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Fostering Financial Stability: The Role for Ministries of Finance

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I will identify four types of intervention that ministries of Finance can use to foster global financial stability: (i) participation in international financial institutions, through which the international financial system is managed; (ii) keeping their own house in order by pursuing sound and credible fiscal policies; (iii) fostering trade liberalisation and improving market access; (iv) adequate financial market regulation and (particularly in Europe) financial market integration.

The Netherlands being a small and very open and internationally-minded economy, the Dutch Finance Ministry sees its role primarily through the active participation in the multilateral fora and institutions that are dealing with financial stability, such as the IMF, the World Bank, the Financial Stability Forum and the Financial Action Task Force on Money-Laundering. We believe in a strong rules-based international system, where there is equal treatment and in which every country has a voice. Only such a system can take decisions that are effective, legitimate and that will find the widest possible support in the international community. For us, the IMF, with its almost universal membership is the central institution for global financial stability. The G-7 can never substitute for that, because of the inherent limitations to the G-7 concept.

Global financial stability is high on the agenda on the IMF, notably through the work on crisis prevention and on crisis management. Making countries' financial systems stronger and more

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resilient and promoting transparency by disseminating more financial data is the aim of the many standards and codes the adherence to which the IMF is monitoring, notably in the so-called Report on the Observance on Standards and Codes (ROSC). In addition, the IMF's Financial Sector Assessment Programme (FSAP) reviews the strengths and weaknesses of a country's financial sector. Although the participation in these exercises do make a heavy demand on the often limited resources of emerging market economies, the benefits are also clear: reform of a financial sector so that international standards are fully or almost met, will improve a country's creditworthiness in the international capital markets.

In the field of crisis management, efforts in the IMF have focussed on the wider introduction of so-called Collective Action Clauses in bond contracts and the design of a Sovereign Debt Restructuring Mechanism (SDRM), through which sovereign debt restructurings can take place in a more orderly manner than has been the case so far. Particularly, the work on Collective Action Clauses has been relatively successful, given its much wider use recently. While it has been difficult to find agreement on the SDRM among the IMF member states, the discussion has led to a better understanding of the crucial role of transparency and of early and continuous communication between debtors and creditors, particularly in times of stress, when a debtor country has (or is perceived to have) difficulties in repaying its creditors. In this context, proposals for Codes of (Good) Conduct have been made by the Institute of International Finance and the Banque de France.

A second element of how ministries of Finance can contribute to global financial stability is to keep or put their own house in order. Sound fiscal policies are key to this. Developed countries in particular should commit themselves to sustainable fiscal positions. Credible medium- and long-term fiscal strategies and their implementation will lead to lower long-term interest rates. As most public budgets in developed countries will be burdened by rising costs because of the ageing of their populations, most countries still have some work to do. Failure to put public finances on a sustainable footing will not only lead to higher interest rates, but also to a situation where international savings will be used to finance public deficits in the developed world, rather than financing investment in developing countries. In Europe, the Stability and Growth Pact provides for a well-defined process of multilateral surveillance and peer pressure

with the explicit aim of ensuring both medium and long-term sustainability of public finances.

A third element is the advocacy role of ministries of Finance, in particular regarding trade liberalisation and access to trade for developing countries. Greater access to trade would make developing countries less susceptible to shocks in private capital and reversals in ODA flows and so could lead to greater stability. Most ministries of Finance do not have a direct responsibility for trade issues, but, given their central role in economic policy-making, both nationally as well as internationally, they have an important role to play in focusing the international community in taking actions to move forward with trade liberalisation. In particular, the reduction of agricultural subsidies in developed countries needs to be addressed, since they burden the budgets of developed countries as well as prevent developing countries from exploiting their comparative advantages.

Last, but certainly not least, ministries of Finance are responsible for the regulation of their national financial markets and for providing the institutional structure for supervision of domestic financial markets and institutions. In the aftermath of the past stock-market bubble and in the post-Enron world, the need for adequate regulation of financial markets, supervision and for strengthened accounting standards and improved corporate governance is almost self-evident.

In Europe, there is a strong drive to financial markets integration to arrive at a fully integrated single European financial market. In 1999, EU ministers of Finance adopted the Financial Services Action Plan (FSAP). It has three main strategic objectives:

1. to establish a common legal framework for integrated securities and derivatives markets; financial integrity is a cornerstone of this objective;
2. to establish open and secure retail markets;
3. to have state-of-the-art prudential rules and supervision.

A deeper and more liquid EU-wide capital market will be able to provide participants from inside or outside Europe with more tailor-made financial instruments, will facilitate access to credits at lower costs, and will be able to absorb shocks better.