

Sustainable Finance: Seeking Global Financial Security

Addressing the critical need for a more integrated and sustainable financial system, this paper draws together an overview of viewpoints from a range of different groups and sectors. Firstly, it examines current trends in the financial system. The paper then goes on to describe some existing instruments and institutional frameworks to deal with the causes and consequences of:

1. Short term financial volatility and crises
2. Long term financial insecurity

It profiles some key ideas that have been proposed for financial reform, before finally considering key questions that will need to be addressed in the future.

BACKGROUND

At the UN Commission for Sustainable Development (CSD 8) and the World Summit on Social Development (Copenhagen +5) last year governments committed to investigate new mechanisms toward enhancing global financial security. They agreed that the current system has not attained the objectives of poverty eradication, social equality, environmental sustainability and economic growth. They also recognised that although financial markets profit from a certain degree of volatility, the markets do not take account of the consequential impacts of crises and financial risk on poor communities and the environment, especially in developing countries.

“Given the inherent instability of international capital movements, recent experience shows that any country closely integrated into the global financial system is susceptible to financial crises and currency turmoil. Developing countries are particularly vulnerable owing to their dependence on foreign capital and their net external indebtedness” UNCTAD 2000

A joint committee of the World Bank (WB) and International Monetary Fund (IMF) describes financial security (both short and long term) as a **global public good** - no one is required to maintain it but everyone can benefit from it. In recognition of this situation CSD 8 called on the international community to reform the financial system to prevent further *“recurrence of financial crises and providing better mechanisms for financial crisis management...to support and reinforce sustainable development”*.

TRENDS IN THE FINANCIAL SECTOR

Some of the problems associated with short term financial volatility include:

* *Escalating financial uncertainty:* The financial sector is confronted by an increasing risk of crisis, *“even before the new century had officially begun, instability in the financial markets had become highly dangerous”* (IMF 2000). Analysts warn of a speculative free-for-all, mirroring many aspects that led to the 1929 Wall Street crash. Even famed speculators such as George Soros describe a system unable to handle the influx of “day-traders” that now trade on-line. The impact of instability can be severe, as the “boom and bust” in Dot.com shares demonstrates. Trade in **leveraged derivatives** or “hedge funds” are the most risky of all. In a single day, a drop in hedged derivatives trading of just 2% would be greater than all the world’s central bank reserves put together. “Long Term Capital Management” bonds were hedged bonds held mainly by US investors, that famously collapsed in 1998. The US Federal Reserve intervened to bail out US\$ 200 billion of defaulted debts, over 50 times the original value of the bonds.

* *National economic exposure:* There has been a massive acceleration in the speed of communication and e-commerce e.g. internet banking and share-trading, which has exacerbated the huge escalation of global capital flows. In 1985 US\$ 400 billion of foreign exchange transactions passed through the financial system every day. Now an excess of US \$2 trillion pass daily through the New York clearing house system “CHIPS” and London equivalent “CHAPS” (Boyle 2000). Financial crises can expose domestic economies to greater financial volatility. This is particularly true where public institutions are forced to bail-out companies which have been left crippled by a sudden outflow of foreign investment e.g. during the 1997/8 East Asian financial crisis the Korean government paid billions of dollars “bad” loans owed by Korean banks to financial institutions in US, Europe and Japan. In an increasingly open

market, financial crises can spread across countries and regions, known as “contagion”. The scope and speed of contagion can have massive implications for national and international [capital liquidity](#) and cause large drops in currency value e.g. during the Asian crisis the Indonesian Rupee dropped 80% against the dollar. For developing countries, financial crises also weaken progress toward long-term financial security.

* *Moral Hazard*: Government support in financial crises can incite corporations to take greater financial risks i.e. a “moral hazard” problem. There is a real need to enhance national supervision to ensure private financial institutions take necessary precautions, and bear greater responsibility, over the costs which arises from imprudent [financial risk-taking](#). Yet this situation highlights a regulatory gap within governments and financial institutions to effectively supervise [off-balance sheet activities](#) and financial services. An absence of standardised and prudent reporting methods, as well as poor data on financial products and assets, further impairs analysis and regulation of [financial risk](#). As a result it is easier for regulators to respond during or after volatile periods, rather than take preventative measures in advance of crises.

* *Market saturation*: competitiveness in the private sector is increasingly tough. This is in part because public and private financial markets have converged. Cross-border consolidation or “merger and acquisition” of financial institutions has grown internationally in an attempt to boost profits and dividends, as well as to reduce financial risks. Competition has also meant that the rate of innovation has been unparalleled with the emergence of new financial products. For example, [derivatives](#) markets (trade in Futures and Options equity) now deal in over 47,000 different kinds of Options.

Other factors that impact upon short term stability but also reduce long term financial security include:

* *Mis-governance*: Corruption and national conflicts weaken the institutional conditions necessary to avert and manage financial crises. Whilst corruption is present in most, if not all, countries the key question is the extent to which corruption is systemic and requires major reforms (Commonwealth Secretariat 2000). Diversion of resources through corrupt practices distorts public policy and subverts regulation. When regulatory and legal institutions are weakened the risk of companies defaulting on loans becomes greater and domestic financial vulnerability is magnified across entire economies (IMF 2000). In a poor regulatory environment loan sharks are freer to lure people into a cycle of debt, threats and exorbitant rates of interest. Both corruption and internal conflict not only undermine financial institutions but also the international credibility of a national financial system, deterring both domestic and foreign investment. Under such circumstances laundering of “dirty” money from criminal sources is more likely and it is much easier for dirty money to re-surface as seemingly legitimate investments in offshore financial havens and elsewhere. Only around 69 of the 550 offshore financial institutions are physically located in their so-called islands but they deal with a greater quantity of capital flows than any financial “centre”. Only very recently have these centres began to receive greater regulatory scrutiny (WB a. 2000).

* *Debt*: It is important to highlight significant differences between industrial and developing countries when talking about national vulnerability to financial crises. In 1999 UNCTAD pointed out that “*in developing countries the reversal of external capital flows and sharp declines in the currency often threatens domestic financial stability. Similarly domestic financial crises usually translate into currency turmoil, payment difficulties and even debt crises. By contrast currency turmoil in industrial countries does not usually spill over into domestic financial markets, nor do domestic financial disruptions lead to currency and payment crises*”. It is likely that these differences are tied to large variations in the financial architecture of different countries but is clearly also associated with the on-going debt burden that continues to undermine the long term development of many developing and transitional countries. Between 1990 and 1999 global debt increased by 20%, reaching 41.5% of global Gross National Product (GNP) (Martens 2000). The Jubilee 2000 campaign highlights a growing call for greater private and public accountability and responsibility over debt, while the concept of “*Odious Debt*” in international law also accepts that there should be a shared burden of responsibility, particularly for short-term lending and debt repayment (Rowbotham 2000).

* *Omission of social and environmental factors*: Studies of financial insecurity tend to focus on the financial and macroeconomic conditions just before a crash and in dealing with the consequences. However, there are surprisingly few integrated assessments of the social and environmental factors underlying and affected by financial insecurity. Whilst these factors may be complex and inter-linked, they can be instrumental in raising risks in financial sectors in the short and long term. First, the environment is a key component of financial security. It provides essential natural resources and services (e.g. ecosystems, biodiversity), which require resources to be maintained and enhanced. At the 1992 Earth Summit countries committed to invest \$20 billion a year in biodiversity conservation, and yet we are now in a situation where, on average, governments only give \$6 billion (WB a. 2000). Environmental degradation and pollution have implications for social welfare and the economic conditions underpinning domestic financial stability. For example, conservative estimates suggest that the cost of mitigating disasters related to climate change, i.e. floods, storms and droughts, will overtake global GNP by 2065. Insurance companies are rapidly increasing premiums to reduce the multi-billion payouts that can arise from such “natural” human-induced disasters. Second, educated, skilled, healthy and happy people are key drivers of economic growth and financial stability. This again requires broad and long-term investment in social needs. Yet 20% of the world’s population continue to live in extreme poverty and even in the USA some 20% currently live under the official poverty line. The international community set a target of halving extreme poverty between 1990 and 2015. This will require an estimated 8%

growth in GDP for some countries, impossible at current levels of economic development, financial support and infrastructure. Women and children are particularly affected since they make up the largest proportion of the poor, and it is the poor and marginalised who are least equipped to deal with the impacts of financial crises. The social cost of financial crises is substantial, for example during the 1997/98 crisis unemployment in Thailand doubled, in Korea unemployment (especially in unskilled workers) rose from 2% to 8.7%, and the standard of living in the two countries fell an estimated 14% and 22% respectively. In Indonesia living standards dropped 25% and there was a sharp increase in those living in absolute poverty (WB a. 2000).

EXISTING MECHANISMS

Putting other factors aside, current economic trends in different regions suggest a continued vulnerability to future financial shocks for many countries (Table 1). Tables 2 and 3 profile some of the key instruments and institutional mechanisms that are currently used to maintain short and long term financial security, which are discussed in more depth below.

Table 1. Regional Trends and Prospects

	Regional details
Asia	Japan and East Asia show signs of recovery from the regional financial crisis which cost an estimated \$350 billion to foreign portfolio investors. Although Japan's GDP has grown 10% the benefits do not seem to be reaching all of the population. Household spending and savings are erratic and unemployment, currently at 5%, is increasing. It has a fiscal deficit at 10% of GDP and public debt at 106%. The crisis left many financial institutions insolvent, therefore the region as a whole requires long term infrastructural support, sequenced debt workout, along with enhanced standards of accounting, and financial disclosure. Over the 1990's China saw a decline in poverty but elsewhere in South East Asia it increased. In South Asia there was no change in the absolute number of poor people.
Africa	ODA in Sub Saharan Africa declined significantly in the 90's. This combined with an economic slowdown, indebtedness, critical health issues (e.g. HIV/AIDs), environmental problems and disasters, and civil unrest, makes the region critically sensitive to further financial knocks. A doubling of ODA will be necessary for sector and institutional strengthening, poverty eradication and relief of debt obligations that are never likely to be paid. Those living on less than \$1 per day in Sub Saharan Africa increased 1990-1998, in both the proportion of population and in absolute numbers. In the Middle East and North Africa the numbers of those with less than \$2 per day increased. Africa as a whole has the largest proportion of people in absolute poverty.
North America	The region is generally continuing a process of liberalisation. However there is wide variation between countries, e.g. GDP in Mexico grew 5% compared to -0.6% in Paraguay. Countries such as Argentina, Colombia, Ecuador, Guatemala, Peru, and Venezuela continue to face problems in their financial sectors, whilst others, e.g. Brazil and Mexico, appear to be fairing much better. The total proportion and number of poor declined 1990-1998 but with large swings in employment and income inequality partly as a result of contagious impacts incurred during the Asian and Russian crises.
Latin America	Economic growth in the US has been the most prolonged of any country in the 20 th Century. The US \$ acts as a "currency of refuge" for several countries, who are linked to US \$ through their currencies and \$-indexed debt stocks. The private sector is a key buyer of international debts. In 2000, the US current account deficit (i.e. exports - imports) reached \$5 trillion or \$60,000 per household. This is becoming unsustainable. Economic slow-down and a cut in foreign spending are now inevitable. However, it is the rate of slow-down that concerns other countries. With a rapid drop other countries and businesses will have to react quickly to find alternative markets.
Europe	Eastern Europe is facing the greatest rise in poverty levels of any region e.g. poverty in the former Soviet Union more than trebled between 1990-98. Income inequality has also widened. Parts of the Baltics are in recession as a consequence of Russia's recent financial difficulties and poor aid disbursement and coordination continues to hold back economic recovery in this area. The rest of Europe gives a divergent but generally healthy economic picture. However, the region as a whole remains fairly responsive to US interest rates and may therefore be open to impacts from a US downturn.

Sources: WB 2000, UNCTAD 2000

1. Managing Short Term Financial Volatility and Crises

During periods of severe volatility, countries can experience a sudden withdrawal of foreign and domestic capital and investment. There are a number of mechanisms that aim to these ameliorate short-term problems related to capital liquidity and insolvency.

* *Domestic policy*: Traditionally financial policy to limit the impacts of crises meant tightening of public spending and raising interest rates. This supports gradual stabilisation of established economies but doesn't deal with problems faced by developing and transitional economies. Increasingly, the developing country response is to impose a **Debt Workout**, where the government implements financial and exchange rate controls and **standstills** on debt servicing to reorganise financial concerns. Standstills on repayments give governments and business the space to renegotiate the conditions and procedures for debt servicing, **reschedule** outstanding debts and seek additional finance to supply private debtors with the capital to continue operations. To repay outstanding debts and defaults, finance can be obtained from national reserves, new loans and setting up **contingent credit lines**. However, the long-term viability of financial bailouts by seeking new loans may not be as clear as finance from trade surplus and national reserves (IMF

Table 2. Existing Financial Instruments for Maintaining Financial Security

Mechanism	Stakeholder	Target		Scope	
		Aim	Short term	Long term	
Supplement Reserve Facility (IMF)	Government	Capital liquidity	+		
Special Drawing Rights (IMF)	Government	Capital liquidity	+		
Exchange Rate Mechanisms: Floating, Fixed, Pegged	Government	Efficient currency transaction		+	
Official Development Assistance	Government	Social, economic, environmental development		+	
Contingent Credit Lines (Private and public sources)	Government, Corporate	Debt relief, capital liquidity, economic growth	+	+	
Debt Workouts – Rescheduling, Cancellation, Standstills	Government, Corporate	Debt relief	+		
Debt for Nature swaps	Government, Corporate	Debt relief, environmental protection	+	+	
Tradable Permits (e.g. carbon credits)	Government, Corporate	Environmental efficiency		+	
Financial Screening	Corporate	Social responsibility, environmental management and risk management	+	+	
Credit Guarantees (Government and international sources)	Corporate	Reduced financial risk, economic growth	+	+	
Microcredit (Government, NGO, International sources)	NGO, Small-medium business	Economic growth, poverty eradication		+	
Alternative Currencies (e.g. LETS, Time banks)	NGO, Small-medium business	Domestic economic growth, poverty eradication	+	+	
Global Environment Facility (WB, UNEP, UNDP)	Government, NGO	Environmental enhancement		+	
Foreign Private Investment (e.g. direct & portfolio investment, bonds)	Government, Corporate, NGO	Economic growth	+	+	
Domestic Private Investment	Government, Corporate, NGO	Economic growth	+	+	

2000). Also, there are concerns that the option of a standstill carries a **moral hazard** since this offers the domestic financial sector an escape clause, which can again encourage excessively risky financial behaviour. National submission to impose standstills for approval by an independent assessor, such as the IMF, might reduce this risk (UNCTAD 1998). In terms of domestic financial regulation and supervision, many countries have financial authorities to manage and inspect private banks and financial institutions. For example, Thailand's Financial Restructuring Authority (1997) assesses the viability of debt workouts, offers government backing for creditors and takes an active role in private sector debt restructuring. It has a "Risk Supplement Reserve Facility" that provides creditor assurance in return for credit. The authority has the capacity to liquidate company assets through public auctions, open to bidders internationally, where it aims to avoid sale of domestic assets at enormously undercut prices.

* *Private sector*: New loans and credit lines with domestic and foreign private financial institutions may offer a "last resort" when other sources of finance dry up. However, debts can quickly build up again and are only really sustainable when the interest made from investments and productive assets is greater than the cost of servicing debts. Also access to long-term, low-interest loans for developing countries is typically problematic, especially during volatile periods when interest on repayment is generally much higher because credit risk is perceived to be greater. Risk and credit rating agencies supply information to investors based largely on past performance with little evaluation of future, long term prospects. Also firms and services without credit rating, typically small and medium sized organisations, are grouped together and not assessed for risk of investment, making them much less attractive to prudent investors. The hazard of crises is pushing the private institutions to adopt broader assessments of financial risk. The industry-led International Financial Risk Management Institute and other institutions are developing more standardised approaches in this area. However an on-going lack of standardised, and therefore meaningful, risk assessment means that confidential exchange of information between supervisors and financial firms, is likely to continue for the immediate future.

* *International backup*: A range of international financial support can also be applied during crises. The IMF offers loans through its Supplemental Reserve Facility (SRF). SRF supplies unlimited finance with stand-by conditions for countries in exceptional payment difficulties. However, it seems that this model of "borrow, invest, export, repay" has failed to bring many countries out of indebtedness and insolvency. The **moral hazard** of encouraging imprudent borrowing/lending is also an issue. For example, in 1998 Russia

received \$4.8 billion from the IMF to deal with its' liquidity problems. Although the loan was backed by Russia's nuclear arsenal, return on investments never materialised, the arsenal was "lost" and the loan became unserviceable. The IMF also lacks the necessary funds to bailout every country subject to such short-term difficulties, let alone deal with countries facing full scale "bankruptcy". **Special Drawing Rights (SDR)**, however, could offer an alternative, requiring amendment of the IMF Articles of Agreement. SDR still carries a moral hazard, therefore automatic access to SDR is unrealistic. On the other hand, rigid conditions could impede the quick delivery of essential funds critically needed during periods of crisis, and conditions may be viewed as undermining debtor-country sovereignty where conditions relate to national policy. Other institutions, e.g. WB and regional development banks, offer concessional loans to assist debt workouts in Heavily Indebted Poor Countries (HIPC)s. These loans adopt tranche payments (by instalments) in support of a gradual process of recovery. However, some criticise the involvement of development institutions in this area, arguing that this draws resources away from longer-term objectives.

Even if the IMF became a true "lender-of-last-resort" the risk of moral hazard remains, therefore verification of applications is necessary. The IMF already undertakes surveillance of national macroeconomic and financial policies and reports on these periodically e.g. World Economic Outlook and Public Information Notices. There are also a number of guidelines and standards for national reporting (Table 4). Other supervisory and coordinating bodies exist, including the Basle Capital Accord, which assists coordination of European banks, although some argue that Basle is "increasingly divorced from credit risks faced by banks". Another institution is the Bank for International Settlements (BIS; trustee, clearinghouse and agent for central banks within the OECD and European Monetary Union). BIS has produced a data template for national reporting to better incorporate **off-balance sheet** activities. It is clear however that better supervision and regulation of inter-bank activities is necessary at a global level. The Financial Stability Forum (FSF) works in this area, supporting information exchange, cooperation in supervision and surveillance. It seeks to identify weaknesses in regulatory frameworks and financial markets. However FSF is still in its infancy and has yet to produce concrete results.

Table 3. Existing Financial Architecture for Maintaining Financial Security

	Mechanism	Stakeholder	Target		Scope	
			Aims	Short term	Long term	
National	Institutions: Central Bank, Currency board, Clearing house, Ratings agency, Financial Authority, Financial dept, Accountancy firms, Financial services	Government, Corporate, NGO, investors, borrowers, workers	Fiscal & monetary policy, facilitate financial transactions, financial screening and monitoring, regulation and supervision, debt restructuring, research new mechanisms	+	+	
	National Guidelines*	Government, Corporate	Transparency, risk management, standard reporting, supervision and regulation	+	+	
	National development strategies e.g. Poverty Reduction Strategy Papers (WB), National Strategies for Sustainable Development (UN)	Government, Corporate, NGO, local authority	Poverty eradication, sustainable development		+	
Local — International	Environmental Management Systems e.g. Impact Assessment, Accounting, Cost Benefit Analysis, Life Cycle Analysis	Government, Corporate, NGO, International, workers	Environmental assessment of finance	+	+	
	Social Responsibility: reporting, standards e.g. wage rates, internal/external auditing	Government, Corporate, NGO, International, workers	Social assessment of finance e.g. welfare, equity, human rights	+	+	
	Sustainable Management Systems: Impact Assessment, Reporting, Auditing	Government, Corporate, NGO, International	Integrated assessment of finance		+	
International	Institutions: WB Group, IMF, BIS, Basel Committee, WTO, Financial Stability Forum, UNEP, UNCTAD, UNIDO, IFA, IAIS, OECD, G 7, G 77 etc...	Government, Corporate, NGO, Workers	Regulation and supervision, structural adjustment, financial transactions, debt relief, research new mechanisms	+	+	
	WTO GATS Financial service exemptions (Fifth Protocol and Article 14)	Government	Economic and social safety nets to liberalisation		+	
	Global Compact	Government Corporate	Labour, human rights and environmental principles		+	

* See tables throughout document for examples of guidelines

Information disclosure through standardised reporting will assist transparency and independent assessment. Historically, national reports were limited to exchange rate policies but there are moves to enhance this e.g. the Financial Sector Assessment Programme (WB and government) produces Reports on the Observance of Standards and Codes (ROSC) and external debt management. Increasingly trade and capital movements, net national reserves and the state of the international monetary system are incorporated in national reports. However, there remains concern over the lack of an international standard for financial disclosure, impairing assessment of risks and crises. There is a further difficulty in that financial disclosure influences investor behaviour and thus warnings of risk can become self-fulfilling. It may therefore be necessary to impose some limits to disclosure according to specific national circumstances (IMF 2000).

Table 4. Guidelines for Financial Prudence, Regulation and Reporting

Area	Institution	Guidelines
Liquidity & Insolvency	Bank Committee on Payment and Settlement System	Core Principles for Systemically Important Payments Systems (1999)
	WB	Principles and Guidelines for Effective Insolvency Systems (1999)
	IMF/WB	Guidelines for Public Debt Management (2000)
	UN Commission on International Trade Law	Model Law on Cross Border Insolvency (1997)
Supervision & regulation	Basle Committee on Bank Supervision	CAMELs framework (Capital adequacy, Asset base, Monitoring soundness, Earnings, Liquidity)
	International Organisation of Securities Commissions	Objectives and Principles of Securities Regulation (1998)
	Basel Committee on Banking Supervision	Core Principles for Effective Banking Supervision (1997)
Standard reporting	IMF and WB	Financial Sector Assessment Programmes (12 country pilot Reports on the Observance of Standards and Codes)
	International Federation of Accountants	International Standards on Auditing
	International Accounting Standards Committee	International Accounting Standards
	IMF	Code of Good Practices on Fiscal Transparency (1998) Code of Good Practice on Transparency in Monetary and Financial Policies (1999) Special Data Dissemination Standards (SDDS, 1996)
	BIS Committee on Global Financial Systems	Data template for national reporting within SDDS

2. Facilitating Long Term Financial Security

In seeking long-term financial stability a range of initiatives apply:

* *Reform programmes*: To create more financially robust economies the IMF has long been involved in national reform. IMF Structural Adjustment Programmes (SAPs) allowed IMF intervention in national macro/microeconomic policy, toward improving exchange rate and **Balance of Payments (BoP)** stability. Despite this intervention scarcely any country involved successfully completed their SAP. Some countries and regions, such as Russia, South East Asia, Brazil and Mexico, actually experienced a fall in living standards. Others that didn't undertake SAPs policy, e.g. Mozambique, experienced economic growth and improved welfare (WBI 2000). Recognising the failure of SAPs the IMF introduced an "Enhanced" Structural Adjustment Facility (ESAF), involving low interest loans. This was recently changed again to the Poverty Reduction Growth Facility (PRGF), partly in support of the WB HIPC Debt Initiative. IMF and WB reform policies seek to liberalise economic and financial systems, but liberalisation in developing and transitional countries is not necessarily a clear-cut solution. Abrupt and premature financial liberalisation can expose economies to financial volatility. This is because financial openness relaxes controls on current and capital account transfers, and reduces regulations on economic transactions e.g. ESAF removed the right of governments to impose disincentives on foreign investors. In the past there appears to have been little prior assessment of potential impacts that might arise through the liberalisation of financial systems. Some argue that there is a genuine conflict between opening of financial markets for short term economic growth on one side and long term domestic financial and economic stability, social equity, and environmental protection on the other (Panayotou 2000). Liberalisation of financial services means that the private sector is less influenced by domestic policy and more linked to international

trade policy. Some governments are concerned that WTO curbs on “protectionist” domestic financial policy, such as defined in the Trade Related Investment Measures (TRIMS) and General Agreement on Trade in Services (GATS) principles of “Most Favoured Nation”, “non-discrimination”, “national treatment”. Although these principles may “protect” corporate interests, member countries are not trading on a level playing field and societal and environmental factors are generally neglected. Nevertheless even the WTO recognises the significant impact of financial services on domestic economies. The GATS’ Fifth Protocol on Trade Financial Services (1996) allows countries to impose “temporary” exemptions for specific markets and Article 14 gives exemptions where trade in services can be proved to threaten “human, animal or plant life and health” as so long as it is not so form of “disguised protectionism” (UNCTAD 2000).

Other areas of intervention touch on exchange rate systems and removal of subsidies. **Exchange rate systems** of different countries are diverse. Floating exchange rates are typically advocated as the most flexible system, allowing central banks to concentrate on domestic financial policy. However, floating currencies are also subject to volatility in currency markets, with impacts on national money supply and capital liquidity. Very few of the major changes in exchanges rates have been predicted, nor have **BoP** been improved through floating systems, the global **BoP** imbalance is larger now than at any other time since the Second World War. Secondly, the removal of “distorting” subsidies (because they are generally thought to be economically inefficient) can be problematic because they were often created to provide safety nets for a particular industry or social group e.g. agriculture and farmers. Hence removal of subsidies has immediate consequences for those areas previously supported. This is why a gradual and supportive removal process is crucial to give markets/individuals time to adjust and seek out new opportunities in the changing domestic economy (ECOSOC 2000).

* *Quality of development finance*: Long term development programmes are supported through finance from development banks and bilateral Official Development Assistance (ODA) but these are generally failing to meet the needs of the poor or developing countries. Levels of ODA have declined in all regions except Eastern Europe, between 1992 and 1998. Only Denmark, Norway, Netherlands and Sweden have actually given the promised 0.7% of Gross Domestic Product as ODA. There is also growing consensus that tying ODA provision to **procurement** from donor governments undermines development objectives. Development under “tied-aid” is skewed toward capital intensive, large-scale foreign initiatives instead of small, locally driven, poverty-orientated programmes. To enhance the quality of ODA there have been calls for greater use of grants, especially in critically indebted areas, in order to avoid some of the problems attached to debt servicing (DfID 2000). As an alternative to ODA, foreign and domestic private investment is being advocated to activate development. Although some argue it is more stable compared to other forms of private finance, Foreign Direct Investment (FDI), principally derived from Multi-National Corporations, remains skewed in favour of a select group of countries and sectors (UNCTAD 2000). Many developing and transitional countries, especially Africa, barely receive any FDI or even ODA. Others fail to meet the necessary criteria because they are neither fully integrated into financial systems nor extremely “indebted”. Yet these countries still need to develop their financial architecture and reduce poverty, as well as promote domestic economies to better cope in financial crises (UNCTAD 2000).

* *Enhancing financial governance*: “Good governance is not a luxury but a basic requirement for development” (IMF 2000). As previously mentioned, disclosure and supervision help ensure an efficient financial system. Timely and clear financial reporting, from banks and non-bank services, strengthens regulation, as well as investor and lender awareness, and enhances market discipline. To improve governance at the national level, the IMF advocates independent assessors along with a strong judiciary system which has adequate investigative powers and jurisdiction over both corporate liability and civil law e.g. Hong Kong’s Independent Commission Against Corruption. Such institutions use a variety of tools for regulation and enforcement, such as blacklisting and licences on business conduct. Public access to information on financial markets through the media can enhance public involvement and pressure for government anti-corruption strategies (IMF 2000). Whilst governance measures are easier to implement at the national and local level, if problems are very deep-rooted then international support is necessary. Governance also requires enhancement of procurement practices. WB guidelines allow countries to impose sanctions on those who borrow from countries and firms who engage in corrupt/fraudulent practice. The WB itself can cancel loans, and take away a country’s eligibility for future WB finances. Some regional coordination against corruption exists, e.g. Eastern & South African Money Laundering Group. The OECD Financial Action Task Force has produced 40 recommendations on money laundering (Table 5). The FSF is also examining how to raise international powers for monitoring and the repatriation of laundered money found in offshore banks or elsewhere.

* *Environmental integrity*: Principles of environmental management are applicable to both the public and private sectors but are still not widely applied and there is on-going debate around the methods of environmental valuation and how to standardise approaches. However, activities are underway. For example, the OECD has begun to assess whether and how Export Credit Guarantee agencies (that offer insurance against financial and associated risks) can incorporate environmental elements within their criteria. A number of countries are testing budgetary systems which use integrated environmental and economic accounting (Canada, Colombia, Ghana, Indonesia, Japan, Mexico, Papua New Guinea, Philippines, Rep. of Korea, Thailand & USA). Increasingly Environmental Impact Assessments (EIA) are applied in both public and private realms, and even for regional/bilateral trade agreements e.g. US - Jordan trade agreement and NAFTA were both subjected to EIA. Environmental taxes, tradable permits, standards and legislation help link environmental and financial risks more explicitly. However their implementation requires institutional strengthening and some argue there may be negative impacts on national competitiveness (the “pollution haven” hypothesis) which would need to be limited

Table 5. Governance guidelines

Institution	Guidelines
UN GA Resolution	Code of conduct for public officials
WB	Anti-fraud and corruption provisions in procurement guidelines
OECD	* Guidelines for Multi-National Corporations * Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (1999) * The Model Tax Convention
ICC	Codes of conduct
WBCSD	Good corporate governance
Commonwealth Secretariat	Good Governance

through better international coordination. 35% of the world's largest corporations are now releasing annual environment reports (IMF 2000). Investment in the environment is also evolving. Bilateral ODA and development banks offer some environment funds, as do Debt-for-Nature swaps. Internationally, the Global Environment Facility (GEF) is now supporting more grass-root and NGO-implemented projects. National Environment Facilities seek to use participatory and local solutions to finance environmental projects and programmes. These activities indicate at least a tentative move toward incorporating environmental factors (assets) in economic and fiscal policy (UNEP 2000).

* *Social enhancement*: Investment in "social capital" is another crucial element of long term financial security. Examples of this include increased access to education, technology and health services, training and job opportunities and participation in policy making and financial markets, particularly for the poor. The WB HPIC Debt Initiative was "enhanced" at the G-7 Cologne Summit in 1999 to incorporate, not only economic growth, but "broader, deeper and faster" debt relief for the poor. Countries applying for HIPC funds must produce Poverty Reduction Strategy Papers in consultation with communities and other stakeholders to ensure that assistance is targeted at poverty reduction. However, progress has been slow and as yet only a very few countries have actually received funds. *Microcredit* programmes offer an alternative approach to increasing access to finance for poor and marginalised groups. For development agencies the administrative costs of issuing finance and assessing applicants seem inefficient at this scale. NGO's and locally based community groups are therefore used to facilitate delivery of finances to microcredit and group ending schemes e.g. in Mexico, Bolivia, Egypt, Nigeria and Ghana. The most famous example is the Grameen Bank in Bangladesh. It began in 1976 as a small number of collectives in rural communities. The bank has now grown to 300 branches in 5400 villages, with some 250,000 people involved, 75% of which are women. Access to telecommunications and other media can also assist community understanding and prudent use of financial resources, e.g. the Grameen Phone initiative, where women farmers can phone financial traders to check product prices and improve their bargaining position; and Little Intelligent Communities (LINCOS) in Costa Rica, digital community centres giving local people access to share-trading (WRI 2000). Increased coordination between donor and recipient countries is needed, as well as enhanced local access to finance (ECOSOC 2000). Some governments and local authorities are adopting tax credit schemes, targeted at poor communities and small-medium businesses, as an incentive for new ventures and long term growth. *Alternative currencies*, at the local level, can further boost local economies, e.g. bartering, community currencies, Time Banks and Local Exchange Trading Systems (LETS). These are still perceived as fairly marginal mechanisms in international debates but more local groups are currently using such systems than ever before.

* *Steps toward sustainable finance*: The WB Institute's "Quality of Growth" describes a development process which is characterised not only by economic growth, but also quality of environmental, social, institutional and cultural conditions, as well as, significantly, financial conditions. Approaches which try to adopt this qualitative and integrated approach include Sustainability reporting, auditing and assessment, an extension of *environmental management systems* and corporate social responsibility. An example of this approach is the Global Reporting Initiative (GRI). GRI is a multi-stakeholder process (corporate, NGO, accountants, governments) that is seeking to develop a global standard for corporate sustainability reporting, with the eventual aim of application to public and NGO organisations as well. The project is on-going but the first GRI guidelines were released in June 2000 and piloted by 30 corporations. Also, UNEP's Financial Services Initiative, composed of banks, insurers, asset managers, NGOs and inter-governmental organisations, met in November 2000 to look at some of the linkages between finance and sustainable development. *Sustainability Impact Assessments* are also beginning to appear e.g. the EC funded sustainability assessment of GATS (Kirkpatrick & Lee 1999). *Sustainability Indices* are being used on stock exchanges but they tend to only consider the top performers in a particular sector. For wider application, sustainability assessments, reports and management will be necessary throughout financial and trading systems, along with greater investor awareness and choice, as well as clearer reporting standards (Table 6). Some broad-based indicators/categories will assist integrated baseline assessment, appraisal, amendment and review of financial security (Table 7).

GLOBAL INNOVATION

Table 6. Social, Environmental and Integrated Reporting Guidelines

Area	Institutions	Guidelines
Environment	UNEP	National guidelines on environmental accounting
	London Group on Environmental Accounting, UN, WB, OECD, EC Statistical Office	System of Integrated Environmental and Economic Accounting handbook (available mid-2001)
	World Economic Forum, Global Leaders of Tomorrow	Environmental Sustainability Index
Social	APEC, Financial Social Safety Nets Initiative	Guidelines on Financial Social Safety Nets in policy and programmes
	International Conference of Social Funds	Risk management framework
Integrated	Global Reporting Initiative	Sustainability Reporting Guidelines (1999)

In terms of new ideas for enhancing financial sustainability, at one end of the spectrum there are calls for reform of existing institutions and instruments, while at the other we find advocates of entirely new structures. These suggestions are not necessarily mutually exclusive since new approaches may actually compliment existing ones. Some examples of short and long term proposals for international, corporate and national institutions, are outlined below:

1. New Global Ideas

Short term: There are many suggestions for new institutions. For example, the creation of a World Financial Authority or central bank, to act as a clearing house for international financial flows and a "lender of last resort". Such an authority would require certain powers of intervention but could assist coordination and standard setting between countries. It would have international membership, peer-review and work with both regional and sub-regional organisations. The authority might be formed from existing bodies, e.g. IMF, Bank for International Settlements and IOSCO, or be created as an entirely new institution. Its goal should be to simplify existing processes, reconciling and integrating different legal and policy frameworks. However, it would need to offer very clear benefits over existing institutions since the authority would require major restructuring, investment and certainly political endorsement. Its role would need to be clearly defined to avoid overlap with other institutions and to indicate precisely how its power would be exercised. Another proposal is to introduce an International Bankruptcy Court, equivalent to the US example, offering a global framework to deal with national insolvency. Some argue that new institutions are unnecessary, that reform of IMF, World Bank, WTO and UN institutions would be sufficient. Focusing on IMF reform, the IMF could limit its role to one of crisis prevention and resolution, allowing greater autonomy in developing and transitional countries' macroeconomic policies. Independent evaluation and periodic review of its structure might encourage greater accountability. Further, it could examine the sustainability impacts of leveraged financial organisations, including hedge funds and offshore institutions, encouraging their compliance with internationally agreed standards. Finally if the IMF is to become an international lender of last resort, then Article 4 needs amendment (IMF 2000).

Ideas for new global instruments to assist the regulation of short-term financial difficulties include: circulation charges, e.g. a global Currency Transfer Tax or Tobin Tax (Enayati and Hemmati 2000) and an Exchange-Rate Stabilisation tax, where exchange rates can vary but within a fixed band of values, outside of which a tax would be imposed. Such global mechanisms have been perceived as a threat to national sovereignty. One way to avoid that would be to regulate the currency through central banks and clearing-houses of each country and in offshore financial centres (Martens 2000).

Long term: Certain institutional proposals exist to further strengthen the social and environmental tiers of sustainability, such as creating a World Development Organisation and World Environment Organisation (Dodds 2000). These ideas raise the question as to whether such institutions would bring any better results than those currently in existence. Existing institutions could be improved through greater coordination of financial aims, removing unnecessary crossover and enhancing their specific areas of jurisdiction, in support of more sustainable use of funds. Regional coordination could also be enhanced along the lines of the Lome Convention between European and ACP states. Regarding new long term instruments, the idea of a single Global Currency has been around for a long time. Prior to the establishment of the Bretton Woods Institutions Keynes had considered such a currency, called a **Bancor**. It would require an global clearing house to manage a "system of international exchange in which the trading of goods and services, will be the central feature, financial and capital transactions will play their proper auxiliary role of facilitating trade". Suggested examples of global currencies include a **Fiat Currency**, **Commodity-valued Reference Currency** and **Commodity-Backed Reference Currency**. The aims would be similar to that of regional equivalents (such as the Euro) i.e. short-term price stability and long term financial and trade balance. It would require sufficient power to regulate excessive speculation and encourage prudent behaviour (Leitaer 2000).

To generate funds for long term goals, various forms of global taxation could be imposed e.g. carbon tax for fossil fuel users (Denmark, Finland Netherlands, Norway, Sweden already use a carbon tax); a surcharge for international car registration; taxes for international air transportation and tourism; per capita global environment contribution; also charges for air wave frequencies; sea

Table 7. Examples of Indicators for Financial Assessment

	Issue	Indicators
Social	Gender	Gender Related Development Index
	Education	Estimated adult (15+) illiteracy rate (%)
	Health	Life expectancy at birth (years)
	Equality	Gini-Index (min = greater, max = less equality)
	Institutional	Ratification of international agreements e.g. rights of a child, ILO labour principles, Anti-discrimination convention
Economic	Income	GNP pc (Per capita, \$US)
	National risk	Central Government Surplus, Foreign Debt, International Reserves, Gross Fixed Capital Formation (% GNP), Real Savings (% GNP), Inflation, Private Risk (CAMELS framework)
	Employment	% Unemployment (of total labour force, Male & female)
	Institutional	Observance of financial supervision and regulation e.g. ROSC,
Environment	Natural Resource Use & Quality	Energy use by sector (kg of Oil equivalent pc); Air: Emission of CO ₂ pc (metric tonnes); Water: Annual freshwater withdrawals pc (m ³), Biological and Chemical Oxygen Demand (BOD & COD); Land: % area protected
	Biodiversity	Genetic (taxonomic distinctiveness), species (no. per 10,000 km ²), habitat diversity (no. per 10,000 km ²)
	Institutional	Ratification of Multilateral Environmental Agreements e.g. CBD, CDD, Ramsar, CITES

Sources: IDPM, WB, UNDP, GRI, ECOSOC

bed mining; and the internet. Tradable permits, e.g. a carbon emission trading fund, or purely voluntary funds for global environmental and social protection might also apply. Again, global taxes and even trading of permits may be seen to diminish national sovereignty, but these can still be managed at national levels and such instruments would be strictly limited to those areas identified as “global” priorities (Panayotou 2000).

In dealing with corruption, there have been calls for a non-binding instrument (less than treaty status) or legal global compact against corruption. This would fill the gaps between existing instruments and provide an intergovernmental mechanism to set minimum standards for combating money and asset laundering, and tax evasion. However, it would need to accommodate diverse political, economic, social and legal systems without compromising the principle objective of zero-tolerance on corruption. An independent, impartial mechanism for dispute resolution might be incorporated, working with international agencies to develop standards and assist member governments in the design of anti-corruption strategies. The secretariat would compile and disseminate information on good practice (Commonwealth Secretariat 2000).

2. New National Ideas

Short term: As an alternative to global mechanisms, physical controls can be imposed at the domestic level. For example, foreign investors can be prevented from buying domestic corporate equity, an idea called “waiting at the gate” that would be imposed when/if the ratio of foreign-domestic investment gets too large. In the Chilean system foreign investors are required to keep their investments in a country for at least a year. Also foreign investors could be required to place cash deposits in the host country to act as a guarantee before making investments.

Long term: Commitments to produce National Strategies for Sustainable Development (NSSD) by 2002 (to be implemented in 2005) offer an opportunity to draw out key elements relating to financial institutions and mechanisms. Strategies could include budget reform, strengthening of institutions for better accountability, macroeconomic and legal policy and foreign investment. Where liberalisation is considered, a gradual and consultative process is crucial from the outset. Participation has direct benefits when assessing the impacts of financial liberalisation on sustainability, poverty reduction and welfare generation. It may also help provide ways and means to enhance the management of risks and therefore minimise the negative impacts of liberalisation (WB b. 2000)

3. New Commercial Ideas

Short term: Timely, consistent and meaningful disclosure of [off-balance sheet](#) activities would highlight liquidity problems and reduce risk taking. Small-medium businesses need support to improve their internal assessments e.g. of financial exposure to credit and liquidity problems. The financial services sector could consider creating new forms of credit guarantees, at sub-national levels with reduced government intervention, as well as micro-financing.

Long term: The private financial sector is making moves toward greater socio-economic, socio-cultural and environmental responsibility. These moves could be furthered by the use of environmental and social screening of investments, as well as increased independent regulation and supervision of financial sectors. The sector also urgently needs to build-in more integrative and standardised financial systems and risk management frameworks for sustainable financial management.

A SECURE FINANCIAL FUTURE?

The current climate of short-term volatility, poor governance, weak environmental and social inclusion, debt imbalance, minimal ODA and misdirected FDI suggest long-term financial security remains highly improbable. The numerous processes taking place prior to Earth Summit 2002 will need to address these on-going issues. For example, WTO GATS negotiations will have a direct bearing on future frameworks for public and private financial services. The UN International Conference on Financing for Development in early 2002, is seeking more integrated and participatory approaches to tackling these complex and interconnected issues. There will also be a number of other issue-focused meetings addressing financial sustainability, e.g. the UNFCCC COP 6 part 2, and the Bonn international freshwater meeting. At the Earth Summit in 2002 these processes and institutions need to bring together their outcomes and ideas to develop integrated and forward looking financial strategies. Key questions and issues to address include:

- **Governance:** Whether and how disclosure can be made more effective to counter corruption. Which international, regional, national and local structures and mechanisms offer the best means to enhance supervision and regulation of finance?
- **Short term volatility:** If/when is public intervention prudent i.e. bailout by central banks or last resort lending? Whether and which institutions and groups should be protected from crises by safety nets and what mechanisms should be used?
- **Long term security:** What are the positive and negative linkages between trade in financial services, investment flows and sustainable development? How to further enhance the linkages between private finance and sustainability. Whether experiences from micro-financing projects offer real opportunities for poverty alleviation and can be applied more widely?

Whilst the Seattle and Prague demonstrations were linked to many aspects of globalisation they give a clear indication of the societal alienation, dissatisfaction and anger attached to current international financial and trading systems. Without constructive proposals for reform and open dialogue any changes in the existing global architecture will continue to be slow, and whole-scale change remains a remote prospect. One point is clear, understanding of the linkages between finance and sustainable development, and application of new, and even existing, mechanisms for improving financial security is still fairly limited. Our knowledge of the correlations between finance and economic systems is growing but without greater inclusion of environmental, social and institutional elements, models appropriate for long term financial security will remain poor. Ultimately global financial security is not about stability and wealth generation for their own sakes but is about creating a system of transactions that enhances the livelihoods of people and the natural environment, both now and in the future.

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KEY INTERNATIONAL ORGANISATIONS

- Bank for International Settlements, Centralbahnplatz 2, Basel, Switzerland CH-4002 Basel (+41-61) 280 80 80 <http://www.bis.org>
- International Monetary Fund. 700 19th Street NW, Washington DC, 20431 USA Tel/Fax: +1 202 6237000/4661 <http://www.imf.org>
- Organisation for Economic Co-operation and Development. 2, rue André-Pascal, 75775 Paris Cedex 16, FRANCE Tel: +33 (0)1.45.24.82.00 <http://www.oecd.org>
- United Nations Conference on Trade and Development. Division on Investment, Technology and Enterprise Development (DITE), Palais des Nations, 1211 Geneva 10, Switzerland, Tel/Fax: + 41 907 5707/ 0194, <http://www.unctad.org/iaa/index.htm>
- United Nations Industrial Development Organization. Vienna International Centre P.O. Box 300, A-1400 Vienna, Austria Tel/Fax: +43 1 26026 / 92669 Internet address: <http://www.unido.org>
- UN Financing For Development. Preparations for High Level Conference in 2002 www.un.org/esa/ffd
- World Bank 1818 H Street NW Washington CD USA Tel: +12024771234 <http://www.worldbank.org>
- World Trade Organisation. 154 rue de Lausanne , 1211 Geneva 21, Switzerland Tel/Fax: + 41 22 739 5111/7314206 <http://www.wto.org/>



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