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

Recommendations of the Commission of Experts of the President of the General Assembly on Reforms of the International Monetary and Financial System

Note by the President of the General Assembly

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

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

3. Following the interactive, thematic dialogue on the world financial and economic crisis and its impact on development, held at United Nations Headquarters from 25 to 27 March 2009, and the constructive observations put forward by representations of Member States and civil society on that occasion, I have the pleasure to transmit the recommendations of the Commission of 5 April 2009 for your consideration. I trust that the Members of the General Assembly will find these recommendations useful as they prepare for the Conference on the World Economic and Financial Crisis and Its Impact on Development, to be convened in accordance with General Assembly resolution 63/277, from 1 to 3 June 2009.

Recommendations of the Commission of Experts of the President of the General Assembly on reform of the international monetary and financial system*

I. Preamble

1. The rapid spread of the financial crisis from a small number of developed countries to engulf the global economy provides tangible evidence that the international trade and financial system needs to be profoundly reformed in order to meet the needs and changed conditions of the twenty-first century. Past economic crises have had a disproportionately adverse impact on the poor, who are least able to bear these costs, and can have consequences long after the crisis is over. It is thus important to recognize that this is not only an economic, but also a social crisis.

2. While it is important to introduce structural changes to adapt the international system to prevent future crises, this cannot be achieved without significant immediate measures to promote recovery from the current crisis. Such changes should be designed to protect the poorest in the least developing countries — many of which are located in sub-Saharan Africa — who will bear a heavy burden of adjustment. According to the International Labour Organization (ILO), some 200 million workers, mostly in developing economies, could be pushed into poverty if rapid action is not taken to counter the impact of the crisis. Even in some advanced industrial countries, millions of households are faced with the threat of losing their homes and their access to health care, while economic insecurity and anxiety is increasing among the elderly as they lose their life savings in the collapse of asset prices. ILO estimates that the number of unemployed in 2009 could increase by some 30 million over 2007, and could reach more than 50 million if conditions continue to deteriorate.

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

4. This inclusive global response will require the participation of the entire international community; it must encompass more than the Group of 7, the Group of 8 and the Group of 20, but also representatives of the entire planet, the Group of 192. It was in response to this need that the President of the General Assembly created the Commission of Experts to address the measures needed to meet the crisis and to recommend longer-term reforms. Recognizing the work being undertaken by the Group of 8, the Group of 20 and by other bodies, the Commission sees its own work as complementary, seeking to focus on the impacts of the crisis and the responses to it on poverty and development.

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* Information on the Commission of Experts is available at www.un.org/ga/president/63/commission/financial_commission.shtml.

5. Reform of the international system must have as its goal the better functioning of the world economic system for the global good. This entails simultaneously pursuing long-term objectives, such as sustainable and equitable growth, the creation of employment in accordance with the “decent work” concept, the responsible use of natural resources, and the reduction of greenhouse gas emissions, as well as other more immediate concerns, including addressing the challenges posed by the food and financial crises. As the world focuses on the exigencies of the moment, the long-standing commitments to the achievement of the Millennium Development Goals and to protecting the world against the threat of climate change must remain the overarching priorities; indeed, appropriately designed global reform should provide an opportunity to accelerate progress toward meeting these goals. While the world will eventually recover from the global economic crisis, the resolution of other challenges, including that posed by global warming, additional measures will be required. The conjunction of huge unmet global needs, including responding to the challenges of global warming and the eradication of poverty, in a world with excess capacity and mass unemployment is unacceptable.

II. Responding to the global financial crisis

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

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

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

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

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

good regulatory frameworks, created effective monetary institutions and implemented sound fiscal policies.

11. The principles and recommendations outlined in the present report seek to address both the need to take immediate action to resuscitate the global economy as well as the need to act to resolve underlying structural problems. They focus both on feasible steps that can and should be taken immediately and the deeper medium- and longer-term reforms that must now be initiated to help restore confidence in our economic system, reduce the likelihood of another such crisis and strengthen the international community's capacity to respond to a crisis if it should occur.

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

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

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

(c) Developing countries should have an expanded scope to implement policies and create institutions that will allow them to implement appropriate counter-cyclical policies;

(d) Advanced industrial countries should observe their pledges not to undertake protectionist actions and, even more importantly, ensure that stimulus packages and recovery programmes do not further distort the economic playing field and further increase global imbalances;

(e) Measures to restore domestic financial markets in developed countries through subsidies to financial institutions have been accompanied by a sharp reduction in flows of capital to developing countries. It is important to ensure that these measures do not create a new form of financial protectionism. Financial subsidies can be just as detrimental to the efficiency of a free and fair trading system as tariffs. Indeed, they may be far more inequitable, because rich countries have more resources to support subsidies;

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

(g) The crisis is, in part, a result of excesses in deregulation of financial markets and in international trade. Restoring the global economy to health will require restoring a balance between the role of the market and the role of the State. Both the global economic crisis and the global climate crisis are associated with massive externalities that can only be addressed by appropriate global collective action;

(h) In taking policy actions it is imperative to ensure that they do not exacerbate the current crisis through their impact on other countries or result in structural changes that increase future instability or reduce future growth. For example, in some countries the response to the excessive risk undertaken by financial institutions that were too big to fail has resulted in bank consolidation, which increases such risks in the future;

(i) If the world is to emerge from the crisis into sustainable, balanced growth, it is essential that Governments undertake reforms that address some of the underlying factors that contributed to the current economic crisis — it is not enough simply to return to the status quo ex ante. Initiation of such reforms may, in addition, produce immediate dividends in the form of enhanced confidence;

(j) Appropriately designed short-run measures may be complementary to long-term goals, especially those related to climate change and the environment. The policies for recovery should include large-scale environmental investments. Such investments, in both the public and private sectors, can be brought about by strong incentives and deep reforms of national and international policy frameworks, including the introduction of price measures on carbon emissions.

III. Immediate measures

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

14. The following 10 immediate measures are essential for global recovery.

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

(a) Stimulus should be timely, have large "multipliers", help address the strains posed by the economic downturn on the poor, help address long-term problems and prevent instability. While decisions on stimulus are national, they should be judged on their global impacts; if each country looks only at the national benefits versus costs, for example an increase in the national debt, the size of the global stimulus will be too small, spending will be distorted and the global impact will be eviscerated;

(b) If developing countries are unable to mobilize the required resources to finance domestic stimulus policies, they may have to introduce procyclical policies that counter the positive impact on global growth of the stimulus policies in developed countries. Sufficient financing must thus be made available to all countries to ensure that the policies of both developed and developing countries are complementary and that they reinforce global recovery;

(c) National stimulus packages should thus include spending measures to be undertaken in developing countries to offset the impact of the decline in world trade and financial market disintermediation. Industrialized countries should dedicate at least 1 per cent of their stimulus packages to support the recovery of developing countries, in addition to augmenting traditional official development assistance commitments. To ensure that the financing of stimulus policies in developing countries does not lead to additional external indebtedness that would offset their benefits, financing of stimulus packages should be implemented through grants as well as loans.

2. Developing countries need additional funding:

(a) Developing countries will need substantial additional funding to participate effectively in a global stimulus. Sources of funding for developing countries that could be activated quickly and are not subject to inappropriate conditionality are necessary. Indeed, additional funding is required just to offset the imbalances and inequities created by the massive stimulus and bail-out measures introduced in the advanced industrialized countries. Additional funding from developed countries is also required for climate change adaptation and mitigation in developing countries, as is currently being negotiated under the United Nations Framework Convention on Climate Change. Such funding should be made available within a short time frame;

(b) An important source of funding could be provided immediately by completion of the issuance of special drawing rights approved by the Board of the International Monetary Fund (IMF) in September 1997 through the proposed fourth amendment to the Articles of Agreement of the Fund, that is, to double cumulative allocations of special drawing rights to $42.8 billion. In addition, rapid action should be taken to provide for the issuance of additional special drawing rights through standard procedures in the amount of at least $250 billion per year for the duration of the crisis;

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

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

(e) Developed countries must make a renewed effort to meet the commitments made in the Millennium Declaration, the Monterrey Consensus, the 2005 World Summit and the Doha Declaration by 2015.

3. Additional funds for developing countries, including through a new credit facility and new methods of disbursement:

(a) Developing countries will require access to additional funding in order to participate in global stimulus measures as well as to finance the additional measures needed to: protect the most vulnerable by strengthening social protection; provide trade finance and finance to private corporations whose sources of international credit may have dried up; and bolster domestic financial institutions weakened both by the withdrawal of funds and the precipitous collapse of export earnings;

(b) In order to mobilize additional funds, the creation of a new credit facility is a matter of urgency. The current system does not provide an efficient mechanism for mobilizing the funds available in countries that have accumulated large reserves. It would be beneficial for all participants in the global economy if savings from emerging markets could be utilized in support of developing countries. Existing facilities do not meet these needs for two reasons. Government agencies in some emerging market countries are reluctant to provide development funds to existing multilateral institutions because these countries are often underrepresented in their governance structures and because they perceive the policy advice and conditionalities provided by such institutions as inappropriate to the needs of developing countries. **The reluctance of many countries to accept assistance from certain institutions and the reluctance of some potential lenders to provide funds to certain institutions constitutes an impediment that may not be fully addressed by the reforms that are likely to be made in the short-run.** In addition, there is a lack of appropriate funding facilities to respond to the interests of some developing countries with high reserves, such as sovereign wealth funds that seek investment possibilities with acceptable return and limited risk. The current financial system does not provide this intermediation facility;

(c) The new funding facilities should be designed with the intention of attracting funds from countries that have accumulated large international non-borrowed reserves. These funding commitments could be backed by guarantees provided by advanced industrial countries. They could be leveraged by borrowing in global financial markets. With regard to the utilization of the funds, there are different (complementary) options. First, there is an urgent need for balance-of-payment and budget financing, with the objective of increasing developing countries' capacities for anti-cyclical fiscal expenditures. Second, the funds could be used for key investments, where some of the emerging markets have a particular interest, such as developing agriculture in African countries, including their capacity to export, thus contributing to food security in other regions, for example in Asian and Arab countries. Another possibility is to use those funds to help developing countries finance guarantees for trade credit or for the debt of their corporations, forestalling the risk of a run on these corporations;

(d) Such facilities would require a different governance structure from existing global financial institutions, reflecting the new sources of global financing and the necessity of giving a greater voice to emerging markets and countries providing the funds, but also by giving voice to recipient countries. They could be located under the umbrella of existing institutions — such as the World Bank or regional development banks, where developing countries are already strongly represented — or established as a new institution. There is no dominant view among the members of the Commission on the location of the new facility. In any case, it would be vitally important that the facilities adhere to current international standards, in particular social and environmental safeguards.

4. Developing Countries need more policy space:

(a) Conditionality continues to be attached to official lending and support provided by international financial institutions. These conditionalities contribute to global asymmetries, disadvantage developing countries relative to developed countries, undermine incentives for developing countries to seek support funding and contribute to global economic weakness. Other conditions required or encouraged countries to adopt the deregulatory financial policies that are now recognized to have contributed to the current economic crisis;

(b) Developing countries, in particular, need policy frameworks that can help protect them from regulatory and macro-economic failures in systemically significant countries. Developing countries have had imposed on them not only deregulation policies akin to those that are now recognized as having played a role in the onset of the crisis, but they have also faced restrictions on their ability to manage their capital account and financial systems (for example as a result of financial and capital market liberalization policies); these policies are now exacting a heavy toll on many developing countries.

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

Policy space is circumscribed by a lack of resources and the imposition of conditionalities, as well as by international agreements that often accompany assistance. Many bilateral and multilateral trade agreements contain commitments that limit the ability of countries to respond to the current crisis with appropriate regulatory, structural and macro-economic reforms and rescue packages, and may have exposed them unnecessarily to the contagion from the failures elsewhere in the global economic system.

6. Crisis response must avoid protectionism:

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

7. Opening advanced country markets to the exports of least developed countries:

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

8. Learning from successful policies to undertake regulatory reforms:

(a) The financial crisis is widely viewed as being the result of the failure of regulatory policies in the advanced industrial countries. While full regulatory reforms will take time, it is imperative that work on regulatory reform begin now. The collapse in confidence in the financial system is widely recognized as central in the economic crisis; restoration of confidence will be central in the recovery. But it will be hard to restore confidence without changing the incentives and constraints facing the financial sector. It is imperative that the regulatory reforms be real and substantive and that they go beyond the financial sector to address underlying problems in corporate governance and competition policy, and in tax structures, giving preferential treatment to capital gains that may provide incentives for excessive leverage;

(b) While greater transparency is important, much more than improving the clarity of financial instruments is needed. Even had there been full disclosure of derivative positions, their complexity was so great as to make an evaluation of the balance sheet position of the financial institutions extraordinarily difficult. There is still a need for much greater transparency, including forbidding off-balance-sheet transactions and full expensing of employee stock options;

(c) Well-regulated economies have to be protected from competition from economies with inadequate or inappropriate regulatory systems. The problems of regulatory arbitrage and tax evasion are closely linked. Tax havens and financial centres in both developed and developing countries that fail to meet basic standards of transparency, information exchange and regulation should be given strong incentives to reform their practices, for example by restricting transactions with financial institutions in those jurisdictions. Institutional arrangements for improving harmonization and transparency should be strengthened, including the United Nations Committee of Experts on International Cooperation in Tax Matters, which should be transformed into an intergovernmental organ. In addition, other international arrangements and conventions, such as the United Nations Convention against Corruption, should also be strengthened.

9. Coordinating the domestic and global impact of government financial sector support:

(a) Government bail-outs have substantial redistributive consequences that must be analysed in assessing their impact on recovery. In addition, because of the urgency of the situation, they often fail to observe principles of good governance and especially of democratic transparency. This may lead to the introduction of inappropriate incentives, as well as failure to recognize possible adverse effects on other countries, especially on developing countries that lack equivalent financial resources. Developed countries should undertake financial support policies recognizing that even symmetric policies can have asymmetric effects because guarantees by developing country Governments are likely to be less meaningful than those by the Governments of developed countries;

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

10. Improved coordination of global economic policies:

(a) There is a need for substantial improvement in the coordination of global economic policy. Global economic integration has outpaced the development of the appropriate political institutions and arrangements for governance of the global economic system. Remedying this lacuna is a matter of urgency, but it will not happen overnight.

(b) In the short term, there should be an appropriate mechanism within the United Nations system for independent international analysis of questions of global economic policy, including its social and environmental dimensions. Following the successful example of the Intergovernmental Panel on Climate Change, an expert panel could be created to offer advice to the General Assembly and the Economic and Social Council, as well as to relevant international organizations, to: enhance their capacity for sound decision-making in these areas; identify gaps and deficiencies in the global economic architecture; and assess progress and problems in the functioning of the global economic and social system. At the same time, such a panel would contribute to the fostering of a constructive dialogue and offer a regular venue for fruitful exchange between policymakers, the academic world and key international organizations. The panel should comprise well-respected academics from all over the world, representing all continents, including representatives of international social movements. The panel should be able to follow, analyse and assess long-term trends, key developments and major dynamics for global change affecting all peoples around the globe, identify problems in the global economic and financial architecture and provide options for coherent international action and recommendations for political decision-making processes.

IV. Agenda for systemic reforms

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

A. A new global reserve system

16. The global imbalances that played an important role in this crisis can only be addressed if there is a better way of dealing with international economic risks facing countries than the current system of accumulating international reserves. Indeed, the magnitude of this crisis and the inadequacy of international responses may motivate even further accumulations, contributing to the deflationary bias in the global system and impairing prospects for a robust recovery. Inappropriate responses by some international economic institutions in previous economic crises have

contributed to the problem. In addition, the difficulties associated with the dominant use of a single national currency as the international reserve currency are well known and solutions have been proposed in the form of a global reserve system. Such a system could be based on an expanded role for the special drawing rights, with regular or cyclically adjusted emissions calibrated to the size of reserve accumulations. Such a system would be in the interest of all countries and would contribute to global stability, economic strength and global equity.

17. Rapid introduction of the new global reserve system would represent an important step in global recovery. A transition process could be initiated based on an annual emission of at least $250 billion special drawing rights during the duration of the current crisis. These emissions would be an important source of funding for developing countries needing additional funds in order to cope with the crisis and build confidence in the viability of a new reserve system. The final report of the Commission will include a discussion of a number of institutional arrangements (including systems for allocating new emissions) for the new global reserve system, as well as a discussion of the transition and steps to ensure that it enhances stability.

18. Currently, poor countries are lending to the rich reserve countries at extremely low interest rates, which has increased the gap between the opportunity cost of their resources held as reserves and the returns they receive. Moreover, the emergency measures introduced in support of developed country financial systems have brought radical changes in the management of central bank balance sheets, and in some countries have produced large increases in Government debt to gross domestic product (GDP) ratios. This has generated concern and anxiety over the long-term stability of the value of the assets held as reserves in developed country financial markets and created additional uncertainty concerning the stability of global financial markets.

19. The risks of instability, deflationary bias and the potential accumulation of debt in a single-country reserve system have long been recognized. However, the crisis, and the problems that have emerged as a result in the current reserve system, has made reform a matter of urgency. But, a two- (or three-) country reserve system, to which the world seems to be moving, may be equally unstable. The new global reserve system is feasible, non-inflationary and could be easily implemented, including in ways that mitigate the difficulties caused by asymmetric adjustment between surplus and deficit countries.

B. Reforms of the governance of the international financial institutions

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

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

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

23. Elections of the leaders of the World Bank and IMF should take place under an open democratic process.

C. A global economic coordination council

24. As a complement to the existing specialized institutions and ad hoc intergovernmental groups of restricted membership, a globally representative forum should be created to address areas of concern in the functioning of the global economic system in a comprehensive way. At a level equivalent with the General Assembly and the Security Council, such a global council should meet annually at the Heads-of-Government level to assess developments and provide leadership in economic, social and ecological issues. It would promote development, secure consistency and coherence in the policy goals of the major international organizations and support consensus-building among Governments on efficient and effective solutions for issues of global economic governance. Such a council could also promote the accountability of all international economic organizations, identify gaps that need to be filled to ensure the efficient operation of the global economic and financial system and help set the agenda for global economic and financial reforms and would be supported intellectually by the work of the international panel discussed in paragraph 14 above. Representation would be based on the constituency system and would be designed to ensure that all continents and all major economies are represented. At the same time, its size should be guided by the fact that the council must remain small enough for effective discussion and decision-making. Important global institutions, such as the World Bank, IMF, WTO, ILO and entities of the United Nations Secretariat dealing with economic and social issues would provide supporting information and participate in the council, which could thus provide a democratically representative alternative to the Group of 20.

D. Better and more balanced surveillance

25. The intensity of surveillance of economic policies should be calibrated to the systemic significance of the country. Responsibility for surveillance should be separate and independent from lending institutions, and should also be subject to effective political accountability. There should be a broad mandate to cover not only price inflation, but also levels of unemployment, sources of instability for the global financial system and the impact of built-in stabilizers, or destabilizers, and systems of social protection.

V. Reforming central bank policies to promote development

26. Whereas price stability is desirable in support of growth and financial stability, it is not sufficient. Central banks should therefore aim to ensure price stability in the context of delivering long-term sustainable growth while maintaining sensitivity to risks to financial stability, capital flows and exchange rates. Central banks also need to give consideration to financial market and asset price developments. This may entail central banks using a wider range of instruments, including prudential instruments. A distinction may need to be made between the roles of central banks in maintaining financial stability under normal circumstances and during crisis periods. Central bank governance arrangements may need to differ depending on their precise role. In particular, any actions which may impose serious risks on a country's fiscal position, such as those now being implemented in many countries as part of financial institution resolutions, should be subject to coordination.

VI. Financial market policies

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

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

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

A. Financial product safety

30. Sustainable recovery will depend on appropriate regulations (across countries, products and institutions). Regulations should be based on what things are, not what they are called, that is, insurance products should be regulated the same way, whether called insurance or not. Financial regulators should be mandated to

ascertain the safety and appropriate use of various financial instruments and practices, including through the creation of a financial products safety commission.

31. Core depository institutions should be restricted from undertaking excessively risky activities and should be tightly regulated. Close oversight over all highly leveraged and systemically significant institutions is necessary, but there should also be oversight over all financial institutions. Institutions can quickly become systemically significant.

B. Comprehensive application of financial regulation

32. The fact that correlated behaviour of a large number of institutions, each of which is not systemically significant, can give rise to systemic vulnerability makes oversight of all institutions necessary. There needs to be tighter regulation of incentives, especially in the core institutions; part of the current problem is a result of distorted incentives that encouraged short-sighted and excessively risky behaviour. It may be easier to increase public oversight over existing incentives rather than to prohibit every instance of perverse incentives. Restrictions on leverage, with automatic countercyclical capital adequacy and/or provisioning requirements, are needed.

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

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

C. Regulation of derivatives trading

35. The large-scale use of unregulated, unsupervised over-the-counter derivatives has resulted in undue complexity, opacity and mispricing of these instruments, and has facilitated the evading of meeting capital adequacy requirements by financial institutions. These practices have weakened our financial system significantly and have made the resolution of failing firms extremely difficult.

36. Regulations should ensure that derivative instruments are held on balance sheets, valued at independently audited real transaction prices, with appropriate capital provisioning and clarity of purpose. Standardization of contracts and the registration of transactions on regulated exchanges should be adopted wherever possible, with the associated regulatory restrictions, including limits on non-commercial traders. Complex, customized, over-the-counter derivatives that cannot be standardized or that do not generate sufficient volume to be traded on an exchange should, when used by core institutions, be accompanied by a higher margin

capital charge than those traded on exchanges. Institutions using non-standardized contracts should be subject to more intensive supervision by regulatory authorities.

D. Regulation of credit rating agencies

37. A major reform of credit rating agencies and their role in the financial system will have to be undertaken. When financial regulations make use of credit ratings, regulators must have a mechanism to evaluate the quality of ratings provided. They must also consider mechanisms for avoiding conflict of interest in the provision of ratings by the agencies, and may consider the scope for encouraging new actors so as to encourage competition in the business of credit rating. The reforms needed in this field and in the systems of information provision will be addressed in the final report of the Commission.

E. Host country regulation of foreign subsidiaries

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

F. International regulations

39. Market-driven international capital flows are of such a magnitude and volatility that they can offset any formal mechanism to provide additional finance for development. Thus, an active management of foreign capital inflows will be required to ensure that they are supportive of the counter-cyclical policies of Governments. The Articles of Agreement of IMF provide members with the authority to control capital inflows and expressly exclude the use of Fund resources to meet imbalances resulting from capital account disequilibrium. The Fund should be encouraged to return to its original principles and to support countries that attempt to manage external capital flows in support of domestic counter-cyclical policies.

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

G. Regulatory institutions

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

H. Towards global institutional arrangements for governing the global economy: a global financial regulatory authority; a global competition authority

42. The Financial Stability Forum was created in the aftermath of the financial crisis of 1997-1998 in order to promote international financial stability, improve the functioning of financial markets, reduce the tendency for financial shocks to propagate from country to country and enhance the institutional framework to support global financial stability. It is now apparent that the reforms proposed, by the Forum, although important, have not been sufficient to avoid major global financial instability. If it is to become the main instrument for the formulation of reforms of the global financial system, the Forum must take into consideration the importance of financial stability for the development of the real economy. In addition, it must increase the representation of developing countries in order to adequately reflect their views and the conditions in these countries and be made accountable to a democratically representative institution, for example the global economic coordination council proposed above.

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

VII. Support for financial innovations to enhance risk mitigation

44. The international community must further improve its strategies for preventing crises and coping with external shocks. In the absence of global systems of risk-bearing and the absence of, and in some cases resistance to, innovations that would facilitate efficient risk-bearing, there is a need to push ahead with the development of new instruments to provide better protection for developing countries from the ever-increasing volatility of markets (commodities, foreign exchange, food, etc.). Examples include local currency lending instruments, risk-mitigating facilities and GDP-indexed and commodity-indexed bonds. Credit facilities with flexible debt service are another option to be explored more proactively.

45. Regional development banks and other official institutions should be encouraged to play an active role in the promotion of such financial products. International financial institutions need to explore meaningful innovations that would enhance risk management and distribution, and how to encourage markets to

do a better job. In particular, while there has been some expansion in capital markets in domestic currencies in developing countries, developing countries still bear the brunt of fluctuations in exchange and interest rates. Lending by international and regional financial institutions in local currencies, baskets of local currencies or in regional units of account, as well as the provision of exchange and interest rate covers might be important steps in improving international risk markets.

46. Improved mechanisms and new international institutions to mitigate the risk of international investment could also have a positive impact on global demand if they allow countries to maintain the same level of protection against global financial instability with lower levels of international reserve balances.

VIII. Mechanisms for handling sovereign debt restructuring and cross-border investment disputes

47. Several developing countries are already facing debt sustainability problems. It is important to ensure that counter-cyclical recovery measures introduced in developing countries do not generate unsustainable debt dynamics. In those countries where the crisis is seriously threatening debt sustainability, consideration could be given to debt moratoriums and, where appropriate, partial debt cancellation. In addition, low-income countries, in particular, need more access to highly concessional funds if they are to meet their essential spending needs without getting back into debt. Multilateral development banks and other bilateral donors should make every effort to make repayment flexible in response to exogenous shocks.

48. There is, therefore, an urgent need to develop an equitable and generally acceptable sovereign debt restructuring mechanism. The mechanism should ensure that restructuring is sufficiently deep in order to give countries a fresh start. All debtors and creditors, should be treated on an equitable basis, including implicit creditors such as social security claimants. This mechanism should be complemented by an improved framework for handling cross-border bankruptcies. One way by which this might be done is through the creation of an independent structure, such as an international bankruptcy court.

49. The current crisis has already seen a number of bankruptcies of companies that operate across national borders, and this number is likely to increase. The absence of a formal mechanism for dealing with the impact of cross-border bankruptcy and insolvency, especially when related to financial institutions, transmits adverse economic effects to the global economy.

50. It is therefore especially important to achieve a uniform approach to financial and investment disputes on bankruptcy and insolvency. One way of achieving this may be through the international bankruptcy court discussed above.

51. Management of external financial flows and external debt are integrally related and of crucial importance to the successful implementation of a national development strategy that is sustainable and resistant to global crisis. International development institutions should ensure that developing countries have sufficient technical advice and management expertise available to build domestic competence in dealing with such issues.

IX. Completion of a truly development-oriented trade round

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

X. More stable and sustainable development finance

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

54. The international community needs to explore a variety of mechanisms of innovative finance, including regular emissions of new global reserves (such as special drawing rights), revenues generated from the auction of global natural resources (such as ocean fishing rights and pollution emission permits), and international taxes (such as a carbon tax, which would simultaneously help address problems of global warming, or a financial services tax, which would simultaneously help stabilize international financial markets). The receipts could be directed in part to defray the cost to developing countries of reducing greenhouse gas emissions in the context of their national policies to promote sustainable development.

55. The effective implementation of national systems of taxation form a crucial part of domestic development finance. Measures must be taken to preserve national autonomy in the selection of the sources and methods of government financing while ensuring that national differences do not create incentives to evade the responsibility of contributors to the support of government policies. An efficient method of achieving this result would be to make the exchange of information automatic.