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Foreword

The financial crisis which hit a number of emerging markets in Asia, Russia and Brazil in 1997 and 1998 prompted the Dutch government to ask the Advisory Council on International Affairs (AIV) to produce a report on the way in which financial problems can affect trade policies. (The government's request for advice is enclosed as Annexe I.) The request for advice expresses concern that financial crises in emerging markets may trigger negative responses to extreme fluctuations in exchange rates in the form of adjustments to international trade policies and protectionist measures. These, in turn, may exacerbate the crises and their consequences, thus creating a downward economic spiral.

The AIV notes that the financial crises in the emerging markets did not trigger any changes in the trading relationships between the countries in question and the industrialised nations. There was, however, one clear case of a response affecting relations between certain emerging markets themselves, notably in the trade relationship between Brazil and Argentina in the framework of Mercosur (see Section II.2).

The fact that the markets in the industrialised nations remained open and there was no widespread recourse to protectionism may have been because – despite the severe social impact which these crises had, particularly in many developing countries – the impact on international markets and the world economy in general was much less dramatic than many observers had initially feared.[1] The chief reason for this was the extremely robust state of the US economy, where growth rates were setting new records. The US authorities succeeded in maintaining the momentum of economic growth by pursuing a relaxed monetary policy in response to the financial crises, with the aim of avoiding credit crunch. The strong growth rate in the US economy also helped to ensure that the financial crises had only limited economic repercussions in Europe. Thanks mainly to the fact that economic growth continued uninterrupted, the ever-present undercurrent of protectionist sentiment never actually managed to break the surface (see Section II.2). As has already been pointed out, there were a large number of developing countries for which the financial crises had much more serious consequences, in both economic and social terms (see Section II.1). In addition, the financial crises would also appear to have had an adverse impact on the political climate surrounding the international trade talks in the context of the WTO (see Section II.2).

Another key factor which helps to explain the absence of any marked trend towards protectionism is the fact that, whilst those emerging markets that were affected by the crises saw the value of their currencies plummet, the rate of decline was slowed down by the monetary policies pursued by the governments in question, which received both encouragement and assistance from the IMF.

1 Speaking to UNCTAD X in Bangkok, Thailand, on 16 February 2000, Mike Moore, the Director-General of the WTO, had the following to say about the absence of protectionist reactions: 'These rules, as embodied in the WTO [...] ensured that markets remained open, and that economic difficulties of some nations of this world were not amplified by an upswing in protectionism by their trading partners. [...] [T]he system held together, and the markets of the North stayed open despite enormous political pressure.'

Whilst the financial crises had very little impact on trading policies along the lines described in the government's request for advice, this is no guarantee that this will not occur in the future. Particularly if such a crisis would occur during a period of economic recession, the repercussions for the world economy and the international financial system could well be much more serious. Again, the calls for some form of protectionism could also be much more vociferous, especially if the climate in general were much more inclined towards protectionism.

This means that there is every reason for seeking to learn lessons from the financial crises that affected the emerging markets in 1997 and 1998, and for devising ways and means of reducing the risk of similar crises occurring in the future. It is vitally important in this respect that the emerging markets take the necessary steps themselves to strengthen their financial sectors and to put in place a system of independent supervision of their financial institutions.

It is also important to enable and encourage both lenders and borrowers to be aware of the potential risks involved. Virtually all the measures that are currently under discussion in various international fora are intended either directly or indirectly to have this effect. Lenders should play a full role in the process of abating acute financial crises, as international financial institutions and governments will otherwise automatically be expected to take over if things go wrong.

The AIV approved this report during its meeting on 10 April 2000. The report was prepared by a committee which the AIV set up for this purpose, consisting of the following members of the various permanent committees: Professor A. Szász (chair, European Integration Committee), H.J. Brouwer (European Integration Committee), W.S.J.M. Buck (European Integration Committee), Professor F. van Dam (Development Cooperation Committee), Professor W.J.M. van Genugten (Human Rights Committee), Professor J.W. Gunning (Development Cooperation Committee), Ms C. Hak (Human Rights Committee), F.D. van Loon (Development Cooperation Committee), Professor B.A.G.M. Tromp (Peace and Security Committee), and E.P. Wellenstein (Peace and Security Committee). The members of this committee would like to express their gratitude to the staff of the Dutch central bank (De Nederlandse Bank, DNB), and in particular to Ms R.M. Oort, for supplying them with information and for their expert assistance. The head of the staff of the AIV, F. van Beuningen, acted as the secretary of the committee that prepared this report. He was assisted by two trainees, Ms M. van Dok and S.M.G. van der Hijden.

The report contains three annexes. Annexe I is a copy of the request for advice of the Netherlands government. A number of tables and figures are reproduced in Annexe II. Annexe III contains a glossary of abbreviations used in the report.

I From euphoria to crisis – a brief review of the financial and monetary crisis that affected the emerging markets in 1997 and 1998

I.1 Introduction

There was a spectacular increase in the volume of international capital movements during the years preceding the financial crises. Barriers on the capital markets were rapidly pulled down during the course of the 1990s, not only in the industrialised countries, but also (in part as a result of pressure exerted by international financial institutions) in the emerging markets in Asia and Latin America as well as the emerging economies in Europe which were making the transition from a command economy to a market economy.[2]

The international economic and financial system is still in the process of adjusting to the scale of today's capital flows and the speed with which they are capable of moving around the world. The issue of the adjustment of this system has been on the political agenda ever since the financial crises in Southeast Asia, the Russia Federation and Brazil, partly as a result of the failure of the Japanese banking sector and the problems affecting the Long-Term Capital Management Fund in the US, the collapse of which was only just averted. The adjustment proposals will be discussed later on in this report. We should like to start, however, by giving a brief general outline of the development of the present financial and economic system.

I.2 The international context of the crises in the emerging markets

The economic and financial system is a patchwork of institutions and arrangements which are geared broadly to the situation prevailing at the end of the Second World War, but which have been extended and modified during the intervening period to keep them in line with new developments. The pivot around which international financial and monetary policy-making revolves is formed by the Bretton Woods institutions, i.e. the World Bank and the IMF. After the Second World War, the World Bank (officially known as the International Bank for Reconstruction and Development) rapidly switched from financing the reconstruction of Europe to focusing on development projects in the Third World. Its expertise and financial clout mean that many developing countries regard the World Bank as the most important international institution for their economic and social development.

The role of the IMF has changed since the collapse of the Bretton Woods system of fixed exchange rates in 1973. Since then, the Fund's supervisory or 'surveillance' role has been limited to issuing advice on adjustments in the rates of exchange applying to

2 On the basis of their GDPs, their economic growth rates, their share of world imports and aggregate incoming foreign investment, the Ministry of Economic Affairs classifies the following 22 countries as 'emerging markets': Argentina, Brazil, Chile, China, the Czech Republic, Hong Kong, Hungary, India, Indonesia, Israel, Malaysia, Mexico, Peru, the Philippines, Poland, Russia, Singapore, Taiwan, Thailand, Turkey, South Africa and South Korea (Opkomende markten – Ontwikkelingen en perspectieven, Ministry of Economic Affairs, December 1999, p. 5).

individual currencies, whilst its function of assisting countries in balance-of-payments difficulties has become much more pronounced. In its latter role, the IMF provides financial support, subject to conditions, mainly to emerging economies or other developing countries. (It has now become very rare for industrialised countries to borrow from the IMF.) By attaching conditions to its financial aid, the IMF is in a position to influence the economic and financial policies pursued by the countries to which it lends. The principal aim of the adjustments which borrowers are asked to make is to redress the macro-economic balance in the country in question. The IMF's main policy-making body is the International Monetary and Financial Committee (formerly called the Interim Committee), the half-yearly meeting of 24 Ministers of Finance each of whom represents either a country or an electoral group (or 'constituency') consisting of a number of member states, of which there are 182 in total. The Netherlands is also represented on the IMFC. Day-to-day policy is decided by the 24-member Council of Governors. The Development Committee is a joint body of the IMF and the World Bank, that meets twice a year at ministerial level in order to discuss policy on developing countries.

The Bank for International Settlements (BIS), which was founded in 1930 for the purpose of handling the payment of reparations by Germany after the First World War, is the oldest of the international financial institutions. The BIS's chief function has gradually shifted to the promotion of global cooperation between national central banks, and the BIS has evolved into 'a central bank of central banks'. Apart from organising monthly meetings of central bankers, it also reports on international financial and monetary developments, paying special attention to their potential implications for macroeconomic policy. In 1974, the supervisory authorities – mainly central banks – of a group of ten countries (the G10, see below) set up the Basle Committee on Banking Regulation and Supervisory Practices, which was given the task of boosting confidence in the international banking system by comparing and, where possible, harmonising supervisory regulations. This led to the conclusion of the Capital Convergence Accord, which was amended for the last time in 1988. The Accord seeks to mitigate lending risks by requiring lenders to ensure that they have sufficient equity capital to back their loans. In other words, the Basle Capital Convergence Accord imposes capital adequacy requirements on lenders. For example, short-term inter-bank loans are subject to a 20% solvency ratio, and no account is taken of the country from which the bank in question is operating. A large number of non-G10 countries have now accepted this solvency requirement as a general principle. In 1995, the Basle Committee also drew up a set of core principles for effective bank supervision. These include the independence of the supervisory body, the supervisory requirements relating to risk control, financial reporting, the rights of the body to take corrective action and the supervision of international banks.

Other important bodies in this respect are the Paris Club and the London Club. The Paris Club is a group of countries, practically all industrialised nations, that holds meetings in varying composition to discuss the repayment of government loans that have been granted to countries that are no longer capable of meeting their financial obligations. The course of action taken is generally one of debt consolidation, which means that a new schedule of principal repayments and interest payments is agreed with the borrower. The London Club is a forum in which commercial lenders discuss debt management and the settlement of problem loans. The main focus is on short-term foreign-currency receivables (such as bonds and securities) that may be called in at any time at the prevailing market price and rate of exchange. When this happens, whether this is in the midst of a financial crisis or at a time when such a crisis is looming, lenders have a tendency to follow the herd and all to demand repayment at the same time.

As far as international trade is concerned, the GATT was for many decades the chief regulatory and negotiating forum, with successive negotiating 'rounds' gradually leading to an increasing liberalisation of world trade. A number of developing countries were admitted to the GATT over the years, whilst various former Communist states also joined the organisation in the 1990s. More recently, the GATT has been superseded by the World Trade Organisation (WTO), which embraces the increasingly important trade in services alongside the more traditional trade in goods. With the start of the new 'millennium round' of negotiations now having been postponed due to a lack of political agreement at the ministerial conference held in Seattle in December 1999, the WTO will need to prove its resilience in the coming years as a body that is capable of regulating and stimulating international trade. Finally, the role played by UNCTAD, which originally made a name for itself in arranging preferential tariff treatment for developing countries, has gradually shifted from operational activities to providing a forum for discussions between developed and developing countries.

The US played a leading role in the international financial and economic system in the second half of the twentieth century. At the outset, the system benefited from the relative homogeneity of its members. However, the system has undergone a number of changes in recent years, and these are described in more detail below.

(a) The markets for goods, services and technology have been both internationalised and liberalised. National economies are growing ever more closely intertwined. This has led to a substantial increase in the volume of international private-sector capital movements, including direct cross-border investment. This trend has been given an added impulse by the 'borderless' growth in information and communication technology (ICT). Firms are internationalising at high speed, in part by merging with and taking over other firms, and this has acted as an additional spur to international capital movements. In many countries, the liberalisation of international capital movements has gone hand-in-hand with the deregulation of domestic markets. Liberalisation and reductions in information and transaction charges have reinforced one another, again heightening the international mobility of capital. Some commentators have even used terms such as 'flash capital' and 'casino capitalism' to describe the effects of these trends. With the commercial sector now having gained in importance, there has been a shift in the traditional division of tasks between government and market: the combination of globalisation and liberalisation has made the job of coordinating international economic and financial movements more difficult.

(b) The leading role played by the US in the international economic and financial system has been changing. US leadership is predominantly selective and frequently reactive in nature. Moreover, decisions are often based on political considerations, such as when the IMF agreed to provide support to the Russian Federation.

The tripolar financial and economic system (i.e. coordinated by the US, the European Union and Japan) that some observers had expected to come into being has failed to get off the ground. The economic structures of and performances recorded by the US, the EU and Japan have been too disparate to enable this to take place. The US has remained the locomotive of the international economy, although it is true that the eurozone countries posted higher growth rates in 1998 and 1999 than in previous years. Now that the EU has added a common monetary policy to its common trade policy, it seems reasonable to assume that the EU will be better placed to present a more united front and that it should therefore be capable of playing a more prominent role. (In any event, the agreements reached within the EU on trade and monetary policy provide the framework for Dutch policy and the position of the Dutch government.) The recession which has affected the Japanese economy in recent years is another reason for the failure of the tripolar system to gather momentum. It is worth mentioning that the Japanese economy seemed to be picking up slightly in 1999. Whether the trend will continue remains to be seen.

Although the US has been trying to get the G7(8) to play a coordinating role, the group is not representative, is poorly organised and is only capable of a limited degree of coordination. Moreover, it operates largely on an *ad hoc* basis. Another relevant forum is the G10, a group of ten industrialised countries, including the Netherlands, that was founded in 1962 as a consequence of the establishment of the IMF's general financial support facility. The G10 does not play a coordinating role at present. In an attempt to enhance representativeness and hence both improve the prospects for effective coordination and exert its full influence, the US recently set up a Group of Twenty (G20) in which countries from five different continents are represented. It remains unclear, however, as to whether all these various initiatives will be capable of mustering the additional political support that is required for coordinating international economic trends and financial flows.

(c) There has been a spectacular growth in the number of countries that are or wish to become members of the institutions responsible for overseeing the international financial and economic system. This has resulted in problems both of an organisational nature and in relation to policy coordination. Emerging economies and regional powers have been jockeying for position. Instead of a homogeneous association of basically like-minded countries, heterogeneous groups are developing, thereby further reducing the potential for coordination.

The consequence of the three trends outlined above is that the international financial and economic system is tending increasingly to take on the appearance of a relatively unstructured framework. The term 'architecture' that is often used to describe the system, suggests a degree of order that is consistent with something produced on a drawing board, but does not do justice to a situation in which political, economic and financial forces have been given free rein. Whilst it is true that the players in the international financial market are subject to certain rules and arrangements, there is very little coordination and systematic supervision of the market itself, against the background of internationalisation and liberalisation, the increasing importance of the commercial sector, the predominantly selective and frequently reactive nature of US leadership (to which there is no alternative at present) and the rise in the number of participants.

I.3 A review of the crises in the emerging markets[3]

The emerging markets have liberalised their financial sectors during the past decade, so as to give them access to larger volumes of foreign capital and hence boost their own economic growth. The emerging markets accounted for an ever growing share of international capital flows in the 1990s. *To illustrate this point, Annexe II contains a table entitled 'Emerging Market Economies: Net Capital Flows' (table 2.2 from the*

3 This review is based largely on information contained in the annual reports for 1997 and 1998 published by DNB (viz. pp. 37-45 of the 1997 annual report and pp. 95-105 of the 1998 annual report).

IMF's World Economic Outlook published in April 2000). The situation halfway through the 1990s was that approximately 40% of all foreign investments were going to the emerging markets.[4] Indeed, a number of Asian countries were so successful in attaining the desired economic growth that they earned themselves the title of 'Asian tigers'. In spite of the growth they managed to achieve, however, many of the emerging markets became more vulnerable to the mood of the financial markets. This effect was amplified by the increase in private capital flows relative to trade-related flows. The situation today is such that capital flows have a greater impact – not only because of their scale, but also on account of the speed with which they move from country to country – on the demand for and the supply of foreign currencies than does international trade.[5] The extent of this vulnerability was to become apparent when the financial crises began to take hold, first in Asia, and then in the Russian Federation and Brazil.

The Thai currency, the baht, was pegged to a number of other currencies, the most important of which was the US dollar, which accounted for 80% of the value of these other currencies. This disproportionately strong link with the dollar was not consistent with the country's trade flows, in which the Asian region predominated. When the value of the dollar rose relative to the yen and other currencies which were important to the Thai economy, the result was that the baht also effectively rose in value. A sharp rise in investments, funded with foreign capital, led to real increases in both wages and costs and this, in turn, eroded the competitiveness of the Thai economy. In a situation of declining exports and a rising current account deficit, the baht's value was sustained by a policy of keeping interest rates at a higher level than in the US. The result was an influx of foreign capital that was invested in assets with increasingly short maturities. In the end, it proved untenable to sustain the linkage of the baht with the US dollar, and the principle was finally abandoned in July 1997, sparking off a financial crisis precipitated by the country's high foreign debt.

The financial turbulence spread to the rest of Asia, initially to those countries which were in a broadly similar position to Thailand, i.e. the Philippines, Indonesia and Malaysia. In spite of their healthier economic structure, Singapore, Hong Kong and Taiwan were also affected by the financial unrest later on. One of the contributing factors was the decline in the interest shown by international investors in Asian investment funds, and another was fading demand from regional export markets. By the end of 1997, both South Korea and Japan were afflicted by the same financial unrest, and this intensified the economic recession in which both countries already found themselves.

The financial crisis that hit a number of Asian countries was the result of a combination of factors: rampant economic growth and a strong influx of foreign capital, leading to high asset prices; the false sense of security created by the policy of pegging the national currencies to the dollar in particular (which later showed that the governments concerned had overestimated the hardness of their own currencies); a massive *de facto* appreciation of currency values which had the effect of undermining external competitiveness; a large and steadily mounting short-term debt denominated in foreign currency; excessive lending; and, finally, a weak banking system that, in many countries,

4 See Bakker, A.F.P. and Meesters, J.H. (1999), *Grenzen aan het vrije kapitaalverkeer? Liberalisatie in opkomende economieën: een herwaardering.* Wolters-Noordhoff, Financiële en Monetaire Studies (formerly Rotterdamse Monetaire Studies), p. 12.

5 Bakker et al., p. 11.

was also dominated by political forces, providing plenty of opportunities for clientelism, nepotism and corruption. Unlike the Latin American debt crisis in the mid-1980s, it was not a question of the Asian governments having overborrowed. The culprits this time were private companies and financial institutions, which left the countries concerned much more exposed to the whims of the market.

The financial crisis forced most of the countries in the region to abandon the pegging of their national currencies to the dollar or the yen, once a flurry of massive intervention had depleted their reserves over a short space of time and interest rate rises had also failed to take the pressure off. The most severely affected countries (the Philippines, Malaysia, Thailand, South Korea and Indonesia) saw their currencies fall by between 40% and 80%. Share prices also nose-dived, particularly when compared with the sharp rises that were recorded on the stock markets in the US and Europe. The net outflow of capital from the Asian countries affected by the financial crisis represented 12 billion dollars in 1997. Of the countries hit by the crisis, Taiwan, Hong Kong and Singapore all pulled through fairly well, partly thanks to the relatively healthy state of their financial sectors.

The adjustment programmes agreed with the IMF are aimed at stabilising the exchange rates of the Asian countries concerned and reforming their financial sectors (in particular, reorganising the financial sector, putting a supervisory system into place and enacting new legislation, notably in relation to bankruptcy). However, the economic recession in the Asian region proved deeper and more intractable than had initially been thought. For this reason, the IMF gave its consent to a slight relaxation of the strict budgetary policy in order to enable the countries concerned to pull out of the economic trough in which they found themselves, in many cases with the aid of World Bank programmes. This helped to bring about a relatively rapid restoration of the confidence of the international financial markets in Thailand and South Korea. Partly because of the uncertainty about political developments in Indonesia, the financial markets stuck to their wait-and-see attitude to the latter country for longer than was the case with other countries. The Indonesian economy shrank by some 12% during the first half of 1998, and the depth of this economic recession forced the international financial institutions to provide additional support. Unfortunately, this support proved unable to sustain the rupiah, which collapsed for a second time in mid-1998. All the relevant countries in the Asian region have now made arrangements with commercial banks on debt rescheduling and recovery loans.

After the problems affecting the Asian currencies, the Russian rouble came under pressure. A combination of domestic political uncertainties and falling oil prices made it increasingly difficult for the Russian government to keep up with its high repayment obligations. The Russian government therefore requested the IMF in July 1998 to adjust the existing programme. The IMF not only granted this request, but also agreed to provide Russia with an additional loan. However, as a result of opposition in the Duma, the Russian parliament, the agreed action was never actually put into effect, thus further increasing the pressure on the rouble. In August 1998, the Russian government decided unilaterally (i.e. without consulting the IMF) to devalue the currency and to suspend repayments both on foreign debt and also on domestic debt held by foreign investors. Taken together with continued domestic political chaos and the absence of any measures to improve the state of government finance, this only served to further undermine market confidence. As a consequence, the rouble lost 60% of its value against the dollar, hitting Russian banks with large external obligations particularly hard. When it became clear that Russia was not going to be able to carry out the IMF's old programme, a new programme was devised in consultation with the Russian Federation in 1999, the key elements of which were improving the effectiveness of the tax collection system and reforming the banking sector. According to a report issued by the Managing Director of the IMF in December 1999, not only are there reasons to believe that the financial support provided in this context has been misappropriated, but the Russian Federation has still not done enough to achieve its policy goals, notably in relation to the laws on bankruptcy and the establishment of an independent system of supervision of government expenditure from the social funds.

The Russian government's unilateral announcement of a debt moratorium sparked off a capital flight into more low-risk investments. Investors withdrew their money massively, not just from the Russian Federation, partly to discourage other countries from following the example set by Russia, but also from other emerging markets. This action exacerbated the economic recession affecting other countries, and had a particularly powerful impact on Brazil. Brazil has had a large external government debt since the early 1990s, on which a previous attempt at restructuring with the aid of 'Brady bonds' has in fact had little effect. In these conditions, a combination of a current-account deficit and a government budget deficit made Brazil particularly susceptible to market sentiment. Confronted with a capital flight on a massive scale, Brazil applied for support from both the IMF and the international community in the autumn of 1998. A package of financial aid worth over 40 billion dollars was agreed, with the IMF contributing almost half, viz. 18.1 billion dollars, in the form of a loan. A set of measures was also agreed with the Brazilian government, the main objectives of which were to reduce the deficit on the government budget, and the deficit on the social security budget in particular, and to bring down inflation by enforcing a tight monetary policy. The revitalisation of the banking sector was another important goal. However, the Brazilian parliament initially opposed the restructuring package, which only served to increase the degree of uncertainty and hence encouraged capital flight on an even greater scale. In these circumstances, the government was unable to sustain its policy of pegging the value of the Brazilian currency, the real, to the US dollar. The currency has lost half of its value in the meantime. Under the new exchange rate regime, agreement has now been reached with the IMF on a new adjustment programme for the Brazilian economy.

In retrospect, the liberalisation of the capital market has made it easier for emerging economies to raise capital abroad. At the same time, the macro-economic performances recorded by these countries and their apparently healthy future prospects have encouraged lenders to make loans to the emerging markets. With hindsight, commentators have questioned the ease with which banks, most of them Western, were prepared to lend money to these countries.[6] The unchecked operation of hedge funds pushed up lending volumes to record heights. These stimuli on both the supply and the demand sides led to 'explosive growth in international lending to the emerging economies. The flip side was a similarly explosive increase in foreign debt, and the bubble finally burst when doubts arose about the borrowers' ability to service their debts.[7] The economies of the emerging markets were a highly inflammable mixture of overvalued currencies, an excessive level of short-term debt, current account deficits and poor financial systems. The problems in Brazil and the Russian Federation were complicated by the additional

6 1997 annual report of DNB, p. 132, and Bakker et al., p. 108.

7 Bakker et al., p. 52.

factor of a government budget deficit. In short, a small spark was enough to set off an explosion and expose the fundamental weaknesses of these economies. Despite the fact that the currencies of all the countries affected by the crises were pegged in one way or another, the governments did not have a policy that would enable them to rapidly adjust the value of their currencies if they became overvalued. *To illustrate this point, Annexe II contains a table showing the depreciation of the currencies of selected emerging market economies in Asia and Latin America (figure 2.9 from the IMF's World Economic Outlook published in April 2000).*

One of the main reasons for the financial crises that hit the emerging markets was the growing tension between the international financial markets and their own domestic financial sectors. As a result of the rapid growth of the international financial markets (see above) and the increasing speed and efficiency with which massive capital flows can be channelled to and from investment vehicles in emerging markets in particular, the disparity between the international markets and the financial sectors in most of the emerging markets and other developing countries, which were developing at only a slow pace, simply became ever wider. In many cases, the differences with international standards became too great, not only in relation to the organisational structure and management of the firms operating in the financial sector (i.e. banks, insurance companies and investment funds), but also with regard to the way in which the financial industry is supervised and regulated.

There were a number of reasons why the various crisis-affected countries were vulnerable to capital outflows: Brazil had chronic deficits on both its current account and its government budget; and this engendered a tremendous borrowing requirement; the Russian government had the dual problem of not being capable of collecting enough tax revenue and of a brief period of extremely low oil prices; for the Asian countries, finally, the key problem was a weak banking sector and the financial obligations created by a relatively high level of short-term debt.

The level of net capital flows to the emerging economies in 1998 was half that in 1996, when there was a net influx of over 300 billion dollars. In the wake of the financial crises, investors would appear to have adopted a policy of waiting to see whether the promised reforms would actually be implemented and, if so, whether these would be translated into a positive economic performance. The economies of most of the emerging markets in Asia have recovered more quickly than had been expected. South Korea is a good example of such rapid recovery, although even countries such as Hong Kong, Malaysia and Thailand, whose economies were still officially shrinking in 1998, recorded growth in 1999. Even Indonesia, whose economy was hit particularly severely by the crises, would now seem to be over the worst. The growth of the emerging markets in Asia has been buttressed largely by external factors, such as the sustained high level of growth recorded by the US economy and the cautious, incipient recovery of the Japanese economy. In Russia, the first signs of economic recovery remain extremely fragile, with the main uncertainties stemming from the high level of its debt obligations and the lack of any progress in implementing structural reforms. The Latin American economies would appear to have posted hardly any growth in 1999. The Argentinian economy actually shrunk, and the same applies, albeit to a lesser extent, to Brazil.[8]

8 This information has been obtained from the report entitled 'Opkomende markten: ontwikkelingen en perspectieven' published by the Dutch Ministry of Economic Affairs in December 1999 (pp. 5, 6 and 21).

I.4 How the financial crises were resolved

In order to promote the economic recovery of the emerging markets hit by the crises, the countries in question have formulated recovery programmes in consultation with the IMF, the World Bank, regional banks (such as the Asian Development Bank) and commercial banks. The IMF and the World Bank are working in close collaboration to achieve this common goal, with the IMF providing both financial support and advice on macro-economic policy. The World Bank's role is basically one of providing structural support, for example in cases where courses or other forms of promoting expertise are needed in order to ensure that the measures taken are indeed put into effect. The fact that the World Bank has also provided a great deal of financial support to the emerging economies in Asia, in order to help them overcome the financial crises, has caused observers to question whether it is really the World Bank's job to be providing this type of financiel support. The assumption has been that the World Bank should concentrate instead either on assisting the poorest countries or on alleviating the social impact which crises have on the poorest groups of citizens.

The IMF's recovery programmes involve not only financial support, but also a combination of macro-economic stabilisation and structural reforms, with the emphasis being placed firmly on the financial sector. The main thrust of the measures is to ensure that monetary policy is tightened and, in the specific case of the Russian Federation and Brazil, to reduce the government deficit. The IMF has imposed a number of conditions on the financial sector, and these include the formulation of supervisory criteria that banks must meet, the closure of financial institutions that are not able to meet these criteria within a given period of time, the establishment of an independent supervisory body, the lifting of restrictions on foreign investments in the financial sector, and the dismissal and replacement of directors of insolvent banks.[9]

With the IMF providing such a large share of the financial support to countries hit by the financial crises in the emerging economies, the IMF's liquidity ratio (i.e. the ratio of liquid assets to short-term receivables) has also suffered accordingly. The ratio declined from 119% to around 25% between the end of 1996 and 1998. By mid-1999, it had reverted to a healthy 115%, primarily as a consequence of the payment of the 11th quota rise (i.e. extra subscription payments from the member states). The scale of the financial support provided by the IMF grew at an exceptionally rapid rate in the 1997-1998 period, and the number of countries receiving assistance from the IMF has now risen to over 90. By mid-2000, the volume of the financial support provided by the IMF stood at some 76 billion dollars.[10]

The question is, however, whether, in taking this type of action, the international community is sending the right sort of long-term signals. Resolving debt problems by providing a growing level of support may lead to what is known as 'moral hazard'.[11]

9 See the 1997 annual report published by DNB, p. 105.

10 See 'IMF Financial Activities', http://www.imf.org/external/np/tre/activity/2000/042100/htm.

11 The term 'moral hazard' is the name given to a situation in which lenders and borrowers base their decisions on the assumption that financial support will be provided in the event of a borrower being unable to repay its debts. This prospect may prompt both parties to accept a higher degree of risk than they would otherwise be likely to do.

Investors and lenders may be tempted to take insufficient account of the potential risks inherent in their investments, and to place too much emphasis on the likely yield, if they are led to believe that international organisations are bound to come to the borrower's aid anyway if the latter gets into trouble. It would be wrong if commercial lenders were able to count on bail-out packages that would safeguard them from any substantial level of risk. Similarly, borrowers could be tempted to continue pursuing inappropriate policies (although the prospect of the imposition of structural measures by the IMF could restrict this type of undesirable behaviour). The dilemma is that a decision to limit the 'moral hazard' by denying support to borrowers in need may mean accepting the inevitability of an adverse economic and social impact.

It is against this background that we have formulated, in Section III.3.2, a recommendation about the role which the IMF should play in relation to financial crises.

It is important to bear in mind that the implementation of measures agreed with the IMF was problematic, particularly in the Russian Federation and Brazil, where political opposition caused a weakening of monetary discipline. This prevented market confidence from recovering and meant that capital continued to flow out of the country. It was only then that the national authorities seemed to realise that financial support on its own is not sufficient for regaining the confidence of the financial markets. Clearly, economic policy also needs to be properly adjusted if the exchange rate is to be stabilised and the country in question to set out on the path to economic recovery.

II The possible interaction between financial policy and trade policy

II.1 The general economic effects of turbulence on the financial markets

The financial crises in the emerging markets of Southeast Asia, the Russian Federation and Brazil, as described in Chapter I, had a dramatic economic and social impact. Annexe II includes a set of charts entitled *'Selected Emerging Market Economies: Quarterly Real GDP' (figure 2.6 from the IMF's World Economic Outlook published in April 2000), to which charts showing the GDPs for the Russian Federation, the US and the European Union have been added by way of comparison.* It should be remembered that economic growth rates in emerging markets tend to be less stable and more volatile than in the industrialised countries. These markets are more sensitive than the industrialised countries to fluctuations in the prices of commodities, especially oil. Accordingly, growth rates may move up and down by as many as a dozen percentage points from year to year. This means that changes in government policy and movements in the government budget may be extremely marked and perhaps even extraordinary by the standards of the industrialised nations. The same applies to the level of government expenditure and revenue, which may be affected by swings of a dozen percentage points. The social and political effects of this type of extreme fluctuation in the economy and government spending may be very dramatic, for example in terms of the impact on people's daily lives or on the way in which firms operate. Unlike the situation in the industrialised countries, the emerging economies do not generally have any government-sponsored institutions that are capable of helping people to deal with the effects of an economic recession. In other words, if the economy takes a turn for the worse, the vast majority of the population have nothing to turn to other than improvised social safety nets, many of which are full of holes.

Massive quantities of foreign capital were withdrawn by investors during the financial crisis in Asia, resulting in a downward economic spiral of falling consumption and investment, corporate bankruptcies, rising unemployment, problems for the financial sector, rapidly declining tax revenue, government spending cuts aimed at preventing the budget deficit from rising any further, interest rate hikes, etc. The social impact was particularly severe for the poorest sections of the population in the crisis-hit countries. The economic impact was felt particularly keenly in export-dependent sectors. The severity of such economic fluctuations may affect the political systems in the emerging markets, many of which are still vulnerable, 'emerging' democracies.[12]

The financial crises in the emerging markets had only a limited effect on economic growth in the industrialised countries. The financial crises did, however, cause global growth to level off and hence exerted a temporary, strongly downward pressure on the prices of oil and other commodities.[13] Apart from these effects, the financial crises did not have any lasting or profound impact on the economies of the United States, Japan or the member states of the European Union. The crises did, however, prompt the industrialised countries, and the United States in particular, to adjust

12 Hausmann, R. (1997), Will Volatility Kill Market Democracy? Foreign Policy (Fall 1997).

13 1998 annual report published by DNB, pp. 32 and 33.

their monetary policies. Once the Russian Federation was sucked in by the crisis in mid-1998, there was a brief period lasting about two weeks in which investors operating on the financial markets sought to avoid any risks as much as possible. Stock markets throughout the world subsequently fell back sharply as a sense of pessimism quickly took hold. With financial institutions and other investors suffering heavy losses as a result, concerns were expressed about the stability of the financial system. It was at this point, i.e. the autumn of 1998, that a large US hedge fund known as Long-Term Capital Management (LTCM) encountered dire cash-flow problems. The fact that an American financial institution that had until then been an impressive player on the market could apparently find itself so easily in such severe difficulties only served to amplify the doubts that were already beginning to spread. Calm was restored on the financial markets once the US Ministry of Finance put together a rescue package in conjunction with the Federal Reserve Board, and the US decided to cut interest rates, its example being swiftly followed by most of the other industrialised countries. The agreement that was reached on IMF support for Brazil and the progress made in reforming the banking sector in Japan also helped to restore calm in the financial markets.

Share prices reached record highs in July 1998 and then fell back sharply after August 1998, mainly as a result of the financial crisis in the Russian Federation and the resultant turbulence on the financial markets. Prices recovered exceptionally well later, in the autumn of 1998.[14]

Other developing countries (i.e. non-emerging markets) also felt the effects of the financial crises. Firstly, demand for their products slackened, leading to fewer export opportunities. Secondly, as the growth of the world economy as a whole levelled off, so commodity prices fell, in some cases extremely dramatically. The price of oil, for example, fell by over 50%. (It should be said that not only has the price of oil recovered at record speed during the first half of 2000, but it has also hit record highs thanks to production quotas imposed by OPEC. Other commodity prices have yet to regain their pre-crises levels.) Thirdly, the flow of capital to the developing countries virtually dried up as a credit crunch took hold.

The impact which the financial crises had on developing countries took the shape of a reduction in domestic economic activity (i.e. lower economic growth, and in some cases even a shrinking economy), worse terms of trade, more expensive imports and a smaller amount of capital available for financing investments or imports. Many developing countries found themselves trapped in 1997 and 1998 in the same downward economic spiral of falling consumption and investments into which the emerging markets had been sucked. And developing countries have the same problems of having an extremely fragile political system without any institutionalised social safety net. *In order to give an impression of the economic decline described here, a table showing selected economic indicators for groups of developing countries has been included in Annexe II (table 46 from the IMF's World Economic Outlook, published in April 2000). This is followed by a summary (table 27 from the IMF's World Economic Outlook, published in April 2000) of payments balances on current account for various groups of countries (not just developing countries) and showing the impact that the decline in demand had on Asia, as well as the drop in export sales recorded by African countries. (This table also shows the huge extent of the US current account deficit; see Section II.2.)*

14 1998 annual report published by DNB, pp. 39-43.

II.2 Is there an inherent risk that financial crises will inevitably lead to protectionism?

Financial crises are capable of placing great pressure on the system of international trade, as countries see their competitiveness shifting as a result of abrupt changes in exchange rates. We have already mentioned, in the previous section, such effects as falling direct investments, capital flight and the loss of purchasing power in the emerging markets hit by the financial crises, as well as the unfavourable impact which the crises had on developing countries. After 1996 and 1997 had seen annual growth rates of around 10%, the growth in world trade levelled off at 3.5% in 1998. In this sense, it is clear that the financial crises had a direct impact on world trade.

To a certain extent, they also had an indirect impact: the adverse economic impact on emerging markets and developing countries made at least some of them more sceptical about the workings of internationalisation. Regarding themselves as occupying a vulnerable position in a rapidly internationalising world, the representatives of emerging markets and developing countries were reluctant to accept any further liberalisation of world trade, and this was reflected by their opposition during the start of the WTO's millennium round in Seattle in December 1999. (Interestingly, some US trade unions share their scepticism.) With plenty of differences of opinion already in evidence in Seattle, the lack of enthusiasm displayed by these countries only served to further muddy the waters. The growing opposition to any further liberalisation of world trade, which has taken root among certain emerging markets and developing countries since the financial crises, may be seen as an indirect effect of the financial crises.

The primary effect of the financial crisis in the emerging markets on the United States has been higher imports and lower exports, thereby causing the already high US current account deficit to grow even further in 1998 and 1999. This is one of the main reasons for the unwillingness of the US trade unions to support a further liberalisation of world trade (although it is important to realise that the US economy has also benefited in the recent past from exceptionally high growth rates in emerging markets.) The negative balance of imports and exports provoked a clamour for protectionism from the US private sector (notably the steel and automotive industries). The US steel industry claimed that imports of cheap steel from countries such as Brazil, the Russian Federation and South Korea were tantamount to dumping, and a number of US Congressmen called for import quotas in order to prevent these alleged dumping activities. In the event, no such quotas were introduced, whilst steel imports from Brazil have dropped in the meantime and the recovery in South Korea has returned the country to a more normal competitive footing. If the US administration had indeed decided to impose import restrictions, this would undoubtedly have provoked a protectionist response from other countries.

Shrinking export markets caused a great deal of unrest in the US agricultural industry at the time of the financial crises. Productivity increases in recent years have resulted in surpluses of agricultural produce, increasing even further the sector's dependence on exports. The financial crises resulted in a declining volume of exports to Asian countries, and hence in lower income for American farmers. In an attempt to restore the level of exports to their former level, the agricultural sector has been urging the US administration to try and break down international trade barriers in other countries, so as to open up access to other markets. This has also meant increasingly vociferous American criticism of the EU's common agricultural policy, and hence rising tension in the WTO.

The European Union also suffered from the effects of the financial crises in the emerging markets, notably higher imports and lower exports, although the impact was less pronounced than in the US. The financial crises had an indirect effect in slowing down economic growth: producer confidence fell sharply and, in the autumn of 1998, there was a substantial decline in growth in industrial output in the EU's eurozone. Dutch exporters also recorded lower export growth in the same year.

Another consequence of the financial crises in the emerging markets was a fall in commodity prices. Although a number of American oil companies instituted anti-dumping proceedings against countries such as Mexico, Venezuela and Saudi Arabia during this period, the price of crude oil has climbed since then to a much higher level than before it started falling. The production restrictions agreed by OPEC have pushed prices up, thereby dispelling any suspicion that the OPEC's action had resulted in the imposition of a trade barrier. It should be mentioned, however, that the prices of many other commodities have failed to regain their pre-crises levels.[15]

It is worth bearing in mind that the much publicised trade disputes between the United States and the EU (in relation to bananas and hormone-containing meat) have nothing to do whatsoever with the financial crises in the emerging countries (and indeed actually predate the crises). In 1998, EU representatives protested when the US administration agreed to grant extra financial support to US steel and energy companies to counterbalance the effects of cheap imports. Other trade restrictions which the US has imposed on the EU member states have been based on rulings given against the EU by the WTO and should for this reason be considered as forming a separate category. The same applies to the decision taken by the WTO in early 2000 to censure the favourable tax status granted to export revenues under rules issued by the US administration. The WTO classified these tax benefits as non-permissible corporate subsidies.

Interestingly, it was not in the relations between developing countries or emerging markets and the industrialised countries that clear evidence emerged of a link between financial policy and trade policy, but between two major emerging markets themselves, i.e. Argentina and Brazil. After a period in which it had been overvalued relative to the Argentinian peso, the Brazilian currency, the real, was devalued in January 1999, mainly as a result of the financial crises in Southeast Asia and the Russian Federation (as discussed in Chapter I). Exports to Brazil have traditionally formed a key aspect of the Argentinian economy, accounting for between a quarter and a third of all Argentinian exports. For Brazil, on the other hand, the Argentinian market represents no more than 15% of its aggregate exports. The devaluation of the real pushed up the price of Argentinian exports to Brazil by an average of between 25% and 30%, resulting in a 30% decline in the volume of Argentinian exports to Brazil in the first half of 1999. (Brazilian exports to Argentina also declined during this period.)

The devaluation of the real led to trade conflicts and the imposition of protectionist measures by the two neighbouring countries. The latter measures ranged from non-tariff barriers, anti-dumping measures and levies to import restrictions. Brazil lodged an official protest with Mercosur, the customs union of which the two countries are members, but this was to no avail. Relations between the two countries reached their lowest ebb in the summer of 1999, when Argentina and Brazil decided to suspend talks

15 The above information is taken *inter alia* from the 1998 annual report published by DNB, and specifically pp. 34-36, p. 40, p. 45, graph 2.1 on p. 46, and p. 60.

on the trade conflicts. The tension was gradually defused only by the establishment of a Mercosur monitoring committee, high-level, bilateral political talks, and the Argentinian decision to withdraw its import restrictions on Brazilian textiles. However, the protectionist spiral into which the two neighbouring countries were drawn in 1999 looks set to undermine trade relations between Argentina and Brazil for a considerable time to come.

In conclusion, both a deterioration in relations between industrialised countries as well as financial crises may induce countries to set up trade barriers. It is not always clear, however, which of these two factors carries the greater weight. At the same time, the protectionist measures that were actually taken as a result of the financial crises in the emerging markets in 1997 and 1998 were only limited in scope (the only exception being the trade conflict between Brazil and Argentina). This limited impact is very probably due to the extremely propitious economic climate that has prevailed in the industrialised countries in recent years, particularly in the United States, and also to the fact that many Asian countries succeeded in recovering relatively rapidly. There can be no doubt that financial crises always involve a risk of financial and monetary developments having a negative impact on trade policy, in the form of protectionism. Whether this actually happens, however, would appear to depend primarily on the state of the economy worldwide.

III Preventing and resolving financial crises and their effects: conclusions and recommendations

III.1 General

The conclusion to be drawn from the preceding chapters is that the best policy to pursue in relation to financial crises is one of prevention. The emerging economies – and developing countries in general – should seek to prevent financial crises by adopting good economic policies, enforcing the rule of law, including a reliable and impartial system for supervising the financial sector, and by good governance in general.

At the same time, relations among the industrialised nations and the policies they pursue are of vital importance. A protectionist climate in the industrialised world heightens the risk of developments in the emerging markets resulting in the imposition of trade restrictions by the industrialised countries. And the more unfavourable economic conditions are, the greater is the risk of this happening. In other words, the industrialised countries were posting healthy economic figures and enjoying good economic prospects at the time of the financial crises in the emerging markets in 1997 and 1998. The situation may be completely different if new financial crises occur in the future. This is one reason why it is so important to resist protectionist tendencies.

The Netherlands' main contribution to the prevention of financial crises is necessarily through the European Union, and more specifically by exerting influence on the policies pursued by the EU. The common agricultural policy, for example, is generally regarded as being protectionist and must therefore be reformed. The EU also has an important role to play in improving the effectiveness of the WTO. Not only the way in which the issue of the banana import regime was dealt with, but also the tendency to drag out disputes for as long as possible are both consequences of and factors that contribute to a protectionist climate. The more credible the EU's position is perceived to be, the less risk there is of the EU being accused in specific cases – such as in relation to meat imports – of being motivated primarily by protectionist considerations. Similar arguments apply *mutatis mutandis* to the trade policies pursued by the United States. These, too, are partly dependent on the stance adopted by the EU. Both the US and the EU are key players who are capable of setting their stamp on international economic and financial policies providing that they act in unison. Given the increasing importance of the developing countries, the US and the EU need, however, to take closer account of these countries' international economic and trading interests (although the poorest countries are not members of the WTO). A number of suggestions were voiced during the meeting in Seattle for taking more account of the interests of developing countries, for example, when setting the agenda for the next round of trade negotiations, by creating a 'law centre in Geneva' that would be capable of giving developing countries legal support in the resolution of disputes by arbitration under WTO regulations, and by helping developing countries to ensure that their policies take full account of social and environmental impacts. Unfortunately, the agenda at the meeting in Seattle was so full that there was not enough time to discuss these suggestions properly.

Persistently imbalanced exchange rates in the industrialised world also have the effect of intensifying the clamour for protectionist measures, notably among countries whose currency is overvalued. There is no point in looking for a remedy in the form of untenable exchange rate arrangements, particularly if no action is taken to resolve the underlying causes of the imbalances. Balanced exchange rates require international policy consistency, and a willingness to take systematic account of the external effects of policies. It is important in this connection to see if anything can be done to strengthen the role played by the IMF, both in terms of multilateral supervision of the exchange rate policies pursued by its member states and in relation to the regular policy consultations with member states. This is a complex issue, however, that goes beyond the scope of this report.

It is clear from Chapters I and II that the financial crises affecting the emerging markets were caused by both national and international factors. Against this background, the conclusions and recommendations included in this chapter focus on the interaction between national economic and institutional weaknesses on the one hand, and the shortcomings and imperfections of the international financial system on the other.

III.2 Criteria for assessing policy

A key lesson to be learned from the financial crises in Asia is that, even if the IMF gives an advance warning, it is not possible to prevent a crisis if the country in question is not willing to recognise the imminent risks or the problems which have already arisen and the potential solutions to them. Thailand, for example, had been warned about the threat of a crisis during a period of some 18 months before it actually broke.[16] In other words, early recognition that a financial crisis is imminent is a pre-requisite for taking remedial action at the right time. Procrastination only serves to make the necessary adjustment more painful. The responsibility for making sure that action is taken in good time lies in the first instance with the country affected by the crisis.

Although the importance of pursuing a policy aimed at minimising the risk of financial crises is self-evident, it would be illusory to think that crises can always be prevented. Practical experience has shown that it is not easy for international institutions to prevent such crises from occurring. Given that financial crises will always be with us, crisis management remains an aspect of critical concern. Nevertheless, the emphasis in our policy recommendations will be on crisis prevention, as this offers opportunities for pursuing a carefully considered, proactive policy, whereas dealing with a crisis that has already broken out requires a more reactive response in which the conditions prevailing at the time are all-important.[17]

Against this background, we have decided to focus these policy recommendations on the concept of good governance. This is a vital concept both for the industrialised countries, and for the emerging markets, the developing countries in general and the commercial sector. It is a precondition for the achievement of macro-economic stability. Moreover, good governance forms the cornerstone of the Dutch government's policy on development cooperation. Alongside development and social policy, the key aspects of good governance are transparency and accountability. In this context, the AIV has formulated the following criteria against which the policies pursued by governments, commercial actors and international institutions may be measured:

16 1997 annual report published by DNB, p. 107.

17 See 'Preventing and Resolving Financial Crises: The Role of the Private Sector ' – Michel Camdessus (Washington D.C., 9 June 1999), pp. 2 and 3.

- governments must create the conditions which are needed in order to allow the market to operate effectively, i.e. by putting in place the requisite institutions and enacting the appropriate legislation (e.g. rules preventing private interests from becoming intertwined with public interests, bankruptcy laws, anti-corruption laws, an effective land registry in which ownership rights are recorded, etc.). Governments must also enact measures to guarantee the independent supervision of the financial sector;

- governments must pursue a sound macro-economic policy and must supply information on their economic and financial policies in accordance with international standards;

- commercial actors (i.e. private-sector financial institutions) should operate in accordance with international standards, particularly those concerned with risk management and risk appraisal. Running the business in a systematic manner and monitoring the quality of management are both steps in the right direction. Accounting, reporting and auditing procedures should also be consistent with international standards;

- international public-sector financial institutions such as the IMF, the BIS and the World Bank should be transparent and should encourage their members to observe transparency.

These criteria can be used as a means of assessing whether, broadly speaking, the policies pursued are sufficiently transparent and accountable, both aspects being of vital importance if financial crises are to be prevented. These criteria form the basis on which the following conclusions and policy recommendations have been formulated. The conclusions and recommendations have been divided into two categories:

- conclusions and recommendations reflecting the state of the international debate, and including a summary of the main measures that either have already been taken or are planned for the future (see Section III.3);
- conclusions and recommendations relating directly to Dutch policy or to views which the Dutch government should adopt in international fora. The chapter concludes with a section in which the AIV responds explicitly to the questions put by the government in its request for advice (see Section III.4).

III.3 Measures to prevent and/or resolve financial crises

The economic and social cost of the financial crises in the emerging markets has brought the international debate on the need to reduce the volatility of capital flows sharply into focus. The ideas that have been mooted in this context range from designing a completely new 'financial architecture' to more pragmatic measures that are intended to prevent brief, but extremely violent movements of capital.[18] The issue that has now moved to the forefront of the international debate is how to secure both financial and economic stability in a world that is characterised by ever larger and ever faster capital flows. It is important to be aware that not all the measures described below have received the same reception: some measures are the subject of international consensus, with the debate now centring on the question of how they should be enforced, whilst others have encountered a great deal of opposition and stand very little chance of actually being implemented in practice.

18 Bakker et al., pp. 17 and 18.

In the following sections, the measures under discussion in the international arena have been divided into four categories:

1 improved information flows (transparency);
2 improved supervision (both national and international);
3 division of responsibility; and
4 restrictions on lending and borrowing (specifically, by means of levies).

III.3.1 Improved information flows

Transparency is absolutely crucial if the international capital markets are to operate effectively. If both lenders and borrowers have access to reliable information that is supplied in good time, it is easier for them to assess the risks in the light of the actual conditions prevailing in the relevant market. Unfortunately, many markets lack this level of transparency. Timely information removes uncertainty, thus reducing the risk of abrupt mood swings on the financial market and consequently helping to prevent unexpected capital movements. Moreover, the presence of accurate and fast information flows may also help to reveal instances of mismanagement, thereby making it easier to take early action before things go wrong.

The commercial sector, with international banks and investment funds at the forefront, made clear that they wished to see a harmonisation of statistics on international capital flows published by international institutions. This led to the creation of the Special Data Dissemination Standard (SDDS), a publication standard for macroeconomic statistics compiled by an inter-agency task force on which institutions such as the IMF, the World Bank, the BIS and the OECD were represented. The standard lays down when a country should report on which particular aspects (i.e. what information should be published, and what should be the frequency of publication).[19] Some 50 countries had subscribed voluntarily to the SDDS by the beginning of the year 2000.

Events immediately preceding the financial crises in the emerging markets revealed certain shortcomings in the standard, and this has underlined the need for further improving the quality of information. For this reason, the standard has been extended to include data on the volume of a country's available short-term net international reserves. The monetary authorities are now required to report on their short-term liabilities and off-balance-sheet foreign currency liabilities, in addition to specifying the available foreign currency reserves. The availability of all these figures means that interested parties can obtain a clearer picture of each country's net reserves.[20]

One of the points that has been raised in discussions on the SDDS is the desirability of achieving a higher level of detail by breaking down the data on foreign debt according to maturity as well as the economic sector in which the borrowers operate. However, no agreement has been reached yet on this point, partly because of the heavy administrative burden that such a requirement would impose on countries. After all, the borrowers in question consist in each case of many thousands of firms performing a very wide range of economic activities.

19 1998 annual report published by DNB, p. 100.

20 1997 annual report published by DNB, p. 106, and DNB Statistical Bulletin, September 1999.

In April 1998, the IMF published a ‘Code of Good Practices on Fiscal Transparency’. This is based on the assumption that a requirement to publish clear information on the state of the government budget may act as an incentive and encourage governments to rebalance their budgets (or keep them balanced). After all, untenable situations can be identified at an earlier stage. Countries subscribe to this code on a voluntary basis. In the same year, the IMF also formulated a ‘Code of Good Practices on Transparency in Monetary and Financial Policies’ in conjunction with institutions including the World Bank and the OECD. This code contains guidelines for promoting central bank transparency on monetary policy.

Clearly, transparency also hinges on the information supplied by commercial lenders and investors. Such information can help both governments and shareholders understand the policies pursued by players in the financial markets, and hence discourage irresponsible (i.e. risky) behaviour. The Institute of International Finance (IIF) is coordinating private-sector initiatives for enhancing transparency.[21] In addition, a working party has been created from among the members of the Basle G10 Committee, on which commercial financial institutions are also represented, which has been given the job of devising publication standards relating to the risks run by commercial lenders (i.e. banks and other financial institutions).[22]

The talks between the IMF and its member states have also gradually gained in transparency. Relations between the IMF and its member states vary, and arrangements are made in advance with each member state as to the type of information that may or may not be published. Both the IMF’s general opinion on the economic and financial situation in a particular country and its annual reports (known as the ‘Article 4 evaluations’) are regarded as being public provided that the member state in question has given its approval. In practice, most member states agree to the publication of this information, which means that the underlying country appraisals are also made public.

If the IMF agrees to provide financial support to a particular country, the letters of intent exchanged at the start of the reform programme are made public. These contain the policy proposals for putting the country’s economy in order and are absolutely crucial factors in regaining the confidence of the market in the economy. Both the Article 4 evaluation and the reform programme are discussed by the Board of Governors, and press releases are issued on these discussions.

Effective crisis prevention also hinges on the ability of the Managing Director of the IMF to issue public warnings highlighting the potential economic and/or financial dangers facing a particular country. The more delay there is in issuing such a warning, the more difficult it becomes to give it at all, amid mounting concern that it may act as a self-fulfilling prophecy and trigger the very crisis it is supposed to avert. Whilst this possibility of giving an early public warning is also an aid to transparency,[23] it is important not to lose sight of the precarious balance between openness and confidentiality that characterises the relationship between the IMF and a member state. Openness may be a way

21 Report of the Working Group on Financial Crises in Emerging Markets – Institute of International Finance (January 1999).

22 1998 annual report published by DNB, p. 101 and p. 132.

23 1998 annual report published by DNB, p. 101.

of persuading the authorities in a country to recognise the gravity of the situation. However, if openness simply causes the authorities to clam up by making them unwilling to release certain information, it is transparency that suffers as a result.

The AIV recognises that more and more information is being exchanged promptly, thereby promoting the transparency of the financial markets. Bearing in mind the precarious nature of the balance described above, the AIV supports the policy pursued by the Dutch government of seeking to achieve further improvements in information flows and transparency through the IMF and other appropriate fora.

III.3.2 Improved supervision

Full and timely information is also vital for the necessary process of improving the supervision of the players on the financial markets, and this is a point that has been borne out once again by the financial crises in the emerging markets. As we have already pointed out, the Basle Committee on Banking Regulation and Supervisory Practices has drawn up a list of core principles for effective bank supervision. These were adopted in 1997 by the states represented at the annual meeting of the IMF and the World Bank,[24] although this does not necessarily mean that all the states concerned have now taken the necessary action to enforce all these principles in practice. Here too, there is plenty of scope for improvement.

The Basle Committee on Banking Regulation and Supervisory Practices has also discussed the question of whether to modify the Capital Convergence Accord, which contains a set of capital adequacy rules for lending banks, and does not make any allowance for the country in which the bank in question has its seat (see Section I.2). In the wake of the role played by the banks as lenders during the period prior to the financial crises in the emerging markets in 1997 and 1998, the question has been raised as to whether the capital requirements should not be brought more closely into line with the actual level of risk. The Basle Committee presented a set of proposals in June 1999, which involve conducting a more detailed risk appraisal when calculating the requisite solvency level. The Committee has also proposed improving the transparency of the information supplied by banks by means of a ‘supervisory review’, so as to enable supervision to be intensified. These proposals will form the subject of debate in 2000, the ultimate aim being the adoption of a revised Capital Convergence Accord in December 2000.[25] Although it now looks as though the Accord will indeed be revised, the talks on the review process still have a number of problems to resolve including, for example, the issue of how risks should be measured and appraised.

The Basle Committee has also sought to identify the characteristics of non-regulated financial institutions with a distinct risk profile of their own, such as hedge funds. In January 1999, the Basle Committee published its recommendations on how banks should deal with non-regulated financial institutions. The main thrust of these guidelines is that banks are expected to exercise greater prudence in relation to direct credit risks (the term used in this connection being ‘sound practices’). These recommendations should also help to tighten banking supervision.[26]

24 1997 annual report published by DNB, p. 132.

25 See Quarterly Bulletin published by DNB in September 1999. For more information on the problems still in need of resolution, see ‘Bank rules in disarray’ (The Economist, 27 November 1999, pp. 89 and 90).

26 1998 annual report published by DNB, p. 131.

A ‘Financial Stability Forum’ was set up at the G7(8) in Cologne in June 1999, with the aim of enhancing ‘international cooperation and coordination in the area of financial market supervision and regulation’.[27] The Forum has led to the launch of a number of working parties which will be looking at topics such as highly leveraged institutions (such as hedge funds), short-term international loans and financial offshore centres. The working parties will be submitting progress reports both to the G7(8) meetings and to the IMF.

The AIV welcomes the attempts that are being made to improve the supervision of financial institutions on the lines described above. It supports the steps taken by the Dutch government to further strengthen this supervision. The AIV would like to see the Bank for International Settlements (BIS) playing a stronger role, which should be secured by encouraging as many emerging economies and other developing countries as possible to join the existing and future arrangements made by the BIS. The IMF and the World Bank can assist with the implementation of the measures in member states. The AIV also urges the Dutch government to argue forcefully in favour of a review of the Capital Convergence Accord, first signed in 1988, along the lines described above.

During the IMF’s annual meeting in Hong Kong in 1997, it was agreed that a study would be carried out into possible ways of adjusting the IMF’s Charter so as to take account of the liberalisation of capital movements. The objective would be to ensure that the IMF played a role in promoting a careful liberalisation of capital movements, so that the Fund could help countries take the right action at the right time, in accordance with the economic situation prevailing in the country in question (a concept known as ‘sequencing’). However, the financial crises in the emerging markets have shed new light on the consensus reached a few years ago on the free movement of capital. The Dutch government has argued in favour of the IMF playing a role in the further, prudent liberalisation of capital movements. *The AIV supports the standpoint which the Dutch government has adopted and urges it to continue to defend it when the debate resumes. In particular, the AIV believes that changing the IMF’s Charter along the lines suggested here would strengthen the IMF’s supervisory role and that this could help the member states of the IMF pursue a stable macro-economic policy. Moreover, such a change would be consistent with the increased significance of international capital flows in the international economic and financial system.*

III.3.3 Division of responsibility

In resolving the financial crises in the emerging markets, considerable use was made of the resources of public-sector international financial institutions, particularly those of the IMF and the World Bank, as well as those of the member states, both directly and indirectly. We have already pointed out in Section I.4 the extent to which the IMF’s liquidity ratio declined as support flowed on a massive scale to those emerging markets and other developing countries which found themselves in difficulties as a result of the financial crises. Commentators have consequently raised the question of how commercial banks can be involved more closely and systematically in the prevention of financial crises and how – in the event of a crisis occurring – they can be prevailed upon to accept a larger share of their joint responsibility for the resolution of the crisis. One of the key benefits of the systematic involvement of the commercial sector, alongside fair burden-sharing, is a reduction in the level of moral hazard.

27 G7 Statement, p. 2, point II.A.

One of the tools that could be used to strengthen the role played by commercial financial institutions is the introduction of a universal rollover option in international loan contracts. This would mean that ‘all loans denominated in foreign currency would have to include a universal rollover option with a penalty clause that would guarantee the borrower’s right to roll over the loan’.[28] This option, which would form part of the original loan contract, would grant the recipient country the right to extend the debt for a given period of time in return for the payment of a penalty the value of which would have to be set so high that it would only be attractive to exercise the option during a financial crisis. The objective of the option would be to prevent foreign lenders all suddenly calling in their loans (as they did during the financial crises in the emerging markets). Universality would be needed in order to discourage lenders from looking for ‘free rides’ on the backs of competitors, and also in order to ensure that the inclusion of such a clause in a loan contract could not be construed as evidence of a lack of creditworthiness or of a lack of willingness to repay debts. In addition, if the option were not used across the board, this would lead to an interest rate differential between loans with and loans without a rollover option.

Whilst the rollover option has not been introduced on a universal basis, certain states (such as South Korea and Brazil) have made *ad hoc* debt rollover arrangements with commercial lenders. Peer pressure from other international institutions may help to encourage this type of behaviour, as was the case in the two instances referred to above.

A tool known as the ‘contingent credit line’ (CCL) has been introduced for the same purpose, i.e. to prevent lenders from calling in their loans en masse. This type of credit is designed for countries which have good macro-economic policies, but which are at risk of being ‘infected’ by international financial turbulence. The extra credit can help to protect these countries from such risks and enable them to reschedule their debts.[29] The idea is that, with CCLs available as a bridging facility, foreign lenders will be discouraged – or perhaps even prevented – from calling in their loans. Both the IMF and commercial institutions have introduced CCLs.

The AIV urges the Dutch government to encourage the private and public sectors to work together so as to ensure that the credit facilities provided by the IMF act more as catalysts, encouraging countries to raise commercial loans. Not only is the IMF only capable of meeting a small proportion of the demand for credit on its own, but it also needs to keep a close eye on its liquidity ratio in order to guarantee its long-term continuity. In other words, the prime role played by the IMF should be, by attaching policy conditions to its lending activities, to help put in place the conditions that are needed to guarantee the involvement of the commercial sector, even in crisis situations. This is on the assumption that the involvement of the commercial sector will help to prevent financial crises from occurring and spreading. The more widespread use of private-sector CCLs and rollover options is consistent with this policy, and the Dutch government could seek to promote their use. The AIV wishes to stress that the IMF should no longer be seen as a lender of last resort, as this can only exacerbate the problem posed by moral hazard.

28 Bakker et al., pp. 88 and 89. This discussion of the rollover option is based primarily on Bakker et al., pp. 88-92.

29 1998 annual report published by DNB, p. 103.

III.3.4 Restrictions on lending and borrowing

Countries which have liberalised their capital movements may wish to impose levies as a means of restricting lending or borrowing activities. In terms of the general trend towards liberalisation, this will, of course, be regarded as a retrograde step. One example of such a levy is the 'Chile tax', which was intended to discourage the inward flow of short-term capital into Chile. Since 1991, banks in Chile have been obliged to deposit, in a non-interest-bearing account with the Chilean central bank, a specified proportion of any short-term foreign loans they receive. Although opinions differ on the effectiveness of capital import restrictions, this particular levy would appear to have worked well in Chile's case. The Chilean government has now lifted this restriction.

Other countries have also imposed temporary restrictions on capital movements. One particularly salient case is Malaysia, which used measures such as foreign exchange controls, foreign investment controls and the freezing of foreign accounts denominated in the national currency to restrict capital flows on a temporary basis. These restrictions had the effect of making it extremely unattractive for creditors to invest in or lend to Malaysian firms. Whilst Malaysia would seem to have benefited from these measures, their success may have been at the expense of other countries in the region, where a fear of similar restrictions may have been one of the reasons behind the mass exodus of investors. Malaysia has now phased out the restrictions in the wake of criticism of its stance. As a rule, the longer such restrictions last, the less effective they will become, partly because both borrowers and lenders will gradually find more and more ways of circumventing them.[30]

The 'Tobin tax' is the name given to a levy which has been proposed. It should operate on an international scale. The idea behind the proposal is to levy a small amount of tax on every foreign exchange transaction, and to use the proceeds for development aid.[31] Because the tax burden would rise in accordance with the number of transactions, the tax would affect short-term capital movements in particular, whilst there would be hardly any increase in the cost of long-term capital movements. In other words, the idea is that the tax would act as a disincentive to short-term loans, thus leading to a decline in the relative share of the aggregate national debt accounted for by such loans. The plans for the 'Tobin tax' have not been put into operation, however, partly because of the practical difficulties involved.[32]

The AIV is not in favour of the introduction of the Tobin tax. One of the main problems is that it imposes a higher level of cost not just on speculative capital, but also on all short-term capital flows, including those associated with trade. Moreover, there is very little chance of it being implemented on a global basis, partly because of the administrative complications which are likely to be encountered. Finally, it is not clear whether the tax will actually have any impact: the tax is insignificant when compared to the profits and losses that can be made from gambling on exchange rate movements, which means that it will not discourage speculation.

30 See Bakker et al., pp. 78-82, for a detailed discussion of the Chile tax. See p. 51 for more information on Malaysia.

31 This report only discusses the effects of the Tobin tax on capital movements.

32 See Bakker et al, pp. 82-84, for a detailed discussion of the Tobin tax, including the numerous objections that have been made to it. See also the memorandum which the Dutch Minister of Finance sent to the chairperson of the permanent finance committee in the Lower House (September 1998).

Despite occasional past successes, the AIV is basically opposed to the idea of imposing restrictions on international capital flows that have already been liberalised, even if the restrictions in question are only temporary. One of the main objections to such restrictions is that they interfere with market forces. Countries which decide to use them run the risk of being labelled as having 'mousetrap currencies', meaning that they allow capital in, but not out. Moreover, such countries are then tempted to bank on the effectiveness of capital controls and hence postpone more fundamental macro-economic adjustments. As a further point, restrictions imposed in one country may hit other countries particularly hard. Finally, the success of such regimes hinges entirely on the administrative capacity of the country in question and the practicability of the measures.

III.4 Recommendations for the Dutch government

III.4.1 The creation of a financial sector in emerging markets and developing countries

The creation of an adequate financial sector, including a system of independent supervision and regulation, is one of the most urgent tasks facing the governments of the emerging markets and other developing countries. As the international capital markets have opened up, so it is now generally accepted that countries cannot afford to let their own domestic financial sectors fall behind. In order to minimise the degree of dependence on volatile international capital flows, there is an overriding need for countries to develop financial markets in their national currencies. Strengthening domestic institutional investors, such as insurance companies, pension funds and social security funds, forms part of this process.

Building up a financial sector along these lines in emerging markets and other developing countries is a slow and laborious process. In the industrialised nations, national legislation has gradually evolved to form a network of laws, regulations, standards and customs. A prerequisite for an adequate financial system is the presence of a legal framework that is capable of guaranteeing the performance of contracts as well as, for example, providing for effective debt management and creating a proper method of dealing with bankruptcies. Although the quality of governance and the operating processes used within the financial sector (for example, in relation to risk management) are a prime concern, the quality of an independent, supervisory body is also a key factor. This body must have the authority to bring problems and irregularities to the attention of players operating in the financial sector and also to force them to change their behaviour, where necessary. As we have already pointed out, the Basle Committee on Banking Regulation and Supervisory Practices has drawn up a list of 'core principles' for independent bank supervision which can be used as a frame of reference by countries in designing a national system of independent supervision.

Both small and large firms in developing countries are at a severe disadvantage due to the absence of adequate sources of finance. For example, a firm wishing to invest in a particular asset may only be able to raise credit for a six-month period, and will then depend on a combination of coincidence and the whim of the lending bank in order to extend the credit to a period that is consistent with the nature of the investment. Firms from countries with a more highly developed financial system already hold a competitive advantage by enjoying access to international financial markets, and this is one of the reasons why the need to strengthen the financial sector occupies such a prominent part of this report. This is also the reason why not only multilateral international financial institutions, but also organisations such as the Dutch Finance for Development (FMO) are already granting long-term loans to banks in developing countries, on condition that these loans are used in turn for making small, but long-term loans to local firms.

The AIV urges the Dutch government to offer generous technical support to emerging markets and other developing countries with which the Netherlands enjoys intensive bilateral relations, so as to assist them in creating the infrastructure required for an effective financial sector. In addition to the activities already performed by the IMF and the World Bank, such support could consist of the provision of technical assistance to both private-sector and public-sector parties on how to combine modern business practices on the part of firms and organisations in the financial sector with government regulation on the one hand and supervision by an independent supervisory body on the other.

The AIV also believes that, thanks to its strong position in the financial world, the Netherlands has an outstanding opportunity to make a valuable contribution in this important field, both through Dutch development cooperation and through other channels. Cooperation with the World Bank, the IMF and regional development banks will be crucial, given that these institutions are best informed about any initiatives which have been taken to strengthen the financial sector in emerging markets and other developing countries. It would also seem worth taking full advantage of the EU's development policy in this context.

Among the forms which technical assistance could take is the provision of advice on legislation. Another important aspect involves fostering local expertise by means of training programmes (for finance ministries, central banks, etc.). Also, representatives of private-sector firms need to be informed of the relevant legislation, and of enforcement practices, in relation to the financial sector. Courses in management, financial control and planning, and enforcement practices can help to achieve the long-term goal of creating an adequate financial sector in emerging markets and other developing countries. To this end, the level of funding committed to the Dutch FMO's Investment Promotion and Technical Assistance Programme, which is geared largely to the financial sector, should be raised. With a view to encouraging cooperation between the private and public sectors, the Dutch government should ask the Netherlands Financial Expertise Partnership[33] to play a role in providing the necessary courses.

III.4.2 Investment insurance

The conduct of both lenders and borrowers is affected by political risks (i.e. country risks). In theory, other risks – such as commercial and market risks – apply equally to capital flows between industrialised countries and to capital flows from industrialised countries to emerging markets and other developing countries. One of the characteristics of capital flows to the latter countries is that lenders tend to attach great importance to the political risks (i.e. inconvertibility, capital transfer prohibitions, nationalisation, political unrest, failure to discharge contractual obligations, etc.). This means not simply that less credit is granted and that any loans made are subject to a higher level of cost, but also, and more importantly, that there is a tendency for lenders suddenly to call in all their loans at the same time if there is any suggestion of a looming crisis.

Clearly, reducing these risks could have an impact on the use made of capital. Although various instruments already exist for this particular area, including those offered by both multilateral financial institutions (e.g. complementary co-financing facilities, guarantees and insurance policies) and private insurers, and although a number of institutions are

33 This is a joint venture between DNB, the Dutch Ministry of Finance and the three leading Dutch commercial banks, i.e. Rabobank, ABN-AMRO Bank and ING Bank.

already active, the less developed countries in particular face severe problems in raising the capital they need.[34]

In this connection, the AIV proposes that the Dutch organisation Finance for Development (FMO) should use additional funding from the development cooperation budget to develop a flexible set of instruments for providing political risk insurance for investments in developing countries. The guarantees provided would need to cover both equity investments and long-term loans, and would supplement the facilities already offered by multilateral international institutions. The new guarantee facility would initially be targeted at those countries with which the Netherlands has a structural bilateral development relationship.

III.4.3 Answers to questions in the request for advice

The original letter requesting the AIV to produce an advisory report on the link between financial problems and trade problems contains three specific questions. The AIV wishes to conclude this report by restating its conclusions in the form of answers to these questions. These answers, and the conclusions and recommendations already formulated, may have an impact on the political stability and burgeoning democracy, as well as on the situation in relation to poverty and social security, in the relevant emerging markets and developing countries. Whilst it would be beyond the scope of this report to go into each of these issues in further detail, there is clearly a link between tighter supervision and greater transparency in a country's financial sector on the one hand, and the development of a democratic system on the other. There is also a correlation between the situation in relation to poverty and social security and the way in which the country in question liberalises the capital market. By formulating criteria in Section III.2 and by underscoring the importance of a process of careful liberalisation that takes account of the country's economic situation (in Section III.3.2), we have sought to shed some light on these correlations within our terms of reference.

1 How realistic does the Advisory Council believe the above risks are, in particular a decline in foreign investments, the direct effects of shifts in competitiveness and imbalanced exchange rates, and their potential impact on trade policies?

The above description of the origins of the recent financial crises in Asia, the Russian Federation and Brazil shows that there is a risk of a decline in foreign investment, of the direct effects of shifts in competitiveness, and of imbalanced exchange rates. It is now broadly accepted that these are realistic risks, especially if no reforms are implemented either in the countries concerned or in the international financial system. The AIV therefore underlines the importance of preventive policy, in relation to both the countries concerned and the international financial institutions. As regards the interaction between financial crises and trade policies, future risks cannot be ruled out, as the main reason why the recent financial crises did not prompt any stronger protectionist responses in the industrialised countries was the fact that the international economy happened to be in a healthy state at the time.

2 How is it possible to ensure that, when the international community responds to sudden financial crises, the trade policies adopted do not militate against the inte-

34 The Multilateral Investment Guarantee Agency (MIGA) is the main international multilateral institution issuing guarantees to protect private foreign investments in developing countries. The Agency has been successful, which is why it was recently decided to increase its capital.

gration of the developing countries concerned in the system of trade and investment? The key point here is to achieve consistency in the way in which the national governments in question seek to resolve a crisis and the international response to the same crisis.

Having accepted that the best way of dealing with financial crises is to pursue a systematic preventive policy as described above, the next most important step is to ensure that there is no deterioration in the political climate surrounding international trade policies (see Section II.2 in this context). Indeed, this is particularly crucial as US competitiveness has worsened in the wake of the sharp rise in the dollar, as reflected by a current-account deficit of the order of 4% of GDP; if economic growth in the US starts to slacken, the likely response will be an increasingly vociferous clamour for protectionism. An effective WTO is absolutely vital in this context, which means that the current political impasse afflicting the organisation needs to be broken. This can only happen if the European Union and the United States recognise that widespread protectionism is bound to have disastrous consequences, and that they should therefore be more willing to accept compromise, as well as WTO arbitration in the event of any trade disputes. Another significant element is the Dutch proposal under which the WTO would grant technical (legal) assistance to developing countries caught up in trade disputes with industrialised countries. A climate in which there is no room for protectionist tendencies can provide the basis for a coherent strategy for dealing with financial crises.

3 With a view to promoting such coherence, how could the government in general and the Directorate-General for International Cooperation in particular help both to prevent crises (e.g. by promoting capacity-building in the countries concerned, by helping to plan liberalisation processes, and so forth) and to resolve acute crises, in both a national and an international context?

The chief role that development cooperation could – and indeed should – play in preventing financial crises lies in promoting institution-building, particularly by strengthening the financial sector in emerging markets and other developing countries by providing technical assistance and investment insurance, as described above. The development cooperation budget is not intended to be used for resolving acute financial crises, and indeed is not adequate for this task. The Dutch input in this particular area should be channelled in the first instance through the IMF and in the second instance through the World Bank, in relation to which the Netherlands (as a supplier of governors to both institutions) is in an excellent position to promote the formulation of a policy along the lines described in this report.

Annexes

Ministry of Foreign Affairs

Professor R.F.M. Lubbers
Chairman, Advisory Council on International Affairs
P.O. Box 20061
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Strategic Policy Orientation Unit
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Re:	Advisory report on the link between financial problems and trade policy		

Dear Mr Lubbers,

A number of countries, including emerging Asian markets such as South Korea, Thailand, Malaysia and Indonesia, as well as Brazil and Russia, have been hit by serious financial crises in recent years. Whilst it is true that these crises were sparked off to some extent by different factors, such as macro-economic imbalances and untenable forms of currency pegging, virtually all of them occurred in settings in which an underdeveloped domestic capital market and financial sector coexisted with relatively free capital movements. In addition, all the crises involved a mass exodus of capital as a result of a loss of confidence in the national governments. This loss of confidence and capital flight caused the currencies of the countries in question to plummet. In such conditions, it is difficult to prevent the exchange rate from overshooting its long-term equilibrium value.

Although these crises had major implications for the countries that were affected by them in terms of the state of their domestic economies, the government's interest lies primarily in their international economic impact, and more particularly in the way in which financial events can affect trade policies. Financial crises place the system of international trade and investment under severe pressure. The ability of the countries affected to revert to a balanced growth path depends to a certain extent on whether trade and investment channels can be kept open. The problem is how to avoid imbalanced trade patterns from arising in the wake of financial crises. On the one hand, the countries concerned themselves need to do everything within their control to retain an open trade and investment regime (as is required of them under macro-economic and structural adjustment programmes). On the other hand, they must be given an opportunity to improve their trade balances by stepping up their volume of exports.

It is not possible to give any hard-and-fast guarantees that the integration of developing countries into the international trade and capital system will not prompt any further financial crises in the future. However, it is important to prevent such crises both from threatening this process of integration and from eroding the confidence and support that are needed in order to operate an open system of international trade and investment.

More specifically, the government wishes to address the following issues.

Capital flows out of the country. Increased volatility may lead to a more powerful tendency to reduce access for new capital, i.e. to screen off the domestic capital market from the outside. There is a risk that this will also discourage foreign investment, including both direct investment and portfolio flows, as well as jeopardise the liberalisation of financial services.

There is a direct correlation between the trade system and the exchange rate policies pursued by the countries in question. The real exchange rates resulting from the crises have the effect of strengthening these countries' competitiveness and hence raising their level of exports. This shift in the balance of competition may place pressure on the trade system and entails a risk of competitors responding by adjusting their trade policies. This risk is especially evident in those cases in which a falling currency overshoots its equilibrium value, even if a correction eventually takes place.

There is a risk of industries in rich countries finding themselves facing increased competition and perhaps even suddenly losing part of their market. Once lost, such ground is difficult to regain, even after the competitive balance has been restored to a more normal footing.

The affected industries in importing countries will consequently put pressure on their governments to make more and more use of trade policy instruments (e.g. anti-dumping laws, exemptions and retaliatory tariffs, including liberal interpretations of such instruments). This will shake the developing countries' faith in the multilateral trading system. They may even proceed to use such instruments themselves, not only against the rich countries, but also in their dealings with each other. All in all, there is a clear risk of a vicious circle coming into being.

Such developments undermine support for any further liberalisation of the trade and investment system, and may form a threat to the success of the next round of trade talks.

Against this background, the government would like the Advisory Council on International Affairs to answer the following questions:

1 How realistic does the Advisory Council believe the above risks are, in particular a decline in foreign investments, the direct effects of shifts in competitiveness and imbalanced exchange rates, and their potential impact on trade policies?

2 How is it possible to ensure that, when the international community responds to sudden financial crises, the trade policies adopted do not militate against the integration of the developing countries concerned in the system of trade and investment? The key point here is to achieve consistency in the way in which the national governments in question seek to resolve a crisis and the international response to the same crisis.

3 With a view to promoting such coherence, how could the government in general and the Directorate-General for International Cooperation in particular help both to prevent crises (e.g. by promoting capacity-building in the countries concerned, by helping to plan liberalisation processes, and so forth) and to resolve acute crises, in both a national and an international context?

This request for an advisory report has been compiled in consultation with the Minister of Finance and the Minister for Foreign Trade and Regional Policy, and is also submitted on behalf of the Minister of Defence and the Minister of Foreign Affairs. I look forward with interest to receiving your reply.

Yours sincerely,

(signed)

Eveline Herfkens
Minister for Development Cooperation

Table 2.2. Emerging Market Economies: Net Capital Flows[1]
(Billions of U.S. dollars

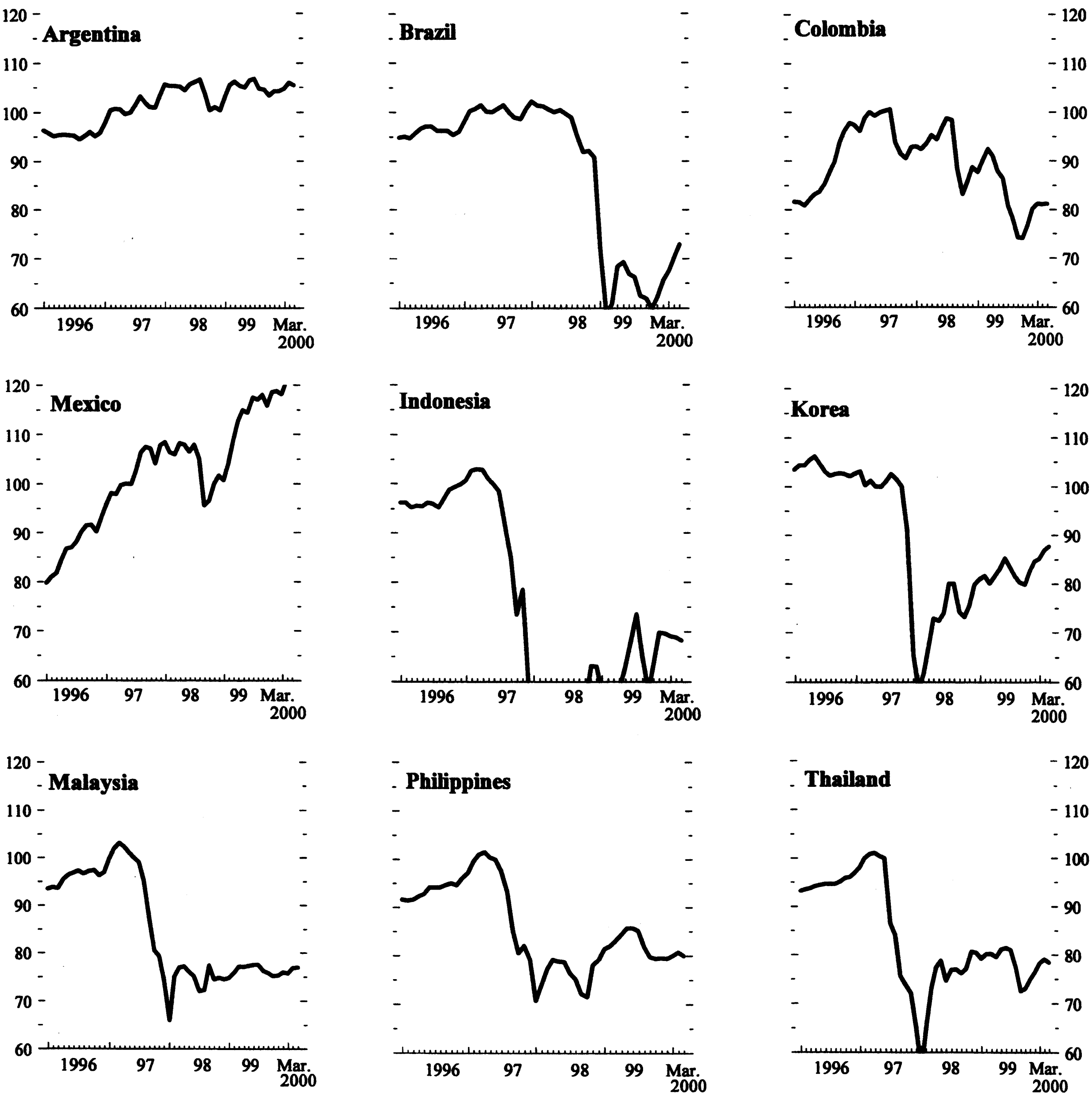
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total										
Net private capital flows [2]	112.6	172.1	136.3	226.9	215.9	147.6	75.1	80.5	70.9	127.8
Net direct investment	35.4	59.4	84.0	92.6	113.2	138.6	143.3	149.8	153.0	144.6
Net portfolio investment	56.1	84.4	109.6	36.9	77.8	52.9	8.5	23.3	30.4	33.5
Other net investment	21.0	28.3	-57.3	97.4	24.9	-43.9	-76.7	-92.5	-112.5	-50.3
Net official flows	21.2	17.2	3.4	11.7	0.4	23.5	44.7	3.0	14.4	6.6
Change in reserves [3]	-56.9	-63.7	-63.6	-117.9	-114.2	-73.1	-37.8	-78.5	-102.2	-100.7
Memorandum										
Current account 4/	-78.5	-118.9	-75.8	-107.0	-94.4	-72.1	-50.9	14.0	22.8	-25.5
Africa										
Net private capital flows [2]	-4.0	-1.8	2.9	10.9	7.5	16.7	11.5	14.8	16.1	15.9
Net direct investment	0.6	1.9	2.3	2.2	4.8	7.4	5.2	9.5	9.2	8.3
Net portfolio investment	1.8	1.0	2.0	1.4	1.3	3.7	4.3	4.4	2.6	2.3
Other net investment	-6.4	-4.7	-1.4	7.3	1.4	5.6	2.0	0.9	4.4	5.3
Net official flows	10.4	6.3	7.7	7.3	4.6	-1.4	2.5	1.6	-4.5	0.7
Change in reserves [3]	0.7	3.2	-6.0	-3.3	-9.2	-11.2	1.2	-3.0	-11.7	-7.4
Memorandum										
Current account 4/	-10.0	-11.2	-11.5	-16.5	-7.0	-7.4	-20.0	-16.8	-7.7	-13.8
Asia 5/										
Crisis countries 6/										
Net private capital flows [2]	29.0	31.8	36.1	74.2	65.8	-20.4	-25.6	-24.6	-40.6	-18.1
Net direct investment	7.3	7.6	8.8	7.5	8.4	10.3	8.6	10.2	12.0	7.2
Net portfolio investment	6.4	17.2	9.9	17.4	20.3	12.9	-6.0	6.3	6.6	3.0
Other net investment	15.3	7.0	17.4	49.2	37.1	-43.6	-28.2	-41.1	-59.2	-28.3
Net official flows	2.0	0.6	0.3	0.7	-0.4	17.9	19.7	-4.7	5.0	-1.9
Change in reserves [3]	-18.1	-20.6	-6.1	-18.5	-5.4	30.5	-52.1	-44.5	-17.2	-20.3
Memorandum										
Current account 4/	-16.1	-13.5	-23.2	-40.4	-53.0	-25.0	69.1	62.9	43.1	36.7
Other Asian emerging markets										
Net private capital flows [2]	-8.3	25.6	27.5	30.8	38.3	19.0	-17.0	-2.5	10.6	10.3
Net direct investment	8.4	26.3	38.3	39.1	44.6	45.1	49.7	39.6	41.3	39.3
Net portfolio investment	2.6	4.6	1.8	-3.2	-7.4	-9.4	-11.9	-11.9	-0.4	-3.5
Other net investment	-19.3	-5.3	-12.7	-5.1	1.1	-16.7	-54.7	-30.2	-30.4	-25.6
Net official flows	8.3	7.9	10.4	5.8	4.1	3.7	7.9	3.8	5.1	8.6
Change in reserves [3]	-6.6	-16.6	-47.3	-27.6	-44.8	-46.7	-18.2	-15.9	-32.9	-40.2
Memorandum										
Current account 4/	14.0	-8.2	16.8	-4.5	16.2	48.2	44.5	32.9	31.7	33.7
Middle East and Europe 7/										
Net private capital flows [2]	38.0	28.7	16.0	13.9	15.2	24.0	21.9	27.1	-0.0	18.6
Net direct investment	1.1	4.3	6.1	5.5	2.1	2.9	2.7	3.3	8.7	9.5
Net portfolio investment	14.9	8.8	9.0	5.0	3.5	5.0	0.2	10.2	-0.1	7.9
Other net investment	22.0	15.7	0.8	3.3	9.6	16.0	19.1	13.5	-8.5	1.2
Net official flows	-1.3	2.3	-1.1	-1.2	-1.1	-0.7	-0.5	-1.8	0.6	-0.7
Change in reserves [3]	-8.7	1.6	-3.0	-9.2	-21.5	-20.7	14.7	-12.0	-13.7	-10.1
Memorandum										
Current account 4/	-26.7	-31.8	-7.9	-7.0	4.5	2.2	-31.1	-5.5	19.7	-4.7
Western Hemisphere										
Net private capital flows [2]	55.6	66.8	49.4	53.1	72.1	85.5	70.0	54.1	69.8	74.9
Net direct investment	13.9	13.4	23.1	24.7	39.5	53.1	56.1	63.6	57.0	55.4
Net portfolio investment	30.3	44.0	66.7	3.0	41.0	19.2	14.7	10.6	12.9	16.6
Other net investment	11.4	9.4	-40.4	25.5	-8.4	13.2	-0.8	-20.1	-0.2	2.9
Net official flows	-1.8	0.5	-3.6	8.1	-4.7	-3.6	6.1	3.6	6.8	-1.1
Change in reserves [3]	-22.6	-20.1	4.6	-21.9	-30.8	-15.3	17.4	5.1	-17.5	-12.0
Memorandum										
Current account 4/	-34.5	-46.0	-52.2	-36.8	-38.3	-64.1	-88.6	-54.2	-56.5	-60.8
Countries in transition										
Net private capital flows [2]	2.3	21.0	4.5	44.0	17.0	22.8	14.2	11.6	15.1	26.1
Net direct investment	4.2	6.0	5.4	13.6	13.7	19.7	21.0	23.5	24.8	24.8
Net portfolio investment	0.1	8.7	20.0	13.3	19.2	21.5	7.2	3.7	8.9	7.1
Other net investment	-2.0	6.3	-21.0	17.1	-15.8	-18.4	-14.0	-15.6	-18.6	-5.8
Net official flows	3.6	-0.4	-10.3	-9.0	-2.1	7.6	9.0	0.6	1.4	1.0
Change in reserves [3]	-1.7	-11.2	-5.7	-37.4	-2.4	-9.6	-0.8	-8.2	-9.2	-10.7
Memorandum										
Current account 4/	-5.1	-8.2	2.1	-1.8	-16.9	-26.1	-24.8	-5.3	-7.5	-16.7

[1]Net capital flows comprise net direct investment, net portfolio investment, and other long- and short-term new investment flows, including official and private borrowing. Emerging markets includes developing countries, countries in transition, Korea, Singapore, Taiwan Province of China, and Israel. No data for Hong Kong SAR are available.
[2]Because of data limitations, "other net investment" may include some official flows.
[3]A minus sign indicates an increase.
[4]The sum of a current account balance, net private capital flows, net official flows, and the change in reserves equals, with the opposite sign, the sum of the capital account and errors and omissions.
[5]Includes Korea, Singapore, and Taiwan Province of China. No data for Hong Kong SAR are available.
[6]Indonesia, Korea, Malaysia, the Philippines, and Thailand.
[7]Includes Israel.

Figure 2.9. Selected Emerging Market Economies: Real Effective Exchange Rates[1]

(June 1997=100)

Real effective exchange rates have depreciated in Brazil and Colombia since early 1999, but have strengthened in Mexico. They remain significantly below pre-crisis levels in east Asia.



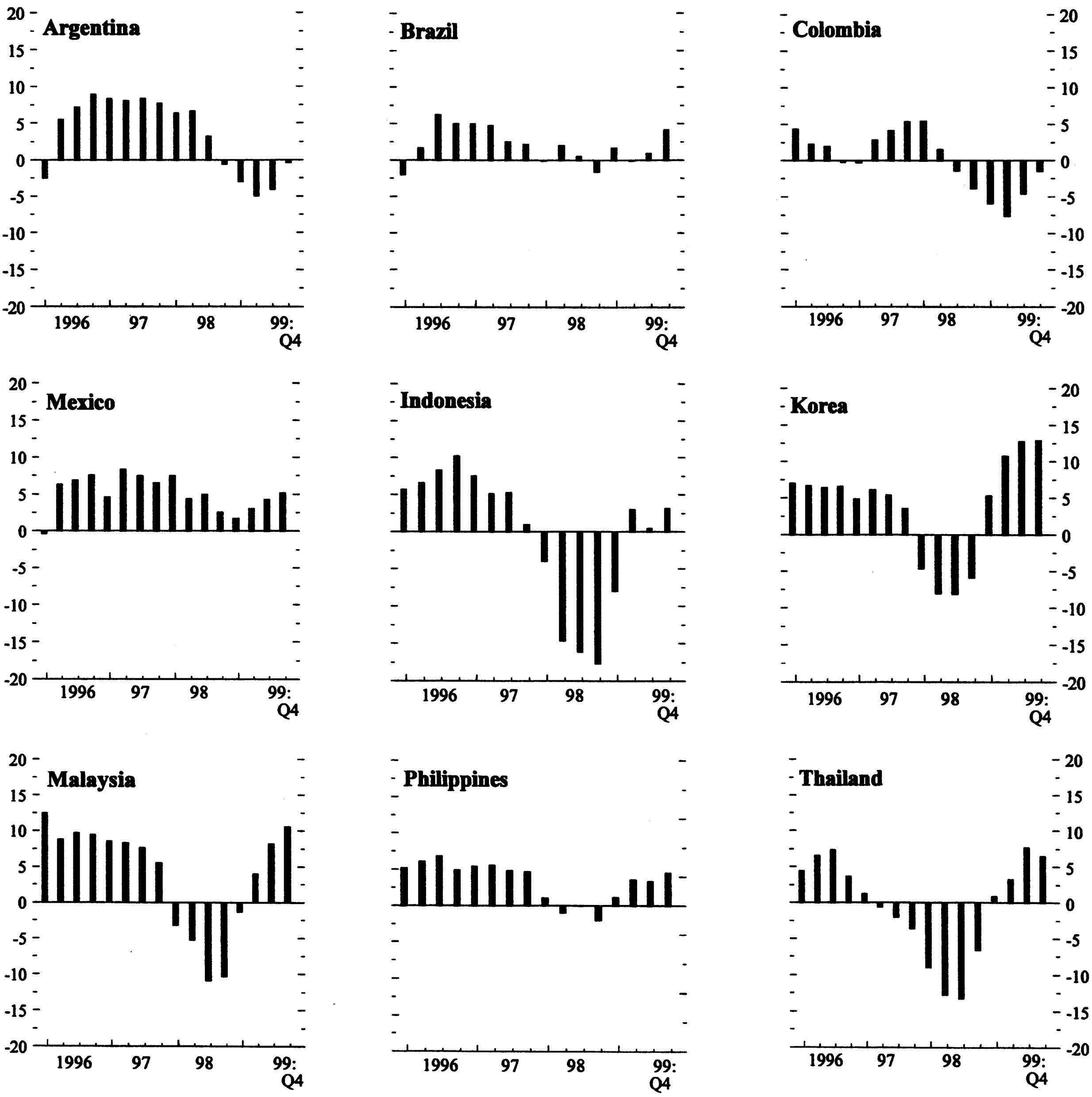
Source: IMF staff estimates.

[1]Defined in terms of relative consumer prices based on 1988–90 trade weights.

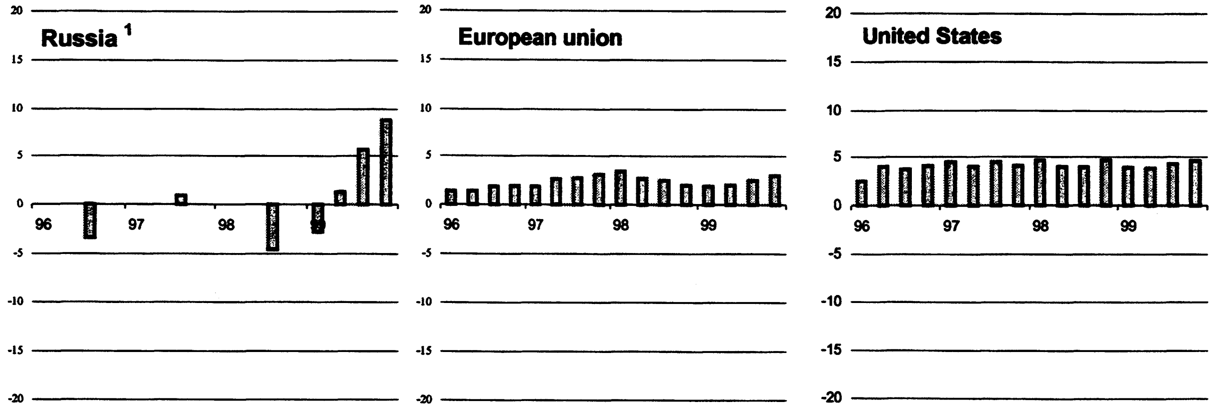
Figure 2.6. Selected Emerging Market Economies: Quarterly Real GDP

(Percent change from four quarters earlier)

The emerging market economies of Latin America experienced recessions of varying degrees in 1999. The east Asian countries have rebounded strongly from deep recessions.



Sources: Country authorities; and IMF staff estimates.



[1] Annual data; 1999 quarterly data.

Source : World Economic Outlook, IMF, April 2000, BIS and Datastream.

Table 46. Developing Countries—Medium-Term Baseline Scenario: Selected Economic Indicators

	Eight-Year Averages 1982-89	Eight-Year Averages 1990-97	Four-Year Averages 1998-2001	1998	1999	2000	2001	Four-Year Averages 2002-2005
				Annual percent change				
Developing countries								
Real GDP	4.3	5.8	4.4	3.2	3.8	5.4	5.3	5.9
Export volume [1]	3.8	9.4	6.0	4.5	1.7	9.7	8.3	8.8
Terms of trade [1]	-3.5	–	-0.5	-5.3	3.1	2.4	-2.0	-0.3
Import volume [1]	1.1	9.3	4.5	0.4	-0.3	9.8	8.5	9.1
Regional groups								
Africa								
Real GDP	2.5	2.0	3.6	3.1	2.3	4.4	4.5	5.0
Export volume [1]	5.1	2.7	5.2	1.3	0.1	7.2	12.7	5.9
Terms of trade [1]	-2.3	0.9	-1.1	-8.8	3.8	9.8	-8.1	-0.4
Import volume [1]	3.8	2.8	4.1	2.9	-0.5	9.4	5.0	5.7
Asia								
Real GDP	7.2	8.0	5.5	3.8	6.0	6.2	5.9	6.7
Export volume [1]	7.3	13.3	6.5	4.2	1.7	11.2	9.1	10.8
Terms of trade [1]	-1.5	0.1	-0.4	0.5	-1.2	-0.8	–	0.2
Import volume [1]	5.1	11.9	4.8	-6.4	3.3	12.7	10.7	12.3
Middle East and Europe								
Real GDP	3.1	3.9	3.0	2.7	0.7	4.6	4.0	4.4
Export volume [1]	1.1	7.6	3.5	4.2	-0.7	7.2	3.5	3.5
Terms of trade [1]	-5.9	-0.9	-0.9	-14.9	10.7	7.3	-4.5	-0.4
Import volume [1]	-1.8	5.0	2.9	3.4	-3.1	4.6	6.8	3.8
Western Hemisphere								
Real GDP	1.7	3.5	2.7	2.1	0.1	4.0	4.7	4.9
Export volume [1]	4.2	8.7	7.4	7.1	4.2	9.8	8.5	10.0
Terms of trade [1]	-3.6	0.3	-0.7	-5.8	3.0	1.5	-1.2	-0.9
Import volume [1]	-2.5	12.7	5.4	8.3	-3.1	9.3	7.7	8.5
Analytical groups								
Net debtor countries by debt-servicing experience								
Countries with arrears and/or rescheduling during 1994-98								
Real GDP	2.9	3.6	2.4	-0.8	1.8	4.1	4.5	5.1
Export volume [1]	6.2	4.6	5.7	3.6	-4.2	13.2	11.2	10.9
Terms of trade [1]	-4.0	-0.6	0.2	-3.3	3.6	4.2	-3.3	-0.8
Import volume [1]	0.8	6.3	2.7	0.3	-9.7	13.2	8.5	10.3
Other net debtor countries								
Real GDP	5.3	6.8	5.2	4.8	4.6	5.8	5.7	6.3
Export volume [1]	6.1	11.3	6.8	5.9	3.7	9.0	8.6	9.0
Terms of trade [1]	-2.1	0.5	-0.6	-3.3	1.3	-0.1	-0.5	0.1
Import volume [1]	2.3	11.0	5.7	0.4	3.7	10.1	9.0	9.6

Table 46 (concluded)

	1989	1993	1997	1998	1999	2000	2001	2005
			Percent of exports of good and services					
Developing countries								
Current account balance	-7.2	-16.0	-4.7	-7.7	-2.6	-0.8	-3.3	-6.4
Total external debt	203.0	195.2	150.7	172.7	163.2	145.6	141.6	119.6
Debt-service payments [2]	23.6	23.6	24.6	26.8	27.8	23.3	21.7	17.9
Interest payments	11.3	9.8	7.9	9.2	9.2	9.3	8.9	7.8
Amortization	12.3	13.8	16.7	17.6	18.6	14.0	12.8	10.0
Regional groups								
Africa								
Current account balance	-11.5	-11.3	-5.4	-16.5	-13.2	-5.1	-8.9	-8.3
Total external debt	241.9	276.4	222.5	251.8	244.4	205.4	208.4	177.0
Debt-service payments [2]	27.5	28.5	22.6	24.0	22.9	22.3	21.9	19.8
Interest payments	11.5	11.3	9.6	11.2	10.0	10.6	10.7	9.6
Amortization	16.0	17.2	13.0	12.8	12.9	11.7	11.1	10.2
Asia								
Current account balance	-12.5	-11.5	1.2	9.1	7.3	4.9	4.0	-3.1
Total external debt	171.4	153.6	114.6	122.9	115.1	103.5	97.0	78.9
Debt-service payments [2]	21.1	17.9	14.6	17.9	18.7	13.5	13.3	12.1
Interest payments	8.8	6.8	4.8	5.6	6.0	5.4	5.2	5.3
Amortization	12.3	11.0	9.7	12.3	12.7	8.1	8.1	6.9
Middle East and Europe								
Current account balance	-1.8	-16.2	2.2	-13.9	-1.7	7.3	-1.0	-3.8
Total external debt	138.7	122.3	99.8	130.5	123.1	104.7	111.3	112.2
Debt-service payments [2]	14.9	14.2	16.2	16.9	16.6	18.8	17.1	11.8
Interest payments	6.7	5.7	4.2	5.8	5.4	7.3	7.3	5.6
Amortization	8.2	8.5	11.9	11.1	11.2	11.5	9.8	6.2
Western Hemisphere								
Current account balance	-3.6	-25.7	-22.0	-31.1	-18.2	-16.7	-16.5	-13.8
Total external debt	278.9	292.9	231.4	265.4	254.9	232.9	221.6	184.2
Debt-service payments [2]	32.5	40.0	52.2	52.5	56.7	46.0	41.1	32.3
Interest payments	18.5	18.1	16.1	17.7	18.3	17.7	16.4	13.6
Amortization	14.0	21.9	36.1	34.8	38.3	28.3	24.7	18.7
Analytical groups								
Net debtor countries by debt-servicing experience								
Countries with arrears and/or rescheduling during 1994-98								
Current account balance	-10.5	-15.7	-16.4	-21.2	-10.2	-7.0	-7.9	-8.4
Total external debt	292.5	325.0	253.0	299.1	279.6	236.5	224.6	181.0
Debt-service payments [2]	29.2	33.4	37.1	44.5	53.5	37.8	32.7	24.3
Interest payments	13.3	12.4	11.5	14.3	14.6	15.2	13.5	9.4
Amortization	15.9	21.0	25.5	30.2	38.9	22.6	19.2	14.9
Other net debtor countries								
Current account balance	-8.3	-17.0	-2.7	-1.5	-0.3	-2.1	-3.0	-6.7
Total external debt	191.1	177.1	132.6	143.9	138.7	130.3	125.8	106.9
Debt-service payments [2]	25.2	24.3	22.5	23.2	22.0	20.9	19.9	16.8
Interest payments	12.3	10.6	7.4	8.0	8.2	8.1	8.0	7.8
Amortization	13.0	13.7	15.0	15.2	13.8	12.8	11.9	9.1

[1] Data refer to trade in goods and services.

[2] Interest payments on total debt plus amortization payments on long-term debt only. Projections incorporate the impact of exceptional financing items. Excludes service payments to the International Monetary Fund.

Table 27. Summary of Payments Balances on Current Account
(Billions of U.S. dollars)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Advanced economies	**-10.5**	**66.0**	**32.5**	**56.5**	**43.4**	**93.9**	**43.1**	**-133.7**	**-212.9**	**-215.5**
United States	-50.6	-85.3	-121.7	-113.6	-129.3	-143.5	-220.6	-338.9	-419.4	-460.9
Euro area	-51.3	26.9	19.3	56.6	89.9	112.5	86.5	43.7	64.9	95.8
Japan	112.3	132.0	130.6	111.4	65.8	94.1	121.0	107.0	102.4	112.6
Other advanced economies	2.2	8.6	2.0	-0.1	10.6	14.1	54.6	69.7	56.0	61.1
Memorandum										
Industrial countries	-26.9	47.8	19.7	55.7	48.4	86.2	-22.2	-193.2	-261.4	-263.4
Newly industrialized Asian economies	16.3	20.8	16.1	5.9	0.3	11.2	66.1	61.0	49.8	49.8
Developing countries	**-84.0**	**-120.4**	**-88.6**	**-111.4**	**-74.2**	**-59.1**	**-89.9**	**-32.7**	**-11.6**	**-49.2**
Regional groups										
Africa	-10.0	-11.2	-11.5	-16.5	-7.0	-7.4	-20.0	-16.8	-7.7	-13.8
Asia	-12.6	-34.0	-20.4	-56.3	-38.7	6.8	48.9	42.3	31.7	28.1
Middle East and Europe	-26.8	-29.2	-4.5	-1.8	9.8	5.6	-30.3	-4.0	20.9	-2.8
Western Hemisphere	-34.5	-46.0	-52.2	-36.8	-38.3	-64.1	-88.6	-54.2	-56.5	-60.8
Analytical groups										
By source of export earnings										
Fuel	-29.9	-24.1	-4.9	0.8	30.0	21.4	-34.6	3.4	45.3	12.1
Nonfuel	-54.1	-96.3	-83.8	-112.3	-104.4	-80.7	-55.7	-36.1	-56.7	-61.4
By external financing source										
Net creditor countries	-15.2	-13.0	-6.4	1.9	13.2	11.7	-21.3	-0.1	31.2	8.7
Net debtor countries	-68.6	-107.1	-82.0	-113.0	-86.9	-70.1	-68.5	-32.2	-42.2	-57.2
Official financing	-6.2	-8.2	-10.0	-12.1	-9.2	-4.6	-10.0	-9.7	-3.6	-6.7
Private financing	-38.9	-72.7	-59.9	-86.1	-67.9	-50.3	-39.3	-17.0	-32.8	-42.6
Diversified financing	-15.1	-21.0	-16.7	-17.4	-15.0	-16.9	-16.3	-8.7	-6.5	-8.2
Net debtor countries by debt-servicing experience										
Countries with arrears and/or rescheduling during 1994-98	-22.1	-30.3	-21.1	-48.0	-41.4	-48.8	-57.3	-29.7	-23.8	-28.5
Other net debtor countries	-46.7	-77.1	-61.1	-65.2	-45.9	-22.0	-11.4	-2.9	-18.9	-29.4
Countries in transition	**-5.1**	**-8.2**	**2.1**	**-1.8**	**-16.9**	**-26.1**	**-24.8**	**-5.3**	**-7.5**	**-16.7**
Central and eastern Europe	-2.3	-9.8	-5.3	-4.9	-16.8	-19.4	-22.4	-22.5	-23.3	-23.5
Excluding Belarus and Ukraine	-1.9	-8.5	-3.4	-2.9	-15.1	-17.2	-20.2	-22.0	-21.6	-22.3
Russia	-1.2	2.6	8.2	4.6	3.8	-3.0	2.5	19.8	18.7	10.3
Transcaucasus and central Asia	-1.7	-1.0	-0.8	-1.6	-3.9	-3.7	-4.9	-2.6	-2.9	-3.5
Total [1]	**-99.6**	**-62.5**	**-54.0**	**-56.7**	**-47.6**	**8.8**	**-71.7**	**-171.7**	**-231.9**	**-281.4**
In percent of total world current account transactions	-1.0	-0.7	-0.5	-0.5	-0.4	0.1	-0.5	-1.2	-1.5	-1.7
In percent of world GDP	-0.4	-0.3	-0.2	-0.2	-0.2	–	-0.2	-0.6	-0.7	-0.8
Memorandum										
Emerging market countries, excluding Asian countries in surplus [2]	-86.4	-104.7	-77.0	-76.2	-75.6	-106.8	-172.3	-86.7	-61.4	-107.3

[1] Reflects errors, omissions, and asymmetries in balance of payments statistics on current account, as well as the exclusion of data for international organizations and a limited number of countries. See "Classification of Countries" in the introduction to this Statistical Appendix.
[2] All developing and transition countries excluding China, Hong Kong SAR, Korea, Malaysia, the Philippines, Singapore, Taiwan Province of China, and Thailand.

Key to abbreviations

AIV	Advisory Council on International Affairs
BIS	Bank for International Settlements
CEI	European Integration Committee (AIV committee)
CMR	Human Rights Committee (AIV committee)
COS	Development Cooperation Committee (AIV committee)
CVV	Peace and Security Committee (AIV committee)
DNB	De Nederlandsche Bank (the Dutch central bank)
EU	European Union
FMO	Finance for Development (Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden)
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee (of the IMF)
LTCM	Long Term Capital Management Fund (US hedge fund)
OECD	Organisation for Economic Cooperation and Development
OPEC	Organisation of Petroleum-Exporting Countries
SDDS	Special Data Dissemination Standard
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organisation

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