions. The expanded SDDS, which will go into effect in April 2000, addresses gaps in the original standard established in 1996. Efforts are also being taken through the *Inter-Agency Task Force on Financial Statistics* to harmonize the statistics published on developing and transition countries' external debt by the BIS, IMF, OECD, and the World Bank, and quarterly publication has begun.

- The IMF' s *Code of Good Practices on Fiscal Transparency* has been approved by the Executive Board and was endorsed by the Interim Committee in April 1998. An implementation manual, questionnaire, and self-evaluation report have been prepared and are being disseminated.

- A draft *Code of Good Practices on Transparency in Monetary and Financial Policies* has been published for comment and should be completed by the 1999 IMF Annual Meetings.

The IMF has also approved a number of measures to increase transparency in member countries' economic policies as well as its own operations, including: (i) greater use of Public Information Notices to provide information on IMF policy issues; (ii) procedures for the release of Letters of Intent, Memoranda of Economic and Financial Policies, and Policy Framework Papers that underpin IMF-supported programs; (iii) publication of the Chairman's statement following Board approval or review of members' programs; and (iv) a pilot project for the voluntary public release of Article IV staff reports. In the World Bank, Country Assistance Strategies, which set out the major development challenges of individual countries and guide the Bank's lending programme, will in principle be made public as of July 1999.

Transparency of the private sector is of particular importance to the orderly and efficient functioning of financial markets. The Basle Committee, IOSCO, and the IAIS have established Core Principles for supervision in their respective areas of responsibility. Valuable actions in this area also include IOSCO's issuance of Disclosure Standards to Facilitate Cross-Border Offerings and Initial Listings by Multinational Issuers. The Committee on the Global Financial System (CGFS) is reviewing ways to improve market disclosure, including a model template for public disclosure of their exposures and risk profile by institutions engaged in trading, investment and lending activity, both regulated and unregulated. Further work on this issue, involving other relevant authorities, was supported in the Financial Stability Forum.

We support and commend the efforts being taken by private sector bodies to enhance transparency. We welcome the completion by the International Accounting Standards Committee of its core set of international accounting standards, and we look forward to IOSCO, IAIS and the Basle Committee completing their reviews. We urge all those involved in setting accounting standards to work together so that high quality accounting standards can continue to be developed and agreed internationally.

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With considerable progress already having been made in the development of standards and codes of good practice, the key challenge now facing the international community is to encourage implementation. We attach high priority to the following steps:

- Wider compliance with the SDDS by countries with access to the international capital markets, wider agreement on specific SDDS standards for reporting of external debt, addition of indicators of financial sector soundness, and efforts to promote greater public awareness of, and use of, the information conveyed by the SDDS.

- Steps further to increase transparency in the IMF's own operation and its member countries' economic policies, including the greater release of Board documents.

- Developing a system for surveillance of implementation of the codes and standards, built on the Article IV process of the IMF, involving close collaboration with the World Bank and the standard setting bodies. To this end, we call on the Fund to develop a mechanism for coordinating this liaison, and to report on the effectiveness of the Article IV process as a means of monitoring and encouraging adherence to standards. Country adherence to standards should also be used in determining Fund conditionality.

- Systematic incorporation of information on a country's observance of transparency standards in the Fund's regular Article IV surveillance reports, as well as in special reports on country transparency practices prepared by the staff. We are encouraged in this respect that experimental transparency reports have already been prepared by the Fund staff, and that countries have engaged in pilot self-assessments of their own transparency practices. We look to these reports to be extended to form an integral part of the Article IV surveillance process.

- Continued efforts towards implementation of the Core Principles established by the Basle Committee, IOSCO, and IAIS, including in the context of the Core Principles Methodology Working Group and with appropriate involvement by the IMF and World Bank.

- Moves by our regulators to consider a country's adherence to the range of relevant international standards, including international standards for banking supervision, as part of the prudential criteria used when considering market entry by foreign banks.

- Recognising the importance of providing a sufficient degree of transparency by all market

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participants, steps should be taken to improve transparency by all market participants, including steps to improve the quality and timeliness of public disclosure of direct material exposure to highly leveraged financial institutions, and of relevant information by highly leveraged institutions. We look forward to the work of the Financial Stability Forum on this issue.

- The ongoing efforts by IOSCO to review the advisability and feasibility of imposing transparency and disclosure requirements on highly leveraged institutions.

- Completion of the work of the CGFS on reporting of aggregate positions and transactions in foreign exchange markets.

- Measures to induce off-shore centres to comply with internationally agreed standards and codes in the area of transparency and supervision. We look forward to the work of the Financial Stability Forum on this issue.

- The OECD's recently-approved core principles on corporate governance, and the World Banks continuing work with the OECD and other international institutions to encourage the broadest possible adoption and implementation in emerging market and industrial countries.

- Compilation of the various financial and economic policy standards and best practices into a common reference such as a compendium on international financial and economic policy standards, through which countries could articulate their intention to implement the various standards and best practices.

C. Strengthening financial regulation in industrial countries

The past two years have reminded us that investors and creditors often tend to underestimate risks as they reach for higher yields. In periods of market euphoria, market participants can make credit and investment decisions that might not otherwise have been made. In hindsight, the failures on the part of lenders and supervisors in the major countries include poor risk management practices, inadequate information as well as inadequate attention to available information, and capital standards that provide unintended incentives to lend to risky borrowers. Such excessive risk taking, combined with high degrees of leverage, can magnify

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the negative effects of any event or series of events.

Measures to induce creditors and investors to act with greater discipline (i.e., to analyse and weigh risks appropriately in their lending and investment decisions), should aim at avoiding excessive leverage and encouraging more prudent assessment of the risks associated with lending to emerging markets. In addition to the measures on transparency set out above, we have identified three critical areas that should be addressed by industrial countries:

- Improving risk assessment and risk management. Measures to induce creditors and investors in industrial countries to act with greater discipline can dampen investors tendency to underestimate risks in good times and exaggerate them in bad times. These measures can take the form of increased supervisory oversight of firms' risk management practices, and strengthened capital adequacy.

- Assessing the implications for supervisors and regulators of Highly Leveraged Institutions (HLIs). Leverage can play a positive role, but problems can arise when excessive leverage is accompanied by excessive concentration of risk. In addition, concerns have been expressed about the activities of HLIs with respect to their impact on market dynamics generally and vulnerable economies in particular.

- Encouraging offshore financial centres (OFCs) to comply with international standards. Financial market participants need to compete on a level playing field. Therefore, as we continue to strengthen our own regulatory standards, it will be important for OFCs to strengthen their supervisory systems and standards.

A substantial amount of work has already been undertaken. In particular, in January 1999, the Basle Committee promulgated guidance on sound practices for banks in relation to HLIs, including credit analysis practices, and the development of more accurate exposure measures. The sound practices also include setting meaningful overall credit limits for HLIs, and monitoring credit exposures relating to HLIs.

On risk assessment and risk management, the existing work of the Basle Committee provides a useful start for further work in this area. More work is now required:

- We welcome the Basle Committee's recent agreement on proposed revisions to the Capital Accord to make it more sensitive to risk, including credit risk involved in lending to

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emerging markets and in short-term lending, and reflecting compliance with international standards such as the SDDS and Basle Core Principles. We welcome the Basle Committee's intention to consider broader revisions to the existing system of risk-based capital regulation, taking into account changing market practices.

- We encourage private firms to strengthen their own risk management practices. In this regard, we note that the Counterparty Risk Management Policy Group will soon issue a report on strengthened risk management practices. Once issued, we call on national authorities to consider whether to endorse these recommendations.

- National authorities should ensure that banking institutions in their countries implement adequate risk management practices in accordance with the recommendations set forth in the Basle Committees January 1999 papers on HLIs.

- We welcome the efforts of IOSCO to strengthen risk management practices for securities firms in relation to HLIs and to consider other measures to limit counterparty risk in dealings with HLIs.

On highly-leveraged institutions, we look forward to the work of the new Financial Stability Forum on a number of issues, including systemic issues relating to market dynamics generally and vulnerable economies in particular. Considerations should be broadly based and encompass the whole range of available measures, including of the pros and cons of indirect and direct supervisory approaches as well as of enhancing transparency by improving reporting and disclosure.

Special requirements are demanded by the supervision of complex, internationally active financial organisations. The Joint Forum on Financial Conglomerates has done valuable work on the development of principles, regulatory techniques and other guidance for meeting some of the most significant regulatory challenges arising from the emergence of internationally active financial conglomerates. In February 1999 its parent organisations, the Basle Committee, IOSCO and IAIS endorsed and released a package of papers dealing with, among other things, techniques for:

- assessing the capital adequacy of conglomerates,
- facilitating the exchange of information among supervisors, including the identification of co-ordinators,

- facilitating co-ordination among supervisors, and
- testing the fitness and propriety of managers, directors and major shareholders of conglomerates.

Some offshore centres have already taken measures to enhance home country supervision. However, not all countries have yet taken such measures. Moving forward, we hope the following will occur:

- Countries with close relations with OFCs should exert pressure on those jurisdictions to comply with international standards.

- As noted above, the Basle Committee should link risk weights to compliance with international standards.

- IOSCO and Basle-sponsored working groups should make membership in their bodies contingent on progress towards implementation of international standards.

- The Financial Action Task Force should take concrete steps to bring OFCs, and under-regulated and non-cooperating jurisdictions, into compliance with the 40 recommendations against money laundering and to protect the international financial community from the adverse impact of those that do not comply.

- More generally, we look forward to the work of the Financial Stability Forum on OFCs.

In writing this report we took account of the reports of the G7 Financial Experts Group on Supervision and Regulation in the Financial Sector and the G7 Working Group on Financial Crime.

D. Strengthening macroeconomic policies and financial systems in emerging markets

Recent financial crises have demonstrated the need to strengthen economic fundamentals and financial systems in emerging economies. This is essential not only to improve economic welfare in these countries, but also to help create an environment conducive to international economic and financial stability. While large-scale international capital flows have provided an important contribution to the development of emerging economies, they have also changed

the nature of risks facing those countries: weak macro-economic policies and financial infrastructures can be penalised more severely and more suddenly by investors. A broad international consensus has recently been formed on a number of issues:

- Countries need to pursue sound macroeconomic policies, including sustainable exchange rate regimes and prudent fiscal policies. They should adhere to sound principles of debt management. A high priority should also be given to strengthening emerging economies' financial sectors and supervisory regimes.

- Some emerging economies have sought to achieve exchange rate stability by adopting peg regimes against a single currency or a basket of currencies, often in the same region, of countries with which they have the closest trade and investment links. Countries choosing fixed rates must be willing, as necessary, to subordinate other policy goals to that of fixing the exchange rate. If countries choose fixed rates, recent history suggests that arrangements institutionalising that policy can be useful to sustaining a credible commitment to fixed rates.

- There are particular risks and vulnerabilities associated with excessive short-term borrowing, particularly in foreign currencies. Where problems have developed, there have often been important and unwise policy biases in favour of short term capital flows. Countries should avoid excessive accumulation of short-term debt, maintain an appropriate structure of liabilities, and seek to eliminate biases in favour of short-term borrowing.

- Capital account liberalisation should be carried out in a careful and well-sequenced manner, accompanied by a sound and well-regulated financial sector and by a consistent macroeconomic policy framework.

- The use of controls on capital inflows may be justified for a transitional period as countries strengthen the institutional and regulatory environment in their domestic financial systems. Where financial sectors and supervisory regimes are weak, safeguards may be appropriate to limit foreign currency exposure of the banking system. More comprehensive controls on inflows have been employed by some countries as a means to shield themselves from market pressures. Such steps may carry costs and should not in any case be used as a substitute for reform. In addition to these considerations, controls on capital outflows although can carry even greater long term costs. They have not been

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a very effective policy instrument and should not be a substitute for policy reform, although they may be necessary in certain exceptional circumstances.

We agree that emerging economies themselves must take the lead in strengthening their economies and financial systems. In addition:

- It is our objective to help emerging economies adapt their policies and organisations to those required to participate fully in the world economy.

- The IFIs and other international bodies should enhance their cooperation in terms of giving useful advice and assistance to emerging economies.

Numerous countries will need technical assistance if standards of best practice are to be implemented without delay and effective supervision is to be achieved. As there is only a limited number of experts available both in national authorities and in international organisations, we call on Financial Stability Forum to consider methods to improve the coordination of technical assistance, including the possibility of establishing a clearing mechanism for this purpose at the international level to ensure that technical assistance is co-ordinated and to make best use of all available resources.

Exchange rate regimes

Further work is needed on appropriate exchange rate regimes for emerging market economies. The choice of exchange rate regime is critical for emerging economies to achieve sustainable economic development, and also has important implications for the world economy, including in the context of large-scale official financing. In this context:

- We agree that the most appropriate regime for any given economy may differ, depending on particular economic and other circumstances, and that stability depends on the exchange rate regime being backed by consistent macroeconomic policies and supported by robust financial systems.

- We agree that the international community should not provide large-scale official financing for a country intervening heavily to support a particular exchange rate level, except where that level is judged sustainable and certain conditions have been met, such as where the

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exchange rate policy is backed by a strong institutional commitment and by consistent domestic policies.

- We encourage the IMF to continue its work in this area and to enhance the attention it gives to exchange rate sustainability in the context of its surveillance activities, giving early warnings and advice to countries moving towards unsustainable positions

Financial systems

Further efforts are needed to strengthen financial systems in emerging markets:

- We commit ourselves to enhancing our cooperation, together with the IFIs and relevant international regulatory bodies, to promote improved financial supervision in emerging economies.

- The IMF and the World Bank should coordinate their advice to emerging economies, in particular in the area of financial sector reforms. As part of policy reviews, they should enhance surveillance over the broad range of policies now understood to be crucial to financial stability. Countries should be encouraged to demonstrate their commitment to making rapid progress towards full compliance with existing international codes as part of IMF and World Bank conditionality when the IFIs extend loans or credits.

- We welcome the establishment of the Financial Sector Liaison Committee (FSLC) in September 1998, and the IMF - World Bank Financial Sector Assessment Programme (FSAP), enhance effective collaboration between the Fund and Bank in this area. The breadth and pace of these efforts need to be increased, by more effectively integrating the efforts and operations of the two institutions in the financial sector, also drawing on relevant expertise in national and international regulatory and supervisory bodies. We call upon the Fund and the Bank to prepare a joint report on their progress and on proposals to meet these objectives by the time of the Annual Meetings in September. These proposals should aim to provide more effective organisation and deployment of resources to improve crisis response, the design and delivery of financial-sector programmes, and technical assistance for member countries.

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- We welcome commitments given by the emerging economies of Asia and Latin America in various fora to take the necessary steps towards implementation of the Basle Core Principles for effective banking supervision. We call upon the governments of other countries to make every effort to ensure that by 2001 plans are in place to implement the Core Principles. The core principles of IOSCO and IAIS should also be implemented by all countries without delay.

- Governments should narrow the scope of their guarantees of private obligations so as to make sure that creditors do not lend to private entities with the expectation that they will be protected from adverse outcomes. Those guarantees that are provided should be clear and transparent: non-bank financial institutions that fall outside the scope of such regulation should not be covered by explicit or implicit government guarantees created for the banking sector.

Capital flows

We encourage the IMF to continue its work on the appropriate pace and sequencing of capital account liberalisation, and to explore further issues related to the Fund's role in facilitating an orderly approach to such liberalisation. In this context, particular attention should be paid to eliminating policy biases in favour of short-term capital flows, particularly in foreign currencies, and promoting sound debt management policies. The IMF should also further refine its analysis of the experience of countries with the use of capital controls. In this regard, there is a strong case for further studying the benefits and costs of market-based prudential measures aimed at curbing excessive capital inflows, including those used by the Chilean authorities in a recent past.

We call on the IMF and other relevant institutions to cooperate with national authorities to create a better system for monitoring cross-border capital flows:

- We note the importance of timely and comprehensive data on capital flows, and encourage the IMF and national authorities, with the assistance of relevant institutions such as the BIS, to create more detailed data on inflows and outflows of capital by maturity, currency, type, and borrower. In this context, we welcome the agreement to improve data on short-term liabilities of the official sector in the context of strengthening the Special Data Dissemination Standard (SDDS).

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- We encourage the use of high-frequency debt monitoring systems which can be used to verify the sustainability of debt structures, especially of foreign short-term exposures, and encourage the IMF to intensify its work with member governments in this area.

- We look forward to the work of the Financial Stability Forum on short-term capital flows.

Debt managment

We will work with emerging market economies and the IFIs to promote best practices in debt management, which should:

- encourage greater reliance on long-maturity, and if possible domestic-currency denominated, debt to maintain a debt profile that provides substantial protection against temporary market disruption; avoid transforming long-term debt into shorter-term debt;

- remove biases which encourage short-term private borrowing;

- encourage the creation of deeper domestic bond markets to facilitate long-term domestic currency debt financing; and

- encourage governments that are heavily dependent on commodities revenue to hedge their exposure to commodity price volatility, and promote arrangements that provide greater contractual risk-sharing between creditors and debtors;

- promote debt management that minimises exposure to liquidity risk, including rollover risk, rather than minimises short-term borrowing costs. Provisions in sovereign debt that can augment balance of payments pressure in a crisis should be avoided; and

- promote the use of contractual provisions in offshore sovereign bond documentation that facilitate orderly restructuring, as described in section E below.

E. Improving crisis prevention and management, and involving the private sector

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Recent crises have emphasised the need to improve the approach of the international community to financial crisis prevention and resolution, and adapt it to a world of open capital markets. We need to shape expectations so that private creditors know that they will bear the consequences of their investment decisions, and to identify ways to reduce the risk of contagion.

Crisis prevention

Prevention of financial crises is key. The measures that we have outlined above provide important ways to improve crisis prevention. In addition, new clear principles and new tools are needed to limit contagion and to fully recognise the crucial role private investors play in today's integrated financial markets.

The new IMF contingent credit line (CCL) will play an important part in promoting international financial stability. This facility aims at protecting from contagion countries with reasonable debt structures, sound macro-economic and structural policies, and which are also engaged in an appropriate process of consultation with private creditors. The facility should encourage the IMF towards an increasing focus on crisis prevention, and will provide further incentives for countries to take early measures to avoid the risk of financial crisis. The CCL provides an additional mechanism for encouraging countries to implement standards.

Countries should take *ex ante* steps to strengthen the framework for the market-based, cooperative and orderly resolution of the debt payment difficulties that do arise. We have agreed on the following measures:

- Appropriate communication between debtors and creditors is also important in both crisis prevention and resolution. We encourage emerging economies to develop mechanisms for more systematic dialogue with their main creditors. We also support strengthened dialogue between the international financial institutions, notably the IMF, and the private sector.

- We encourage the use of market based tools aimed at preventing crises and facilitating adjustment to shocks, including through the use of innovative financial arrangements, including private market-based contingent credit lines in emerging countries and roll-over options in debt instruments. These measures would facilitate access to the international

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markets in times of instability for emerging countries, and, in the context of a sound debt management framework, can thus help prevent liquidity crises and give countries a breathing space to make decisive macro-economic or structural adjustments.

We have agreed on the importance of stronger efforts to encourage progress in broadening the use of collective action clauses in sovereign debt contracts, along with other provisions that facilitate creditor coordination and discourage disruptive legal action. We recommend:

- making the use of such provisions a component of international best practices in debt management, and a consideration in determining access to the IMF's Contingent Credit Line;

- focusing attention on the use of these provisions in international surveillance, and making such provisions a consideration in IMF conditionality, as appropriate;

- considering incorporating these provisions into sovereign debt that is enhanced by the multilateral development banks;

- Further considering the possible inclusion of such provisions in our own debt instruments, and otherwise encouraging the use of such provisions in the debt instruments issued by other sovereigns in our markets.

We also encourage efforts to establish sound and efficient bankruptcy procedures and strong judicial systems. We support the work of the international financial institutions to help countries to improve the transparency, predictability, and equity of their insolvency and debtor-creditor regimes.

A framework for private sector involvement in crisis resolution

In addition to crisis prevention measures addressed above, we are agreed that the international financial community needs to set out in advance a broad framework of principles and tools for involving the private sector in the resolution of crises. The following framework is designed to help shape expectations to reduce the risk that investors will take positions based on the expectation that they will be protected from adverse outcomes, and promote

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more orderly crisis resolution. It will also help to promote cooperative solutions between borrowing countries and the private sector.

Principles

We agree that this framework should comprise the following key principles:

- The approach to crisis resolution must not undermine the obligation of countries to meet their debts in full and on time. Otherwise, private investment and financial flows that are crucial for growth could be adversely affected and the risk of contagion increase.

- Market discipline will work only if creditors bear the consequences of the risks that they take. Private credit decisions need to be based on an assessment of the potential risk and return associated with a particular investment, not on the expectation that creditors will be protected from adverse outcomes by the official sector.

- In a crisis, reducing net debt payments to the private sector can potentially contribute to meeting a country's immediate financing needs and reducing the amount of finance to be provided by the official sector. It can also contribute to maintaining appropriate incentives for prudent credit and investment decisions going forward. These potential gains must be balanced against the impact that such measures may have on the country's own ability to attract new private capital flows, as well as the potential impact on other countries and the system in general through contagion.

- No one category of private creditors should be regarded as inherently privileged relative to others in a similar position. When both are material, claims of bondholders should not be viewed as senior to claims of banks.

- The aim of crisis management wherever possible should be to achieve co-operative solutions negotiated between the debtor country and its creditors, building on effective dialogues established in advance.

Considerations

The principles outlined above, and the tools we propose below, should help establish a broad framework for making judgements about the policy response appropriate to a given case. The

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appropriate role for private creditors, if any, and the policy approaches needed to induce private creditors to play this role will vary depending on the circumstances of the particular case. There are advantages to making clear in advance the basic considerations that will guide our actions and specific approaches we will employ. The principles and tools we propose should help provide a degree of predictability for investors, without sacrificing the flexibility required to address effectively each particular financial crisis.

There is a variety of circumstances where countries might face external financing pressures There are circumstances where we believe emphasis might best be placed on market-based, voluntary solutions to resolve the country's financial difficulties. There are also cases where more comprehensive approaches may be appropriate to provide a more sustainable future payments path. In practice, there will be a spectrum of cases between these two extremes. Where a country falls on this spectrum will help to determine the policy approach best suited to its particular circumstances. Relevant considerations include the country's underlying capacity to pay and its access to the markets.

In addition, the feasibility of different policy approaches will depend on the nature of outstanding debt instruments will influence assessments of which claims need to be addressed to resolve the country's financing difficulties, the magnitude of possible concerns about equitable treatment among various categories of creditors, and the scope for voluntary versus more coercive solutions. The nature of the relevant debt obligations is crucial. These can differ along many axes, including whether the debt obligations are principally: private or public; foreign or local currency; short-term or long-term; payment of principal or interest; offshore or onshore; secured or unsecured; held narrowly or held by a diffuse group of creditors.

It is important to put into place incentives that would encourage a country to take strong steps at the early stages of its financial difficulties to prevent a deepening crisis.

Tools

To address effectively a wide range of potential cases, the international community needs to have a broader range of tools available to promote appropriate private sector involvement. The tools available to the international community should comprise the following:

- Linking the provision of official support to efforts by the country to initiate discussions with its creditors to explain its policy program.

- Linking the provision of official support to efforts by the country to seek voluntary commitments of support, as appropriate, and/or to commit to raise new funds from private markets.

- Linking the provision of official support to the country's efforts to seek specific commitments by private creditors to maintain exposure levels.

- Linking the provision of official support to the country's efforts to restructure or refinance outstanding obligations.

- In cases where a country's official debt needs to be restructured in the Paris Club, the Paris Club principle of comparability of treatment applies to all categories of creditors other than the international financial institutions. The Paris Club should adopt a flexible approach to comparability, taking into account factors, including the relative size and importance of different categories of claims.

- Imposing a reserve floor that effectively ensures that the private sector makes an adequate contribution, such as through debt restructuring, alongside official resources in the resolution of crises.

- In exceptional cases, it may not be possible for the country to avoid the accumulation of arrears. IMF lending into arrears may be appropriate if the country is seeking a cooperative solution to its payment difficulties with its creditors.

- In exceptional cases, countries may impose capital or exchange controls as part of payments suspensions or standstills, in conjunction with IMF support for their policies and programmes, to provide time for an orderly debt restructuring.

We call on the IMF further to develop and define the legal and technical questions involved in implementing the specific approaches identified in the framework agreed here. We look forward to its conclusions by the autumn Annual Meetings.

In order to guide expectations more effectively, we agree that we will seek to provide a clear

and timely explanation of the policy approaches in individual cases adopted in relation to the principles and considerations that we have laid out above.

F. Promoting Social Policies to Protect the Poor and Most Vulnerable Issues

Recent events in the world economy have underlined the important link between economic and social issues; and that good economies depend both on stable relationships between governments and their citizens, and strong social cohesion. An efficient social system, by equipping people for change, builds trust and encourages people to take the risks which are a necessary part of a competitive modern market. This in turn helps to mitigate the risks and spread the benefits of globalisation.

Effective social policy can in particular ease the task of adjustment during times of crisis, helping build support for necessary reforms and ensuring that the burden of adjustment does not fall disproportionately on the poorest and most vulnerable groups in society.

Action in these areas can be subject to a number of constraints. In general, the resources available for social programmes are limited, other priorities are pressing and institutional capacity is stretched. In times of downturn, policy makers may face particularly difficult choices between safeguarding immediate social welfare, and ensuring the adjustment necessary to restore confidence and promote stable growth, which provides the best way of reducing poverty and supporting social welfare. We believe there are strong benefits for all countries and the IFIs in working together to develop and promote practices in social policies which most effectively support economic development.

Countries, each with their different culture and traditions, have developed their own systems and practices for addressing social issues. There is likely to be mutual benefit for countries in sharing experiences of policies which work best at different stages of development. Experiences were discussed amongst countries participating in the G33 International Architecture Seminar in Washington on 25 April. The seminar:

- Considered the most important areas of social spending, the ways in which public expenditure can be effectively targeted to the neediest, and the trade-offs which are involved when levels of social spending are determined.

- Underlined the importance of monitoring social developments and operating social policy in a transparent way, so that both governments and their populations can be more aware, at the earliest possible stage, of areas of particular need, and plan on that basis.

Moreover, since countries operating in the modern globalised economy are likely to face similar pressures, there is a case for identifying principles, policies and best practices, and for their promulgation through International organisations. We note with approval the principles of good practice in social policy which had been prepared by the World Bank, in collaboration with the United Nations. At the last meeting of the Development Committee Ministers asked the World Bank to report back at the 1999 Annual Meetings on its work on policies and best practice to protect the poorest groups and maintain the momentum for development.

Further work is needed to identify and promulgate principles, policies and best practices in social policy. We call on:

- the UN to make rapid progress in developing the basic social principles as part of the follow-up on the Copenhagen Declaration of the World Summit for Social Development;

- the World Bank, with full participation from the IMF, to report back to the 1999 Annual Meetings on identifying policies and best practice to support the process of economic development. In times of crisis, these can be drawn upon in the design of adjustment programmes to ensure protection of the most vulnerable;

- the IMF and the World Bank, in their work on transparency and good governance to consider more explicitly the way in which this can be geared to ensuring implementation of social programmes which minimises waste and maximises efficiency;

- the World Bank and the IMF to strengthen collaboration in the preparation of public expenditure reviews of individual countries which analyse the composition and efficiency of public expenditure;

- the IMF, in assisting countries to develop macroeconomic frameworks in times of crisis, to take into consideration the degree to which the adjustment programmes provide for adequate spending in the social sector.

- the World Bank to work with countries, the Fund and Regional Development Banks on

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826 drawing up and monitoring implementation and follow up of social indicators.

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828 – the Fund and Bank to increase the attention they give to these issues in the design of
829 adjustment and sector programmes, and to develop further their cooperation in this area.
830 In addition, we call on all countries to consider what more can be done to encourage the
831 pursuit of sound social policies both inside and outside of crisis situations.

832

833 Effective social policy will help provide a foundation for sustainable development, by ensuring
834 that the benefits of globalisation are widely shared, equipping people for change and ensuring
835 that economies are more robust.

836

837 Sustainable development at a global level, enabling all countries to share the benefits of
838 economic growth, also depends on measures to reduce the unsustainable debt burdens on
839 the poorest countries and alleviate poverty. The initiatives on social policy must therefore be
840 taken forward together with initiatives on debt relief and poverty reduction, on which we have
841 presented separate proposals to our Heads.

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847 **Additional language for chapter A**

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849 [We agreed to strengthen the Interim and Development Committees, through a series of
850 measures to increase their effectiveness: renaming the Interim Committee the International
851 Monetary and Financial Committee, Deputies level meetings to prepare for Ministerials, ...]

852

853 [We agreed to establish an ongoing mechanism for dialogue among systemically important
854 countries [complementing the framework]/[in the framework] of the Bretton Woods
855 institutions.]

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ASIA

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

January 17, 1994

MEMORANDUM FOR THE PRESIDENT

FROM: Lloyd Bentsen LM Bentsen

SUBJECT: From Moscow to Asia

I am now in Indonesia on the beginning of a trip through Asia which will end in China. My overall purpose will be to build on your message in Seattle of U.S. Commitment to the Asia-Pacific region.

China

In China, my most important visit, I have two main objectives:

-- To begin a broad economic dialogue based on two goals shared by both countries: expanding mutually beneficial economic ties and promoting China's successful transition to a market-based economy. In this regard, I will revive a reformulated Joint Economic Committee, which will focus on opening China's market in the areas of trade, investment, exchange system reform, and financial services; and

-- To emphasize the continued importance of further Chinese progress on human rights as a condition for renewal of MFN.

The Chinese are at a critical point in their transition to a market-based economy. The Communist Party Congress has just approved sweeping reforms of the fiscal, financial, and foreign exchange systems. These reforms are essential for establishing the basic tools for managing fiscal and monetary policy in a market economy and letting the market determine allocation of foreign exchange. At the same time, the government is struggling with serious stabilization problems: it wants to sustain high growth in order to bolster support for reform, while simultaneously limiting the acceleration of inflation. We have a large stake in the success of the reform program. This will be a basic focus of our economic dialogue and the JEC meetings.

We will also be working to shape reform in a way that improves U.S. access to China's markets for goods, services, and investment. I will commend China on its recent progress on market access (under the 1992 Market Access Memorandum of Understanding) and liberalization of exchange controls and unification of its exchange rate, as well as China's agreement to bilateral negotiations on services trade and improving protection of intellectual property. But I will stress that additional market-opening progress is essential for improved bilateral economic relations.

I will also pursue important issues related to U.S. investment in China's markets, both financial markets and direct investment in plant and equipment. These areas are now relatively neglected in our bilateral relations, and I can use the broad JEC forum to initiate discussions. Regarding our textile trade with China and the forthcoming cuts in China's textile quotas, I will reinforce the USTR message that China must take action to control the problem of transshipping of China's textile products and evasion of U.S. quotas.

I will meet with all of the key players that need to hear our message on human rights: President Jiang Zemin, Premier Li Peng, and Vice Premier Zhu Rongji. I want to deliver a credible, strong message on our overall human rights agenda. And in that context, I hope to be in a position to announce progress on preventing exports produced by prison labor, one of the criteria in your Executive Order, so that we put that dimension of the MFN decision behind us.

Other Goals

The trip will also serve to promote two additional regional policy goals:

-- the need for strengthened regional cooperation through APEC; and

-- the importance of further opening of financial markets.

I will focus on regional cooperation, in particular, in Indonesia, which is APEC chair this year. I will also highlight the importance of U.S. economic relations with Indonesia. It has a large market (185 million people) that is growing very rapidly (averaging 6 million per year for the last 25 years).

In Thailand, I plan to outline our road map for financial services negotiations after the Uruguay Round in the context of a broad message on the positive contribution that open and integrated capital markets can make to regional growth.

With respect to regional cooperation, I intend to begin consultations with Asian economic leaders on the structure and content of the APEC Finance Ministers Meeting endorsed by your Leaders' Meeting. I propose to convene a meeting of the Finance Ministers in March 18-19 in Hawaii. I will offer three broad challenges as the focus of the discussions: sustaining growth with low inflation throughout the region: promoting increased private investment and financing for infrastructure development; and promoting development of securities markets in the developing countries of the region, including opportunities for foreign investors and foreign investment firms.

1996-SE-002467

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

March 27, 1996

MEMORANDUM FOR THE PRESIDENT

FROM: Robert E. Rubin R.E.R.

SUBJECT: APEC Financial Ministers Meeting

I have just been to Kyoto for the third APEC Finance Ministers' annual meeting. I also met there bilaterally with my Japanese and Chinese counterparts, among others, and then stopped in Hong Kong and the Philippines. I thought the following observations might be of interest, especially the comments on China in the Hong Kong section. Additionally, I would note, the extensive press coverage in Asia throughout the trip reflects the focus of this area of the world on the United States and the U.S. relationship with Asia.

APEC Finance Ministers' Meeting

The APEC Finance Ministers group is developing as a useful forum. The Ministers' interactions were stronger and more engaged than last years.

- Last year, their overriding concern was the yen-dollar exchange rate. This year, the major preoccupation was how the developing member countries can meet their massive infrastructure investment needs.

- This concern is leading them to see the urgency of developing their domestic capital markets and draw on global financial markets.

- In private conversations, there was much concern about the US/China relationship and its effect on economic and security conditions in their region.

- There was a healthy focus on the need to address social issues -- especially the problem of the least well-off -- as integral to continued economic progress.

- I also used the Kyoto meeting to focus my counterparts' attention on the need to combat money laundering.

Japan Bilateral

- Japan's economy is doing better but still needs stimulative policies for the recovery to be sustained.

- Minister Kubo and I agreed to continue as we have in exchange markets and cooperate when appropriate.

- I impressed on him how seriously we take their failure to implement our insurance agreement and urged him to work constructively with Mickey Kantor.

China Bilateral

- I told Minister Liu that, having delinked MFN and human rights in 1994, you are committed to continue on that track. But, I strongly expressed our grave concern that they have failed to make progress in this area and that, also, new issues have arisen: nuclear proliferation, their actions in the Taiwan Straits, and IPR.

- I cautioned Liu that Congress' support for MFN renewal was a problem. I am not convinced that he believed me.

- We agreed to work toward holding a session of the Joint Economic Committee in Washington later this year in order to talk more deeply about these issues.

Hong Kong

Hong Kong's reversion and China's MFN renewal dominated my discussions with officials (Governor Patten, Finance Secretary Tsang, and Monetary Authority Executive Director Yam) and with representatives of the Hong Kong and U.S. business communities, including Chinese business people with strong ties in the PRC.

- **Reversion** - The public and private sectors both seemed confident that Hong Kong will retain its special economic and financial status after June 30, 1997. They were less confident that China would refrain from intervening in the political sphere.

- **MFN** - Officials and business groups both warned that failure to renew MFN would severely damage Hong Kong's economic prospects, spill over on other economies in the region, and damage the position of the United States involvement in the Asia/Pacific region.

- Hong Kong businessmen voiced alarm that we and China are ships passing in the night: China fails to understand our values and the dynamics of our political system; we fail to understand China's insecurity and hypersensitivity to what it sees as our threats to its sovereignty.

- I urged officials and U.S. and Hong Kong business people to help Beijing see the risks of its actions. They claimed to have tried, said they would continue, but did not seem to expect that they would get through.

The Philippines

President Ramos and Roberto DeOcampo, his first rate Finance Secretary, received me very warmly.

- The Philippines is starting to see the fruits of several years of good economic policies; but much remains to be done.

- Also, they are concerned to see the benefits of growth spread in ways that empower the great majority of people who are too poor to help themselves.

I also had the opportunity to visit a micro-enterprise credit program being implemented in the Manila area by a non-governmental organization with financing from the Asian Development Bank, the Philippine government, and the project beneficiaries, and brought some ideas back to apply to our own micro-enterprise lending in CDFI.

cc: Laura Tyson
Anthony Lake

prepared by
Jeff Shafer

Please log and file
3/27/96

1997-SE-002961

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

MEMORANDUM FOR VICE PRESIDENT GORE

FROM: Robert E. Rubin /s/

SUBJECT: Your Trip to Asia

Prior to your departure for Japan, South Korea and China, I wanted to outline some key messages that could be delivered in your discussions. I have included a background paper that provides more depth on these issues, as well as a copy of a speech delivered by Deputy Secretary Summers last week in Hong Kong.

Key Message for Japan:

- We are concerned that a failure to restore and maintain a strong domestic demand-led expansion will slow Japan's GDP growth and create the conditions for a significant increase in Japan's current account surplus.

- This would risk undermining what we have achieved under the Framework talks over the past four years and could lead to an increase in protectionist pressure outside Japan.

Key Message for China:

- The economic and financial side of Hong Kong's reversion appears to be well managed. However, policies that weaken civil liberties and restrict freedom of information will badly damage market confidence. This would be disastrous for Hong Kong's economy and would limit the benefits China could reap from a successful transition.

- We recognize there are a number of microeconomic and macroeconomic factors underlying China's global current account position, as well as our own bilateral trade deficit with China. Given China's strong economic growth and healthy reserve position, we believe you are in a strong position to undertake more aggressive trade liberalization.

Key Message for Korea:

- Sticking forcefully to your medium-term economic reform program is the best guarantee against instability in the short-term, as it contributes to investor confidence.

- In this regard, following through on reform efforts to liberalize your investment regime and financial markets is essential.

The Secretary of the Treasury

March 17, 1997

NOTE FOR DAVID LIPTON

FROM: BOB RUBIN

Well done -- I kept attachment for my use.

Attachment

1997-SE-008005

From: Patrick Stuart
To: thailand, velthausa
Date: 7/23/97 5:37pm
Subject: Developments as of July 23

Thailand

The Thai baht continues to plummet versus the dollar, losing another 4.7% from yesterday to trade at 32.4/$ in onshore markets. The baht traded as low as 32.6/$ in onshore markets before the Bank of Thailand (BOT) intervened, according to dealers. The baht did not lose as much in offshore markets, trading at 31.5/$, 2.6% weaker than on Tuesday. The key factor in today's decline appears to have been dollar demand by importers and hedging activities by Thai corporates with dollar-denominated debts. According to news reports, Thai debtors had been waiting for cheaper dollars, but this hedging activity indicates that Thai corporates now see increased downside risk. Bank intervention was reportedly small, as trading was still thin.

In contrast to yesterday, though, the stock market fell by 4.3%, as the wave of bad news on profits continued throughout the banking and finance sector. Krung Thai Bank, the second largest lender, declared a 37% drop in profits for the first half of 1997. Cumulative declared losses for the finance sector are $113 million, and not all finance companies have reported their earnings yet. The stock market was also pushed down by major dollar debtors, such as Siam Cement, which stated that it will see a $330 million drop in profits due to the baht's devaluation if the baht stabilizes at 30/$ (with larger losses at current levels). That is almost half of the relief fund proposed by the Thai government to cover forex losses. The Thai stock market could accelerate this decline tomorrow, when most banks are expected to release their non-performing loan figures.

The Thai authorities have not announced any new policy measures since Stan Fischer's lecture, but according to one report, they are considering a set of "secret" options to revive the economy, so secret that they have not even discussed them with the IMF. In other reports, Finance Minister Thanong hinted at unspecified monetary and tax policies that would be in line with IMF recommendations, while continuing to stress that Thailand would not seek IMF financing. On the finance front, the government has only said that it is reviewing rehabilitation plans at the 16 closed finance companies and may announce approved plans on July 28. The BOT did state, however, that it has extended by three years the time limit for setting aside provisions for substandard loans. Banks and finance companies now have the "option" of taking until 2001 to make adequate provisions.

Somprasong Land is now formally in default on its $80 million in convertible bonds, becoming the first Thai company to default on its international loans. Somprasong first missed its interest payments back in February, and bondholders had been in negotiations with the company since. Analysts expect more Thai companies to default on their international debts over the next year.

PStuart

Philippines

Philippine markets remained quiet, with the peso virtually unchanged in light trading. In an apparent attempt to encourage banks to sell dollars, the central bank halved the overbought limit to 10%, while doubling the oversold limit to 20%.

AMarcus

Indonesia

The value of the rupiah was little changed today. In Asian trading, the rupiah continued its gains from Tuesday, rising as high as 1.7% to 2,540, or within 10 rupiah of mid-point of Bank Indonesia's intervention bank. However, the fall of the baht and the rise of the dollar against other major currencies caused the rupiah to fall off to about 2590 in later trading. Following previous comments by Finance Minister Muhammad, Bank Indonesia Governor Djiwandono stated that the central bank would intervene to prop up the rupiah, a further signal that Indonesia intends to keep the rupiah within the intervention band. There were some reports of Bank Indonesia intervention, but these have not been confirmed.

Although Bank Indonesia's monetary stance has remained largely unchanged in the past week, it raised the rate on its one-month certificates by 25 basis points to 10.75 percent.

The Jakarta stock exchange closed up about 1% on news that inflation slowed in June and the trade surplus in March was double February's.

Malaysia

The Malaysian ringgit was only slightly lower than yesterday. Some traders believe that renewed attention on the baht and recent attention on the rupiah have given the ringgit a respite, but that there could be more downward pressure in the future.

Back on the job after a two-month vacation, Prime Minister Mahatir issued a sharp criticism of George Soros, claiming he has been plotting to destabilize South East Asian currencies to punish ASEAN member economies for allowing Burma to ASEAN. While Soros has publicly criticized ASEAN's decision to allow Burma to join ASEAN, he issued a statement that there is "absolutely no connection" between Burma's entry to ASEAN and recent currency turmoil.

The composite index of the Kuala Lumpur stock exchange rose by 1.6% due to bottom fishing and Chairman Greenspan's testimony indicating that U.S. interest rate hikes are unlikely in the near term.

Singapore

The Singapore dollar was down about 0.3% from yesterday due mostly to the baht's fall. Some traders indicated that comments by Finance Minister Hu caused concerns in the markets. In response to concerns in Singapore's parliament that the Singapore dollar had appreciated relative to other ASEAN currencies, Dr. Hu commented that the value of the Singapore dollar is determined by market forces and managed on a trade-weighted basis with a medium-term view.

The main index of the Singapore stock index gained 1.24%, rising to a two-week high on expectations of a rebound in global demand for electronics products. Chairman Greenspan's testimony had a positive impact similar to that in Malaysia.

AVelthaus