

# Instabilities, Crises and Agenda for Possible Reform of the International Monetary System and the International Financial Architecture in the XXI Century

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***ABSTRACT** - Recent global, world occurrences (turbulence, volatility, risks, huge transaction costs, the weakness of public and private banking, financial structures, instabilities in the international financial activities and excessive international financial crises) made clearly, that the current international monetary system can't insure global stability and prosperity, neither the system can adapt to a more modern economic and social structure. Instabilities and unbalances, which characterised the system in the past century and at the beginning of the XXI century, have been brought by the economic globalization, in other words financial globalization. Intensive widespread of these instabilities, between developing countries and even to the industrialized world, have influenced on the international policymakers (called as the international financial institution) to start the initiatives about possible reform of the international monetary system and its international financial architecture.*

## Introduction

Recent global, world events (turbulence, volatility, risks, huge transaction costs, the weakness of public and private banking, financial structures, instabilities in the international financial activities and excessive international financial crises) on the international economic and financial stage, made clearly that current international monetary system can't insure global stability and prosperity, neither the system can adapt to a more modern economic and social structure. Namely, adverse, unfavourable and overload volatile global financial movements brought the international monetary system and its structure (the international financial architecture) in the state of deep crisis and collapse, with expressive risks and instabilities from the actual international economic and financial integration. Suggestions for exceeding this negative situation become actually, a workable and necessary initiative of the international financial and other institutions, for creating the fundamental framework of agenda of the future reform of the international monetary system and the international financial architecture. It was realized, that the international financial crises are very «contagious and contaminate», and that they have a «strength» to spread even to the industrial, developed countries with sound economic structures and macroeconomic management. However, the most unsuccessful and vulnerable are shown by developing countries and countries in transition (emerging nations). This pattern has been aggravated by premature, previous and hasty liberalization of the capital flows, fragile domestic financial structures and very weak financial regulation and supervision of the national and international financial institutions. Thus, there is no need for wondering, that the special place in reforming of the international monetary system take developing countries and countries in transition. Regardless of how is the reform of the monetary system running, it is certain clear that there is need for better coordination and collaboration between international economic policies of both, industrial developed and developing countries.

## **Instabilities and crises of the current (actual) international monetary system and the international financial architecture: necessity for reform**

In last few decades, process of globalization had a big influence on the evolution and functioning of the international monetary system. Although the system was changing and adopting to new circumstances and environments, becoming aware of its disadvantages and lacks, that same institutional framework of international economics (the international monetary system) didn't avoid cyclic movements, which emerged in the middle of the XX. century and at the beginning of the XXI century. Namely, the system has been agitated with the international financial crises, starting with ERM crisis (European exchange rate mechanism, 1992./93), «tequila» crises 1994./95, and crises in Asia, Russia, Brazil, Argentina in the period from 1997. till 2001. Excessive and foster liberalization of the international capital flows, frequent speculative strokes on the international monetary and national financial systems, evolution and appearance of the financial disturbances and crises, (un)adequate established foreign exchange rate regimes etc., were just some of a few global financial problems spread in the last decades. Besides, insufficient, slowly and unsuitable activities of the international financial institutions in the field of: maintaining the international economic relations, solving the financial crises and supporting suitable developments and growth of developing countries, were pointing that there were a serious problems in the system. Such instabilities and economic unbalances are became more global and systematic, and trying to solve this limits are not enough. Additionally, the problems in the international financial architecture are more strengthen with the existence of a huge volume of the international financial transactions and insensitive transfer of financial instruments, also with the integration of the international financial markets, with inconsistent of the exchange rate policy with macroeconomic performances, problems in creating a stable currency configuration, a single global currency, increasing systematic risks, a deep corruption in governments («crony capitalism») and also with problems of maintaining the international liquidity. All that, interrupted global financial stage and had influence on decreasing the possibilities for keeping the international trade in balance. This aggravates the current situation, because the high-risk financial activities can deepen the unbalances in the future.

Unfortunately, at the beginning of the XXI century, the diagnosis of instabilities and problems in the international economic relations is still remaining. Although, there was established an actual coordination between macroeconomic politics on global level, the biggest monetary problem, which global economy is facing with, specially developing countries, made an impression that the current international monetary system is more unstable today, than in last decades. Today's monetary system is threatened by collapse, but that shouldn't prevent the international and national economic politics to learn about the structure of the system, about the arrangements, procedures, instruments and institutions, which are necessary for defining common standard of valuing global currencies. Hence, it is necessary to do something, in way that global economy becomes more stable and resistant on sudden and unexpected gaps. A propos, there is an important question: can the current international monetary system resist of the challenges of economic or financial globalization, so as the question: what kind of the international financial architecture would suit to the current international monetary system?. All past and current instabilities were *raison d'être* for forehand (timely) action and the reform which realizes: providing the international liquidity, global consistency of the macroeconomics policies and financial regulation in developed and developing countries, crisis resolution, crisis prevention, solving debt problems, liberalization of the capital flows, involving or bailing the private sector in solution of currency and debt crises. In this respect, in global academic economic literature, more and more attractive, will become a crisis management discipline (crisis resolution, crisis prevention) which might *ex ante*, with new tools prevent financial disturbances. With predicted, anticipated reform of the international monetary

system, it should be only partly decreased frequencies of the turbulences and bring long-term monetary stability which will strength the international trade and keep the global economy more resilience versus the erratic financial disturbances. No expectations to creating alias a «new international monetary system». It must be emphasized that the present system is badly equipped to prevent financial crises and only partly equipped to manage them and that is also one of the reasons of reforming it.

The recent crises (crises in USA, Europe, 2007/08.) have demonstrated a serious problem in global economy: the enormous, huge discrepancy that exists between an increasingly sophisticated and dynamic international financial world, with intensive financial globalization, and the lack of a adequate institutional framework to regulate it. In other words, existing institutions are inadequate to deal with financial globalization. This is true of institutions at the international level, which have manifested significant shortcomings in the consistency of macroeconomic policies, and in the management of international liquidity, financial supervision and regulation, it is true, also of national institutions in the face of globalization. These systemic deficiencies, above mentioned, and the associated threat of recurring crises in the future have, thus, underscored the need for a comprehensive, immediate reform of the international monetary system, geared to prevent costly crises and to manage them better if they occur. Besides, these systematic shortages became the threats to global system, even with the possibilities to appear in the near future. And, excessive liberalization of international capital flows, (un)adaptable foreign exchange rate regimes, financial and technical-technological solutions and innovations did not effect just on the increasing of the international financial transactions, also on the increasing volatilities in the international economic relations. A several times, repeatedly, on the Conferences preceded by the International Monetary Fund (IMF), the World bank and the other international financial institutions, have been noticed the needs for (possible) reform of the international monetary system in way to prevent the crises situations. The expected results of the (possible) reform of the system and financial architecture will be based on improvement of global economic prosperity and welfare, on forming global financial market, a single currency and single monetary and fiscal policy.

This chaotic state in the international monetary system provoke numerous discussions, that there is no the international monetary system, then the «no system» or even «clear-cut» system. Because of existence of huge proposals for the reforming of the international monetary system, it is hard to establish unique consensus about how the reform of the system should be realized. Instance for, R. Mundell suggested the fixed exchange rate and a single currency, M. Friedman free floating exchange rate, J. Williamson target zone, R. McKinnon coordination of the macroeconomic politics, J. Tobin foreign exchange tax proposal and capital control, etc. Thus, there isn't an optimism for creating the «clear-equalize» international monetary system. It is impossible to establish single currency and single exchange rate which will be appropriate for all countries. No single currency regime is right for all countries at all time, and no single «rules of the game» for the developing countries and developed countries.

## **The fundamental framework of agenda for future reform of the international monetary system and the international financial architecture**

The reform of the international monetary system and the international financial architecture, for a long time, was metaphorical. However, in the last few decades of the XXI. st century has been realized that for the long term global prosperity, stability and welfare is indispensable the reform of the international monetary system and the international financial architecture. The first serious move about this theme was noted in Mexico on the Conference called The United Nations International Conference on Financing for Development in march 2002. At the same time, that skip was

considerable as the main (key, basic) turning point in completing the agenda for possible reform of the international monetary system and the international financial architecture. Even then, there were established a composition of the reform (directives): minimizing the financial and market risks (because these risks could bring back again the systematic, currency, debt crises), insure stability and «calm» functioning of the system and insure the early warning system with so-called Financial Indicators for Assessing Financial System Soundness (MPI). In other words, there is need for starting new activities for correcting the basic weaknesses, which the current international monetary system revealed at the beginning of the XXI century.

The possible directions for reforming the international monetary system and international financial architecture became the real challenges for policymakers, international financial institutions, as on its broad, as on its complexity. Namely, the starting premise for reforming the system is that, the significant economic growth, integration of the international financial markets of the one part, and a new structure of the monetary system and financial architecture of the other part, would contribute to larger investments and development in global economy, especially in the developing countries. The main goal, is actually, to enhance the international integrated system, which will be establish on stabile economic policies, stabile national financial system, more open international financial markets, bigger transparency, legitimacy and right social-economic polities. There is need for harmonization of the rules, rights and accountabilities of different constituents in global economy staring with: governments, citizens, private corporations, special financial institutions and international financial organizations. The International Monetary Fund (IMF) isn't only responsible for performing already mentioned activities. It should be involve the other international financial organizations and institutions as: the World bank, OECD, Bank for Settlements and the other special financial agencies, institutions and non-profit organizations. With the regarding to justification and indispensable reform of the monetary system, in meanwhile the number of directions has been increase (since 2002. up to 2008.). Reforms in this area must be addressed with a sense of urgency in several key areas:

- strengthening and reforming the international financial institutions, thereby improving transparency, international standards and codes, international codes of conduct, improved information, quota, voice reforms,
- involving the private sector in crisis resolution and crisis prevention,
- improving the «crisis management» discipline,
- enhancing social politics of developing countries,
- adopting adequately foreign exchange rate regimes,
- provisioning of adequate international liquidity in times of crisis,
- orderly debt workouts,
- capital account management,
- liberalization of the capital flows,
- strengthening national financial systems and enhancing financial supervision and regulation, etc. [IMF,(2007), 9-15.]

Proposals and suggestions for the reform go in two lines: the first one, is consideration of re-shaping the goals and models of the current international monetary system and the other one, is establishing the different, but new tools, rules for system and new international financial institutions, with new missions and functions («new rules of the game»). Still remain to see in which direction reform needs to run.

As we can notice, there are many areas of potential or possible reforms, but it will be introduced just few of them.

The most controversial dilemma is reforming the International Monetary Fund (IMF), as a main holder (carrier) of the international monetary system. The arguments of the adherents of the Fund (proponents), understand that this central institution will gets out its members and staff with weaker financial status from the economic difficulties, and enable them prosperity and progress. The other side, the opponents of the Fund think that the institution has the monopolistic position, putting the developing countries in bigger economic and financial problems. No matter of, many discussions put on the first place strengthening and reforming the international financial institutions. The main goal of this activities is mostly directed on improving efficiency of the institutions. So, the international economic policy are agreed that, IMF and World bank should have (and keep) a central role in the international monetary system and strengthening the cooperation between developed and developing countries. In that way, with supervision and regulation the monetary system would be more robust. Also a less radical reviewers and mostly of the members of the Fund, consider appropriate that institution need to stay «with us», and reform of that institution should go towards the agency which will help in eliminating global misery and poverty. There are many opinions how the reform of IMF should go, but the main subjects are improving the activities in the surveillance of global economy (IMF surveillance over the policies of creditors as well debtors, national financial systems) and finding balance between confidential advices and possible escalation [Salvatore D., (2007), 790]. Fundamental directions is actual in the current year (2008) and will be in the next two or three years. Besides, the Fund's Surveillance is being influenced by efforts to improve transparency and accountability of its members, to develop international standards and financial sector assessments. Simplify, it became clearly that the prevention and resolution of the financial crises, require greater transparency and disclosure of information, regarding the activities of the public sector, financial markets and institutions and international financial institutions.

Now, IMF publish most of country documents and policy papers (from different countries), and IMF's goal is encouraging and promoting transparency in member countries. Also, the Fund has to form an efficient and independent mechanism for its politics, programs and operations (accountability), which will help the institution to demonstrate the responsibility and to justify trusts to its participants in the international financial markets. The action in the international institution (IMF, World bank) has so far concentrated on setting standards for improving the timeliness and quality of information concerning key macroeconomic variables, and transparency of public sector activities including fiscal, monetary and financial policies or data dissemination, transparency of fiscal, monetary and financial policies and banking supervision. And of course, the transparency is the «the gold rule» for the successful of reforming of the system. The governments, non-financial and international financial institution, have to subjugate to those standards and codes. However, the special problem for developing countries, is that they aren't agreed, completely, with adoption of these standards, because there are a lot of different standards and very often the institution put on adoption the «one-fits –all standards», which sometimes don't suit to the economic politics of emerging markets. Anyway, we emphasis the agenda of these standards and codes: Code of Good Practices on Fiscal Transparency, Code of Good Practices on Transparency in Monetary and Financial Policies, Special Data Dissemination Standard (SDDS), Data Dissemination Standards, Basel Core Principles, Financial Sector Assessment Programme etc.

There are some initiatives for reforming the activities of the World bank. Two key principles are guiding the Bank's work in support of the reform of global system: the Bank's primary focus is to assist developing countries integrate with the global financial system based on demand-driven



country assistance strategies, and the Bank is well placed to bring developing country experience and perspectives to the discussions that are underway on reform (trainings, consultation).

IMF and the World Bank need to work better together, in way of creating the stronger culture of cooperation, creating a more equalized dialogue and monitoring process (voting methods). Although, the Fund and other international financial institutions work for USA (which possesses a huge influence in decision-making), those organizations shouldn't forget their mission: supporting the sustainable development, long term reconstruction of economies, short term financial supports, collaboration with its staff, human rights, environmental protecting, social care system and welfare. Recent events in the world economy have underlined an important link between economic, social issues and global system, and that economies depend, both, on stable relationships between governments and their citizens and strong social cohesion. An efficient social system, by equipping people for change, builds trust and encourages people to take the risks which are a necessary part of a competitive modern market. This in turn helps to mitigate the risks and spread the benefits of globalisation. Effective social policy can help in building the support for necessary reforms and ensuring that the burden of adjustment doesn't fall disproportionately on the poorest and most vulnerable groups in society (still, there is a big problem—a deep financial gap and improper distribution international liquidity in times of crisis between developed and developing countries). And, if policy makers succeed to restore confidence and promote stable growth, parallel, they will reduce poverty and supporting social welfare. Therefore, the initiatives on social policy must be taken forward together with the initiatives on debt relief and poverty reduction.

IMF surveillance hasn't been successful in preventing international financial crises. Because of that, involving the private sector in crisis prevention and crisis resolution is very an important direction. One of the most complex tasks is how could the private sector be involve in crisis prevention and resolution. In that way, the international financial institutions suggest to develop better cooperation between debtor and creditor, finding a new crisis prevention measures and new institutions for crisis resolution. The role of the private sector in reforming of the system, should help in promotion cooperative decisions between countries in debt and private sector, and improving the activities which will decrease risks of investors. These framework, which relief cooperation debtor/creditor, can minimize frequency and intensity of crises, but the crises can't be eliminate. In view of the growing size and integration of the financial markets, every major financial crisis now has global ramifications. Consequently, preventing a crisis is a concern not only for the country immediately affected, but also for other countries. With the increased frequency of crisis in emerging markets, a consensus has emerged on the need to provide contingency financing to countries experiencing payments difficulties. Above (preliminary) direction is often supplement by the disciplines which are called crisis prevention and resolution. And, IMF has been working on the creation the adequate, Supplemental Reserve Facility (SRF) or new Contingent Credit Line (CCL) which will improve the stability of the international monetary system and decrease the frequency of the crises. The activities are still actual and will be the theme of discussions on the next international conferences.

The crucial question is adoption and choosing the adequate and properly exchange rate regime. So, the actual regime today is hybrid foreign exchange rate system. The system includes three blocks: hard peg fixed exchange rate regime (monetary union, dollarisation, eurisation, currency board), intermediate regimes (adjustable peg, crawling peg, basket peg and target zone), managed and clean floating. Also, countries could decided between two solution: to use free course or to tide up the currency to one of leading currencies like US dollar. There are suspicions that this solutions couldn't stop instabilities and financial crises in countries. Neither of this system is favourable to terms of trade and competence. Countries with flexible exchange rates are no

less vulnerable to financial crises than those with pegged fixed exchange rates. This provoke discussable questions: which exchange rate regime is best?, who is right?.[Pilbeam K., (2006), 289].

### **Is there progress or ...?**

Despite the general consensus, that the reform of the global monetary system is-imperative, by then no efforts are done towards reform. Developed, industrial countries aren't ready for activating developing countries in discussions about the mentioned theme. The biggest disappointment was shown by the international public financial institutions and their little interesting for reconstruction of the global finance. Mostly economists can find the main reasons for the reform of the international monetary system and international financial architecture, in excessive volatility international capital mobility and foreign exchange rate regimes, in deepening gaps between developed and developing countries, and in frequent appearance of the «virtual contagion and disease» of monetary system (demonstrated by financial crises and large but extremely volatile and highly concentrated private capital flows). The predictable reforms they called the «cure», which should mitigate instabilities and frequency of the financial appearance and bring a long term monetary stability, specially in the developing countries. Also, the reforms should have the same echo in the national, as in the international economic policies, which means-the effects of the proposed reforms should compose the long term period, so that the results of renovating of the system could manifest also on developing countries.

The tasks, which global economy had established, are the challenges to all actors of the international monetary system, starting with industrial, developed countries, developing countries, international financial institutions and actors on the international financial markets (banks, pension funds, commercial institutions). So, if developing countries want to be involve in progress of reforming and modernizing the monetary system and the financial architecture, they need to create the consistent strategy of negotiating with developed countries. From the start, countries with difficulties should represent needs for a new international financial architecture, providing the main directives for sustainable economic growth and development. Instance for, providing a few credit facilities, strengthening and regulations of national financial system, accepting and improving the standards and good practice, codes, liberalization of capital account, decreasing the possibilities for beginning and spreading crises by cooperating with industrial countries, their investors, exporters, and creditors, international banks and companies.

The progress for the reforming started, but insufficient. The current international financial institutions and their arrangements are seem so inadequately, and the international financial crises are still actual. From all that reasons, it is very necessary to, intensively, follow all «mini» progress of reforms of the international monetary system. So, the developed countries, should strength as their own individual financial system, macroeconomic politicises, so as the resistance on vulnerabilities and crises. However, the progress on reforming the international financial system and financial architecture doesn't go asymmetrical in developing and developed countries. One of the reasons is, even if they know that the problem already exist, but there isn't defined the adequately framework of the international monetary system, that should adapt to new environments and circumstances. Also, there is no consensus, which will support and realize the reform in the future.

Given this support, why has more progress not been made? An important part of the answer seems to be that while there is broad consensus on the need for reform, there is far less agreement on specific measures needed to build a new financial architecture (Table 1). All actors have a individual approach to the reform of the international monetary system and international financial architecture. Analyzing the Table 1., it is very hard to find common denominator of these directions (improving and adoption the international standards and codes, improving the level of inter-

national liquidity, developing the global finance, adoption the international regulation, orderly debt workouts, participations of the developing countries...), which will suit all actors, in the same time and under different circumstances. Also, there is no common attitude toward each one directions. Only that we can emphasise is, adopting of standards, codes, good practise and transparency.

*Table 1.: Looking a progress of reform of the international monetary system*

Agreed/Disagreed Yes/No	Industrial, developed countries	Developing countries, countries in transition	International financial institutions (IMF, World bank...)	Definitive outcomes
Adoption of codes and standards	Yes, for equalize adoption	Yes, for equalize adoption Yes, searching for adequate directives of provision of sufficient international liquidity	Yes, for equalize adoption Yes, searching for adequate directive of provision of sufficient international liquidity	Changes occur
Provision of sufficient international liquidity	No large provision for developing countries	No, not enough	Yes, but not enough	Changes do not occur
Increased development finance	No, not enough	Yes, but not enough	Yes, but not enough	Changes do not occur
Provision of sufficient and appropriate international regulation	Yes, but not enough	Yes, but not enough	Yes, but not enough	Changes do not occur
Increased participation by developing countries	Not ready for activating developing countries	Yes, but not enough	Unclear	Changes do not occur
Adoption of standstill and orderly debt workouts	Yes, some quite keen, but no progress	Varies, not too keen, but no progress	Quite keen, but no progress	Changes do not occur

## Conclusion

Modernizing and redesigning the international monetary system and the international financial architecture are very important for all world. It is very important to support these mutual-connected trends and activities of reforms in the future. Debates about reforming the international monetary system and international financial architecture, still will remain in the framework of the theory and politics of the representatives (the international financial institutions, the International Monetary Fund (IMF) and World Bank). The main factor which are stopping the realization of the reform, is asymmetrical policy-economic interests of developed, industrial countries and developing countries. Because of that, the global prosperity is not yet accomplish.

Efforts in creating the new international financial architecture are becoming «hostage» of agreements between developed countries (G7) and developing countries. To decrease these problems, mostly economists have to continue the discussions and to organize diverse debates about exploring the factors which brought international monetary system in this situation. Also, debates should compose: detail problems of weak national financial systems, unreasonable way of lending,



inconsistent macroeconomic politics and foreign exchange rate regimes, problem of confidence, problem of international liquidity, etc.

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