Increasing participation of developing countries in global financial governance

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[1] This paper has been prepared for the South African Ministry of Finance.

I Introduction

Insufficient or no participation of developing countries in international financial institutions is an important weakness of current financial arrangements for a number of reasons. Increasing developing countries' participation is therefore an urgent task.

In this brief paper, we will first discuss why increasing participation of developing countries is important (section II). We will then look (in section III) at concrete ways in which developing country participation can be incorporated in bodies where they have no participation at all.[2] This seems a particularly urgent task.

II Why is increasing participation of developing countries in global financial governance so important?

A first reason why it is important to increase or include developing country participation in international financial institutions is to increase those institutions' legitimacy. The legitmacy of the international financial institutions has been increasingly questioned by a wide range of actors, such as developing countries themselves as well as NGOs. Reducing their democratic deficit will therefore strengthen these institutions and increase their legitimacy. This position was clearly taken in the UK government White Paper Making Globalisation Work for the Poor which commits to "build an effective open and accountable international system in which poor people and countries have an effective voice." This is particularly important given that developing countries represent 85 per cent of the world's population and a significant proportion of the world's GDP.

A second reason why it is important to include or increase developing country participation is because it will clearly increase the commitment and ownership by developing countries to implement policies and regulations being adopted by those bodies. More broadly, increased developing country participation in these bodies would deepen their own commitment to the aim of open and free markets, as well as to financial stability, both globally and in their own economies, which is clearly in the interest of developed economies.

Thirdly, the participation of developing countries will increase the efficiency and effectiveness of these institutions. For example, the Financial Stability Form (FSF) aims to improve global financial stability. All major financial crises in the last decade have taken place in developing countries; therefore these countries can add valuable insights and perspectives to the discussion of crisis prevention and management. Indeed, it could be argued that an FSF without developing countries is somewhat like "Hamlet without the prince."

Fourthly, greater participation by developing countries in international financial bodies, could add far greater impulse for necessary changes in the global financial architecture. These changes, and the resulting positive impact on global financial stability and growth would not just benefit developing countries; it would also have significant direct and indirect benefits on

[2] For a broader discussion of increasing developing country participation, see S. Griffith-Jones and J. Kimmis, (2002), *The Reform of Global Financial Governance Arrangements* and S. Griffith-Jones, (2002) *Governance of the World Bank* report prepared for Department of International Development. Both available on the IDS website: http://www.ids.ac.uk/ids/global/finance/intfin.html

the developed world. There is an interesting parallel with the situation that emerged at Bretton Woods, where Keynes – by defending the interests of debtor nations such as the UK – was defending also the interests of a more prosperous and stable global economy.

III Incorporating developing countries into international bodies where they have no participation

There are three areas where increasing developing country participation in global financial governance is urgent. The three areas are: 1) incorporating developing country participation in the Financial Stability Forum and the Basle Committee on Banking Supervision), where at present they do not participate at all, even though they are invited to the working groups, 2) increasing participation of developing countries in the BIS (where there has been some, but clearly insufficient increase in participation) and in the Basle Committees (where there is no formal participation, though there has been increased consultation) and 3) enhanced participation of developing countries in the IMF and World Bank Board, where developing countries already have quite important, but still insufficient participation. In this paper, we concentrate on the first category.

1. The Financial Stability Forum

In the wake of the Asian financial crisis, the Financial Stability Forum was created with three main purposes: 1) the identification of vulnerabilities in national and international financial systems and sources of systemic risk, 2) ensure that international rules and standards of best practice are developed, and gaps are identified and filled and 3) arrangements to ensure that consistency in rules across all types of financial institutions is improved.

The creation of the Financial Stability Forum was a very valuable step towards co-ordination of various bodies and actors to improve global stability. However, it is highly problematic that at present developing countries are not at all represented in the Forum itself.

Indeed, FSF membership is limited to three representatives from each G-7 country (one from the finance ministry, one from the central bank and one from the regulatory agency) one representative each from Holland, Australia, Hong Kong and Singapore (the latter two because they are a major financial centre). The IMF and the World Bank have two representatives each, as has the Basle Committee on Banking, IOSCO, and IAIS. The BIS, the OECD and the two other Basle Committees have one representative on the FSF. With the chairman, Mr Crockett, this implies a total size of 40 members at present.

At present the FSF does not include any representation from developing countries, even though many of these are major recipients of international private flows and all major crises in recent years have been in these countries. There are therefore clear reasons why developing countries should be included. Furthermore, when the FSF was established by the G-7, they stated that "while the FSF initially would be limited to G-7 countries, it is envisaged that other national authorities, including from emerging market countries, will join the process at some stage."

Efforts to increase ad-hoc consultation by the FSF with developing and transition economies in recent years is clearly welcome, but it is obviously no substitute for appropriate and formal representation.

There is a strong case to argue that the time has come for ensuring that this formal developing country participation takes place. Several G-7 countries are known to be sympathetic. Indeed, the Commonwealth Finance Ministers Meeting (in September 2000), which includes the UK, Canada, Australia and New Zealand, explicitly endorsed developing country participation. The Chairman of the FSF has also publicly expressed sympathy for developing countries' inclusion.

A specific formula could be proposed to include developing countries in the FSF. If six developing countries were included, the membership of the FSF would rise from 40 to 46, which is slightly more than 10 percent. Developing country representatives, for example from countries with large levels of private capital inflows in proportion to their GDP, could be chosen on a regional basis: there could be two Asian, two Western Hemisphere and two African. This would ensure that the perspectives of poorer countries would also be represented. These representatives could be appointed for a fairly short period (for example two years) and then rotated. This type of representation by developing countries operates in other contexts e.g. in the Boards of the Bretton Woods institutions.

The FSF is a very important initiative. Adding a small representation of developing countries to it would: a) increase its legitimacy, b) increase developing countries' commitments to its aims and c) add valuable insights and perspectives to its decision-making process. This would be achieved without a major increase of its membership.

2. The Basle Committee on Banking Supervision

Meeting in Basle, under the umbrella of the BIS - but not part of it - are three important Basle Committees. They are the Basle Committee on Banking Supervision (which is currently making a major revision to its' Basle Capital Accord), the Committee on the Global Financial System and the Committee on Payment and Settlements System.

The Basle Committees define regulatory and other standards, that are increasingly implemented world-wide and that are increasingly becoming part of the IMF and World Bank surveillance of developing countries. However, the membership of one of these committees, the Basle Banking Committee, is still purely G-10, even though they do increasingly consult with developing and transition countries. Decisions are implemented either via "soft law", and increasingly via IMF and World Bank surveillance (and possible future conditionality) by large numbers of developing countries. Furthermore, the current revision of the Basle Capital Accord, could have not only significant and problematic effects on developing countries' banking systems, and their capacity to lend domestically, but also on international banks' willingness to lend to developing countries.[3] The risk of such negative effects on developing countries could significantly be reduced if developing countries were represented on the Basle Banking Committee. Indeed, it has been widely acknowledged that the risk of significantly reduced bank lending to SMEs in developed countries, due to the revised Basle Capital Accord, has been significantly reduced, due to the intervention of the German authorities, to avoid negative impact on the German economy. Where the SME sector is large, and to an important extent financed by bank lending.

[3] See Griffith-Jones, Spratt and Segoviano (2002) The Onward March of Basel II: Can the Interests of Developing Countries be protected. On the website: http://www.ids.ac.uk/ids/global/finance/intfin.htm

At present, developing countries are unable to defend their economies in similar ways because they do not have a seat at the table. This may be an important reason why several aspects in the proposed Basle Capital Accord may still have very strong negative effects on developing countries, even though several important modifications have been made.

The Basle Banking Committees, currently made up of G-10 countries and Switzerland, should be initially expanded to include one developing country representative for each region [Latin America, Asia and Africa]. These representatives could be appointed for a two year period and then the countries rotated. This would not excessively expand the size of the committee, and would allow crucial developing country participation.

This is not a particularly radical proposal, but just implies a fairly significant acceleration of recent trends; indeed, the other two Basle Committees already have some developing country representation.

In fact, in some of these areas it may be easy to achieve agreement, as several developed country representatives may well agree with these proposals. The problem may be of effective implementation. It may therefore be desirable to establish a small liaison group, for example between the FSF and the Basle Banking Committee and a group representing developing countries, e.g. G-24, to help make concrete suggestions for creating mechanisms to ensure rapidly some developing country participation in the FSF and the Basle Banking Committees, along the lines suggested.