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DO GLOBAL STANDARDS AND CODES PREVENT FINANCIAL CRISES? SOME PROPOSALS ON MODIFYING THE STANDARDS-BASED APPROACH

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Benu Schneider*

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Benu Schneider

Financing for Development Office, Department of Economic and Social Affairs
United Nations

> And I have become convinced that it is in the interests of stability – and of preventing crises in developing countries and emerging market economies – that we seek a new rule-based system: a reformed system of economic government under which each country, rich and poor, adopts agreed codes and standards for fiscal and monetary policy and for corporate governance. … over time – the implementation of codes and standards should be a condition of IMF and World Bank support …[1]

Abstract

After the crises in emerging market economies beginning with that of Mexico in the mid-1990s, the adoption of internationally recognized standards and codes (S&C) of financial best practices came to be seen as a way to strengthen the international financial system. The S&C initiative was launched as such in 1999 but included within its scope work on standards for the different subjects included which had often already been under way for some time. This paper evaluates the progress made so far and considers some of the basic assumptions of the S&C initiative. In particular it examines how far S&C can be instrumental in preventing financial crises, and focuses on issues raised by the initiative from a developing-country perspective. It devotes special attention to both the process of surveillance of S&C by the Bretton Woods institutions (BWI) and to the information which this process generates. In this context it appraises the use of this information by the private sector whose increased engagement with emerging markets is a major part of the rationale of the exercise.

[1] Gordon Brown, Chancellor of the Exchequer, United Kingdom, in his speech at the Federal Reserve Board, New York on 16 November 2001.

I. INTRODUCTION AND POLICY CONCLUSIONS

The standards and codes (S&C) initiative has its genesis in its present form in the East Asian financial crisis in the late 1990s and the subsequent problems in Latin America and Russia.[2] "Standards and codes play a central role in the new international financial architecture being developed to promote greater financial stability following crises in Asia and elsewhere. The emphasis in Standards and Codes reflects a view that vulnerabilities are reduced if transparency in the institutional and regulatory structures of the economic and financial sectors, and in the information these sectors provide to the public, reflects the good practices that many countries follow."[3]

Five years have elapsed since the initiative was launched. This paper evaluates the progress made so far[4] and considers some of the basic assumptions and rationale of the S&C initiative and examines how far this initiative can be instrumental in preventing a financial crisis. It considers some issues that arise while analyzing the initiative from a developing country perspective and further explores those related to surveillance mechanism and the information generation system set up at the Bretton Wood Institutions (BWI). In addition, it appraises the response of the private sector whose increased engagement with emerging markets is the basis for this exercise. The main points of debate are:

1) ***A global initiative?*** Although the initiative on S&C was taken in response to the financial crises of the 1990s in developing countries, difficulties with compliance and implementation also exist in the industrialized countries as recent events in the United States and other industrialized capital markets have illustrated. Despite this the incentive structure for implementing standards and codes – other than those dealing with money laundering and terrorist financing – applies primarily to developing and transition countries that borrow from the private financial markets or from bilateral or multilateral official sources.

   The standards and codes exercise is not the result of a participatory process jointly owned by all countries; rather, it is designed mainly by the Group of 7 (G7) and other industrialized countries.[5] This is why developing countries need a greater voice at the FSF. Issues as appropriateness and ownership, as well as the resources for implementation are a major concern.

2) ***Re-defining the objective function.*** The objective of the standards and codes exercise is global financial stability. But the present prioritization of countries and codes for monitoring compliance by the BWI indicate that global financial stability was not the main objective in

[2] Standards are not new. The international standard-setting bodies have existed for a long time, but each was developing common codes and rules in isolation. There are various international and national organizations which, over the years, have made significant contribution to raising standards of soundness and risk-awareness in financial systems. Some examples are the *Principles for the Supervision of Banks' Foreign Establishments* agreed to by the Basel Committee on Banking Supervision (BCBS) in 1983, and the *Framework for International Convergence of Capital Measurement and Capital Standards*, published in 1988. Work on some standards, such as those for data dissemination and fiscal transparency, existed prior to the outbreak of the East Asian crisis. The Special Data Dissemination Standard (SDDS), for example, was developed by the IMF in response to the deficiencies in major categories of economic data following the Mexican crisis in December 1994. The OECD countries adhere to standards defined by the OECD Codes of Liberalisation, and they have been subject to self-assessments with a peer review process. Other countries adhere to standards defined by their own national bodies and also international bodies. So, what is really new is the setting of an international forum for defining and redefining them, so that all countries in the world adhere to a global set of standards and rules.
[3] IMF Outreach on Standards and Codes, *IMF Survey*, 29(15), 30 July 2000.
[4] The analysis in this paper is based on published and publicly available information.
[5] See Annex 1 for Countries' participation in Standard Setting Bodies and Annex 2 for Membership of Financial Stability Forum Working Groups.

choosing either the countries or codes. A better objective may be to utilize the standards to benchmark financial sector reforms while acknowledging that in the long-run financial sector reforms are likely to make an important contribution to global financial stability. The shift in emphasis on the rationale for this initiative will also result in a re-prioritization of resources and efforts in the standards and codes exercise.

3) ***The role of the IMF in the monitoring mechanism: Is there an alternative?*** The shortcomings of the present monitoring mechanism through reports on the observance of Standards and Codes by the BWI suggest that there maybe other alternatives to manage it. Self-assessments by countries, backed by a peer review process, offer the potential for independence, ownership and rigor. It is a better way of dealing with ground realities and the appropriateness of standards. It also offers a constructive channel for feedback from countries across the world into the work at the Financial Stability Forum (FSF) to define codes that are flexible enough to cope with a dynamic and heterogeneous world.

4) ***The role of the IMF in the information generation process and the quality of information.*** A lot of emphasis was given to the provision of information to the private sector to enable them to make better assessment of risk and emerging vulnerabilities. Is it the role of the IMF to provide information to the private sector? It is assumed that more information will lead to better judgments and act as a tool of crisis prevention. Some, while accepting transparency is good, question if too much transparency may be bad by leading to a crisis or contagion.

   There is also a tension between the information demanded by the market in a simplified quantitative format, and a time-consuming complex process of implementing the codes whose progress cannot be quantified in any reasonable form. In the face of the evidence of the limited use of this information by the private sector, is the exercise worthwhile?

5) ***Private sector response***. The private sector response to the standards and codes exercise is a muted one. The origins of the exercise lay in the view that it was lack of transparency that led to misinformed judgments about economies that resulted in herding behaviour and contagion. The subdued response weakens the market incentive as an incentive to comply with the codes.

The paper is organized as follows: the second section presents the background for the present discussion; the third analyses the incentive structure for implementing the standards and codes exercise. It critically evaluates the sources and quality of information on compliance with the standards and examines the degree of compliance; the fourth critically evaluates the role of the BWI in the standards and codes exercise and analyses the private sector response. In section five developing country issues are examined with respect to ownership, appropriateness, resource needs, the need for transition and the political economy of implementation and its role in determining the degree of compliance; and the last section concludes and makes some policy suggestions for giving a new rigor and orientation to the standards and codes exercise which is better suited to the aspirations of developing countries.

II. BACKGROUND

In the aftermath of the East Asian crisis the international community has been engaged in reforming the international financial architecture to deal with some of the dangers inherent in globalization. The dynamic growth in capital markets following the liberalization of financial markets in many countries occurred without taking fully into account domestic, economic and financial weaknesses, and regulatory and supervisory frameworks. A vital lesson that has been learnt is that the health of both internal and external balance sheets is important in all sectors of the economy, be it the central bank, the government or the private sector. Another important lesson concerns the role of information in the smooth functioning of international financial markets, a lack of which often leads to contagion and herding by international investors.

The crisis highlighted that capital account liberalization in emerging markets was not without risks and in many cases has the potential for bringing about severely destabilizing effects not only in the countries of origin but also within the region and in other parts of the world. The limited attention given to policies towards capital movements in recent years as such is quite surprising. The crisis, in addition, revealed the lack of transparency on the part of international institutional investors and the inability of the international financial architecture to prevent and manage financial crises. The post-crisis international emphasis has been on strengthening players through stronger risk management, more prudent standards and improved transparency. The establishment of the Financial Stability Forum (FSF) in February 1999 by the G7 finance ministers and Central Bank governors[6] was a new initiative in direct response to the East Asian crisis, and it reflects the importance given to globally coordinated financial and regulatory aspects of domestic policy and the need to rethink those regulations grouped together under the heading of S&C. This is the first attempt to develop a single set of international rules and principles for crucial areas of domestic policy in the financial and monetary spheres.

Five years on there is also a surveillance machinery to assess compliance. The key instrument is the Report on the Observance of Standards and Codes (ROSC), prepared by the IMF as a part of Article IV consultations, or through joint missions with the World Bank on Financial Sector Assessment Programmes (FSAP). At the time of writing, there are ROSCs for 99 countries. There is also some self-assessment in the public domain, and some private sector activity.

Identifying standards is a complex task. Moreover, the dynamic nature of financial markets and their increasing sophistication mean that these standards will have to be flexible enough to incorporate processes of change. The FSF has identified seventy standards; and a set of standards (see Table 1) in the three areas of macro policy and data transparency, institutional market infrastructure, and financial regulation and supervision, have been endorsed by the G7 countries and the multilateral institutions as being necessary to ensure for financial stability.

In practice, the classification of the standards and codes into these three categories is not very distinct. For example, macroeconomic policy can have a crucial effect on financial stability through its impact on the values of financial firms' assets and liabilities as well as on the functioning of the payments and settlement system (which is at the heart of the infrastructure of financial markets). Effective financial regulation and supervision are related inextricably to accounting, auditing and insolvency procedures.

[6] Its membership consists of representatives of the national authorities responsible for financial stability in selected OECD countries, Hong Kong (China) and Singapore, and of major international financial institutions, international supervisory and regulatory bodies and central bank expert groupings.

Table 1
Key standards for financial systems

Subject Area	*Key Standard*	*Issuing Body*
Macroeconomic policy and data transparency		
Monetary and financial policy transparency	Code of Good Practices on Transparency in Monetary and Financial policies	IMF
Fiscal policy transparency	Code of Good Practices in Fiscal Transparency	IMF
Data dissemination	Special Data Dissemination Standard (SDDS) / General Data Dissemination System (GDDS)	IMF
Institutional and market infrastructure		
Insolvency	Principles and Guidelines on Effective Insolvency and Creditor Rights System	World Bank
Corporate Governance	Principles of Corporate Governance	OECD
Accounting	International Accounting Standards (IAS)	International Accounting Standards Board (IASB)
Auditing	International Standards on Auditing (ISA)	International Federation of Accountants (IFAC)
Payment and settlement	Core Principles for Systematically Important Payment Systems Recommendations for Securities Settlements Systems	Committee on Payment and Settlement Systems (CPSS) CPPS and International Organization of Securities Commissions (IOSCO)
Money Laundering	The Forty Recommendations/ 8 Special Recommendations Against Terrorist Financing	Financial Action Task Force (FATF)
Financial regulation and supervision		
Banking Supervision	Core Principles for Effective Banking Supervision	Basel Committee on Banking Supervision (BCBS)
Securities Regulation	Objectives and Principles of Securities Regulation	International Organization of Securities Commissions (IOSCO)
Insurance Supervision	Insurance Core Principles	International Association of Insurance (IAIS)

Source: Financial Stability Forum.

Insurance products are frequently incorporated into, or sold in close conjunction with, investment products thus increasing the channels through which disturbances affecting the market for one financial service can be transmitted between markets. And even such an apparently self-contained issue as money laundering has on occasion threatened the stability of financial firms (UNCTAD 2001). Still, the codes provide a body of "best practice" pooled from different international standard-setting bodies and regulatory frameworks related to the legal, regulatory and institutional framework for any financial system. Many of them are intended to serve as guidelines, but some, such as the standard on data dissemination, can be detailed and precise.

The implementation of Standards and Codes was announced to be voluntary and the implementation was to be different across countries and firms.[7] In order to discuss implementation of international best practices relating to the legal, regulatory and institutional framework underpinning a financial system, a global overview of the present situation with regard to compliance would be desirable, but this is not readily available. In order to understand the motivation by countries to adopt (or not adopt) the Standards and Codes initiative, it is needed to clarify the incentive structures existing for each player of the game. The next section offers a critical point of view on these issues.

[7] In practice, conditions for implementation of some of the codes are gradually creeping into Fund programmes.

III. INCENTIVES FOR IMPLEMENTATION, SOURCES OF INFORMATION AND THE DEGREE OF COMPLIANCE

A. The incentive structure of the Standards and Codes initiative

The FSF Task Force on the Implementation of Standards, established in September 1999, identified a blend of market and official incentives to encourage the implementation of standards and codes; the FSF follow-up group examined these in September 2000. Compliance thus rests either on countries being convinced of the usefulness of such standards and voluntary cooperation, or through pressures from the markets for their observance.

Compliance can therefore be based in principle either on positive incentives or negative ones (compulsions). Here we catalogue market[8] and official[9] incentives, laying emphasis on the former. If the market does not assimilate the information generated by a publicly-led approach to ensure the financial stability that enables market incentives to work, will some of the negative official incentives mentioned here (but for the most part not recommended) become the norm to be imposed by international organizations and by individual countries, or some groups of countries?

The first item in the incentive list (see Box 1) from the official sector – making IMF funds contingent on compliance – is among the actions already taken[10]. Section 5 discusses some of the evidence on standards and codes becoming a condition in Fund programs. Banking supervision in the home country is already a condition in several countries for market access to foreign financial firms.

The disadvantage of this line of approach is that, despite implementation of S&C being a global issue, the pressures for implementation become restricted to countries that seek funds from the IMF. Negative incentives may therefore have the undesirable consequence that issues of financial stability may be lost because such incentives work in the case of only a few countries (those that seek IMF funding). Implementation of codes is of interest to a country only if it intends to borrow from the private financial market or from bilateral or multilateral official sources (see Box 2).

The official incentives are not valid for the G7/G10 countries as they no longer borrow from multilateral institutions. The market incentive also works asymmetrically in the case of industrialized and emerging market economies (EMEs). Although industrialized countries do borrow from private capital markets, these markets do not necessarily take the degree of their adherence to international standards into account. For example, Germany only published its report on Fiscal Transparency (and most other codes) during late 2003, but this does not have a serious effect on its credit rating and ability to borrow, as would be the case in an emerging market's economy.

Furthermore, the incentive for industrialized countries to comply with many standards may not be very strong because, unlike emerging market economies, it is possible for them to borrow capital in their own currency. Hausmann and Panizza (2002) refer to this as the "original sin". Developing countries are faced with the exchange-risk impact on their balance sheets because they almost always borrow in

[8] The key requirements for these to be effective would be (i) market familiarity with international standards; (ii) their assessment of its relevance for assessments of market risk; (iii) market access to information on compliance and the degree of compliance; and (iv) use of information by the market in risk assessments.
[9] The period for assessing the effectiveness of market incentives is, admittedly, very short. Nevertheless, assessment of some codes in the literature points to the limited use of the market incentive. See, for example, Mosley (2001).
[10] For a further discussion on this issue see UNCTAD (2001).

Box 1
Incentives and compulsions to implement Standards and Codes

Positive incentives
- National interest
- Technical assistance
- Policy advice

Incentives that could be applied directly by IFIs
- Making the access to IMF funds contingent on compliance in standards and codes[1] including implementation of certain S&Cs in the conditions of an IMF adjustment programme.[2]
- Making implementation of S&Cs a condition for membership in international groupings.[3]
- Obligating countries that do not implement S&Cs to pay higher charges for the utilization of IMF funds is not under active consideration but remains one of the possible future steps.[4]

Incentives from the "market side"
- Disseminating information on compliance.
- Encouraging private institutions to be concerned about compliance, and including this information in their risk assessment.[5]
- Restricting market access either for selected foreign institutions to the domestic market or for domestic institutions to selected foreign markets.[6]

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[1] Access to the CCL (contingency-credit lines) is subject to the adherence of, at least: (i) subscription to and use of the IMF's Special Data Dissemination Standards, which guide countries making economic and financial data available to the public; (ii) compliance with the Basel Core Principles for Banking Supervision; (iii) use of the IMF-designed code on fiscal transparency; and (iv) use of the IMF-designed code on transparency in monetary and financial policies. A more comprehensive analysis of adherence would be possible where a Report on Observance of Standards and Codes (ROSC) has been prepared. ROSCs include assessment of adherence to seven other sets of standards and codes, (IMF Executive Board Meeting, 17 November 2000).
[2] Conditionality in the Fund-Supported Programmes-Policy Issues (IMF 2001b).
[3] FSF 2000.
[4] Ibid.
[5] "The Group believes that, in addition to the continued encouragement to governments and congresses, implementation of standards could be promoted effectively by leveraging the private sector within EMEs, especially borrowers and recipients of foreign investment" (FSF 2000).
[6] "(i) A host jurisdiction in deciding whether, and if so under what conditions, it will allow a foreign institution to operate in its markets, could take into account the degree to which that institution's home jurisdiction observes relevant standards. (ii) Where regulatory approval is required, a home jurisdiction could place restrictions on its domestic financial institutions' operations in foreign jurisdictions with material gaps in observance of relevant standards" (FSF 2000).

Box 2
Why identified incentive structures may not work in the case of industrialized countries

Positive incentives
- Self-interest is muted because the recent crises have been domestic financial crises combined with external payments only in developing and transition economies.
- There is reduced exchange risk compared with developing countries, as it is possible for them to borrow in their own currencies.
- They do not need technical assistance as an incentive.

Official incentives
- Inapplicable as the industrialized countries no longer borrow from multilateral institutions.

Market incentives
- There is asymmetry in the way the market assesses the same information for industrialized, emerging markets and developing countries. For example, when one of the G7 countries did not comply with fiscal transparency it did not affect its credit rating seriously or its ability to borrow from private markets.
- Thus the idea that the market can punish for non-compliance through higher costs or the drying-up of funds may not be valid for the industrial countries.

a foreign currency; industrialized countries can avoid this risk, and there is therefore less incentive for them to implement standards.

This is presumably because domestic financial crises have been combined with external payments crises only in developing and transition economies. Another approach, adopted with some success both by the OECD's Financial Action Task Force (FATF) with regard to countries that do not combat money laundering actively enough, and by the OECD in dealing with tax havens (Speyer 2001), is "name and shame". Key sanctions under "naming and shaming" are advisories that raise transaction costs in dealings between non-cooperating and cooperating countries.[11]

Research on the relationship between the implementation of standards and the development of the macro economy, and of financial stability, is scant. A better case for "ownership" can be made if countries can be persuaded that implementation of standards and codes is in their national interest in order to maintain domestic financial stability and hedge against external shocks. A crisis is a costly affair, and it is in a country's interest to avoid it. Moreover, a strong, healthy, financial sector is essential for the efficient allocation of resources and improved growth performance. Thus, self-interest is the best incentive.

An unsolved issue when considering the incentive structure for developing countries is if the market does not assimilate information, as recent outreach activities and research shows, will negative official incentives be put to use? This question will be taken up in more detail in the developing country issues section of this paper.

B. The sources of information and evidence on the degree of compliance

Once the incentives to comply with the standards are internalized, the next step is to analyze whether the corresponding convergence is brought about as expected. But assessing the degree of compliance is a difficult task. The exercise is presently underway as a part of IMF Article IV consultations and FSAPs. Information is also available on different aspects covered by the codes in the public domain such as Central Banks reports. This information is then made available by the following sources: the Reports on the Observance of Standards and Codes (ROSCs) prepared by the IMF, countries' own self-assessments, and the information provided by a specific private sector initiative, the E-Standards Forum.[12]

1. Assessing ROSCs

The preparation of ROSCs started in the 1999 assessments, and publication is voluntary. Some of the ROSCs are part of the FSAP, run jointly by the IMF and the World Bank. ROSCs were, as of 8 March 2005, available for 99 countries. Major players, as some G7 countries, have only published their first ROSCs very late in 2003 (Germany's first ROSC appeared in September 2003 while the United States' first and only one in August 2003); there are many OECD countries have not published any ROSC at all. In addition, there are several problems regarding the quality of ROSCs:

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[11] See Box 4.

[12] Other private sources include Credit Lyonnais, the assessment of corporate governance standard of Standard and Poor's and the opacity index of Price Waterhouse Coopers. This paper analyzes ROSCs which are available in the public domain and the information produced by the E-Standards Forum.

- Their turgid language;
- They are dated;
- There is no continuous stream of information;
- They are not standardized;
- There is no public schedule of announcement of country coverage and coverage of codes;
- There are problems in priority setting, in sequencing and follow-up action. For instance, there is very little link between the First Initiative that was set up to provide technical assistance and the recommendations on follow up actions in FSAPs;
- Very limited information is gained.

What is important to say is that if the goal is indeed international financial stability, then the IMF should be focusing on key players in financial markets.[13] The distribution of published ROSCs by regions in Table 2 indicates the priority which the surveillance mechanism has given to regions and codes. For the macroeconomic policy and data transparency code covered by the first three codes in the table, published ROSCs are the highest for transition economies, followed by advanced economies and Africa. Banking supervision, which has been identified as a vital area which requires strengthening as countries open up their capital accounts, has a higher number of ROSCs for Africa, transition economies and advanced economies. Western Hemisphere and Asia, regions in which financial vulnerability was a major problem in the late 1990s, have been given lesser importance. Fiscal Transparency ROSCs for Russia, another country afflicted by financial problems, was published as late as September 2004.

This choice of regions and codes does not reflect the background in which the exercise was motivated – particularly the vulnerabilities in East Asian and Latin America. In one case, Argentina, which had the maximum number of ROSCs, the information did not get reflected in the assessments about the country before the crisis. The distribution of ROSCs by codes indicates that fiscal transparency has been given the highest priority, followed by banking supervision, data dissemination and monetary transparency. There is not a single ROSC for Corporate and Accounting scandals for the advanced countries which should have been given priority following the corporate accounting standards in ENRON, WorldCom and others.

Chart 1 shows available ROSCs classified into key players in financial markets and non-key players in financial markets for each of the 12 codes. There have been more ROSCs conducted for non-key players in financial markets than for key players. The figures inside the bars indicate the proportion of key players that has a ROSC for a particular code to total key players in the market, and the proportion of non-key players that have a ROSC for a given code to total non-key players. The main finding is that there is not enough information on all of the key players in international financial markets.[14] And these are precisely the G10 countries and top emerging markets, who are expected to affect global financial stability. In addition, there is no ROSC for any of the industrialized countries regarding corporate governance and accounting and auditing. Figures in the chart for corporate governance are only for emerging market economies.

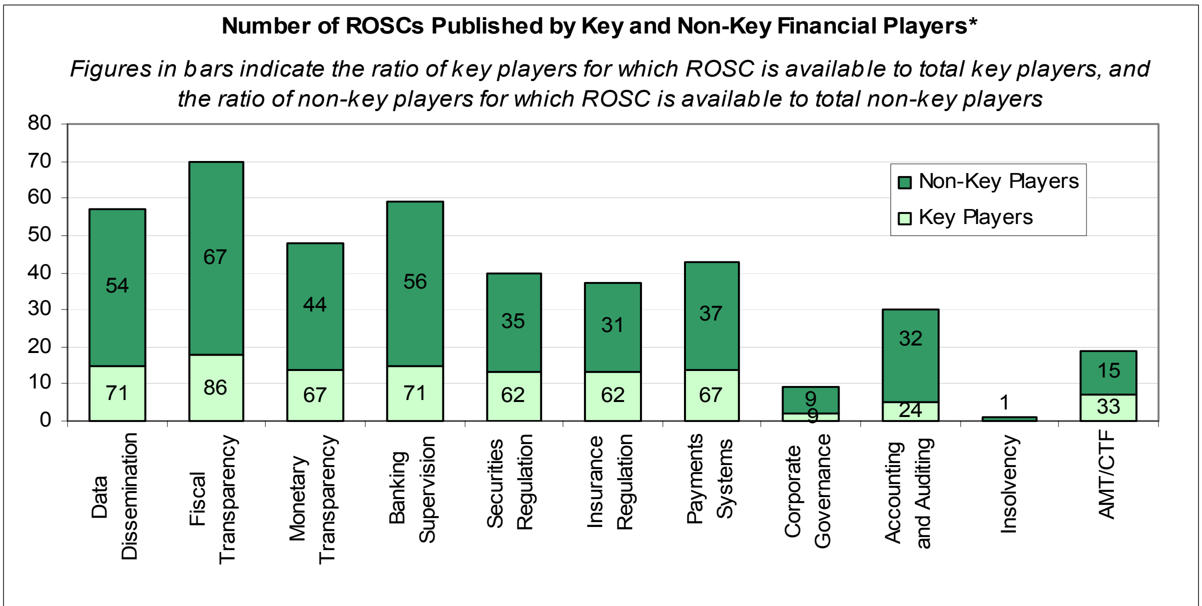
[13] The Fund may argue that the S&C exercise is a voluntary process. In practice, however, the Fund has enough room for manoeuvre through Article IV consultations and through its programs with borrowing countries.
[14] ROSCs for majority of the OECD countries have been published only very recently. There are no ROSCs available for Denmark.

Table 2
Distribution of ROSCS published by region and category*
(As of 8 March 2005)

	Region						
ROSCs published	*Africa*	*Asia*	*Western Hemisphere*	*Middle East*	*Transition***	*Advanced*	***Total***
Data Dissemination	17	7	8	2	26	12	**72**
Fiscal Transparency	17	14	10	1	38	23	**103**
Monetary Transparency	11	5	5	1	23	19	**64**
Banking Supervision	14	5	7	2	28	19	**75**
Securities Regulation	7	3	3	1	19	17	**50**
Insurance Regulation	6	3	2	0	19	13	**43**
Payments Systems	6	3	3	1	20	16	**49**
Corporate Governance	1	2	1	0	4	1	**9**
Accounting and Auditing	5	4	5	2	14	0	**30**
Insolvency	0	0	0	0	1	0	**1**
AML/CFT	3	2	1	1	5	7	**19**
Total	**87**	**48**	**45**	**11**	**197**	**127**	**515**

Source: Author's calculations based on information on the IMF website.
Note: There is more than one ROSC for some standards in some countries.
NB: Japan included in *Advanced* countries; Hong Kong (China), Taiwan Province of China, Mongolia and the Republic of Korea classified under Asia.
* Country classification according to World Economic Outlook, IMF.
** Includes Central-Eastern Europe and Independent Countries.

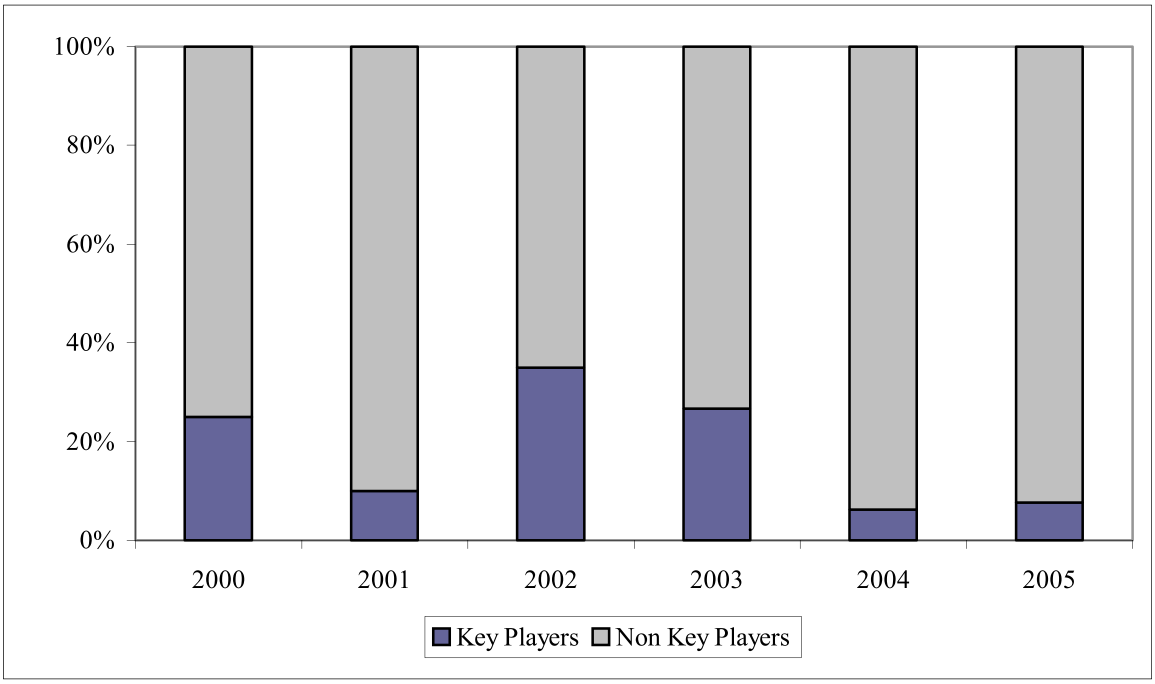
Chart 1



* 21 Key players: G-10 (Canada, France, Germany, Italy, Japan, Sweden, Switzerland, United Kingdom, United States) and major EMEs (Argentina, Brazil, Hong Kong (China), India, Republic of Korea, Mexico, Philippines, Poland, Russia, Singapore, South Africa, Turkey); 78 non-key players, for a total of 99 countries. Information as of March 2005.

Chart 2

FSAP published per fiscal year: country groups



A similar analysis can be done with respect to FSAPs. According to a recent evaluation by the IMF's independent evaluation office,[15] only 18 reports have been undertaken per fiscal year – counting those ongoing and planned for 2004 and 2005. Key players have not represented a great deal of the FSAPs undertaken (Chart 2) – around 20 per cent in average, while G10 countries' participation is even worse with only about 10 per cent.[16]

If global financial stability is the objective function of the standards and codes exercise, then prioritization of the countries should ideally be on the basis of openness of the economies, Further data analysis is carried out and presented to provide the evidence on prioritization of countries and whether it was in line with the degree of capital account liberalization.

Three approaches were adopted to gauge the degree of openness of an economy for this analysis. The first criteria are based on Summary Tables from the Fund's 1996–2004 Annual Reports on Exchange Arrangements and Exchange Restrictions.[17] The second looks at the actual financial account[18] to GDP as an indicator of openness and the third, the ratio of foreign assets and liabilities to GDP which is an approximate guide to the degree of financial integration.

Chart 3 shows the number of ROSCs published for countries which have no restrictions on their capital account based on the information in the IMF's Annual Exchange Rate Arrangements. The figures inside the bars show that for 62 percent of the countries with fully open capital accounts, no

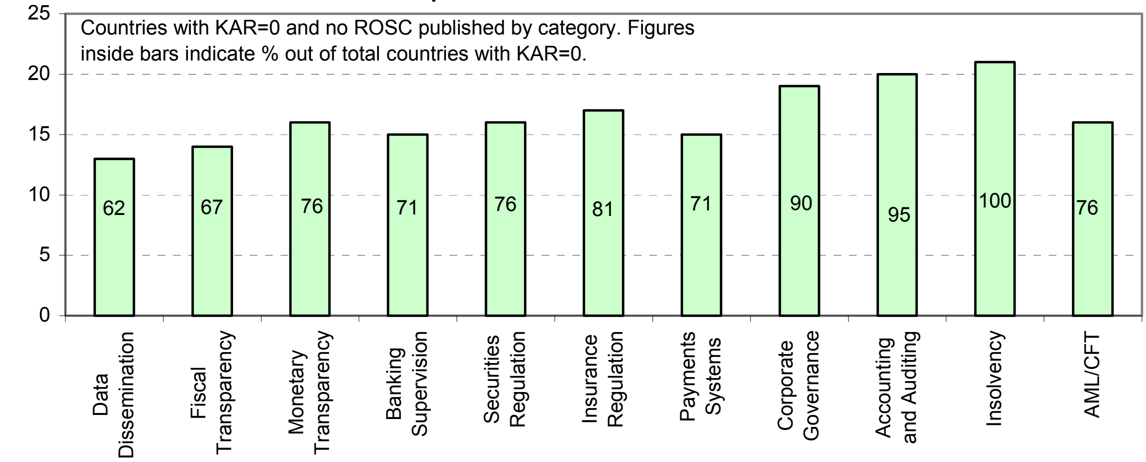
[15] Independent Evaluation Office. "Evaluation of the Financial Sector Assessment Program". Draft. Issues Paper, 25 August 2004. We refer to table published as Annex I, p. 18.
[16] See Annex 3 for a list of published FSAP reports classified by the G10, major emerging markets and non-key players in financial markets available in August 2004.
[17] A summary table on capital account restrictions from this source was kindly provided by Gian Maria Milesi-Ferretti, IMF.
[18] Since 1995 the presentation of the capital account data at the fund has changed. Two categories are reported now, financial account and capital account, the former reporting financial assets and the latter non-financial assets.

data dissemination ROSC is available. The percentages of countries with no ROSCs and fully open capital accounts are very high for all the other key standards.

A similar analysis is carried out to establish the prioritization of countries by the Fund and the Bank for FSAPs conducted. In Chart 4, 81 per cent of countries with zero restrictions had no FSAPs. The percentage remains high even when we go to progressively more restrictive capital accounts.

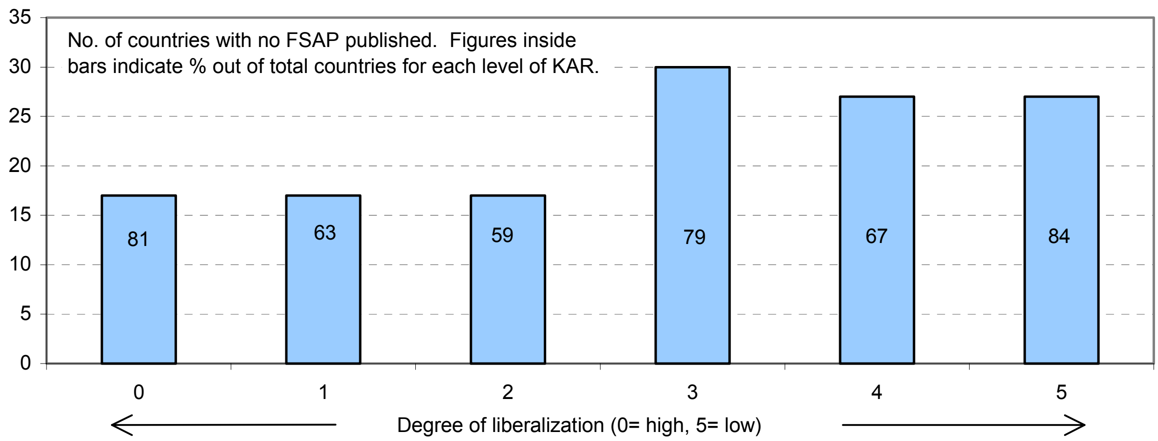
Further, Charts 5 and 6 show the non-availability of ROSCs for the top 50 net capital exporters and importers from the IMF membership. The financial account is averaged over the period 1999–2003 and the charts explore the link between high capital flows and the availability of ROSCs for key standards. The paucity in information for countries classified by the top 50 in terms of their financial account to GDP is very high for both net capital importers and net capital exporters. The picture does not change when looking at countries without ROSCs for the top 25 for the sum of assets and liabilities as a ratio to GDP in Chart 7.

Chart 3: Capital account liberalization and ROSCs

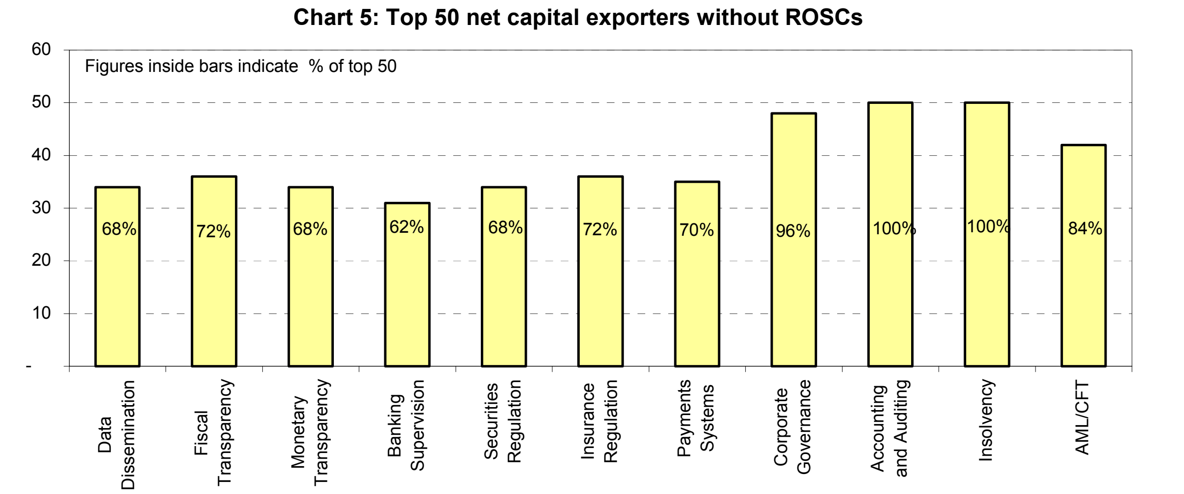


Source: Author's calculations based on the IMF website as of March 8, 2005. The variable KAR measures the degree of capital account liberalization and ranges from 0 (high) to 5 (low). Information was available for 187 countries.

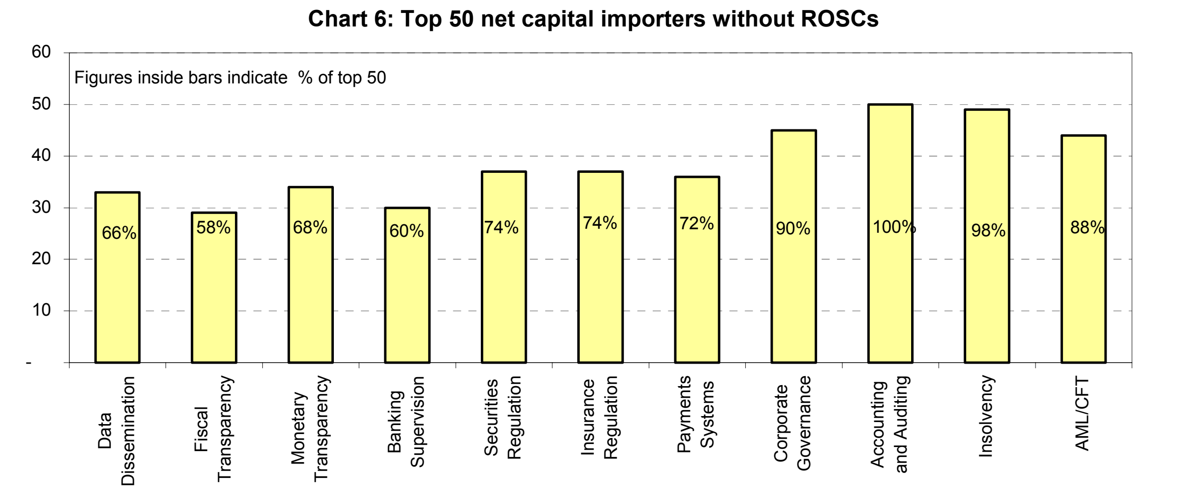
Chart 4: Capital Account Liberalization and FSAPs



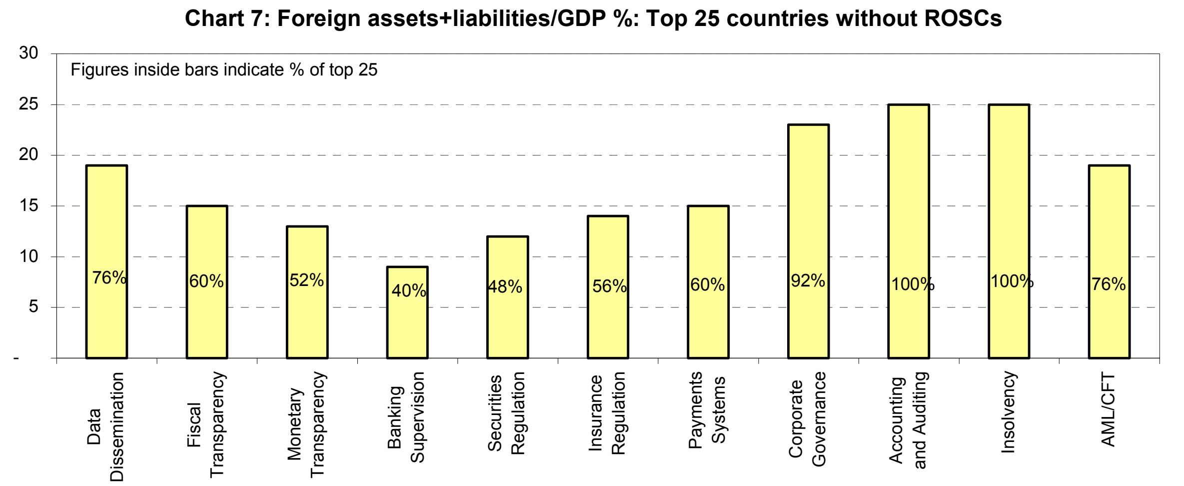
Source: Author's calculations based on IMF information as of 2004. KAR measures degree of capital account liberalization. Information was available for 187 countries.



Source: Author's calculations based on information on the IMF website as of March 8, 2005. Net capital exports correspond to a negative net financial account (average 1999-2003). Financial account information was available for 154 countries.



Source: Author's calculations based on information in the IMF website as of march 8, 2005. Net capital imports correspond to a positive net financial account (average 1999-2003). Financial account data was available for 154 countries.



Source: Author's calculations based on information on the IMF website as of March 8, 2005. Top 25 according to size of assets+liabilities (average 1999-2003). Information was available for 86 countries.

The data analysis is indicative of the lack of emphasis on the degree of capital account liberalization in prioritizing the codes. For further work at the Fund in this area, it is imperative to re-evaluate the purpose of which the ROSC exercise is being carried out and prioritize them according to the objective function. This analysis is pinpointing that global financial stability was probably not the key criteria in selecting countries for the assessment of the standards and codes.

2. The case of the eStandards Forum

Self-assessments are not collected systematically by any international organization, and information about them is sometimes difficult to obtain. Private initiatives, such as the *e*Standards Forum website (http://www.estandardsforum.com), collate and provide information on the implementation of S&C from public sources for a large number of countries in the form of scores for compliance ranging from full compliance to zero compliance. This is to cater to the needs of market participants who prefer information in a simple format that can easily be quantified or used in a classification system that can be incorporated in tick boxes. However, implementation of S&C is a process, and is not designed to meet fixed target deadlines for compliance, or to provide pass/fail tests. Such a process necessarily requires qualitative assessments.

Simplistic quantification and classification risk producing scoring systems capable of creating one-way expectations and bandwagon effects in the market. Moreover, the information can be quite mis-leading. This is illustrated with the information provided by the *e*Standards forum. Chart 8 and Table 3 show what a classification of compliance based on the information in the public domain on their website would bring about. In Chart 8, the scores indicate rankings of compliance. A score of 5 on the y-axis implies full compliance and 0 no compliance. The data on the X-axis is based on the IMF's International Financial Statistics and Balance of Payments Year Book publication and on-line service. The dots in the chart link the degree of compliance with the last date for which the information on that particular variable and country was publicly available from the IMF's data sources.

In the charts, the score on compliance should be higher for those countries publishing more updated or timely information. A cross checking[19] of key data available through the IMF's statistical publications (supposedly, the instrument to check for transparency) and scores of the "E-standards" type do not support the rationale underlying the Standards and Codes exercise.[20] Take fiscal transparency for example (Chart 8). Countries with the higher score are not necessarily those with the latest data while countries with lower scores may even have very updated information. The relationship is not clear. The same result is seen for other codes, and there are even groups of countries with totally different scores publishing data in exactly the same timeline (see Chart 8 for international investment position).

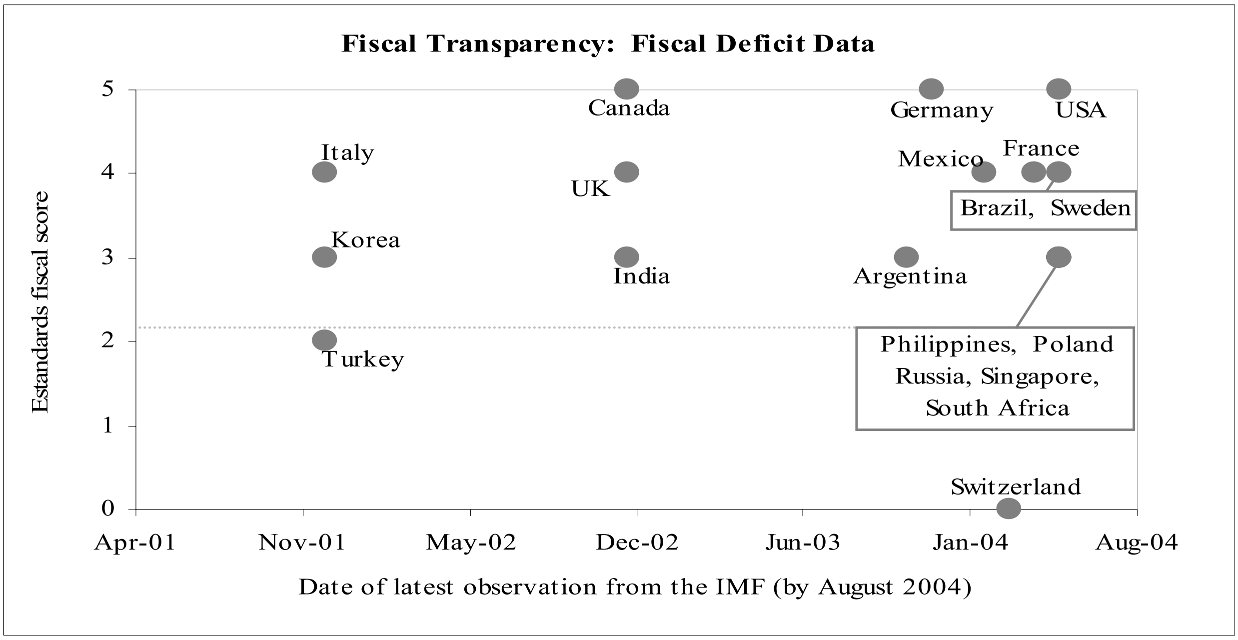
The message is then that a quantitative classification of countries risk ends up giving the wrong message to the markets (or is not giving a message at all, as seen in the charts presented); thus this kind of treatment given to the assessment of the S&C exercise needs to be revised. If market participants are left to make their own discretionary judgements on a country's level of compliance, there is a better chance of a more reasoned assessment.

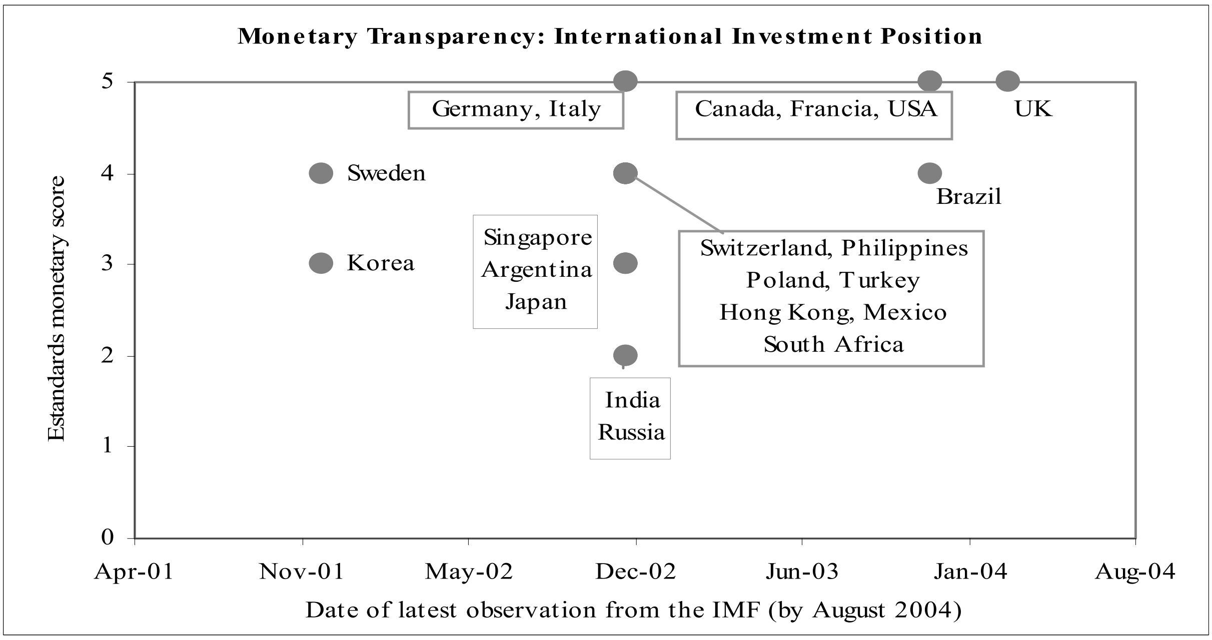
[19] We thank the *e*Standards forum for authorizing us to publish the results of the exercise undertaken using their copyrighted compliance information.

[20] See Annex 6 for a summary of compliance with 13 codes from the *e*Standards forum website.

It is generally assumed that OECD countries are largely compliant with the codes.[21] However, the information obtained from the cross-checking of ROSCs, self-assessments and the *e*StandardsForum clearly indicates that despite the fact that the impetus for an international set of codes came from the G7 countries, compliance with the twelve codes in this group is not complete, and there are varying degrees of compliance with the other standards. In the other OECD countries as well, compliance is weaker and deviations are numerous.

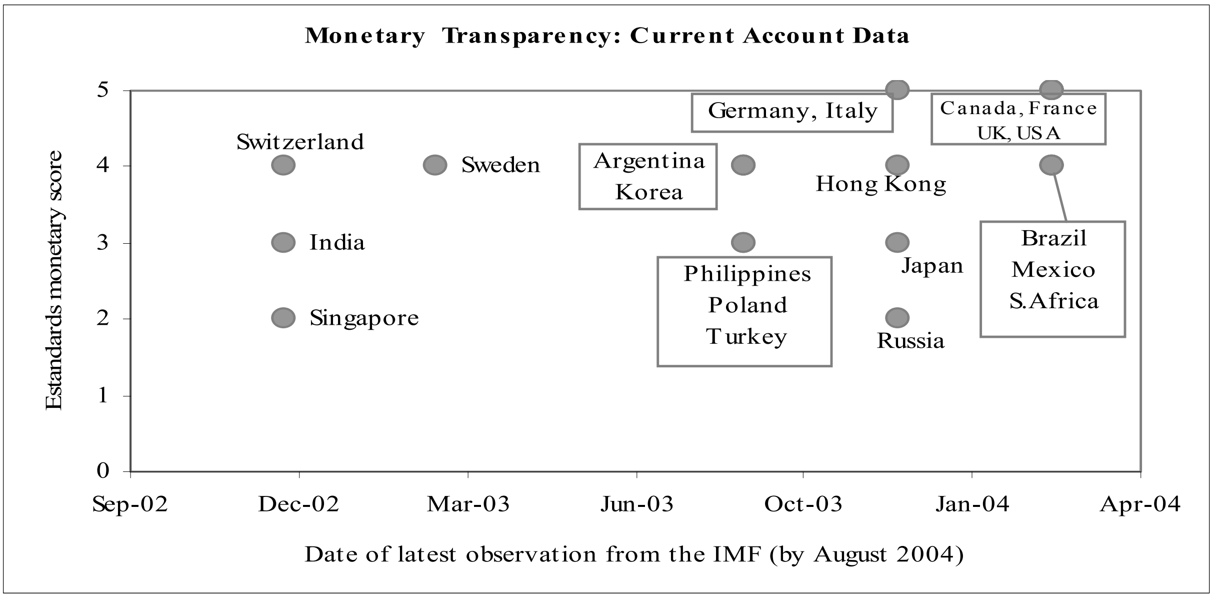
Chart 8

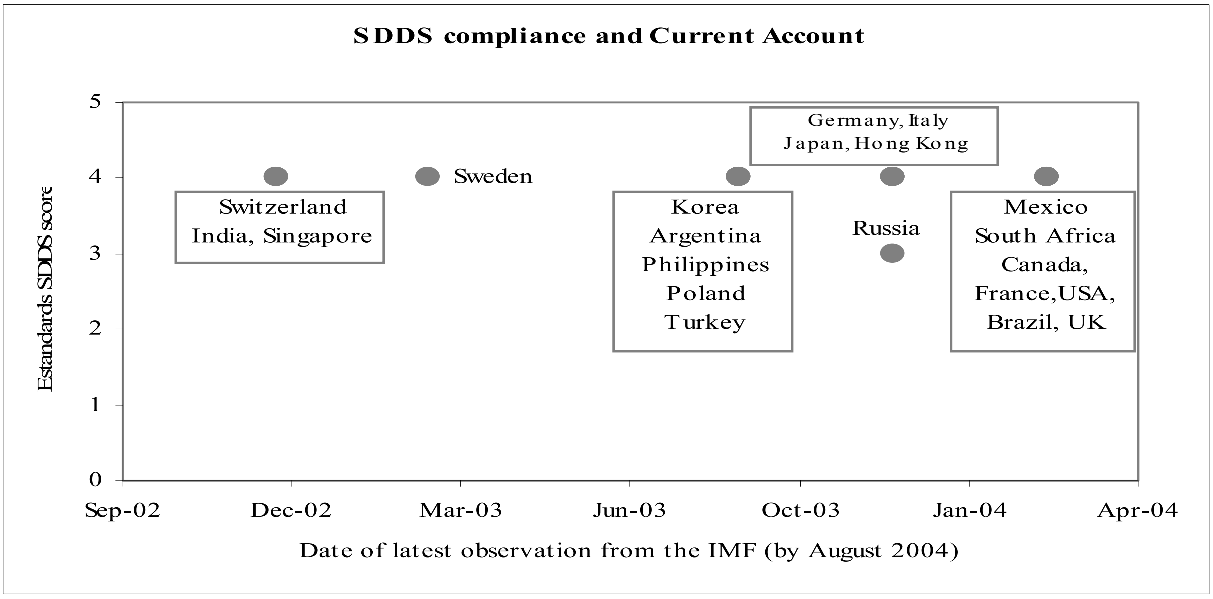


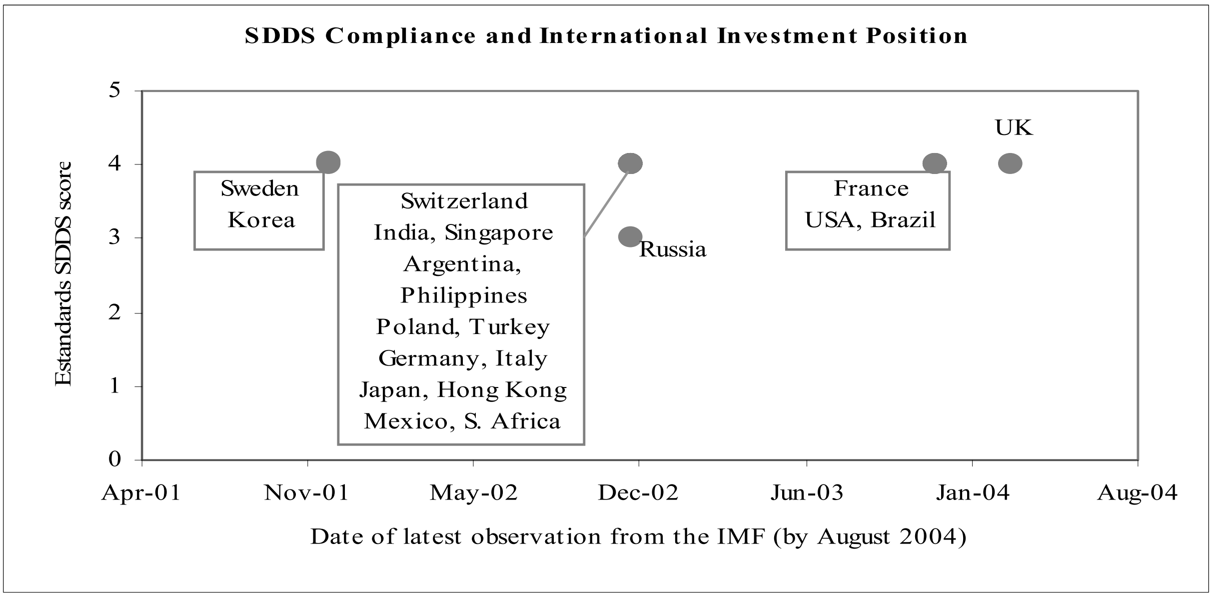


[21] For example, Acharya (2001:38) writes, "As a rule of thumb, most OECD countries are in compliance (or are close to compliance) with most standards, while many developing countries are at varying distances from compliance with regard to most standards."

Chart 8 (concluded)







The burden of transparency has actually been on emerging market economies. Although the East Asian crisis was the trigger in highlighting problems with transparency and central bank balance sheets, the banking system and the corporate sector, implementation of international financial codes is a global issue. The idea that the crisis is an emerging market problem and that these countries had done something terribly wrong is not borne out by evidence because the problem is widely prevalent.

Table 3
Ranking of key players in financial markets

Rank	*Country*	*Score with equal weights*[a]	*Country*	*Score with differential weights*[b]	*Country*	*Scores for full compliance and compliance in progress*[c]
1	United States	78.46	United States	84.00	United States	26.15
2	United Kingdom	76.92	United Kingdom	80.00	Canada	21.54
3	Germany	72.31	Canada	79.00	Germany	18.46
4	Canada	70.77	Germany	79.00	United Kingdom	16.92
5	Hong Kong (China)	69.23	France	75.00	Switzerland	15.38
6	France	67.69	Hong Kong (China)	75.00	France	13.85
7	Korea, Rep. of	64.62	Sweden	67.00	Hong Kong (China)	13.85
8	Singapore	64.62	Korea, Rep. of	66.00	Italy	9.23
9	Sweden	61.54	Mexico	65.00	Korea, Rep. of	9.23
10	Switzerland	60.00	Poland	65.00	Singapore	9.23
11	Mexico	60.00	Singapore	65.00	Sweden	7.69
12	Poland	60.00	Italy	63.00	Poland	7.69
13	Italy	52.31	South Africa	60.00	South Africa	7.69
14	South Africa	52.31	Switzerland	59.00	Japan	6.15
15	Russia	50.77	Philippines	55.00	Brazil	6.15
16	Argentina	49.23	Argentina	54.00	Mexico	6.15
17	Philippines	46.15	Japan	52.00	Philippines	4.62
18	Japan	43.08	Russia	52.00	Turkey	4.62
19	India	43.08	India	50.00	India	3.08
20	Turkey	38.46	Turkey	47.00	Argentina	1.54
21	Brazil	32.31	Brazil	45.00	Russia	0.00

Source: Author's calculations based on information on compliance at the *e*Standards Forum website.

[a] All the thirteen codes covered by the *e*Standards Forum have been given equal weights to arrive at an overall score.

[b] The three standards relating to data dissemination, macro policy and fiscal transparency have been given the highest weight, followed by banking supervision and the other codes have been given the lowest weight. The choice of weights is based on the report of Fitch Sovereign ratings on which standards are useful for credit rating agencies.

[c] Equal weights to full compliance and compliance in progress and for all other rankings zero.

In Table 3 an attempt is made to rank countries by the information available on compliance. The first column with scores gives equal weights to all the codes. This is the ranking which appears on the *e*Standards Forum website. In the second column of scores, transparency codes have been given the highest weight, followed by banking supervision and then all other codes were given equal weights. Both equal and differential weights indicate that many key players including Japan have low scores. In the last column on scores, ranking is calculated for countries with full compliance and compliance in progress for all the codes. Full compliance and compliance in progress are given a positive weight and the rest zero. The overall scores are very low beginning with the United States with a score of 26.15 and others even lower. Japan has a score as low as 6.15.

This analysis, which is based on the information summarized by *e*Standards Forum from publicly available information on compliance with standards and codes, shows that lack of compliance is an issue in the G7 countries as well as emerging market economies.

To summarize, when recognizing that market participants prefer information that can be quantified or used in a classification system that can be incorporated in tick boxes, serious caveats arise:

- First, the implementation of Standards and Codes is a process, and as such, requires qualitative not quantitative assessments.
- Second, a simplistic quantification and classification has the risk of producing scoring systems capable of creating one-way expectations and bandwagon effects in the market.
- Third, if market participants are left to make discretionary judgements on a country's level of compliance based on self-assessments and peer review, there is a better chance of a more reasoned assessment.
- Finally, the use of quantitative scoring systems by multilateral agencies to meet market demand is likely to be counter-productive. Since the qualitative as well as the quantitative dimension of compliance is important, a purely or largely quantitative assessment framework contradicts the objectives of the whole exercise.
- The first attempts at analysis based on the quantification of publicly available information reveals that the ranking of countries according to the degree of compliance is inconsistent with the availability of information from the Fund publications and on-line data base.[22]
- Problems with full compliance and compliance in progress are there for both the G7 countries and emerging market economies as well.

IV. THE LINKS BETWEEN BRETTON WOODS INSTITUTIONS AND THE PRIVATE SECTOR

Attempts by the Bretton Woods Institutions to involve the private sector in crisis prevention reflect their endeavour to deal with emerging issues consequential to the change in the profile of capital flows to developing countries. The experience with private capital flows in emerging markets has demonstrated that financial integration also brings with it many disruptions which not only have significant knockout effects for the countries themselves but that their national and financial policies become a matter of great concern to other members of the international club.

The BWI have spent considerable effort and resources in the surveillance mechanism, provision of information and outreach to the private sector to get them interested in using the information generated (Annex 4 summarizes some of the outreach activities undertaken by the BWI in the last few years; surprisingly, information regarding new activities is not available) .

The involvement of the private sector has two facets. Firstly, the link between the standards and codes exercise and the private sector is the market discipline which the private sector can exert to motivate countries to implement standards. Developing country expectations are the rewards in the form of access to finance and lower borrowing costs. Secondly, it is assumed that transparency will make possible better judgements about individual countries which will reduce the possibility of contagion and herding behaviour. Apart from investors it is expected that credit rating agencies will be more

[22] It may be argued that this is not the responsibility of the Fund, but if the Fund's own data bases available to market participant is dated, then the entire discussion on information and transparency is a moot point.

sensitive to specific country information arising from the reports on the observance of codes and standards. In addition the private sector has begun to play an increasing role in the generation of information of compliance as we have already discussed above.

In this section we analyse if the market incentive to implement standards has led to lower spreads and if there is a relationship between credit ratings and compliance with the transparency standard. The section also explores whether new information is generated by some of the transparency exercise and if the private sector is making use of it.

A. The private sector

International organizations have put increasing emphasis on transparency in macroeconomic policy and data in order to ensure financial stability.[23] The rationale for greater transparency is based on the argument that (i) it forces public and private institutions to be accountable; (ii) it helps lenders and investors to evaluate risk; and (iii) it prevents herding and contagion. Support for this view was voiced soon after the Mexican crisis and reinforced after the outbreak of the East Asian crisis. The G7 finance ministers reported to the Cologne Summit that "the availability of accurate and timely information is an essential ingredient for well functioning financial markets and market economies" (Group of 7, 1999).

Although the benefits of transparency have been recognized, views from both the market and Governments in developing countries have also indicated that too much of a good thing may not necessarily be good. The Group of 22 report on transparency points out that "confidentiality may be warranted in some circumstances: for example, to encourage frank internal policy deliberations. In determining the optimum degree of transparency, the benefits must be balanced against the costs" (Group of 22, 1998). Thus, although transparency is necessary, there is a question mark over how transparent developing countries should become.[24]

The case for transparency rests on the belief that information and transparency are central to successful policy in developing countries. Precise, regular information is essential to attract investors. For example, a case can be made that the marginal product of information in Africa is still very high, given the poor record of disclosure there, and investor ignorance of the region. Many have also argued that the vulnerability of developing countries to self-fulfilling crises is caused by their lack of transparency, which leads to herd-like behaviour in the financial markets. However, the private sector also acknowledges that the provision of information can backfire, since it might highlight faults that are shared by many countries but publicized by only a few. Persaud (2001) argues that, while transparency is a good thing, too much transparency may be self-defeating. His market research makes a convincing case for not making available on daily basis information on reserves and so on.[25]

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[23] See the Code of Good Practices on Transparency in Monetary and Financial Policies at http://www.imf.org/external/np/mae/mft, and fiscal transparency at http://www.imf.org/external/np/fad/trans.

[24] For example, many IMF members have been concerned about releasing data on foreign-exchange reserves as they may reduce the effectiveness of market interventions. These data are therefore now provided following a one-month lag. Similar points were made at the Overseas Development Institute conference in June 2000 (see Development Policy Review, 19(1) March 2001; and Conference Report (2000) on www.odi.org.uk).

[25] Persaud's study bases its argument on the following: (i) In the short run, there is compelling evidence to indicate that markets cannot distinguish between the good and the sustainable; (ii) In a herding environment, tighter market-sensitive risk-management systems and more data transparency in fact make markets more prone to a crisis; (iii) The growing fashion in risk management is to move away from discretionary judgements about risk to more quantitative and market sensitive approaches. Analysis is based on the daily earnings at risk. A rise in market volatility hits the daily earnings ratio (DEAR) limits of some banks, causing a hit in the DEAR limits of other banks. Several banks sell the same asset at the same time, leading to an increase in market volatility and higher correlations.

Transparency alone cannot avert a crisis or prevent contagion. Moreover, in a contagion situation there is a distinction between fully informed traders who follow fundamentals, and less informed "noise traders". In the Keynesian "beauty contest" world, informed traders anticipate irrational trading by noise traders since it is not a question of what one's own beliefs or knowledge are regarding fundamentals but rather that of the common perception. Information may help to ameliorate this situation but it is unlikely to eliminate it entirely.[26] For example, while the Special Data Dissemination Standard (SDDS) was implemented before the crises in Turkey and Argentina, the new disclosure rules failed to serve as an effective warning system.[27]

The IMF's approach to transparency is also asymmetric. "Ownership" of regulatory policies will be facilitated greatly if there is symmetrical treatment between borrowers and lenders (this issue will be analyzed later). One of the FSF working group reports on capital flows, for example, focuses attention on improved risk-management practices and enhanced transparency on the part of the public and private sectors in borrowing countries (Cornford 2000a).

The burden of providing information is asymmetric; transparency rules are adhered to by the developing world, but not necessarily by the lenders. Information on the portfolio share allocated to a particular country, and the time horizon in which this share would be reached, would enable developing countries to plan for their resource gaps in a more effective manner and to finance development from alternative sources. Stability would be enhanced if high frequency data on the largely short-term position of assets denominated in a country's currency held by foreign firms other than banks were endorsed by international action to enable timely action by the national authorities in their foreign-exchange and other financial markets.

Box 3 shows Metcalfe and Persaud (2003) results on transparency.

Box 3
Metcalfe and Persaud (2003)

- While in general stronger data standards will help market efficiency, the question is whether they are the panacea that is often assumed.
- There are some forms of disclosure that might even increase financial instability.
- Improved information flows have and will enable investors to allocate capital more efficiently.
- Disclosure, however, does not appear to warrant its central role in crisis prevention:
    1) First, markets are as prone to crisis now as they ever have been, even though there has undoubtedly been some improvement in information flows.
    2) Second, markets can sometimes turn "a blind eye" to information during bubble.
    3) And finally at its limit, if better disclosure ultimately reduces the diversity of investor opinion, this could actually contribute to greater financial instability.

B. Assessing transparency

In view of the arguments presented before, it is worth to assess the efforts towards increased transparency. The SDDS is one of the major tools for providing transparency. But only 60 out of the 184 IMF member countries are currently subscribers. This data cast some doubts about the role that both market and government responses are playing in favouring adherence to information disclosure projects. In fact this lack of subscription undermines the arguments favouring increased transparency.

[26] Ibid.
[27] The SDDS was launched in April 1996 and became operational in September 1998.

The first line of argument put forth to promote SDDS subscription has been that compliance with the codes brings down spreads. The IMF has produced some research papers that emphasize the link. Although literature is rather scarce in testing the same hypothesis, research does not show conclusive results to confirm the role of SDDS subscription as determinant of borrowing costs. In most cases, macroeconomic fundamentals are the main determinant of spreads. When not, the globalization of financial markets and liquidity conditions are found to be the significant determinants.[28] Table 4 summarizes the results of a simple econometric exercise undertaken on the role of SDDS in spreads

Table 4
The link between sovereign spreads and SDDS: econometric results

	log(Spread)			
Generalized least squares	*GLS*	*GLS with fixed effects*	*GLS with AR(1)*	*GLS with fixed effects and AR(1)*
Constant	5.52[a]		5.75[a]	
GDP growth	-0.05[a]	-0.04[a]	-0.02[a]	-0.01[a]
Long terms interest rate	-0.04	-0.11[b]	-0.37[a]	-0.48[a]
Public debt as a per cent of export	0.02[a]	0.02[b]	0.04[a]	0.02
SDDS	-0.13	-0.21[c]	-0.13	-0.19
AR(1)			0.92[a]	0.81[a]
Fixed effects test		62.11[a]		63.24[a]
R2	0.95	0.98	1.00	1.00
F	971[a]	666	24580[a]	2.E+11[a]
DW	0.29	0.58	.76	1.71
Total panel observations	250	250	239	239
Included observations	36	36	36	36
Period 94.1–02.4				

Source: Author's estimations.
Note: The estimation method is GLS (Cross section weights).
[a] Denotes significant at the 1 per cent level.
[b] Denotes significant at the 5 per cent level.
[c] Denotes significant at the 10 per cent level.

determination. The finding is that, once allowing for auto correlation and fixed effects[29], SDDS is not significant.[30]

The studies by the IMF do not factor in the fact that spreads have been going down for all countries (thus, it is a global trend), not just for the countries that comply with the SDDS or the GDDS. Thus, the international environment and international liquidity have not been factored in those exercises. In

[28] Some research includes Ferrucci (2003) on determinants of emerging market sovereign bond spreads, Gelos and Wei (2002) on transparency and international investor behaviour, and Kamin and von Kleist (1999) also on determinants of spreads.

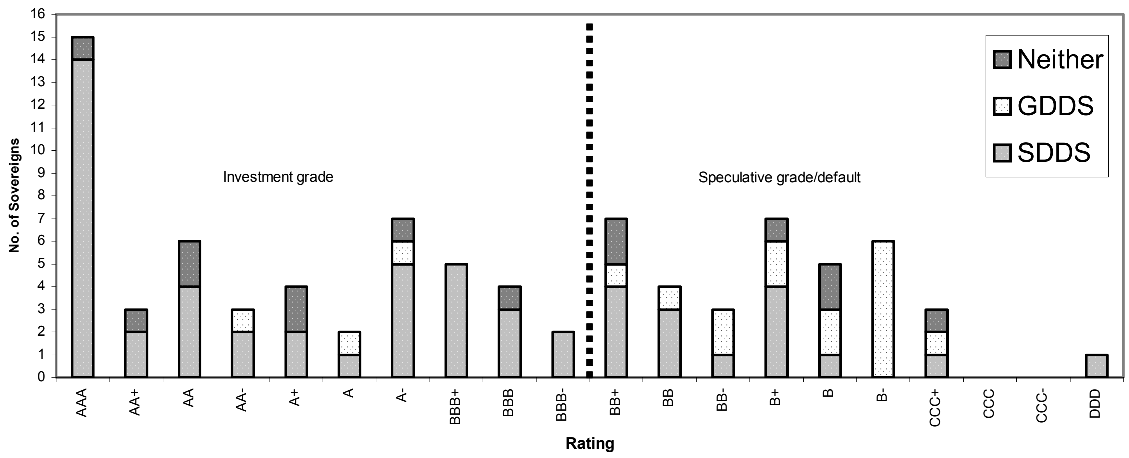
[29] Fixed effects estimation is a method of estimating parameters from a panel data set. This approach is relevant when one expects that the averages of the dependant variable will be different for each cross-section unit, or each time period, but the average of the errors will not. In such a case random effects estimation would give inconsistent estimates of b in the model Y + Xb + e

[30] The exercise used time series/cross-section data for 11 countries for the period 1994 I to 2003 IV with a total of 250 observations. The explained variable, the logarithm of the spread, was calculated on the base of the JP Morgan's Emerging Market Bond Index Plus (EMBI+) with quarterly average data. The set of explanatory variables included in the regressions comprised: "Annual GDP growth" in quarterly terms, "long term interest rates" constructed by weighting Government Bond Yields of the United States, Japan and the Euro Area; A series of variables to measure debt factors (debt service as a per cent of exports and public external debt as a per cent of exports); a dummy variable to measure SDDS: 1 after date of subscription; 0 otherwise. For the quarter in which subscription takes place, the dummy is given the value one if the subscription takes place in the first half of the quarter and zero if it is in the second half of the quarter. The estimation method is Generalized Least Squares (GLS). It assumes that residuals are cross-section heteroskedastic and contemporaneously uncorrelated. To correct the heteroskedasticity within each cross-section we used the White covariance estimator. To correct autocorrelation, a common AR(1) term was included in the pool estimation.

addition, there is no economic proof that standards and codes are appropriate. There are a number of studies showing that there is no proof that this really works.[31]

Does subscription to SDDS and GDDS affect sovereign ratings? This is the second line of argument favouring SDDS/GDDS. Chart 9 shows countries classified into investment grade and speculative grade. For both categories there are countries that have subscribed neither to GDDS nor SDDS. This means that, in actual practice, a country can get a credit rating even if it does not comply with the SDDS and the GDDS. Thus the view that market discipline (credit ratings responding to the availability of information based on a consistent data base) in the form of upgrades and downgrades of investor rating) is not really working in practice. Standards and Poor's seems to have ignored the information on compliance to SDDS and GDDS.

Chart 9
Sovereign ratings and SDDS/GDDS



Source: Fitch Ratings

The view from the credit rating agency has been that standards and codes may – although there is no conclusive evidence – affect credit ratings; but there is no evidence on bond spreads: "Credit rating agencies looked favourably at countries that had published ROSCs although there is no conclusive evidence that the resulting upgrades in their assessments had led to lower spreads on international bond issues …" "Credit rating agencies look mainly at the standards on data dissemination, banking supervision and the overall health of the financial sector, fiscal transparency, and transparency regarding monetary and financial policy. The provision of data on official reserves and international investment positions were also seen to be helpful in ratings decisions. While the agencies recognize that issues such as corporate governance were important, these were considered less likely to be proximate causes of a sovereign default." (Price 2003)

Neither on the case of investment grade nor spreads does subscription to SDDS seem to radically benefit a country's situation. Summing up the private sector view, David Lubin argues that "since Standards and Codes is a public-sector driven initiative the private sector interest is a muted one". Also, "the link between transparency and creditworthiness is not straightforward – the causality usually runs from creditworthiness to transparency – while some of the information is not crucial to risk assessments (and the value which the BWI apply maybe too high). What the exercise should do is

[31] See for example Sarr (2001), Mosley (2002) and Rojas-Suarez (2002).

to assess the vulnerability of the foreign exchange balance sheet, as it was the weaknesses there that led to the crisis".[32]

Although the methodology to assess sovereign risk was changed after both the Mexican and Asian crisis, the role played by information provided by the subscription to SDDS and/or the publication of ROSCs is rather a complementary one. After 1997, greater emphasis was put on off-budget and contingent liabilities, reserves adequacy and detailed data regarding external debt.[33] But greater emphasis does not mean that this information was not taken into account before; instead, a new look was given to already existing data.

Credit rating agencies constantly update their methodologies and deal directly with governments and governmental agencies when assessing sovereign risk. Although the new focus on transparency has been instrumental, other factors, such as the widespread use of internet, have also been crucial in the improvement of timeliness and availability of data. Annex 7 shows one example of the marginal changes in risk rating methodologies undertaken in recent times.

Thus, the emphasis given to transparency in the current debate is overemphasized as indicated by these results. The links between compliance with data standards and spreads/credit ratings is weak.

C. The BWI: Monitoring and surveillance

The task of assessing the implementation of standards by countries is carried out jointly by the IMF and World Bank. These assessments are based on the World Bank and IMF FSAPs and IMF Article IV on surveillance, which includes progress in standards implementation among the subjects of surveillance under the heading of the strength of the financial sector more generally. The administrative capacity of the IMF is likely to be stretched by the Reports on Observance of Standards and Codes (ROSCs) conducted for a limited number of codes for some countries.

If the administrative capacity were to be supported by other organizations, the issue of their judgement would arise. And, in the case of the IMF, it would be fair to make the evaluation of monitoring ROSCs independently of its other functions, such as lending.[34] Resources required for assessment and implementation are expected to be large. At the country level, the assessment exercises will often place an additional burden on a limited supply of supervisory capacity. Expanding this capacity takes a considerable time. And countries are then faced with the prospect of the flight of human capital. A well-trained supervisor may be tempted by attractive alternative employment opportunities in the private sector, or even in the IMF or the World Bank which themselves have recently been increasing the number of their staff with expertise in this area.

These organizations are, of course, aware of the problem of human resources, as are the Basel Committee for Banking Supervision (BCBS) and the Core Principles Liaison Group (CPLG), and efforts are being made to coordinate initiatives and to ensure that scarce expert resources are used in the most efficient way. However, there remains a real danger that international assessment of

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[32] David Lubin examines the reasons for the lack of interest by the private sector in standards and codes, and in this context discusses some underlying problems with the initiative. The document further examines other areas where steps need to be taken as a means of crisis prevention. His article is published in Schneider (2003), Chapter 12.

[33] Bhatia 2002:48.

[34] As part of its monitoring task, the IMF has published and evaluation of progress in fiscal transparency ROSCs. The report publishes a cross-country comparison of progress in the form of "check boxes" that end up by providing the private sector with pass/fail criteria. This exercise has the risk of putting the IMF in such a position of a credit risk agency, quantitatively "rating" countries regarding to their progress on ROSC. See IMF 2003, Annex 5.

countries' supervision will be at the expense of actual supervision on ground.[35] A serious limitation of the monitoring process is that there is no public schedule with regard to the timing of future publications, and no information on the criteria followed in prioritizing one country or one code over another. It is therefore impossible to discover whether a ROSC has not been updated because no substantial changes took place in the country, or because there were no resources or time for further analysis. Technical assistance offers a solution but the problem of global compliance across the world will strain both financial and administrative at the domestic and international level.[36]

At this stage it is uncertain how this exercise will prove to be a reliable source of information for investors and credit-rating agencies in order for market incentives to work. Although improvement in information is likely to contribute to financial stability, at the operational level information is scant. The IMF has indicated that work is in progress on standardizing ROSCs.

Some outreach initiatives by the IMF has been to find common interests for its work on fiscal transparency and fiscal ROSCs with civil society organizations (CSO). The involvement of certain CSOs has also been encouraged. Does the IMF intend to bring about compliance with the fiscal code from the pressures created by civil society groups on fiscal transparency concerns? What seems to be apparent is the strong interest of civil society and NGOs to support (and constitute a force to pressure for) fiscal transparency subscription and compliance.[37]

One alternative to deal with the constraints faced by the BWI serving as global monitors would be greater use of self-assessment combined with a peer review process. The FATF model is a useful example where self-assessment and mutual evaluation procedures are the primary instruments to monitor progress. The most interesting features regarding implementation of the FATF's recommendations on money laundering are summarized in Box 4.[38]

The BWI could then be assigned an important role in coordinating the process and providing technical assistance to some countries in self-assessments and implementation. The BWI could also play a useful role as depository of information and links to sources of information at country level on self-assessment, thus facilitating the use of this information by market participants. This would also take care of the problems of resources and conflict of interest present in the BWI.[39]

Moreover, identification of where different countries are with respect to their institutional, legal and regulatory framework vis-à-vis the codes will also help to identify the real problems in applying a uniform rule across countries. The exercise will also be useful in defining the transition period needed

[35] See UNCTAD 2001, Chapter IV.
[36] In the case of human resources, for example, trained personnel for banking supervision are scarce. Technical assistance to train supervisors is a solution, but two drawbacks have to be considered: first, it takes time to train, and second, incentives exist for human capital flight due to competition between the demand for supervisors at local level supervision and those required for global monitoring, as was earlier mentioned.
[37] See Petrie 2003.
[38] See FATF's website: http://www1.oecd.org/fatf/ AboutFATF_en.htm#What%20is for more details on these features.
[39] The first step forward may be country self-assessment available on the treasury website. The United States has set an example; the format is simple and may serve as one example for the simplifying of information. Among emerging markets, India has undertaken an exercise with the technical details of ten standards and posted their assessment on the Reserve Bank of India website (http://www.rbi.org.in/). Technical assistance for self-assessment of the kind India has undertaken may be a better way forward than the use of negative incentives for compliance.

Box 4
The appealing features of FATF

- Members are strongly committed to the discipline of multilateral monitoring and peer review.
- In the self-assessment exercise, every member provides information on the status of its implementation by responding to a standard questionnaire in an annual basis. This information, compiled and analysed, is the basis for assessing the extent of implementation by individual countries and the group as a whole.
- In the mutual evaluation process, each country is examined in turn by the FATF on the basis of an on-the-ground-visit conducted by a team of experts in the legal, financial and law enforcement fields from other member governments. The result of the visit is a report assessing the extent to which the evaluated member has progressed in implementing an effective system to counter money laundering and to highlight areas that still need further progress.
- The mutual evaluation process is enhanced by a policy to deal with members that are not in compliance. It represents a graduated approach aimed at reinforcing peer pressure on member governments to take action to tighten their anti-money laundering systems. First, the policy requires the country to deliver a progress report at plenary meetings. Then pressure is put by a letter from the FATF President or by the visit of a high-level mission. In extreme cases, Recommendation 21 is applied. It consists in issuing a statement calling on financial institutions to give special attention to business relations and transactions with persons, companies and financial institutions domiciled in the non-complying country. This “name and shame approach” are advisories that raise transaction costs between co-operating and non-co-operating countries.
- A final measure is the suspension of FATF membership for the country.

for implementation. Another result of such an exercise will be in defining the areas in which a rule can be applied, and in which voluntary principles can best be utilized.

Thus, self-assessments backed by peer review of the type described offer the potential for ownership, independence and rigor. If supported by technical assistance as needed, they can minimize both the extraordinary cost and difficulty of managing a centralized monitoring system. With these issues in mind, the next section will take a deeper view of the concerns relating to developing countries and the S&C initiative.

V. DEVELOPING COUNTRIES

As it was a challenge to define standards, it is an even greater challenge to gain their global acceptance in order to ensure implementation. However, it is useful to remember here the prevailing asymmetries that impact the way developing countries issues enter into the whole Standards and Codes exercise and into the objective of global financial stability. Box 5 summarizes the argument.

Taking asymmetries into account when explaining the developing country perspective, issues as ownership, appropriateness, incentives, voluntariness, resources and transition periods have to be considered. Although some have already been mentioned, this section provides an in-depth critical approach to each of them and their link with the Standards and Codes exercise.

“Ownership” will not come without the representation of developing countries issues and concerns. “Ownership” cannot be imposed from outside.

The effectiveness of standards and codes as a tool of global financial stability depends on the number of countries adopting them and the extent to which they are implemented. The latter is closely related to the way in which S&C are incorporated into the norms of business practice. In order to achieve effective implementation, country “ownership” of these policies is crucial. In the case of developing

Box 5
The developing country point of view

- Asymmetry in the incentive structure for global participation: industrialized countries do not borrow from the BWI and therefore standards and codes are not binding on them.
- The codes are based on benchmarks appropriate to industrialized countries and their application is a potential source of comparative disadvantage, especially in the financial sector.
- Asymmetry in resource needs of various countries.
- Asymmetry in transparency, e.g. the burden of providing information is on developing countries; information is not the same from the private sector or the industrialized countries.
- The international community shies away from endorsing action to require high-frequency disclosure of data on the large short-term positions in assets denominated in a country's currency held by foreign firms other than banks (a category including hedge funds), which several developing (and some developed) countries perceive as threats to the stability of their exchange rates and financial markets.
- Asymmetry in jurisdiction.[1] The World Bank has no jurisdiction over Part I countries.
- The asymmetry between developing and industrialized countries increases as we move away from using Standards and Codes as informing surveillance to include compliance in their lending decisions.

[1] See Mohammed (2003) for a discussion on this.

countries, "ownership" is not possible without representation and positive incentives for implementation. The most constructive incentive for implementation is the appropriateness and meaningfulness of standards in the national interest.

"Ownership" of reforms in domestic financial architecture cannot be achieved while the membership of the FSF[40] and other international organizations[41] involved in standard-setting is so heavily dominated by the industrialized nations. Although developing countries were well represented in the formulation of some of the codes, such as those on transparency, their participation and representation have been limited with respect to others. This issue takes even more importance when considering the political economy aspects of implementing Standards and Codes. Discussion on this follows below.

The Financial Stability Forum is a very important initiative. To include members from developing countries as full members, and not just a few in working groups, will enhance its legitimacy and increase commitment. It is important that their concerns and subject areas are represented. Involvement brings commitment. "Ownership" is meaningless without representation.

"Ownership" comes with appropriateness.

Appropriateness of the standards is another issue crucial to ensure implementation. The "ownership" principle cannot work if national governments are not convinced about the appropriateness of some standards.

This is the "one size fits all" dilemma. In discussing the appropriateness of the selected standards, Rodrik (2000) points out that many rich countries have prospered by following different paths in corporate governance, where insiders and stakeholders have played a much more significant role; and

[40] At the time of writing, the FSF has a total of forty members, comprising three representatives from each G7 country (one each from the treasury, central bank and supervisory agency); one each from Australia, Hong Kong (China), Singapore and the Netherlands; six from international organizations (International Monetary Fund (two), World Bank (two), Bank for International Settlements (one) and Organisation for Economic Co-operation and Development (one); six from international regulatory and supervisory groupings (Basel Committee on Banking Supervision (two), International Organization of Securities Commissions (two) and International Association of Insurance Supervisors (two)), and two from Committees of Central Bank experts (Committee on the Global Financial System (one) and Committee on Payment and Settlement Systems (one), plus the Chairman). See Annex 1.
[41] See Annex 2 in this paper for the countries represented in the various working groups of the FSF.

in finance, where close links between governments have often been the rule rather than the exception. The Reserve Bank of India, perhaps the only country that evaluates the appropriateness and implementation issues and posts the information in the public domain, makes similar points.[42]

Although there is recognition in principle about the problems resulting from the varying stages of development and institutional capacities, real solutions are required. The resolution of the "one size fits all" dilemma is complex, but increasing developing-country representation and participation, and including subject areas of interest to them will be the first step. Appropriateness is a question of participation and involvement, and may not be achieved by providing economic proof alone.[43]

In the absence of appropriate institutions, developing countries' commitment to embracing standards and codes is not likely to lead to the desired goals. Pistor (2000) examines this aspect with regard to legal rules, and argues that historical evidence supports the proposition that imported legal systems have in most cases not produced very efficient outcomes. The content of the rules is not as important as the existence of constituencies that demand these rules and the compatibility of the imported norms with pre-existing legal norms as well as pre-existing economic and political conditions. Voluntary compliance is important.

Hence standardized rules are unlikely to be effective in countries where complementary laws exist only in part or not at all. For example, commercial law is a necessary prerequisite for the International Organization of Securities Commission (IOSCO) standards, and an independent judiciary is a prerequisite for defining and bringing into practice the code on insolvency. The issue of "ownership" is also related closely to the "incentives" a country has to implement standards, because at the end, self-interest is the best incentive.

"Adoption of standards and participation in external assessments should be voluntary" (FSF 2000:10).

The Executive Board of the International Monetary Fund (29 January 2001) has voiced similar sentiments. The Directors agreed that the adoption and assessment of internationally recognized standards will remain voluntary. They recognized that priorities for implementing standards would differ by country and over time, and that assessments would need to take into account differences in members' economic circumstances and stages of development (IMF 2001a). Although initial public statements have concentrated on the voluntary principle, a shift in focus is perceptible. In some cases, standards and codes are already a part of conditionality:

- Ecuador was required to publish the ROSC report on data dissemination in order to secure a Stand-By Agreement with the IMF.
- Uruguay's Stand-by Arrangement included recommendations of Fiscal ROSC.
- Ghana's arrangements for a Fund Programme included recommendations of financial sector ROSCs.
- Brazil's Stand-by Arrangement included recommendations of the Corporate Governance ROSC.

Linking standards and codes to the idea of conditionality, as evidenced by the quotation at the beginning of this article, has support from high-ranking individuals in the industrialized world.

[42] The reports of the various committees are available on the Reserve Bank of India website: http://www.rbi.org.in/
[43] Nor have studies carried out so far given sufficient economic proof.

Eichengreen (2001:43) makes a case for conditionality. In his view, upgrading practices in such areas as macroeconomic policy and transparency, financial market infrastructure, and financial regulation and supervision is essential in a financially integrated world. International standards, with pressure to comply to be applied by multilateral surveillance, IMF conditionality, regulation and market discipline are the only available means to this end in a world of sovereign states.[44] But he does not take into account the practical aspects of applying a universal rule in diverse conditions.

Developing countries have expressed concern that compliance with standards and codes should not become a part of conditionality; they believe compliance should be voluntary (see, for example, Reddy 2001a and 2001b) because they are already overburdened with conditionality. Many, including Brazil (Gottschalk 2001:16) and Russia (Granville 2001:7) have also expressed the view that capacity building is more important than conditionality. While developing countries have been supportive of the need to observe certain minimum standards in areas relevant to the maintenance of the international monetary system, including greater transparency, there is less agreement on the design of some codes as being relevant and applicable in economies with different legal institutional set-ups and at different stages of development.[45]

How is "ownership" of policies ensured if compliance with standards becomes a part of IMF conditionality? Furthermore, conditionality can take the form of formal or informal conditionality. If the view put forward by the BWI and statements from high-ranking individuals in the industrialized countries lead to the perception that a universal rule ensures financial stability, the market participants will respond accordingly, and even if adherence to S&C is not a part of formal conditionality, the market mechanism will in practice work to achieve the same end through different means.[46]

It is premature to be discussing S&C as a condition for finance.[47] Even informal conditionality through the market incentive is problematic. If credit-rating agencies are assimilating information from ROSCs on the credit ratings of individual developing countries, this confirms their voiced concerns about outreach activities. ROSCs are considered by developing countries to be a useful benchmark; but, as already mentioned, there is concern that the judgements expressed may become a way of giving a simple score to a country facing a complex process (Gottschalk 2001:13).

The international debate needs to focus greater attention on the possibilities of bad judgements by market participants. To reiterate, in order to understand the issues involved fully, research is necessary on the usefulness and effectiveness of codes, and countries' experiences with their implementation.

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[44] The argument contains a certain amount of "idealism", a "wish list" of what lenders ideally would like to have without any reciprocal arrangements. This wish-list is an intrusion in the affairs of emerging markets and developing countries. The destabilizing activities of Highly Leveraged Institutions have been ignored in the discussion. The Report of the Working Group on HLIs (April 2000) identified the capacity of HLIs to establish large and concentrated positions in small and medium-sized markets, and with this capacity the potential to exert a destabilizing influence. Some aggressive practices by HLIs include heavy selling of currencies in illiquid markets, selective disclosures, rumours about future developments, and correlated position taking in the markets for different assets within a country and across countries, with the objective of achieving profitable movements in relative prices.

[45] Mr Jin Liqun, Deputy Finance Minister of China, for example, voiced this at a conference organized by the IMF: "Developing countries are given to understand that they can pre-empt a financial crisis and achieve economic stability, providing they follow rigorously the international standards and codes. But there are two questions to answer: first, are the standards and codes suitable to developing countries at their stage of development; and second, do they have a minimum institutional capacity to apply these standards and codes at the same level as developed countries?"(*IMF Survey* 30(7):103, 2 April 2001.)

[46] Axel Nawrath (Chairman of the Follow-Up Group on Incentives to Foster Implementation of Standards) to William McDonough (chairman of the BCBS) (4 April 2001): "I am of the view that the new [Basel] Accord can provide incentives, albeit indirectly, to banks and other market practitioners to pay attention to Standards. This should in turn raise awareness among economies to the need to upgrade the implementation of Standards in their jurisdictions."

[47] Conditionality is a highly contentious issue. We do not go into this discussion here. For a discussion on effectiveness see, for example, Kapur and Webb (2000) and Killick (1995).

Market incentives have been brought into uncharted territory too early for single rules to be applied globally.

The resources required for the implementation of standards and codes are expected to be enormous, and many countries face serious practical constraints.

Some developing countries have expressed the view that these efforts may be made at the expense of socially vulnerable groups. In a DFID-funded survey on standards and codes, the response of many participants was that implementation would be costly in terms of time and resources, and the need for effective technical assistance was stressed (Gottschalk 2001:13, Granville 2001:26 and Charpentier 2001:17). In some cases it is doubtful if implementing S&C ought to be a priority for countries with very limited resources and deep poverty problems (Charpentier 2001:ii).

It is for this reason that capacity-building efforts are seen as being crucial to strengthening financial systems. The resource constraint has been identified as the major problem in implementing standards and codes, and therefore the Bretton Woods Institutions, the Bank for International Settlements and the standard-setting bodies are all supporting implementation through technical assistance. The Government of the United Kingdom has taken the lead by setting up the Financial Sector Reform and Strengthening (FIRST) Initiative, a technical assistance programme for implementation, in conjunction with other donors.

There is likely to be a resource constraint at both domestic and international levels. So far, no estimation of the costs of implementation is available. That is why some case-study analysis needs to be carried out to gauge what the resource constraints are likely to be, which countries to be targeted, and how much assistance over a considerable period of time is required, as implementation is going to be a long process.

The goals of financial stability are better served if some of the limitations in definition and implementation and intrinsic limits to the codes themselves are recognized.

Countries implementing standards and codes need to recognize that these are not static rules or principles but will need constant improvements and adjustments to keep pace with the dynamic process of change and increasing sophistication in financial markets. Flexibility is important, and governments need to take care not to waste resources on standards that may already be outdated.

Here the political economy of implementing S&C should be considered carefully. International standards and codes are supposed to play a leading role in transforming financial regulatory governance in post-crisis East Asia. Walter (2003) argues that the main problem with this reform strategy is that it underestimates the likelihood of implementation failure in the reforming countries. Contrary to the intention of the standards and codes, the author shows that regulatory forbearance remains chronic in a number of East Asian countries. The result is that standards of prudential regulation lag behind the process of financial liberalization. This “perverse sequencing” creates ongoing financial vulnerabilities for these countries. Since, as the author argues, the reasons for implementation failure are deeply engrained in the domestic political economies, this casts doubt not only upon the role of the international financial institutions and capital markets as “enforcers” of standards and codes, but also upon the wisdom of the S&C exercise in general. This is one reason why the Standards and Codes exercise could even end up threatening global financial stability and why it is so difficult to determine the degree of compliance when the forbearance gap is difficult to assess.

Implementing codes is a very recent exercise, and discussion of their effectiveness and limitations is therefore limited to a few specific codes which have been the subject of recent research. Some examples of the limitations are clear in the carrying out of transparency codes (including SDSS and those on banking supervision and regulation), security listing and banking capital adequacy. In the case of SDDS, Mosley (2002) attributes the prohibitive costs of implementation or transition faced by governments[48] as compared to the rather marginal/indirect use of the information by the private sector as grounds for the under-subscription to the SDDS.[49] Transparency in the field of banking supervision and regulation can also be blurred because of off-balance-sheet items in national accounts and corporate balance sheets. These cannot as yet be covered adequately by accounting rules and thus it may be difficult to assess exposure and its distinction between the short and long term.[50]

In some countries, the criteria for licensing of banks may have (usually proximate) relations to banking stability but cannot prevent serious banking instability or banking crises (UNCTAD 2001). Market incentives are explored in Sarr (2001) by examining the benefits of compliance with securities listing standards, with special reference to the depository receipt market.[51] The finding is that the costs of implementing stringent securities listing standards may exceed the benefits. Thus investing resources in complying with higher standards may not be efficient and should remain voluntary, especially in the case of developing countries. The limitations in the case of banking capital adequacy standard have been studied by Rojas-Suarez (2002) and are summarized in Box 6.

The discussion around Basel II has also illustrated that implementation is beset with problems in developing countries. Some even go as far as to argue that Basel II may increase pro-cyclicality of capital flows and the cost of funds to developing countries.

It is important to acknowledge that financial stability depends on macroeconomic fundamentals, and sometimes on the endogenous consequences of a rapid expansion of lending, and that this poses a limitation on the regulation and supervision of a country's financial system. For example, most bank assets are subject to changes in their quality resulting from broader changes in economic conditions, which are often characterized by cycles of "boom and bust". Moreover, cross-border financing and herd behaviour on the part of investors, along with macroeconomic fluctuations, can further intensify

[48] "For a variety of reasons, ranging from legitimate economic policy-making concerns to pure political opportunism, governments may prefer not to be completely transparent in their dissemination of economic information" (Mosley 2002:26).

[49] The results of a survey of mutual fund managers show their reliance on private agents such as brokerage houses and credit-rating agencies for information. Credit-rating agencies apparently make more use of the SDDS than other market participants, which implies that the SDDS is utilized indirectly. The subjects of the survey were specifically managers of internationally orientated United States mutual funds and managers of United Kingdom funds which invest at least 5 per cent of assets in emerging-markets regions. Mosley's result is consistent with the outreach exercise performed by the FSF which also found that few participants in the market took into account an economy's observance of standards in their lending and investment decisions, though observance of the SDDS was found to influence credit ratings (FSF 2000, Section III). The report was based on an informal dialogue with participants from 100 financial firms in eleven jurisdictions, mainly developed countries. Overall, the FSF found limited awareness of the twelve key standards. Observance of the standards was considered to be less important than the adequacy of a country's legal and judicial framework; political risk and economic and financial fundamentals were more important factors. For more details, see Mosley 2002:13.

[50] The balance sheets of many financial firms have an increasingly chameleon-like quality that reduces the value of their financial returns to regulators. The tensions between financial innovation and effective regulation in modern financial markets are unlikely to disappear, and pose a challenge for financial regulators. See UNCTAD 2001, Chapter IV, p. 102.

[51] Depository Receipts (DRs) are negotiable certificates that certify ownership of a company's publicly traded equity or debt. They differ exclusively by the degree of compliance with transparency codes. There are different types of DRs. The American Depository Receipt (ADR) of Level I, II, III and the rule 144A ADR issued and traded in the United States Global Depository Receipts (GDRs) issued to United States and non-United States traders and are traded outside the country. Level III ADRs can be traded at NASDAQ and the New York Stock Exchange, and require full compliance with the SEC disclosure standards. Level II can also be traded at NYSE and NASDAQ, but has less stringent requirements. Level I ADRs need the least compliance with the standard.

Box 6
Capital adequacy standards

- Capital adequacy was not a good indicator in developing countries. Net equity capital was high and positive in developing countries that faced a banking crisis in the 1990s but negative in the case of industrial ones.[1] The reasons for limited effectiveness are:
- Lack of liquidity for bank shares, subordinated debt and other bank liabilities that are needed to validate "real" value of capital from its accounting value.[2]
- Inadequate capital requirement and regulatory framework.
- Degree of financial development an important factor for capital standards to be effective.[3]

[1] Furthermore, in a related study when Rojas-Suarez (2001) compares various early warning indicators of banking problems in developing countries, capital ratio performed the worst. The same indicator is found to be much more efficient in analysing the soundness of the banking system of developed countries.
[2] When a capital market lacks liquidity and depth, as is the case for many developing countries, changes in the market value of bank capital do not provide much useful information regarding the quality of reported capital. In addition, the market for capital tends to be small and uncompetitive because of highly concentrated asset ownership. This concentration of wealth provides incentives for bank owners to undertake higher risks than in industrialized countries, as it becomes easy to raise low-quality bank capital relative to the bank's capital base. This feature can explain why emerging market countries have had high and positive net capital growth when on the brink of banking crises.
[3] Rojas-Suarez argues that a strict application of the capital standard can have unintended consequences in emerging markets, such as weakening the bank systems. For example, the regulatory treatment of banks' claims on government tends to reduce the soundness of banking systems in emerging markets (see Rojas-Suarez 2002:18–20 for expansion of this point).

problems in the financial system (UNCTAD 2001). Thus macro stability is a prerequisite for the success of the present exercise in new financial architecture.

A PricewaterhouseCoopers study (2004) for the European Commission of the macroeconomic and financial consequences of new rules for the capital of banks in the EU the National Institute of Economic and Social Research (NIESR) of the United Kingdom developed a taxonomy of characteristic features of financial crises, which can serve as a useful benchmark for reviewing the effectiveness of the key financial codes and standards in the prevention and management of such crises.[52] Not all these features were of equal weight in all the historical instances studied.[53]

Many but not all features of financial crisis are covered by the codes and when they are covered, guidelines for policy making at both national and international levels are often missing, or at an early stage of development.[54]

If globalization is here to stay, then the challenge is to prepare developing countries for a highly integrated world.

The risk inherent in opening up capital markets requires a well thought-out preparatory stage and hence the growing acceptance for gradualism. The principles behind standards and codes are also some of the preconditions identified for the opening up of the capital account. Capital account liberalization requires that central banks have effective regulatory, supervisory, enforcement and informational structures in place. Liberalization must not be seen to require authorities to retreat from these essential functions. Priority setting and sequencing of the implementation exercise for standards and codes therefore need to be linked to the timing and sequencing of capital account opening in global capital market.

[52] See PricewaterhouseCoopers, *Study on the Financial and Macroeconomic Consequences of the Draft Proposed New Capital Requirements for Banks and Investment Firms in the EU*, MARKT/2003/02/F, Final Report, 8 April 2004, pp. 133–137 and Appendix 6.
[53] In the interests of abbreviation and clarification the descriptions of features of financial crises which follow sometimes differ in minor ways from those of the NIESR.
[54] See Cornford (2004:14–16).

As emphasized earlier, research on country experiences needs to be collated in order to understand fully the implications of applying internationally defined codes to countries with divergent systems. The risks inherent in introducing codes without an understanding of the outcomes justify a gradual approach to implementation. The dire consequences of adopting a "big bang" approach to capital account liberalization are well documented in the literature (see, for example, Schneider 2001). Gradualism also allows time for the inevitable learning curve in developing countries.

The transition period needs to be considered carefully to take into account the institutional framework such as the legal structure, administrative and human capacity, and financial resources. Technical assistance can play a very important role in the transition period. Priorities need to be established for countries at different stages of development, as well as with regard to the degree of openness of their financial systems.

In addition, it has to be noted that implementation of standards and codes is a process which takes years. For instance, when it is tied to the period of an IMF programme (Standby agreements take one year or 15–18 months), when the programme is over the process of implementation will not be finished but the market will be trying to assess it almost immediately.

That is why for official and financial incentives, an understanding of the transition period is crucial for the initiative to work to ensure financial stability. The IMF and the World Bank can play an important role in helping member countries in this regard. The ROSC exercise may not provide information with respect to compliance in the form desired by the private sector, but it can be useful in identifying constraints in member countries and in working out transition periods.

The importance of transition goes even further when thinking that the prioritized 12 codes will surely take many years to be implemented. How then to ensure financial stability during the transition period? This is particularly worrying since we do not know enough to ensure that at the end of the transition period the codes will really encourage financial stability.

Financial crises have many causes and the danger is that too much emphasis on compliance with standards – as have been stressed all along this paper – detracts the attention of the national and international communities from other policy measures that can bring about more immediate results (like the need for macroeconomic stability). The potential contribution of the standards and codes exercise to global financial stability is then confined only to the long run.

VI. THE WAY FORWARD

There are many issues for consideration in the standards and codes exercise indicating areas for further debate and research.

- The first step is the willingness of the international financial community to re-visit the objective function of the standards and codes exercise and examine the significance of standards and codes for global financial stability. The lack of linkages between open capital accounts, the degree of financial integration, key players in financial markets and the choice of countries for assessment of compliance with standards and codes necessitates a re-evaluation of the exercise. Moreover, the muted response of the private sector along with prioritization by the BWI indicates that the link may not as close as was originally envisaged.

- Presently, compliance with standards and codes is a global issue, although the incentive structure, monitoring mechanism and resources needed for assessment and implementation do not guarantee this.
- The tenuous link between standards and codes and global financial stability may need a re-definition of the objective function. It is suggested that financial sector reforms maybe an appropriate objective and we can make use of standards and codes as international best practices to benchmark financial sector reforms.
- Such a re-orientation of the exercise will reduce the need for quantitative and simplified information by the private sector on an on-going basis; resources required to produce ROSCs can be reallocated to a follow-up of the recommendations of the FSAP reports through technical assistance to developing countries.
- Healthy balance sheets in both the macro and corporate financial sectors are crucial in averting disaster. The World Bank is already working on indicators of financial soundness. Technical assistance can play a role in ensuring the quality of financial sector balance sheets. In terms of prioritization, is this not the first priority?
- The emphasis on standards and codes exercise is closely linked to the degree of international financial integration. Recent research has failed to confirm the link between financial sector liberalization and growth. The sequencing and prioritization of the standards and codes needs to be integrated into the discussion of the degree of financial sector liberalization and work out transition periods instead of instant assessments of compliance for developing countries.
- Lastly, and most important, G7 finance ministers need to recognize that standards and codes on their own are unlikely to provide protection against capital surges and financial crises. Healthy financial sectors are necessary but not sufficient. The crucial need is for a mechanism for provision of liquidity when the first signs of problems emerge, so that a disaster can be averted. The IMF's Contingent Credit Lines, which lapsed in November 2003, went unused because of the conditions attached. Other important areas for policy intervention are debt resolution and even defining the threshold levels of debt for middle income countries.

ANNEX

Annex 1

Countries' participation in standard-setting bodies

	Monetary Policy and Financial Policies	*Fiscal Transparency*	*Data Dissemination*	*Insolvency and Creditor Rights Systems*	*Corporate Governance*	*International Accounting Standards*	*International Auditing Standards*	*Systemically Important Payment Systems*	*Banking Supervision*	*Securities Regulation*	*Insurance Core Principles*
Organization	*IMF International Monetary Fund*	*IMF International Monetary Fund*	*IMF International Monetary Fund*	*WB World Bank*	*OECD Organization for Economic Cooperation and Development*	*IASB International Accounting Standards Board*	*IFAC International Federation of Accountants*	*CPSS Committee on Payment and Settlement Systems*	*BCBS Basle Committee*	*IOSCO International Organization for Securities Commissions*	*IAIS International Organization of Securities Supervisors*
Participation	183	183	183	183	30	160	122	G-10	13	99	66
					Australia Austria Beligum Canada Czech Republic Denmark Finland France Germany Greece Hungary Iceland Ireland Italy Japan Korea Rep. of Luxemburg Mexico Netherlands New Zealand Norway Poland Portugal Slovak Republic Spain Sweden Switzerland Turkey United Kingdom United States				Belgium Canada France Germany Italy Japan Luxemburg Netherlands Spain Sweden Switzerland United Kingdom United States		

Source: Organizations websites and Financial Stability Forum: http://www.fsforum.org/compendium_of_standards_issuing_body_14.html.

Annex 2
Membership in FSF working groups

	Task force on Implementation of Standards	*Incentives to Foster Implementation of Standards*	*Working Group on Capital Flows*	*Working Group on Offshore Centres*	*Working Group on Enhanced Disclosure*	*Working Group on Highly Leveraged Institutions*	*Working Group on Deposit Insurance*
Established	*September 1999*	*April 2000*	*April 1999*	*April 1999*	*June 1999*	*April 1999*	*April 2000*
Ended	*March 2000*	*September 2001*	*April 2000*	*April 2000*	*April 2001*	*April 2000*	*April 2001*
TOR	To explore issues related to and consider a strategy for fostering the implementation of international standards for strengthening financial systems.	To monitor progress in implementing core standards and further raise market awareness of standards.	To evaluate measures in borrower and creditor countries that could reduce the volatility of capital flows and the risks to financial systems of excessive short-term external indebtedness.	To consider the significance of offshore financial centres for global financial stability.	To assess the feasibility and utility of enhanced public disclosure by financial intermediaries.	To recommend actions to reduce the destabilizing potential of institutions employing a high degree of leverage (HLIs) in the financial markets of developed and developing countries.	To review recent experience with deposit insurance schemes and consider the desirability and feasibility of setting out international guidance for such arrangements.
Final report	Issues of the task force on implementation of standards.	Final report of the Follow-Up group on incentives to foster implementations of standards	Report of the working group on capital flows.	Report of the working group on offshore centres.	Multidisciplinary Working group on enhanced disclosure Final Report.	Report of the working group on highly leveraged institutions.	Guidance for developing effective deposit insurance systems.
Member countries	Australia Canada China France Germany Hong Kong (China) (Chair) India Italy Japan Mexico Netherlands South Africa Sweden United Kingdom United States	Argentina Australia Canada France Germany (Chair) Hong Kong (China) India Italy Japan Sweden United Kingdom United States	Brazil Canada Chile France Germany Italy (Chair) Japan Malaysia South Africa United Kingdom United States	Canada (Chair) France Germany Italy Japan Singapore Switzerland Thailand United Kingdom United States	Australia Canada France Germany Japan Mexico Sweden United Kingdom United States	Australia Canada France Germany Hong Kong (China) Italy Japan Netherlands United Kingdom (Chair) United States	Argentina Canada (Chair) Chile France Germany Hungary Italy Jamaica Japan Mexico Philippines United States

Source: Financial Stability Forum: http://www.fsforum.org/publications/publication_24_67.html.

Annex 3
FSAP per fiscal year* (country groups)

	2000	*2001*	*2002*	*2003*	*2004*	*2005*
Key Players:						
G-10	Canada		Switzerland	Japan	*France*	*Italy*
			Sweden	Germany		
			United Kingdom			
Major EMEs	South Africa	Poland	Philippines	Hong Kong (China)		
	India	Mexico	Korea	Singapore		
			Brazil			
			Russia			
Non-key players:	Colombia	Ghana	Gabon	Kyrgyz Republic	Macedonia	Belarus
	Lebanon	Guatemala	Lithuania	Bangladesh	Jordan	*Sudan*
	El Salvador	Armenia	Luxemburg	Honduras	Kuwait	*Norway*
	Hungary	Israel	Costa Rica	Malta	New Zealand	*Belgium*
	Iran	Peru	Bulgaria	Mauritius	*Kenya*	*Paraguay*
	Kazakhstan	Yemen	Sri Lanka	Oman	*Ecuador*	*Rwanda*
	Ireland	Senegal	Morocco	Mozambique	*Azerbaijan*	*Serbia*
	Cameroon	Slovenia	Nigeria	Tanzania	*Austria*	*Albania*
	Estonia	Iceland	Slovak Republic	Romania	*Netherlands*	*Jamaica*
		Czech Republic	Barbados	Algeria	*Nicaragua*	Trinidad and Tobago
		Uganda	Ukraine	Bolivia	*Chile*	*Bahrain*
		Dominican Republic	Egypt		*Saudi Arabia*	Spain
		United Arab Emirates	Zambia		*Pakistan*	
		Latvia			*Moldova*	
		Tunisia			*ECCU*	
		Finland				
		Croatia				
		Georgia				
Total key players	3	2	7	4	1	1
Total non-key players	9	18	13	11	15	12
Total G-10	1	0	3	2	1	1
TOTAL	12	20	20	15	16	13
FSAP Updates		Lebanon	Hungary	Iceland	Ghana	*Senegal*
		South Africa			Slovenia	*Colombia*
					Kazakhstan	*Uganda*
					El Salvador	*Nigeria*
TOTAL	12	22	21	16	20	17
Average FSAP reports per year/only completed reports:		16				
Average FSAP reports per year completed and ongoing/planned reports:		18				

Source: IMF, Independent Evaluation Office. "Evaluation of the Financial Sector Assessment Program (FSAP)". Draft Issues Paper, APPENDIX I, p. 18, 25 August 2004.

* Countries in italics have ongoing or planned FSAP.

Annex 4
Standards and Codes: Outreach activities of the IMF and the World Bank

Since 1999 the IMF and the World Bank have conducted and encouraged a series of outreach seminars at the worldwide level. The program of seminars was officially launched in summer 2000 and, up to the last available report,[55] six rounds of seminars had been held in 24 countries.

Although national authorities have hosted the seminars, they have rather focused on the financial and the non-financial private sectors. These include "representatives from commercial banks, investment banks, professionals involved in country and credit risk assessment and ratings; fund managers and equity analysts".[56] The official sector, the media and the academia have been represented as well.

Reported outreach seminars 2000–2002

Date	*Place*
July 2000	Hong-Kong (China), Japan, Singapore, Thailand
September 2000	Czech Republic (Annual meetings)
November 2000	Argentina, Belgium, Brazil, Chile, Egypt, South Africa, United Kingdom
April 2001	Australia, Bahrain, Hong Kong (China), Philippines
February 2002	France, Germany, Italy, Spain, Tunisia
August 2002	China, Hungary, Russia

Comments received from seminar participants regarding S&C:[57]

- Technical assistance would need to be available once weaknesses are identified.
- The official sector is concerned about the awareness of the importance of S&C among the private sector.
- There are concerns about the complexity of standards.
- ROSCs could be more accurate assessments than private sector assessments about compliance.
- There are concerns about the resources needed to collect required information.
- There are concerns about the varying coverage of ROSCs.
- The IMF was urged to expand the audience for Standards dissemination and to constantly update ROSCs.
- The private sector recognized the influence of standards on their credit risk analysis.
- There is heterogeneous interest and knowledge of standards among the private financial sector.
- Interest to enhance ROSCs: shorter, standardized format and broader country coverage.
- Concern about timely publications and updates.
- Need to distinguish between support to good practices and effective implementation.

A survey of the private sector's awareness and use of the information on standards was performed by the IMF. It complemented the feedback received during the outreach activities and was applied to the major financial institutions worldwide. The main results were as follow:[58]

- Most institutions considered international standards and codes as important for decision making;
- They see the use of standards and codes information increasing overtime;
- Most institutions considered adherence to standards as a factor in country risk assessment methodologies;
- Preferences for ROSCs components reflected the line of business of each institution (fiscal ROSC for sovereign risk ratings, for example).
- Participants made suggestions to enhance ROSCs: increased frequency of updates, uniform structure and clearer language.
- Respondents recognized that the non-publication of ROSCs by a country would negatively affect its perception by the market.

[55] "International Standards: Background Paper on Strengthening Surveillance, Domestic Institutions and International markets", p. 20. Washington DC, Policy Development and Review Department, International Monetary Fund, 5 March 2003.
[56] Ibid.
[57] Ibid., p. 21.
[58] Ibid., p. 27–29.

No updated information regarding outreach activities is registered in 2004 (either in the IMF-WB publications or the Financial Stability Forum). The newest report on Standards and Codes published by the IMF is the Quarterly Report on Assessment and dates from 7 August 2003.[59]

A working paper published in October 2003[60] presented findings on outreach and surveys on the use of fiscal ROSCs by the financial markets and civil society (rating agencies, financial analysts, and civil society organizations).

The main findings are:

- Key sectors of the financial markets -sovereign rating analysts and U.S. based international investment banks- are making extensive use of fiscal ROSCs.
- But awareness is relatively limited in the broader international investment community.
- The level of awareness of fiscal ROSCs is also lower amongst broader civil society, only with a few exceptions.

The main conclusions regarding the improvement of ROSCs[61] are:

"Fiscal ROSCs should:

- Differentiate more clearly between significant and minor nonobservances of the Code;
- Pay particular attention to describing the extent and quality of publicly available information on off-budget activities, contingent liabilities, and quasi-fiscal activities.
- Where quantitative assessments of these have been produced (for example, in published IMF or World Bank reports), these should be cited;
- Provide a clear assessment of the extent to which a country's fiscal data are consistent with recognized international standards;
- Provide better signposting of the contents of the ROSC to ease the task of infrequent readers or those interested only in the Executive Summary or the IMF staff commentary;
- Disclose the publication policy on the cover page; and,
- Provide a contact point for inquiries.
- Fiscal ROSC missions should, with the permission of the authorities, routinely meet in-country with legislative staff and officials, and with representatives of the domestic business community, civil society organizations, and academics and researchers in the course of completing their fiscal transparency assessment.
- Greater outreach efforts would be worthwhile including such activities.
- The publication of each completed ROSC could be accompanied by a plain-language press release aimed at nonspecialists, which would be disseminated within the country as well as being posted on the IMF's website.
- IMF missions and resident representatives could be more proactive in flagging key issues identified in fiscal ROSCs in their presentations and press conferences.
- ROSCs could be translated into the national language for in-country dissemination.
- An e-mail notification service could be offered to those interested in being informed when a new fiscal ROSC or ROSC update is published.
- The information on the SDDS Bulletin Board on the fiscal sector could be supplemented, for example, with the addition of lines indicating whether contingent liabilities are disclosed and whether a fiscal ROSC is available.
- Consideration could be given to posting a periodic Fiscal Transparency Update on the web site that provides information on fiscal ROSCs published in the previous period and pulls together information on developments relevant to fiscal transparency in individual countries contained in recent IMF publications.

[59] "Quarterly Report on the Assessments of Standards and Codes". Washington, DC, Policy Development and Review Department, International Monetary Fund, 7 August 2003.
[60] Petrie (2003).
[61] Ibid., pp. 22–24.

- IMF could publish further periodic analyses of the findings of fiscal ROSCs, including cross-country comparisons. It could also make its fiscal ROSC database and search tools available on its external website to make it easier for users to search by issue or group of countries.
- Greater efforts by the IMF to produce and support new research on the impacts of fiscal transparency on fiscal and financial market performance and to disseminate the results of the research widely could be of major benefit."

Other outreach seminars as reported by the Financial Stability Forum[62]

(Official and private sectors)

Date	*Host*
October 2000	IMF-WB workshop on FSAP (Washington, DC).
	IAIS annual conference (Cape Town).
December 2000	Banca d'Italia workshop for EMEs Central Banks (Rome).
	IAIS and Joint Vienna Institute seminar on Insurance Core Principles (Vienna).
	Banque de France-WB workshop on global financial sector standards (Versailles).
January 2001	IAIS-Bank Negara Malaysia-OECD seminar on Insure Core Principles (Kuala Lumpur).
March 2001	IMF-WB Conference on International Standards and Codes (Washington, DC).
	US-Treasury presentation on Standards to sovereign analysts and rating agencies (United States).
April 2001	IAIS seminar on Insurance Core Principles (Singapore and Basel).
	IADB session on implementation of standards.
May 2001	Asian Development Bank annual meeting.
June 2002	IAIS seminar on Insurance Core Principles (Antigua and Buenos Aires).
July 2001	IAIS seminar on Insurance Core Principles (South Africa).
August 2001	US Authorities – IMF-WB seminar for commercial and investment bank analysts and risk managers (New York).
	IAIS seminar on Insurance Core Principles for insurance supervisors from offshore jurisdictions.

[62] "Final Report of the Follow Up Group on Incentives to Foster Implementation of Standards", Financial Stability Forum, August 2001, pp. 22–24.

Annex 5
Observations on fiscal transparency

	DATA QUALITY				OFF-BUDGET FISCAL TRANSPARENCY			TAX POLICY & ADMINISTRATION	
	Budget realism	*Budget execution data*	*Coverage of fiscal activity*	*External audit*	*Contingent liabilities*	*Quasi-fiscal operations related to financial sector*	*Quasi-fiscal operations related to NFPEs*	*Report tax expenditures*	*Tax Administration*
Developing economies	**Unrealistic budgeting prevalent:** outturns differ greatly from original budget; obligations (e.g. utilities) not covered; overuse of supplementaries	**Weak ex-post data and control procedures:** data not reconciled; non-clearance of suspense accounts; irregular procedures; arrears or netting out common and unreported	**Coverage inadequate:** incomplete data on general government; MOF and central bank coverage differ; extrabudgetary funds excluded; foreign financed projects excluded	**External audit is weak:** audit of the final accounts is absent or with long lags; inadequate resources and weak technical capacity; little or no follow up on findings	**Generally prevalent and not reported**	**Quasi-fiscal activity prevalent and not reported:** interest rates, lending policies, loan guarantees and/or individual lending decisions subjected to political direction	**Quasi-fiscal activity prevalent and not reported:** administratively determined (employment, price setting, or cross subsidizing); other non-commercial functions not covered by subsidies	**Data on tax expenditures not published**	**Generally subject to administrative discretion:** unclear rules; inadequate or bureaucratic appeal procedures; and/or poor observation of existing laws
Benin	x	x	x	x	x	5/	5/	x	
Burkina Faso	x	x	x	x	x	x	5/	x	
Cameroon	x	x	x	x	x	x	X	x	X
Egypt	x	x	x		x	x	X	x	X
Honduras	x	x	x	x	x	5/	X	x	X
Malawi	x	x	x	x	3/	x	X	x	X
Mali	x	x	x	x	x	5/	5/	x	
Mozambique	x	2/	2/	2/	x	5/	5/	x	
Nicaragua	x	x	x	x	x	5/	X	x	
Pakistan	x	x	x	1/	1/	x	X	1/	x
Papua New Guinea	x	x	x	x	3/	x	X	x	
Philippines	x	x	x	x	x	5/	X	4/	x
Sri Lanka	x			x	x	5/	X	x	x
Tanzania			x	x	3/	5/	X	x	*
Tunisia	x				x	x	X	x	2/
Uganda	*	x	x	1/	x	x	X	x	x
Zambia	x	x	x	x	x	x	X	x	

Source: Fiscal ROSC completed as of 31 October 2002 (based on practices noted at the time of the ROSC mission) for the respective countries. Observations do not reflect post-ROSC improvements unless they are noted in a subsequent ROSC update.

Notes: ***x*** indicates that the heading applies substantially; blank or a footnote indicates that the practice is significantly better than the heading description.
***** signifies observation not sufficiently detailed.
1/ Recent improvements (supported by TA) were noted in the ROSCs. *2/* Improvements noted in ROSC update. ***3/*** Contingent liabilities shown in annual accounts. ***4/*** Limited information provided with budget. ***5/*** Not reported but government involvement is limited.

/…

Annex 5 (continued)
Observations on fiscal transparency

	DATA QUALITY				OFF-BUDGET FISCAL ACTIVITY			TAX POLICY & ADMINISTRATION	
	Budget realism	*Budget execution data*	*Coverage of fiscal activity*	*External audit*	*Contingent liabilities*	*Quasi-fiscal operations related to financial sector*	*Quasi-fiscal operations related to NFPEs*	*Report tax expenditures*	*Tax administration*
Transition economies	**Generally not realistic:** under funded utilities a common issue	**Generally sound public accounts data:** some have major problems monitoring of arrears as indicated below	**Coverage has improved substantially:** some need to improve coverage of EBFs and own revenue accounts as indicated below	**External audit is relatively recent and still weak**: inadequate resources or not yet fully operational	**Generally prevalent and not reported**	**Quasi-fiscal activity prevalent and not reported:** politically directed non-commercial obligations, directed lending, and/or below market interest rates.	**Quasi-fiscal activity prevalent and not reported:** energy sector quasi-fiscal deficit a prevalent problem; below cost pricing; non-commercial service	**Data on tax expen-ditures not published**	**Negotiated taxes and discretionary practices in tax administration**
Armenia				x	x		x	x	x
Azerbaijan	x	x	x	x	x	x	x	x	x
Bulgaria	x		1/	*	2/	2/	2/	1/	1/
Kazakhstan			x	x	4/	x	5/	x	x
Kyrgyz Republic	x	x	x	x	x		x	x	x
Latvia				x	3/	5/	5/	x	
Mongolia	x	x	x	x	x	x	x	x	x
Ukraine	x			x	x	x	x	x	x

Source: Fiscal ROSC completed as of 31 October 2002 (based on practices noted at the time of the ROSC mission) for the respective countries. Observations do not reflect post-ROSC improvements unless they are noted in a subsequent ROSC update.

Notes: ***x*** indicates that the heading applies substantially; blank or a footnote indicates that the practice is significantly better than the heading description.

* signifies observation not sufficiently detailed.

1/ Improvements noted in ROSC update. ***2/*** Data reported to legislature. ***3/*** Data published but incomplete. ***4/*** Regular reports on debt and guaranteed debt made available to the public. ***5/*** Privatization has reduced quasi-fiscal activity generally.

/…

Annex 5 (continued)

Observations on fiscal transparency

	DATA QUALITY				OFF-BUDGET FISCAL ACTIVITY			TAX POLICY & ADMINISTRATION	
	Budget realism	*Budget execution data*	*Coverage of fiscal activity*	*External audit*	*Contingent liabilities*	*Quasi-fiscal operations related to financial sector*	*Quasi-fiscal operations related to NFPEs*	*Report tax expenditures*	*Tax administration*
Emerging market economies	**Generally realistic budgets:** some continuing weakness as indicated below	**Generally sound reporting:** some need to improve reconciliation and/or arrears monitoring as indicated below	**Coverage of general government a common issue:** lack of timely data on subnational governments, EBFs or use of privatization proceeds; and/or general government data not properly consolidated	**Generally sound external audit function:** some require more formal or systematic follow up on findings as indicated below	**Generally prevalent and not reported**	**Frequent occurrence and not reported:** politically directed non-commercial obligations: directed lending: and/or below-market interest rates	**Frequent occurrence and not reported:** non-commercial functions not fully covered by subsidies; and/or policy directives regarding price, input and employment decisions	**Data on tax expenditures not published**	**Excessive use of tax exemptions:** non-transparent tax laws that permit discretion; and/or limited taxpayer rights
Brazil	x		2/	x					
Czech Republic			x	x	1/	x	x	x	
Estonia		1/	1/	x		5/	5/	x	
Hungary		x	1/			4/	4/	4/	
India	x		2/			x	x	x	x
Korea Rep. of	x		x		3/	x	x	4/	x
Mexico		x	x	x	x	x	x	3/	x
Poland	x	x			4/	5/	5/	4/	x
Russia	x	x	x	6/	x	x	x	x	x
Slovak Republic						5/	x	x	
Slovenia		x	x		x	5/	5/	x	
South Africa				x	x			4/	
Turkey	x	x	x	6/	x	x	x	x	x
Uruguay			x	x	x	x	x	x	x

Source: Fiscal ROSC completed as of 31 October 2002 (based on practices noted at the time of the ROSC mission) for the respective countries. Observations do not reflect post-ROSC improvements unless they are noted in a subsequent ROSC update.

Notes: ***x*** indicates that the heading applies substantially; blank or a footnote indicates that the practice is significantly better than the heading description.

***** signifies observation not sufficiently detailed.

1/ Improvements noted in ROSC update. ***2/*** Lack of timely subnational data is the main problem. ***3/*** Reported to legislature. ***4/*** Partial data published. ***5/*** Privatization has reduced quasi-fiscal activity generally. ***6/*** Main issue is to limit pre-audit functions and strengthen focus on ex-post audit.

/…

Annex 5 (concluded)

Observations on fiscal transparency

	DATA QUALITY				OFF-BUDGET FISCAL ACTIVITY			TAX POLICY & ADMINISTRATION	
	Budget realism	*Budget execution data*	*Coverage of fiscal activity*	*External audit*	*Contingent liabilities*	*Quasi-fiscal operations related to financial sector*	*Quasi-fiscal operations related to NFPEs*	*Report tax expenditures*	*Tax administration*
Advanced economies	**Generally sound:** some need to move to higher standards on medium-term estimates, analyzing risks and developing performance indicators, as indicated below	**Good monitoring of budget execution:** some need to improve timeliness of reporting within year data, as indicated below	**Generally sound:** some could improve reporting on general government, as indicated	**Generally sound:** some could improve mechanisms to follow up on findings	**Most publish full information on contingent liabilities**	**Generally not reported but limited:** some directed lending or lending at below market interest rates, as indicated below	**Generally not reported but limited:** some social obligations funded by NFPE or regulation, as indicated	**Most publish full information on tax expenditures with the budget document**	**Excessive use of tax exemptions:** non-transparent tax laws that permit discretion; and/or limited taxpayer rights
Canada		x	x						
France	1/	1/		1/		x	x		
Greece	x	x	x,1/			x	x		3/
Italy	x	x	x	x	2/		x		x
Japan	x	x	x		2/	x	x	x	3/
Sweden				x,1/					3/

Source: Fiscal ROSC completed as of 31 October 2002 (based on practices noted at the time of the ROSC mission) for the respective countries. Observations do not reflect post-ROSC improvements unless they are noted in a subsequent ROSC update.

Notes: ***x*** indicates that the heading applies substantially; blank or a footnote indicates that the practice is significantly better than the heading description.
******* signifies observation not sufficiently detailed.
1/ Improvements noted in ROSC update. ***2/*** Partial information published. ***3/*** Clear rules apply to limited discretion.

Annex 6
Summary of compliance with key financial standards

		SDDS	*MPTP*	*FPTP*	*IF*	*IAS*	*CGP*	*ISA*	*ML*	*PSP*	*IPS*	*EBS*	*ESR*	*ISCP*
1	Canada	4	5	5	0	1	3	1	4	4	5	5	4	5
2	France	4	5	4	0	3	3	3	4	4	4	5	3	2
3	Germany	4	5	5	0	2	4	3	4	4	4	4	4	4
4	Italy	4	5	4	2	2	3	3	4	0	4	3	0	0
5	Japan	4	3	4	3	0	3	1	4	0	4	2	0	0
6	Sweden	4	4	4	0	2	3	3	4	3	4	3	3	3
7	Switzerland	4	4	0	0	1	2	3	5	5	5	4	4	2
8	United Kingdom	4	5	4	3	3	4	3	5	3	4	4	4	4
9	United States	4	5	5	4	1	4	0	4	5	5	5	5	4
10	Argentina	4	3	3	3	2	3	3	3	0	0	2	3	3
11	Brazil	4	4	4	2	1	0	2	4	0	0	0	0	0
12	Hong Kong (China)	4	4	5	4	2	2	3	3	2	3	4	5	4
13	India	4	2	3	1	2	3	1	3	2	0	4	1	2
14	Korea Rep. of	4	3	3	2	1	3	3	3	4	4	4	4	4
15	Mexico	4	4	4	3	2	3	3	4	3	2	2	2	3
16	Philippines	4	4	3	0	3	3	3	3	0	0	3	4	0
17	Poland	4	4	3	3	2	3	2	2	2	4	4	4	2
18	Russia	3	2	3	2	3	3	3	3	1	2	3	2	3
19	Singapore	4	3	3	4	3	3	3	4	0	4	3	4	4
20	South Africa	4	4	3	0	3	2	3	3	4	4	4	0	0
21	Turkey	4	4	2	0	2	2	3	4	0	0	2	2	0

Source: Author's summary based on information from *e*Standards Forum.

Index: SDDS = Core Principles of the IMF Special Data Dissemination Standard
MPTP = Monetary Policy Transparency Practices
FPTP = Fiscal Policy Transparency Practices
IF = Insolvency Framework – Key Principles
IAS = International Accounting Standards
CGP = Corporate Governance Principles
ISA = Usage and Implementation Status of International Standards on Auditing
ML = Recommendations on Money Laundering
PSP = Responsibilities of central bank in applying the payment system principles
IPS = Core Principles for Systemically Important Payment Systems
EBS = Core Principles of Effective Banking Supervision
ESR = Principles of Effective Securities Regulation
ISCP = Insurance Supervision Core Principles

Notes: 5= Full Compliance
4=Compliance in Progress
3=Enacted
2=Intent declared
1=No Compliance
0=No assessment available

Annex 7

The Role of ROSCs in risk assessment methodologies by rating agencies

As a result of the Mexican and Asian crisis the methodology to analyze sovereign risk went through some changes. Especially, after 1997 greater emphasis was put on off-budget and contingent liabilities, reserves adequacy and more detailed data about external debt.[63]

For the rating agencies (Standard and Poor's in this case) the ROSC initiative was not the cause of the shift in their methodological approach, although it is considered as "helpful information".[64]

However, it is also accepted that there has been advances in the data produced by countries, especially in the financial area, in public sector statistics (outside the central government) and in external balance sheet information. It is also accepted that information is now more comprehensive and timely. But most changes have to be tracked in a case-by-case basis; there is no generalized "worldwide" new creation of data.

How much of these advances can be attributed to the S&C and ROSC initiative?

In words of S&P: "the growth of internet has radically improved the timeliness and availability of a wide variety of data. Also *instrumenta*l is the greater focus on transparency sought by the IFIs and other global market participants, including the rating agencies".[65] So, if ROSC have helped, they are *part of* and not *the single* most important factor for the progress of data disclosure and dissemination.

The table below compares and highlights the methodology employed by S&P for sovereign rating; shaded areas and topics are those that have been added, changed, or simply emphasized in a new manner with respect to 1997.

GENERAL SOVEREIGN RATINGS METHODOLOGY:*
STANDARDS & POOR'S

PRE-CRISIS (APRIL 1997)		POST-CRISIS (2004)	
Indicator	*Key variables*	*Indicator*	*Key variables*
1) Political stability	▪ Form of government and adaptability to political institutions ▪ Extent of popular participation ▪ Orderliness of leadership succession ▪ Degree of consensus on economic policy objectives ▪ Integration in global trade and financial system ▪ Internal and external security risks	1) Political stability	▪ Stability and legitimacy of political institutions ▪ Popular participation in political processes ▪ Orderliness of leadership succession ▪ Transparency in economic policy decisions and objectives ▪ Public security ▪ Geopolitical risk
2) Economic prospects I: structure	▪ Living standards, income and wealth distribution ▪ Market, non-market economy ▪ Resource endowments, degree of diversification	2) Economic prospects I: structure	▪ Prosperity, diversity, and degree to which economy is market-oriented ▪ Income disparities ▪ Effectiveness of financial sector in intermediating funds; availability of credit ▪ Competitiveness and profitability of non-financial private sector ▪ Efficiency of public sector ▪ Protectionism and other non-market influences ▪ Labour flexibility

[63] Bhatia(2002:8).

[64] Indeed, Fitch has recognized that "When credit analysts do not have access to the information, they will tend to assume the worst, so, potentially, better data could lead to higher ratings. However it is difficult to find evidence for this. Defaulting Argentina has been a keen provider of data. At the other end of the scale, highly-rated countries such as Bermuda and San Marino do not offer much data". Lionel Price, "Standards and Codes - Their Impact on Sovereign Ratings". Special Report, Fitch Ratings, 2002, p. 4.

[65] E-mail communications with Marie Cavanaugh.

Pre-crisis (April 1997)		**Post-crisis (2004)**	
Indicator	*Key variables*	*Indicator*	*Key variables*
3) Economic prospects II: growth	▪ Size, composition of savings, and investment ▪ Rate, pattern of economic growth	3) Economic prospects II: growth	▪ Size and composition of savings and investment ▪ Rate and pattern of economic growth
4) Fiscal flexibility I: budgetary flexibility	▪ General government operating and total budget balances ▪ Tax competitiveness and tax raising flexibility ▪ Spending pressures	4) Fiscal flexibility I: revenue, expenditure and balance performance	▪ General government revenue, expenditure and surplus/deficit trends ▪ Revenue raising flexibility and efficiency ▪ Expenditure effectiveness and pressures ▪ Timeliness, coverage and transparency in reporting ▪ Pension obligations
5) Fiscal flexibility II: public debt	▪ General government financial assets ▪ Public debt and interest burden ▪ Currency composition, structure of public debt ▪ Pension liabilities ▪ Contingent liabilities	5) Fiscal flexibility II: debt and interest burdens	▪ General government gross and net (of assets) debt as a percent of GDP ▪ Share of revenue devoted to interest ▪ Currency composition and maturity profile ▪ Depth and breadth of local capital markets
		6) Fiscal flexibility III: off-budget and contingent liabilities	▪ Size and health of non-financial public sector enterprises ▪ Robustness of financial sector
6) Price stability	▪ Trends in price inflation ▪ Rates of money and credit growth ▪ Exchange rate policy ▪ Degree of central bank autonomy	7) Monetary stability	▪ Price behaviour in economic cycles ▪ Money and credit expansion ▪ Compatibility of exchange rate regime and monetary goals ▪ Institutional factors such as central bank independence ▪ Range and efficiency of monetary policy tools
7) External flexibility I: BOP flexibility	▪ Impact on external accounts of fiscal and monetary policies ▪ Structure of the current account ▪ Composition of capital flows	8) External flexibility I: liquidity	▪ Impact of fiscal and monetary policies on external accounts ▪ Structure of the current account ▪ Composition of capital flows ▪ Reserve adequacy
8) External flexibility II: external debt and liquidity	▪ Size and currency composition of public external debt ▪ Importance of banks and other public and private entities as contingent liabilities of the sovereign ▪ Maturity structure and debt service burden ▪ Debt service track record ▪ Level, composition of reserves and other public external assets	9) External flexibility II: public sector net external debt	▪ Gross and net **public sector** external debt, including structured debt, as a percent of current account receipts ▪ Maturity profile, currency composition and sensitivity to interest rate changes ▪ Access to concessional funding ▪ Debt service burden
		10) External flexibility III: bank and private sector net external debt	▪ Gross and net **financial sector** external debt, including deposits and structured debt, as a percent of current account receipts ▪ Gross and net **non financial private sector** external debt, including structured debt as a percent of current account receipts ▪ Maturity profile, currency composition, and sensitivity to interest rate changes ▪ Access to concessional funding ▪ Debt service burden

Sources: Beers and Cavanaugh, 1997 and 2004.
***** Shaded cells and topics are those that are new, changed or were readdressed in the post-Asian crisis period.

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