Non-state Actors and Global Governance

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Abstract

Non-state actors have come to exert an increased influence on the management, decision-making, and activities of the leading international financial institutions, the IMF and the World Bank. This has important implications for the mandates of the IFIs, global governance, and the interests of developing countries. The paper distinguishes three broad categories of non-state actors – non-governmental organizations, standard-setting institutions, and credit rating agencies – each of which plays a distinct and useful role. NGOs have helped to broaden the development agenda to include the social and environmental impact of the IFIs’ activities and pressed to make the IMF and the World Bank more open and sensitive to public opinion. Improving standards in accounting, auditing, banking, insurance, and security markets should help financial markets to function more efficiently while improving transparency and accountability.

Nevertheless, there are also serious concerns. The increased insertion of non-state actors has served to amplify the already disproportionate power and influence of the industrialized countries in the decision-making fora of the IFIs. The issue of developing country representation in global governance has, therefore, become only more pressing. There is also the question of the increased burden of cost entailed by an ever-broadening development agenda and demands for increased and improved information that the developing countries must provide.

The paper argues that the issue is not one of questioning or fighting the legitimate role of the non-state actors, but one of pace and degree of change that the IFIs may insist on as a condition for their support and operations in the client countries. It identifies six areas of concern that need consideration in the discussion on improving global governance. These are: NGOs’ own accountability, the costs and benefits of additional information, the implications of standards and codes on good practices, the ideological issues they give rise to, the need for interim measures for countries unable to meet the prevailing standards and codes, and the need for improving representation of developing countries in global governance.

The international financial institutions – the IMF, the World Bank, the regional development banks – are all public international organizations, with national governments constituting their membership. Unlike the UN bodies, the governance of these institutions is not based on the principal of one-country-one-vote, but rather on the...
members’ contribution to the capital of these institutions; countries with larger shares enjoy greater voting power. This has tended to tip their decision-making in favor of the concerns and policy stances of the industrialized countries, notably, the United States, the largest shareholder.

In recent years, there has been an increasing insertion of non-state actors – NGOs and standard-setting and credit-rating agencies – in global governance.¹ This has given rise to a number of issues. Should public international institutions, given their charters, involve non-state actors in their decision-making process? Does this help developing countries or simply amplify the power and influence of the industrialized countries in the governance of the international financial institutions (IFIs)? What are the broader implications of this development in enhancing the effectiveness of these institutions in carrying out their mandates to secure economic and financial stability, promote economic development, and alleviate poverty?

This paper attempts to address these questions. The first section explores the rationale and factors responsible for the rise of non-state actors in global governance. This is followed by a discussion of some specific changes that have occurred in the recent past that have brought the non-state actors into increasing prominence. The third section of the paper examines the implications of these developments for the developing countries. The paper concludes with a listing of issues that require attention in the ongoing debate on the international financial architecture.

1. **The Rise of Non-state Actors**

A major factor in the rise of non-state actors has been the broadening of the development agenda over time. In the early phase of economic development, multilateral development agencies and bilateral aid donors as well as client governments were preoccupied with investment planning and financing of specific investment projects and programs. Balance of payments difficulties had also to be dealt with, but they were

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¹ The term “global governance” tends to be rather loosely employed, referring usually to the management, decision-making processes, operations and activities of the leading international financial institutions, the
generally localized to individual countries and posed no systemic threat, even when some major industrial countries were concerned. Dealing with these difficulties was an established, well-honed procedure in the IMF. Whether the concern was with financing public sector investment programs or dealing with macroeconomic difficulties, national government was the interlocutor that development agencies sought.

However, the situation started to change during the 1970s for a host of interrelated reasons. Perhaps the single, most important factor was the accumulation of development experience. It became increasingly evident that a great number of public investment projects in developing countries failed to achieve their key stated objectives, if not failed altogether. In countries that were able to achieve decent economic growth, the benefits did not trickle down to the very poor, with the result that extreme poverty continued to persist. These disappointments gave rise to questions among the donor community as well as in developing countries on the strategies that were being pursued. Under the leadership of McNamara, the World Bank launched a major program of evaluating the poverty-impact of development projects and incorporating “basic needs” into the lending strategy and program.

The catalyst for policy change – or “paradigm shift” as it came to be called – was, however, the external debt crisis in the early 1980s that enveloped a large number of developing countries, especially in Latin America and Africa. A combination of accumulating external debt, failing investment projects and public sector programs, and macroeconomic mismanagement had rendered the great majority of developing countries highly vulnerable. In all this, the State was held to be the principal villain – it was government failure, not market failure, that was held to be at the root of the problem. A consensus started to emerge that government could not be relied upon to deal with alleviating poverty and protecting national solvency.

About the same time, government came under attack also in the major industrialized countries. The persistence of inflation and stagnant economic growth were

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IMF and the World Bank, and the World Trade Organization (WTO). This paper focuses only on the financial institutions.
held to be the result of an undue expansion of the welfare state, which had occurred during the post-war period. The appearance of Reagan and Thatcher on the world stage was a product of growing disaffection and frustration with government. Thus, government had to be “moved off the people’s backs”, markets needed to be liberalized and deregulated, and the private sector allowed to do its job of making profits without government interference.

But, as far as the developing countries were concerned, something more fundamental than simply reducing the government’s role was involved, though that was put forward as the prerequisite of economic reforms pushed by the IFIs and bilateral development agencies in the early phase of neo-liberalism. Voices against the simplistic notion of “getting prices right” and letting the market do the rest were raised, especially as the experience with the World Bank supported structural adjustment programs accumulated. But these did not have any significant impact on the policies and programs of the IFIs for an unduly long time. Nevertheless, in the light of its own research (especially, the work on the East Asian “miracle”), the World Bank started to recognize that the State could not be done away with in the matter of promoting economic development and alleviating poverty. For one thing, attacking the State raised awkward questions for the World Bank’s own role as a public institution; and, for another, there was a respectable body of opinion, even within mainstream economics, which continued to point out the many areas of market failures. Thus, interest shifted from scaling down the size of government to improving its effectiveness. The search started in earnest for good, effective governance, which was required for articulating and implementing sound policies and regulating the economy.

The IMF’s concern with governance issues had rather different antecedents: it arose primarily out of the imperatives of managing and preventing financial crises, which started to afflict the developing world with a regularity as international private capital flows (consisting of commercial bank lending as well as portfolio and direct foreign

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2 This transition is best reflected in the changes in the basic themes and messages of the World Bank’s annual *World Bank Reports*. The ideological shifts occurred with regularity, and are most noticeable in the
investment) gained in importance. Especially after the Asian financial crisis of 1997, a view took hold that lack of transparency and information were the principal cause of capital flight and contagion that characterized international financial crises. Reliable information on the financial status of borrowers, especially the banking sector, was essential to the soundness of foreign lending and investment decisions. Incidental to the rise in private capital flows was an increased interest in the evaluations of private rating agencies as to the credit and country risk.

The problems the IFIs faced in extending their concerns to governance were two-fold. They got involved with issues of national governance but they themselves lacked the expertise (and, strictly speaking, even the mandate) in this politically sensitive area. To this day, their forays into improving governance remain by and large tentative, even amateurish. However, they also discovered that this was a slippery road, requiring them to widen the net of their activities and concerns. Governance has many facets, which necessitate attending to an ever-increasing range of issues: human rights, labor standards, environment as well as corruption, tax evasion, money laundering, etc. This has resulted in holding developing country governments responsible for achieving results in a number of new areas before they can qualify for IFI foreign financing. Thus, demands on developing countries for transparency and better quality and quantity of information have increased enormously over time.

Thus, the rise of non-state actors in global governance was a product of the widening of the development agenda, on one hand, and the scaling down of government’s role in economic activity, on the other. The process has been helped by the realization on the part of the IFIs that dealing with some of the non-state actors is politically convenient and enhances their credibility as far as their major shareholders are concerned.

2. **Non-state Actors’ Emerging Role**

   There are basically three categories of non-state actors that have started to impinge on the governance of the IFIs, viz., non-governmental organizations (NGOs), the...
standard-setting agencies, and the credit-risk rating agencies. NGOs, by and large, represent well-defined interests, notably, the environment, external debt, human rights, labor standards, and trade issues. In advocating their cause, they are sometimes hard to distinguish from political lobbies. Some NGOs are concerned exclusively with the “international financial architecture”, which means that their locus of activity revolves around keeping a close watch on the operations and activities of the IMF and the World Bank, though their expressed goals and concerns may be of a broader humanitarian nature.

The NGOs have generally been influential in promoting and developing the development agenda, and have played a constructive role. Thus, the greater sensitivity to social dimensions and increasing attention being paid to the impact on poverty, the environment, and local communities in World Bank projects (and other development agencies) is in no small measure the outcome of their information gathering, analysis, critique and, not least, mobilization of public opinion. In some areas, the NGO success has been truly outstanding. Without the work of a few NGOs (notably, Jubilee 2000), it is hard to imagine that the HIPC (highly indebted poor countries) initiative on debt forgiveness would have progressed even to the modest extent that it has. The NGO community has also provided backup support to the developing countries in dealing with trade issues in the World Trade Organization (WTO) and was instrumental in killing the initiative on the part of the industrialized countries to work out the Multilateral Agreement on Investment. No less important has been the role NGOs have played in making the IMF and World Bank more forthcoming in information and willing to engage in dialogue with their critics in civil society.

Welcome as all this has been, the NGO activity has also created problems. The NGO community has grown over the years and contains groups with widely diverse goals and agendas. Some have concluded that the existing financial system cannot – indeed, must not – be saved. Nothing less than a complete overhaul would do, though there is less clarity or agreement on what this may entail. The diversity of opinion in the

Africa, which seems to have served as an experimenting ground for policy over the last two decades.
complex area of the reform of the international financial system is inevitable, but there is a problem when some of the actors in the debate wield greater influence in the political process because of their physical proximity and access to the centers of power.

Indeed, a distinction may be made between U.S. and Europe-based NGOs – with generally stronger financial, public outreach, and analytical capacities – and those based mostly in the developing countries. In terms of their access to and influence on the practices and policies of the IFIs, the latter group of NGOs find themselves at a distinct disadvantage. The situation has not been helped by the fact that the two Bretton Woods institutions tend to show greater sensitivity to criticism coming from nearer home. The IFIs’ efforts at disseminating information and engaging civil society in developing countries remain seriously deficient. Their project and policy documents, for example, are seldom, if ever, available in local languages in the developing world.

One somewhat paradoxical outcome of this has been that the activities of Northern-based NGOs (especially where they have successfully mobilized public opinion) have helped to further strengthen the positions of leading industrial countries in the multilateral fora. The impact of civil society criticism on members of the legislature tends to be stronger than on the executive branch of the State. In the United States, where there is a sharp separation of power among State organs, the NGO critique of the World Bank or IMF has strengthened the hand of an already hesitant and suspicious legislature in stopping funding (which must be approved annually) even in cases where an international agreement had already been reached. These positions have unfortunately been helped by misinformation in the media on the true budgetary implications of the financing sought as well as on the activities and policies of the IFIs and other UN bodies.

Since the Asian financial crisis, the IMF, with a strong backing from the G-7, has sought improvements in the reporting from its developing country members on a whole range of areas, on grounds that it is information that makes the markets work well. Creditors would hesitate to lend if they knew the true financial status of their borrowers,

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3 See Kapur (2000) for a discussion of how NGOs, among others, have impinged on the governance of the World Bank.
and commercial banks would remain prudent if they were more effectively supervised. Similarly, portfolio investors’ decisions will be based on securer foundation if the laws governing the security markets were clear and conformed to international standards.

But there is a moral angle to this also.\(^4\) The depth and quality of a country’s reporting and its adherence to international standards and codes of good practices is viewed as a measure of its commitment to sound practice, honesty, and financial probity.\(^5\) Consequently, the development and implementation of international standards and codes in monetary, fiscal, and financial spheres of national economy have now come to be considered as crucial elements in the efforts to strengthen the international financial architecture. In fact, it is one of the few areas where concrete steps have been taken to buttress the shaky international financial architecture.

The IMF is naturally at the center in developing and implementing standards and codes in areas that fall directly under its mandate, viz., in the dissemination of key macroeconomic data (especially a country’s external debt situation and foreign exchange reserves) and ensuring transparency in country reporting on fiscal, monetary, and financial policies and status. Towards this end, the Fund has developed codes on good practices in “fiscal transparency” and “transparency in monetary and fiscal policies”. A “Special Data Dissemination Standard” has also been established to improve statistical reporting.

But, at least in the eyes of the leading industrialized countries, IMF’s focus on its “core” activities is not deemed to be enough. At a Board discussion on the matter in 1999, while there was a consensus on IMF gaining a full understanding of “country practices in areas of direct operational concern” as part of its surveillance activities, there

\(^4\) Mr. Gordon Brown, the British Chancellor of the Exchequer, observes: “By making sure that economic facts cannot be manipulated and underlying problems cannot be hidden, citizens will know their country's real problems and prospects. So the codes will deter corruption, restore public confidence and build public support for the sometimes painful reforms that are essential to long-term economic growth and prosperity. And this is critical for investor confidence in the wake of the Asian crisis and for the prevention of contagion. Without transparency and proper procedures that the codes of conduct will requires, investors may not reinvest on the long-term scale necessary for jobs, growth and social progress.” (Brown 2000)

\(^5\) IMF initially called the reports on the observance of standards and codes as “Transparency Reports”. See IMF (1999).
was also support for the view that countries’ practices in non-core areas also had an increasing bearing on Fund surveillance and Fund-supported programs. The Fund should, therefore, monitor and report on these areas as well, if it was to ensure proper and effective functioning of the financial systems. The non-core issues cover accounting, auditing, bankruptcy, corporate governance, and regulation of insurance and securities markets.

The result is that the Fund’s surveillance is being both deepened and broadened in scope to include areas of activity where it has little or no expertise. The standards and codes in the non-core areas are set by professional, mostly private sector organizations, with some also enjoying supervisory powers. (See the Annex for the list and description of these organizations) This has confronted the Fund with some complex issues. For example, it has still to determine the scope of coverage of the non-core issues and decide on what action to take on the evaluations on the standards and codes. The Fund is not certain of the role standards should play in its surveillance activities and there is need for definition of the role of different bodies and institutions in the establishment, assessment, and monitoring of standards and codes.

The impact of supervisory and standard-setting bodies on the functioning of the two Bretton Woods institutions takes an entirely different form from that of NGOs. The relation here is not one of adversary, but one of partnership, of recognition that these bodies have a mandate and professional standing that is independent of their relationship with the IFIs. But this is also a relationship that is rather difficult to get right. As it is, it has been difficult for the IMF and World Bank to work together, as became particularly evident in the context of the East Asian crisis. Collaboration with other agencies could be more difficult. Apart from the problem of overlapping interests and mandates, the agencies will be hard put to strike a balance between working in harmony with each other and ensuring independence in their judgments and evaluations. There is a real concern that the collaboration among agencies may turn into a “ganging up” against developing countries.

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6 As reported in IMF 1999.
The third category of non-state actors consists of the private credit-rating agencies, whose role and influence gained in importance with the rise in private capital flows and recent international financial crises. The demand for risk assessments of national governments’ ability to meet their foreign obligations – known as “sovereign credit ratings” – rose sharply as more governments, with widely varying default risks, started to borrow in international bond markets. More recently, private firms, operating in risky host countries, have also been accessing foreign bond markets and foreign investors have shown interest in domestic-currency bond markets. There has, therefore, arisen an increased interest also in assessments of overall country risk. Two of the best-known private sector credit-rating agencies – Moody’s Investors Service and Standard and Poor’s, both American – have done these assessments for many decades.

The impact of assessments of sovereign risk on developing countries is both direct and indirect. There is evidence that yields on sovereign debt rise as ratings decline, but the spreads with respect to U.S. Treasuries (commonly used as a benchmark) tend to widen for rankings below “A” grade. There is also evidence that these assessments have a more significant impact than what could be expected from the direct observation of the data (such as, GDP growth, inflation, fiscal and balance of payments deficit, etc.) that serve as the basis of these assessments. This suggests that the announcements of ratings agencies are seen to contain additional information to what could be inferred from the macroeconomic data. Conversely, the availability of the macroeconomic data does allow the market to anticipate rating assessments, and the actual effect on yields gets muted. In other words, the market’s assessment of sovereign risk tends to precede the agencies’ risk assessment. This has important implications for the role of credit rating agencies in containing financial crises.

Credit ratings also have an indirect effect on the cost of borrowing, and this is through the assignment of the so-called risk weights to bank assets in the calculation of capital adequacy requirements, as prescribed by the Basle Committee for Banking Supervision (BCBS). Initially, the BCBS guidelines on capital adequacy applied

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7 These issues are identified and discussed in IMF (1999).
primarily to internationally active banks within its 12 member countries, but in the aftermath of the recent financial crises, the Basle Committee’s mandate has been broadened and has come to be seen as a global standard setter.\(^9\)

The key issues with respect to credit agencies are the reliability of their risk analysis, whether their pronouncements increase the risk of contagion, and what impact they might have on the cost of borrowing for the developing countries. For one thing, the rating agencies do not always agree in their evaluations of risks. Cornford (2000) reports that convergence of ratings between Moody’s and Standard and Poor’s worsened as ratings were lowered, i.e., there was greater agreement for highly rated borrowers than those with low rating. There is also the consideration, as noted earlier, that the agencies’ assessment often follow events (as in the case of the East Asian crisis) rather than presage them. It has also been observed that negative ratings have bigger and quicker impact than positive ratings: the fall in bond prices on receiving bad news is sudden while adjustment to improved outlook takes time.

For all these reasons, it seems likely that risk evaluations are rather likely to worsen fluctuations in credit markets and could possibly trigger a financial crisis. There is, therefore, some cautiousness on the part of not only developing but also developed countries (and, to some extent, among the rating agencies themselves) in adopting credit ratings as a basis for setting banks’ minimum capital requirements.

3. Implications for Developing Countries

The impact of the rise of non-state actors on the functioning of the IFIs has manifested itself primarily through the changes in processes and activities bearing on the developing countries, and, in certain respects, it has been beneficial. The recognition that the development process is complex and national economic management includes social and political dimensions was long overdue. Greater openness and sensitivity to public opinion on the part of the IMF and World Bank can hardly be harmful. The insistence

\(^8\) See Cantor and Packer (1996).
\(^9\) For a fuller discussion of the role of credit rating agencies in the work of BCBS in establishing banking supervision standards, see Cornford (2000).
that concern with poverty alleviation must go beyond lip service and developing country
governments must be held accountable for their actions are moves obviously in the right
direction. Improving information flows, working towards international norms on
reporting of data, auditing, banking, etc. may not eliminate corruption, but should at least
help to reduce its crass forms.

But there is a cost to all this – and the cost, in the current scheme of things, is to
be borne primarily by the developing countries. The corollary to the broadening of the
development agenda, improving data bases, and raising standards and codes on good
practices is the widening of the scope of the IFIs’ surveillance and conditionality. The
involvement of the non-state actors has helped to increase, rather than reduce, the IFIs’
workload. The rise of governance-related conditionality raises awkward questions about
their mandates, their accountability to stakeholders, and their chances of actually
succeeding in improving governance in developing countries.\textsuperscript{10} While the number of
conditions imposed has increased, the criteria of their fulfillment have remained
uncertain or opaque. The undertakings or commitments on the part of the developing
countries are couched in vague terms, subject to wide latitude in interpretation.\textsuperscript{11}

The extension of conditionality to domains that are difficult to monitor and even
more difficult to enforce is neither helpful to the institutions nor to the developing
countries. An inordinate amount of energy and time has to be spent on working out
agreements on texts of undertakings that even with the best of intentions are unlikely to
be met, given the political, financial, and economic uncertainties that face the developing
countries. There are numerous instances where a government changeover necessitated
renegotiation in order to avoid complete abrogation of earlier commitments.

The other side of the expanding conditionality is the phenomenon of “mission
creep” in the IFIs, whose lists of tasks and areas of responsibilities show few signs of
curtailment. This is particularly true of the World Bank, which despite a series of

\textsuperscript{10} Kapur and Webb (2000) address the issues raised by governance-related conditionality of the IFIs.
\textsuperscript{11} Kapur and Webb (2000) note that the program documents are full of vague government promises, using
terms like “adopt”, “assess”, “authorize”, “build upon”, “complete”, “continue”, and other similar
undertakings.
reorganizations, continues to expand its areas of concern, but the IMF too, despite its more precise mandate, could not help but widen its net of concerns. It would seem that the IFIs themselves have remained untouched by the notions of comparative advantage and “core competencies” that they have zealously imparted to developing country governments over the years.

Perhaps, the most serious consequence of the rising demands for information and attention to an increasing set of issues is that developing country governments are being overloaded with tasks at a time when they have been asked to cut down their size and face acute stringency of financial and human resources. Whether or not the actual size of the government has been reduced, there is little doubt that the State in many developing countries has been weakened over the years. Countries’ own mistakes in political and economic spheres are obviously the primary cause of the problems they face, but it seems doubtful that adding new issues and data requirements to their already daunting tasks would further the chances of growth and development.

The IMF and World Bank have both acknowledged that inclusion of monitoring on standards and codes would entail a significant increase in budgetary outlays and hiring of new staff with requisite skills. It is to be expected that the cost to countries of improving their data bases, raising their standards in accounting and auditing, and improving the supervision and regulation of banking and insurance and securities market would be a multiple of this cost. In many cases, new institutions will have to be created, older ones revamped, and complex legislative changes will have to be instituted. All this will inevitably be a very slow process, considering that it took decades, if not centuries, for today’s advanced countries to evolve to the standards they now have. And yet there is a tendency on the part of the IMF to incorporate these desiderata into what are no more than short-term adjustment programs.

The question of participation and involvement of developing countries in decisions that directly concern them cannot be pushed aside. The under-representation of

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12 In view of the mounting criticism of mission creep, the IMF’s new management has shown an intention to arrest this trend.
the borrowers in the IFIs’ decision-making forums has been frequently underscored, but the inclusion of non-state actors – Northern NGOs and standard setting agencies – in global governance tips the scales further in favor of the industrial countries. Surely, a case for “no taxation without representation” could be made in this context.

4. Issues to Consider

The influence and role of non-state actors in global governance has increased over the years. The NGO community has raised important and pertinent questions on the orientation, strategies, and programs for economic development. They have helped to raise consciousness of issues and problems that governments and international development agencies might have otherwise finessed or neglected. Similarly, there can hardly be a quarrel over an insistence on improving governance in developing countries, reducing corruption, and making systems and procedures more transparent. Improvements in data collection and reporting and striving towards global standards and codes of good practices are also matters that would ultimately help the developing countries in carrying out their development task.

But, as noted earlier, there can be little doubt that these improvements will take time to materialize and entail costs that have to be somehow met. The question, therefore, is not one of questioning or resisting the legitimate role of the non-state actors but one of pace and degree of change that the IFIs must insist on as a condition for their operations in their client countries. This question gives rise to a number of issues that have a direct bearing on the changes needed in global governance.

(i) NGOs Accountability

The first set of issues concerns the functioning and financing of NGOs. The NGO community has grown rapidly in size, along with an expansion of the range of subject matters that they are concerned with. But they differ widely in terms of the depth of their

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13 See, for example, IMF (1999) and IMF (2000).
analysis and their influence over public opinion and decision-making at national and international levels. This diversity, while desirable and inevitable, nevertheless raises two sets of questions.

The first concerns the accountability of NGOs themselves. Just as actions of individual governments and international agencies can go wrong, the NGO community must also consider the possibility that their actions may be more disruptive than constructive. Whose interests do individual NGOs represent and who will bear the cost of their mistakes? This question has particularly serious implications for the large majority of developing countries, with weak political structures and vulnerable economies. The issue is complicated by the fact that several international agencies (including the World Bank) as well as industrial country governments provide significant funding (often for specific programs but also for budgetary support) to some of the NGOs that are “service providers” as distinct from others that are advocacy groups. At one level, of course, it would seem laudable that the beneficiaries of financing – NGOs – are willing to bite the hand that feeds them, but there is a problem of both moral hazard (e.g., getting paid for “throwing a soft ball”) and equity with regard to those that do not get financial support.

This gives rise to a second set of issues, i.e., the problem of finding a satisfactory way for aggregating the diverse views and positions of different actors into a coherent agenda for action and reform of global governance. Specifically, what should be the IFIs response when they are faced with conflicting demands from civil society actors? There is some merit in doing nothing, on grounds that opposing views may cancel each other out. However, this is neither practical nor a desirable option. Taking no action would, sooner or later, prove to be self-defeating, because it leaves all the critics unsatisfied. But, more importantly, it is seldom the case that protagonists are evenly balanced: their financial and political “clout” can differ rather widely. This has particular relevance for NGOs based in developing countries, which, because of their limited resources and physical distance from the power centers, find themselves at a disadvantage relative to those based in the United States or Europe.
Kapur (2000) sums up the situation thus: “The increasing participation of NGOs in the World Bank’s governance has also enhanced U.S. influence, particularly in policy formulation. Participatory institutions can often yield highly inequitable outcomes as a result of the inequality of the participation process in already unequal settings, resulting from unequal consciousness of needs, unequal ability to articulate demands or transform these demands into decisions.” (p. 20)

(ii) Information and Financial Markets

The goal of improving information, harmonizing its base, and monitoring its quality is at the heart of standard setting. Since this will entail significant costs, there is a legitimate concern over the benefits to result from the effort. Two points need to be considered. First, there is little question that the quality and availability of information is a major factor in the functioning of financial markets. Higher cost of borrowing or segmentation of credit markets is often the result of information failures. But it is less certain that efficient financial markets by themselves lead to higher rates or better quality of investments. Financial repression and credit allocation by government fiat have been successfully employed in almost all economies that have grown rapidly. Thus benefits from investment in improving information need to be carefully evaluated.

Secondly, it remains questionable whether more and better information is crucial to maintaining financial and economic stability. The view that poor information was a major cause for the failure to predict the Asian crisis seems specious. While the available information was far from satisfactory, the data on countries’ balance of payments situation, external debt and other foreign exchange assets and liabilities, capital inflows and bank lending to different sectors as well as the state of the property market were quite widely reported long before the crisis. It seems rather doubtful that more or better information on borrowers’ balance sheets, for example, would have averted a situation where the countries were simply unable to continue borrowing in the world financial markets. The fact is, as Akyüz and Cornford (1999) point out, the emergence of macroeconomic imbalances and misalignments is a gradual process, spread over a run of years, but their correction is usually sudden. They note: “Indeed, once the rush to exit
has begun, the process itself will lead to a rapid worsening of key indicators and in these circumstances transparency may simply accelerate it.” (p. 22)

Obviously, creditors must have access to all the relevant information on the debtor’s status prior to making their decision and guarantees are needed to ensure that debtor reporting is not misleading or fraudulent. Similarly, financial supervisors must have access to information that they need to carry out their work. In these cases, “the right to know” would appear to be incontrovertible. But it must also be recognized that public disclosure of information submitted to supervisors could enhance uncertainty and the risk of instability. There is, in brief, no consensus on what is relevant information even among the industrialized countries, where differences in the amount and type of information made available continue to persist. But the other side of the coin needs to be considered as well: the full exploitation of information is a time-consuming and expensive process. Thus, investors are unlikely to devote a great deal of time to absorbing all available information if they have only a marginal interest in a particular country.

The insistence on public disclosure of information by civil society actors poses a difficult dilemma for the IFIs. They are physically located within a milieu where the demands for public disclosure have become strident, while their principal clients are governments who tend to be wary for a variety of good (and bad) reasons to allow a full disclosure of the status of their dealings with the institutions.

(iii) Application of Standards and Codes

The resort to specialized bodies to establish standards and codes of best practices in accounting, auditing, banking, etc., was the outcome of a general recognition that the IFIs could (and should) not become global standard-setting authorities in the regulation and supervision of the financial sector. The IMF’s role is simply that of a monitor who is assigned the task of determining, with the assistance of other actors, as to the extent to which different countries satisfy these standards. The reason for placing the responsibility on the IMF is that its surveillance function is an obligation on all members
– not just the developing countries – and because it operates under an established procedure. However, this seemingly straightforward task raises a number of issues.

There is, first, the fact that standards are at different stages of development, and they are hard to assess. This is complicated by the fact that standards in each domain have a variety of elements, requiring judgments on each before an evaluation can be made as to the extent to which a country is in observance. It is for this reason that the Fund recognizes that “it would be difficult, if not impossible, to assign a member a ‘pass or fail’ with respect to implementation of a given standard”. (IMF 1999, p. 6) There is also no clear understanding as to what use could be made of country evaluations on the observance of standards, i.e., what should be the IMF’s response to a given country evaluation other than to encourage the country to make improvements?

A different set of issues arises with respect to the notion of universality of standards and codes. This concerns whether universal harmonization of standards is practical or even desirable. Standards are set by a variety of private agencies (such as International Accounting Standards Committee, or IASC) and public regulatory bodies, and often require legislative action to incorporate standards into domestic law. This is never a simple matter.

As Pistor (2000) points out, there are very few rules that are totally freestanding; most are contextual and interdependent. This interdependence means that in improving standards in any given area generally requires redesigning a complex set of complementary laws. Thus, for example, standards in accounting or auditing cannot be transferred from other countries without revamping the prevailing company law that has changed little since the colonial times in many developing countries. Furthermore, what matters is not standards or codes on the books but their enforcement, which calls for yet another variety of expertise and resources. Some observers question the attempts at harmonization of standards on grounds of the costs involved and argue for “regulatory competition”, i.e., countries competing with each other on the basis of their regulations.
In view of these considerations and the fact that at present standards are by and large voluntary and non-binding, it seems unlikely that many developing countries would invest too much political capital into changing domestic law. It is significant that there have so far been no candidates for the IMF’s Contingency Credit Line (CCL), a scheme to pre-select countries for Fund support threatened by international financial contagion, provided they, among other things, meet “relevant internationally accepted standards”.

(iv) Anglo-Saxon Model vs. Crony Capitalism

The insistence, on the part of the IMF and the World Bank, on transparency, standards and codes, and corporate governance is widely viewed (and not only in developing countries) as part of a broad thrust to make the market systems of other countries to converge to the so-called Anglo-Saxon model. This is occurring under the pressure of globalization, which has brought to light the weaknesses of other market systems and has heightened the need for harmonization and uniformity of laws and regulations governing trade and finance across countries. The fact is that the Japanese economy – not too long ago a great success story and an example-setter – has been mired in economic and financial difficulties and continental Europe is stuck with high unemployment rates and modest growth, while the U.S. economy has been embarked on a path of unprecedented rapid and sustained growth with inflation kept at bay. But it was the East Asian crisis that dealt a harsh blow to the Asian model of market system, known derogatorily as “crony capitalism”.

All this is in sharp contrast to the state of affairs of a decade earlier when it was the Anglo-Saxon model – with its emphasis on individualism, minimal regulation, relatively freely functioning product, capital, and labor markets, and the primacy of the stock market in governing investment, etc. – that was being blamed for its shortsightedness in decision-making, discouragement of innovation, and economic

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14 A critique of CCL is given in Haque (1999).
15 The differences among the market systems became a subject of increased interest after the end of the Cold War and the demise of the only real alternative to capitalism. Discussion of the different market systems became somewhat of a growth industry during the 1990s. See, for example, Albert (1993). The World Bank itself launched an elaborate program of studies on the alternative market systems. In this regard, Aoki and Patrick (1994) and Aoki and Kim (1995) are particularly noteworthy.
inequity. But the rising power and influence of the United States in global governance is viewed as hegemonic, and is for that reason feared and resisted by civil society at large. This was a principal reason for the mass demonstrations during the WTO meeting in Seattle in November 1999 and the Spring Meetings of the IMF and the World Bank last April.

The debate on the relative merits of the different market systems is, however, by and large academic, for each system is strictly speaking home-grown and evolutionary, and has displayed its strengths and weaknesses over time. Thus, for example, there can be little doubt that the “relation-based” system\(^\text{16}\) of East Asia served the countries concerned well during the phase of rapid industrialization. It proved to be particularly effective in allocating finance to fledgling industries and ensuring bank financing at acceptable price to firms in times of distress. This would be rather more difficult when the bank-client relationship is at arm’s length, an important characteristic of the Anglo-Saxon model.\(^\text{17}\)

However, while the attempts at improving governance and controlling corruption by the Fund and the Bank are worthy efforts, the progress can hardly be dramatic in an environment where laws and regulations are poorly drafted and contracts cannot be strictly enforced. In such societies, economic and financial decisions will continue to be backed by implicit or explicit relations, as was the case in the early phase of industrialization of the United States itself.

While other countries’ experiences can provide useful insights that may point to future directions for change, economic, political, or legal systems can never be successfully transplanted. Thus, systemic differences can be expected to persist, and countries will continue to experiment as their systems evolve. But there is a danger that genuine sharing of experience will be frustrated where international institutions are not seen as neutral but rather as serving to further the hegemony of one system. Although

\(^{16}\) Any definition of systems is partial and simplistic. However, the essence of the relation-based system is “a more or less informal set of regular practices, institutional arrangements, and behavior that constitute a system of corporate finance and governance…” (Aoki and Patrick 1994, p.xxi)

\(^{17}\) Rajan and Zingales (?) point out that under the relationship-based system, banks “use their monopoly power to charge above-market rates in normal circumstances in return for an implicit agreement to provide below-market financing when their borrowers get into trouble.” (p. 4)
not a guarantee, it would help if ways were found to give fair representation to all countries in global governance, covering not only the IFIs but also the standard-setting agencies.

(v) *The Need for Interim Solutions*

There continues to be uncertainty as to the practical uses of the reports on the observance of standards and codes. But it is clear that the large majority of developing countries will improve their information gathering and reporting and observance of standards only slowly. The expectation is that countries that meet, or come close to meeting, the established standards and codes, would be more attractive to foreign investors. This is an untested hypothesis, but there are reasons for questioning it. For one thing, foreign portfolio investment, direct investment, and foreign lending to the developing countries grew dramatically over the past decade, despite the many failings of the recipient countries. For another, there seems to be little correlation between the indicators of corruption (as, for example, publicized by Transparency International) and the direction of flows of foreign capital. In some cases, foreign investors seem to rather like weak laws and regulations.

Nevertheless, if the role of standards and codes is as presented by the IFIs, the conclusion suggests itself that countries that fail to meet the standards are not ready for integration into the global financial markets and must exercise caution in liberalizing their capital accounts and capital markets. Until they reach the appropriate stage of reporting and observing standards, the IFIs themselves should counsel against hasty removal of restrictions on capital movements.

(vi) *Governing the Governors*

With the broadening of the development agenda and inclusion of new actors, global governance has come to mean greater intrusion into the independence and sovereignty of developing countries. The monitoring and surveillance is now being extended to areas beyond the national economy. It is acknowledged in this paper that these developments were to some extent inevitable and do contain positive elements with
respect to the long-term interests of the developing countries. However, a discussion of governance issues leads to the important question of the accountability of the IFIs themselves: who should evaluate their performance and who should pay for their egregious mistakes? The reach of the IFIs has been extended and they are frequently called upon for assistance in life-and-death situations. The consequences of misprediction, poor analysis, or faulty advice on such occasions can be very grave indeed.

But there is also the matter of failed strategies, economic models and advice. Few will dispute that ideology has been important in the conduct of IFIs work. The inclusion of standard-setting agencies in global governance has only helped to strengthen the impression that the insistence on a particular type of market system will become stronger. This too gives rise to the question of the institutions’ accountability.

The Bretton Woods institutions are, of course, answerable to their member countries, but the weighted voting system has become somewhat of an anachronism in an environment which values stakeholders. Specifically, it has now become necessary to give recognition to increasing the representation of those who bear the primary impact of IFIs decisions. The critique of their activities by civil society actors has been beneficial, but is not enough. Some improvement in accountability can be expected if the recent efforts to establish truly independent audit of IMF bear fruit, though a replication of the quasi-independent evaluation unit in the World Bank will not suffice. A more ambitious step, though one likely to be strongly resisted by the leading industrialized countries, will be to establish a truly independent but fully representative forum, perhaps under the aegis of the United Nations, where the performance of the global financial system could be evaluated. Clearly, some means need to be devised to govern the governors.
Annex

Standard Setting Agencies

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<tr>
<th>Standard</th>
<th>Key Agency</th>
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<tr>
<td>Accounting</td>
<td>• International Accounting Standards Committee (IASC)</td>
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<td>• International Federation of Accountants (IFAC)</td>
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<td></td>
<td>• Basel Committee on Banking Supervision (BCBS)</td>
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<tr>
<td>Auditing</td>
<td>• International Federation of Accountants (IFAC)</td>
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<tr>
<td>Bankruptcy</td>
<td>• United Commission on International Trade Law (UNCITRAL)</td>
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<td></td>
<td>• World Bank</td>
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<td>• International Bar Association (IBA)</td>
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<td>Corporate Governance</td>
<td>• OECD</td>
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<td>• Basle Committee</td>
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<td>• World Bank</td>
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<tr>
<td>Data Dissemination</td>
<td>• International Monetary Fund (IMF)</td>
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<td>Fiscal Transparency</td>
<td>• International Monetary Fund (IMF)</td>
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<tr>
<td>Insurance Regulation</td>
<td>• International Association of Insurance Supervision (IAIS)</td>
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<tr>
<td>Monetary and Fiscal Policies</td>
<td>• International Monetary Fund (IMF)</td>
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<tr>
<td>Securities Market Regulation</td>
<td>• International Organization of Securities Commission (IOSCO)</td>
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Source: IMF, “Standard Setting Agencies”, downloaded from the internet, address imf.org/external/standards/agency. This document contains very useful details on the status of each standard and responsibilities of each agency.
References


