GLOBALIZATION, CRISIS CONTAGION AND THE REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

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Abstract

The process of globalization has integrated financial markets and cross-border capital flows. This has resulted in the hyper mobility of capital and increased the vulnerability of nations to speculative attacks on their currencies. Capital flows deliver benefits in a first-best world. However, in a second-best world capital controls can reduce the welfare losses due to information asymmetry and other distortions. The speed and sequencing of capital account liberalization are critical to minimize the exposure of an economy to currency crises. Various types of currency crises and resulting contagion and its regional nature have been reviewed. Crisis contagion poses a systemic threat to the stability of the global financial system. Therefore the reform of the international financial architecture in order to minimize the occurrence of crises and crises contagion is matter of utmost importance. The role of the key players in the arena of global capital flows and the proposals for redesigning the international financial architecture are critically reviewed.

Key words: globalization, financial integration, speculative attacks, crisis contagion, convertibility of the capital account, reform of the international financial architecture.

1 THE PROCESS OF GLOBALIZATION

Globalization refers to the symbiotic forces of trade liberalization, revolutionary changes in information technology, labour mobility and the increasing integration of financial markets have intensified over the past two decades. These forces of globalization offer both new challenges and opportunities for developing countries (DCs) attempting to takeoff to rapid self-sustained growth. The financial integration (FI) or increased cross - border capital flows between advanced countries (ACs) and developing countries (DCs) involve potential benefits and costs. For example, the massive influx of capital into the high performance Asian economies (HPAEs) have resulted in miraculous growth rates enabling some of the countries to converge to the per capita income levels of the ACs (World Bank, 1993). However, low-income DCs that failed to lock into the processes of globalization and FI have been lagging behind and diverging from the per capita incomes of the ACs. The processes of globalization and FI whilst accelerating growth in some DCs has also exposed these countries to currency crises due to the sudden speculative attacks and capital flow reversals. Moreover, the occurrence of a crisis in one nation rapidly spreads to another nation in the globalized financial world. This phenomenon defined as crisis contagion has a regional character and poses a threat or systemic risk to the stability of the global financial system. Policymakers are engaged in addressing the issues relating to the redesign of the global financial institutions or the international financial architecture in order to reduce occurrence of crises and the spread of crisis contagion.

Section 2 of the paper reviews briefly the forces of globalization and financial integration. Section 3 enumerates the benefits of free capital flows in a first-best world where there is no market failure. Thereafter, the case for capital controls is reviewed in the context of the troubled world of second-best in order to reduce the adverse welfare effects due to market distortions. Section 4 reviews the leading models of currency crises that shed light on the causal mechanics that underpin speculative attacks and regional contagion. Section 5 presents a typology of crisis contagion and identifies the channels that transmit crisis contagion from one nation to another in the same region. Section 6 reviews the three-pronged strategy aimed at redesigning the international financial architecture in order to reduce speculative attacks on currencies and resulting crisis contagion. Section 7 critically reviews the reform proposals and concludes the paper.

2 GLOBALIZATION AND INCREASING FINANCIAL INTEGRATION (FI)

The symbiotic forces of trade liberalization, adoption of revolutionary information technology and financial deregulation have delivered visible growth economic benefits to some developing economies. These economies have converged or caught up with the per capita incomes of the rich countries as predicted by neoclassical growth theory (Solow, 1956).

Nations in the emergent globalized world of finance have also experienced some difficulties with macroeconomic policy design to address issues of internal balance. These countries have been racked by monetary policy impotence, when adopting a pegged exchange rate and having free capital mobility. Such a loss of policy independence foreshadowed in the 'open economy trilemma' or the impossibility theorem (Isard, 1995). If policymakers want to regain policy control to address issues of internal balance they would either have to abandon the currency peg or institute controls over free capital mobility thus precipitating an economic crisis.

Despite the loss of policy independence, free capital inflows under a pegged exchange rate regime resulted in miraculous growth performance by some Asian economies, christened the High Performance Economies of Asia (HPAEs) by the World Bank (1993). These economies beat the secular decline of the terms of trade that engulfed them as exporters of primary commodities as explained by the Singer-Prebisch thesis (Little, 1982). By adopting export oriented industrialization strategies that were financed by free capital inflows the HPAEs achieved spectacular growth rates during the two decades prior to the Asian crisis that hit them in mid-1977. The miracle growth rates financed by capital inflows motivated the International Monetary Fund (IMF) to spearhead a campaign of recommending open capital accounts or capital account convertibility for developing countries. To this end the IMF amended the Articles of the Bretton Woods Agreement. However, the Asian financial crisis and other financial crises have put a damper on the initial exuberance and there have been a rethink on the case for blanket removal of capital controls by DCs that suffer from congenital market failure or domestic distortions.

The lessons from the Asian and other financial crises demonstrate that open capital accounts with pegged exchange rate regimes in economies with fragile financial systems and implicit guarantees create currency crises. Misperceptions of risk by lenders in ACs and borrowers in DCs opens the door to speculative attacks. These attacks are extremely profitable to the highly leveraged speculators but lethal to the economic growth of nations. Nations that succumb to speculative attacks not only suffer from economic disruption but also spread the crisis through various channels to other nations in the region. The reform of the international financial architecture (IFA) to establish a more resilient international financial system is the most important priority in the international policy agenda (IMF, 2000). A redesigned IFA could reduce the vulnerability of national currencies to speculative attacks and thus contain the regional contagion of a crisis. But, it needs to be noted that a currency crises and regional contagion cannot be completely expunged from the global financial markets.

3 THE PROS AND CONS OF CAPITAL ACCOUNT CONVERTIBILITY.

The case for free cross-border capital flows (portfolio equity, debt instruments, and real asset transactions) where there are no restrictions on the capital account convertibility presents a free market or first best world conditions. In such a world just like free trade free capital mobility would be Pareto optimal and would result in the efficient allocation of financial resources globally. However, in reality most DCs operate in a second-best world riddled with market failure. In a second best world free capital flows can be welfare reducing. Therefore capital account convertibility or removal of all controls on cross-border capital flows entail costs or welfare losses. Furthermore in the troubled world of the second-best domestic distortions such as the fragility of the banking and financial systems could amplify the adverse effects of speculative attacks on the currency peg. The resulting currency crisis could also spread rapidly across national boundaries plunge the whole region into financial turmoil. Therefore, a second-best world there a compelling case could be made for the delay of full capital account convertibility or for the imposition of capital controls on short-term highly reversible cross-border capital flows. Moreover the speed and the sequencing of capital account liberalization have to be carefully crafted so as to minimize the welfare losses in a second-best world in which DCs operate. Otherwise, the influx of short-term capital into an unregulated fragile financial system would lead to asset price bubbles that would eventually burst and trigger financial crises as demonstrated by the Asian currency crisis.

The Asian currency crisis (1997) and before that the Mexican peso crisis (1994) amply demonstrate that free capital mobility or an open capital account could be a double-edged sword. On one side it bestows a cornucopia of economic benefits but on the other hand it could suddenly reverse capital inflows due to sudden changes in market sentiments. This could plunge an economy that was growing at a miraculous rate into the abyss of a catastrophic financial crisis. Such crises were manifest in the recent Asian crisis and the Mexican financial melt-down before that. The deleterious fall out from these crises were not confined to the domestic economy. But they rapidly spread across the region. Such regional crisis contagion was amply demonstrated both by the 'Asian flu' that followed the devaluation of the Thai baht in mid-1997 and by the ‘tequila effect’ that followed the devaluation of the Mexican peso in 1994.

Thus capital account convertibility or free capital flows offers impressive economic benefits to economies where free markets function efficiently. Such markets operate in the ACs or the OECD countries. However, in DCs markets plagued by market failure the case for rapid liberalization of capital account may be a recipe for a speculative attack on the country's currency. In such markets there is a case for sequencing capital account liberalization after market distortions are eliminated.

Therefore, the insights from the Asian and Mexican currency crises clearly indicate that the speed and sequencing of capital account liberalization are important issues that need to be addressed. The case for priortizing the convertibility of current account before opening the capital account (McKinnon, 1982) and the case for sequencing the reform of the weak domestic banking and financial sectors before liberalizing the capital account have been reviewed extensively in the recent literature (Dooley, 1996).

The pros for capital account convertibility or free capital mobility are based on the premise that a first-best world free of market failure prevails. The specific benefits of an open capital account are:

1. The efficient allocation of the world savings leading to high investment and growth rates worldwide. Savings constrained DCs would supplement their meagre domestic savings from the global pool of saving and by investing prudently could achieve higher growth rates. The open capital accounts in East Asia resulting in spectacular growth rates before the currency crisis in 1997 and the relatively closed capital accounts of South Asia and resulting sluggish growth could be cited to highlight the differential growth effects of open and closed capital accounts.

2. Intertemporal consumption smoothing, whereby a nation could borrow from the global capital market during times of economic downturn and repay the loans during periods of economic upturn. Thus smoothing consumption over the business cycle and stabilizing growth and welfare as postulated in the life cycle and permanent income hypotheses.

3. Lubrication of trade and investment flows by providing freer access to international finance and payments. The liberalized trade and capital accounts are cited as evidence in support of the of the success of export-oriented industrialization strategies pursued by the the miracle growth economies of East Asia prior to the currency crisis in mid-1997.

4. Exposure to the rigours of market discipline under an open capital account contributes to sound macroeconomic management. The markets would punish countries that pursue time-inconsistent policies that are prone to exacerbate inflationary pressures. Fund managers would diversify their investment portfolios away from countries that exhibit lax policies.

5. Encouragement of foreign direct investment (FDI) by transnational corporations (TNCs). The TNCs in their quest for globalization of production also transfer the magic package of new technology, marketing, managerial skills and firm specific assets that are in acute short supply in DCs.

6. Promotes the establishment of foreign banks and through competition and better management of the intermediation process reduces financial transaction costs. This contributes to the acceleration of investment and growth through financial deepening.

7. Obviates the pernicious effects of rent seeking and corruption that accompany capital controls. Thus reducing the welfare losses that accompany the directly unproductive activities (DUP) due to capital controls.

The real world of capital flows and DCs are riddled with market failure and distortions. The benefits of capital account convertibility recounted in the context of a first-best theoretical world do not exist in the real world riddled with asymmetric information and other market distortions. Therefore, in such a second-best world of distortions imposing capital controls rather than policy inaction can be shown to be welfare enhancing. Some of the major distortions that vitiate financial markets are enumerated for distortions due asymmetric or unequal information (for example borrowers have more information about the projects they invest in than lenders) and non-information distortions. The distortions due to asymmetric information are an intrinsic feature of financial markets are referred to as adverse selection, moral hazard and herding (Eichengreen et al., 1998). Of course these problems are not insurmountable as the lender can stipulate disclosure requirements from the borrower. Nevertheless, the problems constitute a challenge.

1. Adverse selection results from the selection of low quality investors in preference to high quality investors by lenders due to problems associated with the proper appraisal of the creditworthiness of an investment. Adverse selection of low quality borrowers by lenders lead to sub-optimal investment decisions that undermine efficiency and long-term growth.

2. Moral hazard results in excessive risk taking by some investors who take advantage of implicit guarantees. When projects fail they pass on the cost of failure and resulting to other parties or the tax-payers. An extreme form of moral hazard manifests itself as gambling for redemption, where financial intermediaries with negative net worth may engage in unhedged borrowing in foreign markets in the hope of speculative gains. Such high risk borrowing can finance an asset price bubble that bursts and passes on the bailout costs to international financial institutions and eventually to the tax-payer as testified by the recent currency crises in Asia and Mexico.

3. Herd or panic behaviour occurs when investors in financial markets follow a leader's action regardless of what the macroeconomic fundamentals foretell. Such herd behaviour leads to self-fulfilling expectations that cause switch from a good to bad equilibrium purely because of mass action or herd behaviour. These sudden panic or herd attacks can result in massive capital flow reversals and inflict severe economic hardships in economies that have pursued open capital accounts. Such panic attacks are due to incomplete processing of information by investors and they cause investment in the global financial markets to assume a casino type character.

Besides distortions due information asymmetry there are significant distortions that are of a non-information nature that undermine economic welfare of country pursuing an open capital account (Dooley, 1996; Cooper, 1998). These distortions are attributable to:

1. Policy ineffectiveness. For example, under a pegged exchange rate with perfect capital mobility monetary policy becomes ineffective as enunciated by the impossibility theorem derived from the Mundell-Fleming model for a small open macro economy.
2. Legal distortions. For example, the absence of well-defined property rights can result in capital flight and cause adverse welfare effects on the domestic economy. Capital controls can put a break, albeit for a short while, on such capital outflows.

3. Free trade induced distortions. For instance, the lack of controls can result in a labour abundant economy adopting inappropriate capital intensive techniques.

4. Distortions resulting from financial fragility. For example, excessive short-term borrowing in unhedged foreign currency by unregulated banks and lending to financial intermediaries ignoring guidelines of prudential supervision. Thus exposing the entire financial system to crisis vulnerability due to speculative attacks on the currency peg/

In a second-best world riddled by market distortions there is *prima facie* case for capital controls in order to reduce welfare losses due to free and volatile capital inflows and outflows. The case for "throwing sand on the wheels of international finance" or taxing short-term capital flows was proposed by (Tobin , 1978). It is estimated that the tax penalty designed to discourage round tripping in short-term capital flows would be trivial compared to the adverse effects it has on commodity trade or long-term FDI (Tobin, 1996). Moreover such a tax on short-term capital flows would reduce exchange rate volatility caused by extrapolative speculative activities of Chartists by favouring the foreign exchange activities of the Fundamentalists (Frankel, 1996).

Another measure of capital inflow controls could be found in the non-interest bearing deposit requirements imposed on short-term capital inflows or the *encafe* in Chile in 1991. Malaysia in 1997 introduced draconian capital ouflow controls to stop capital flight and thereby regained a measure of policy control as it was able to implement interest rate cuts to stimulate economic recovery. However, such unilateral controls on capital outflows by one country could lead to regional crisis contagion if investors with draw their funds in the expectation that other countries could also enact controls on capital outflows. Such capital controls should only considered only as a temporary stop-gap measure to arrest sudden capital flow reversals and would not be the ‘magic bullet' required to resolve currency crises and crises contagion (Bhattacharya and Miller, 1999: 365).

The sequencing and rapidity of financial market deregulation or liberalization of capital controls in DCs depend critically on the net benefits that accrue from the removal of market distortions. There is no magic formula for adoption by DCs in implementing policies of capital account liberalization. The Asian currency crisis is a grim reminder that countries open capital account without strengthening the domestic financial sectors are playing with the fire of currency crises and crises contagion.

4 MODELS OF CURRENCY CRISES

The type of currency crises that have engulfed world economies over the recent past can be stylized as first- second- and third-generation models. They provide insights on the causal mechanics that precipitate currency crises. An understanding of such causal mechanics is also useful to gain insights into the process of crisis contagion.

The first-generation or the canonical model of currency crises (Krugman, 1979; Flood and Garber, 1984) explains how speculative attacks caused the collapse exchange rate pegs in Latin American economies in the late 1970s and early 1980s. These models highlight the inconsistencies between macroeconomic policies and the commitment to the exchange rate peg as the cause triggering speculative attacks. For example, the monetization of recurrent budget deficits cause a depletion of foreign exchange reserves setting the stage for a speculative attack resulting in the collapse of the exchange rate peg. The collapse of the exchange rate forces devaluation by regional trading partners in order to maintain their competitiveness in trade and thus spreads the crisis contagion regionally.

The second-generation models of currency crises are based on the Exchange Rate Mechanism Crisis (1992) and the Mexican peso collapse (1994). These models attribute speculative attack on the currency to the market perception that the government would abandon the commitment to the peg when cost of maintaining the peg exceeds the benefits. Such cost-benefit calculations eventuate because the governments' pursue multiple objectives such as employment generation, reduction of the interest rate, besides maintaining the stability of the exchange rate. If the market expects that the government will abandon the exchange rate peg they would engage in self-fulfilling actions such as withdrawing their funds, thus causing a collapse of the exchange rate peg. A noteworthy feature of the second-generation models is that are based on self-fulfilling speculative attacks which occur in a multiple equilibria setting (Obstfeld, 1996; Flood and Marion, 1998). A change in market expectations could cause a switch from a no-run or good equilibrium to a run or bad equilibrium causing the collapse of the exchange rate peg in a manner analogous to bank runs (Diamond and Dybvig ,1983).

The third generation models attempt to stylize the causal mechanics underpinning the Asian currency crisis (1997) as the earlier generation models do not fit the bill. One version of the third-generation model attributes the crisis to implicit guarantees resulting in a massive influx of short-term capital resulting in an asset price bubble that was destined to burst and reverse the capital inflows. The moral hazard behaviour of financial intermediaries that were poorly regulated led to Panglossian investments in risky projects because they were implicitly assured of government bailouts in the event of collapse, partly because of the ‘crony capitalism’ that prevailed in these economies (Krugman, 1998a). Another version of the third-generation model identifies the fragile financial institutions as the cause for the build-up of unhedged short-term borrowing denominated in foreign currency. A sudden change in market sentiment causes panic and herd behaviour causing a reversal capital inflows that turns an illiquidity crisis into an insolvency and a currency peg collapse (Radlet and Sachs, 1998). The third-generation models whilst highlighting the weakness of domestic banking and financial systems also underscore the role played by moral hazard and panic behavior by foreign investors as important factors in triggering speculative attacks on a currency peg. The collapse of the peg also transmits the crisis contagion regionally through various channels engulfing the whole region and posing threats to the systemic stability of the global financial system.

5 CRISIS CONTAGION AND CHANNELS OF CONTAGION TRANSMISSION

Crisis contagion could be defined as the phenomenon of a currency crisis in one nation precipitating a currency crisis in another nation, often in the same region. Crisis contagion has been classified into three broad types by Masson (1999): 1. Monsoonal contagion where bad fundamentals in an AC trigger currency crisis in a DC. For example a rise in the US interest rate triggered the Mexican peso crisis in 1994 and the regional contagion from the crisis has been referred to as the 'tequila effect'. 2. Spillover contagion, occurs when a financial crisis in one DC precipitates a crisis in another DC. For example, the devaluation of the Thai baht caused a loss of competitiveness amongst regional trading partners causing a collapse of long-standing currency pegs. The regional contagion from the Thai crisis rapidly spread to other East Asian economies and the Asian currency crisis was regarded as the biggest threat to the global economic system since the Great Depression of the 1930s. 3. Sunspot contagion occurs when market sentiments shifts due to factors that are unrelated to a nation’s macroeconomic fundamentals. Sunspot contagion also defined as pure contagion shares characteristics with the self-fulfilling multiple equilibria that characterize the second and third-generation crisis models of currency crises discussed above.

The stochastic nature of multiple equilibria makes the design of early warning systems to predict a financial crisis and resulting contagion based on information collection a forlorn task. But nonetheless some argue that it does exculpate policymakers from the blame for resulting currency crisis as they could design policies to engineer the economy to the non-attack parameter range in multiple equilibria models.

Crises contagion could be transmitted from one nation to another by three types of channels related to trade, macroeconomics and finance (Glick and Rose, 1999): First, the trade channel, where a devaluation by one nation could undermine the export competitiveness of the trading partners to devalue and thereby trigger currency crises in amongst nations in the region. The inverse relation between trade and distance as captured by the gravity model further supports the contention that regional crisis contagion occurs through the trade channel. Second, the macroeconomic channel for crisis transmission postulates that nations in a region may affect countries in a region that share similar weak fundamentals such as: overvalued exchange rates, fragile financial systems, low reserves to broad money supply ratios. Such weak fundamentals increase the vulnerability of a nation to a speculative attack and its rapid replication in other nations in the region as foreign creditors withdraw funds by tarring all the economies in the region by the same brush. crisis contagion to economies. Third, the financial channel postulates that because of cross-country financial links, illiquidity in one national market may compel financial intermediaries to liquidate assets liquidation of assets in other markets in the region. The concentration of cross-border asset holdings regionally results in the spread of crisis contagion regionally.

Empirical analyses suggest the importance of trade channel, whilst not ruling out contributions by the other channels in precipitating a crisis. The finding that trade links transmit crisis contagion regionally suggests that reform of the IFA should focus more attention on the regional perspective rather than the narrow national perspective to minimize the ravages caused by speculative attacks and crisis contagion.

6 THE REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE (IFA)

The growing hyper mobility of cross-border capital short-term capital flows, the increasing volatility, the rise in frequency of speculative attacks and the disruptive nature of regional contagion have highlighted that the prevailing IFA needs to be redesigned to meet the needs of a new world economy of globalized finance. It has been observed that the capitalist system is in crisis mainly because it lacks a global institutional framework to regulate international capital flows (Soros, 1998). It has been suggested that the IMF should be abolished and replaced by a troika: a global financial regulator implementing codes and best practice banking standards; a lender of last resort (LOLR) to supply liquidity; and an International Bankruptcy Court to implement orderly debt workouts (Edwards, 1999). The need for reform of the IFA by redesigning it rather than by replacing it seems to be widely acknowledged. In this context it has been suggested that reform of the IFA should be conducted on a three-pronged basis. The three key-players in the IFA , the capital flow recipient nations, originating nations and the international financial institutions should be revamped (Fischer, 1999).

First, the capital flow recipient nations should:

i. Adopt sound macroeconomic policies and exchange rate regimes.

ii. Engage in better disclosure of information so as to warn about crisis and contagion build-up.

iii. Pursue sound banking practices as specified in the Basle Core Principles of Bank Supervision.

iv. Enagage in good corporate governance and establish bankruptcy courts on the lines of Chapter 12 of the US Bankruptcy code.

v. Institute capital controls if necessary as a last resort to safeguard the national currency from a speculative attack.

Second, the capital flow originating nations should:

i. Pursue policies to ensure that the locomotive economies of the world continue to grow.

ii. Adopt sound banking and financial practices so that international lending will not lead to build-up vulnerability to speculative attacks in recipient nations.

iii. Establish a Long-term Capital Management (LTCM) program by monitoring and dissuading the highly leveraged hedge funds and offshore financial centers from engaging in speculative attacks.

Third, the international financial institutions (IFIs) should:

i. Help to redesign the fragile banking and financial systems of DCs by introducing best practice codes of bank supervision and prudential regulation.

ii. provide reliable and timely information to the markets and to this end the compilation of data on the basis of the special data dissemination standards (SDDS) and general data dissemination standards (GDDS) are steps in the right direction.

iii. Undertake more effective surveillance are required by Article IV of the IMF charter. The publication of public information notices (PINs) and letters of intent (LOI) related to Article IV consultation are good moves.

iv. The reinforcing of IMF's lender of last resort (LOLR) role by establishing the Supplementary Reserve Facility (SRF) in 1997 the Contingency Credit Line (CCL) in 1999 will address issues of providing liquidity while at the same time reducing the dangers of moral hazard. The SRF is designed to provide loans at a penal rate subject to conditionality to countries in financial distress. While the CCL aims to provide precautionary funding to a nation vulnerable to a speculative attack.

7 CONCLUDING OBSERVATIONS

The belief that by reforming the IFA by providing more reliable and timely information and by improving surveillance procedures appear to be a trifle misleading. Simply because information asymmetry and resulting problems of adverse selection, moral hazard and herd behaviour is an intrinsic feature of financial transactions that is impossible to expunge. Therefore, the strategy of IFA reform based on the premise that superior information will fix the problems of recurrent speculative attacks that result in financial crises and crisis contagion is based on illusions. In the emergent borderless world of global finance we will have to live with crises and their regional spillover effects.

The IFA reform proposals as announced by the IMF web-site (http://www:imf.org/) do not appear to have given adequate attention to the need to redesign macroeconomic policy to implement a more effective and speedy recovery process. The IMF orthodox medicine of expenditure reduction and expenditure switching aggravated the Asian financial crisis. The fiscal and monetary contractions resulted in interest rate hikes that stifled export activity by a credit crunch that made even securing working capital problematic. But a more serious problem occurred when the massive devaluation increased the domestic currency value of the huge stocks of foreign liabilities. This caused the market to fear sovereign insolvency and it resulted in the sudden and brutal reversal of capital inflows. In reforming the IFA the need for policy design to meet the needs of a nominal anchor under exchange rate flexibility needs to be addressed. Whether inflation targeting aimed at increasing central bank policy credibility meets the challenge needs to be explored.

The reform of the IFA also has to address the task of risk management of lenders in Acs. AC creditors engage in moral hazard behaviour by lending to risky ventures in DCs because they are aware of implicit guarantees provided by both the DCs and the bailout provisions under the IMF LOLR function.

In the new IFA the conflicts that could arise due to the overlapping jurisdictions of the IMF and the World Bank needs to be resolved. The IMF or the Fund has been called upon to improve surveillance and engage in institution building. The latter task of institution building was the concern of the Bank rather than the Fund and there is a need for coordination of the activities of the two organizations to implement this function effectively. Furthermore, the Fund as the LOLR could have a conflict of interest when acting as a regulator and the need to separate the activities of supervision and regulation as in national jurisdictions need to be addressed.

The establishment of proper bankruptcy, stand-still and debt-work out procedures also remain to be addressed through the establishment an appropriate legal and institutional framework.

In conclusion, the reform of the IFA presents enormous challenges to policymakers. The task of reforming the IFA has commenced in earnest but it has a long way to go before it results in reducing the risks of sudden speculative attacks and crisis contagion that endangers the stability of the global financial system.

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