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Dealing with Sovereign Liquidity Crises: New International Initiatives for the New World of Volatile Capital Flows To and From Emerging Markets*

Cynthia C. Lichtenstein**

The author of this paper accepted an invitation to speak on the topic of emerging market banking crises in the summer of 1997, just as the Asian financial crisis flood started with the small stream of an announcement by the Thai authorities that after “a series of increasingly serious attacks on the baht,”¹ they were introducing a managed float of the Thai currency, the baht (in effect, a devaluation).² By August 20th, the International Monetary Fund (“Fund”), the international organization created in 1944 at Bretton Woods, New Hampshire, to be the overseer of the internationally agreed upon rules for nations to follow in their conduct of monetary policy and to administer a pool of currencies to be lent to members undergoing exchange crises,³ was announcing the approval of a “stand-by credit” of \$3.9 billion for Thailand, essentially a promise that the Fund would, if Thailand followed the economic program it and the Fund had agreed upon, lend it over the course of the next 34 months U.S. \$3.9 billion, with \$1.6 billion being available immediately.⁴ By October when the talk was given, the intervention of

* This paper was originally given as a talk entitled “Dealing with Emerging Market Banking Crises: Is an International Banking Standard an Answer?” in the McGeorge Distinguished Speakers Series 1997-1998. I am most grateful to the McGeorge Faculty Committee on Research Development of the McGeorge School of Law, its Chair, Michael Vitiello, and particularly Professor Michael Malloy for inviting me to begin digging into this topic before the subject matter became so pressing with the East Asian financial crisis we are seeing as the paper is being prepared for publication. I am also grateful to the faculty of the McGeorge School of Law for asking me hard questions at the Faculty Colloquium.

** Professor of Law, Boston College Law School, A.B. Radcliffe College, J.D. Yale Law School, M. Comp. L. University of Chicago Law School. I thank, with great admiration for her research skills and above all, her cheerful willingness to tackle any and all tasks *immediately*, my research assistant 1997-98, Jennifer Mencken, J.D. 1998, Boston College Law School.

1. *IMF Approves Stand-by Credit for Thailand*, IMF Press Release No. 97/37 (visited Aug. 20, 1997) <<http://www.imf.org/external/np/sec/pr/1997/pr9737.htm>> [hereinafter IMF Press Release No. 97/37].

2. *Id.*

3. It is not possible in an essay of this length to encapsulate the entire history of the treaty signed in 1944 at Bretton Woods, Articles of Agreement of the International Monetary Fund, Dec. 27, 1945, 60 Stat. 1401, 2 U.N.T.S. 39 (1945), *as amended* by 20 U.S.T. 2775, T.I.A.S. No. 6748 (1968), 29 U.S.T. 2203, T.I.A.S. No. 8937 (1976) and T.I.A.S. No. 11898 (1990) [hereinafter *The Fund Agreement*] or indeed even to write a lexicon of the terms current in international monetary law (such as “stand-by credit” or even “attacks on the baht”). For an attempt to translate some of these terms into non-specialist English, see Cynthia C. Lichtenstein, *The Mexican Crisis: Who Should be a Country's Lender of Last Resort?*, 18 *FORDHAM INT'L L.J.* 1769 (1995). Suffice it to say that both the Fund Agreement and the rules are in need of serious overhaul, but at the time of this writing, all immediate attention of both the international financial organizations and the industrial countries' financial policy makers is going to dealing with the East Asian crisis.

4. IMF Press Release No. 97/37, *supra* note 1.

the Fund in the crisis and the announcement by the U.S. that the administration's access to the Exchange Stabilization Fund would constitute a "secondary line of defense" had not been effective and Indonesia and Malaysia were experiencing the collapse of their nascent stock exchanges and, even more significantly for their economies, the extreme depreciation of their currencies.⁵

By December 1997, the contagion had spread north from East Asia to South Korea and that nation faced the possibility of being unable to pay its short-term debts coming due at the end of December,⁶ this despite the announcement of a \$57 billion bailout agreement coordinated by the IMF.⁷ The Korean Development Bank had delayed the sale of \$2 billion of bonds, planned as a means of paying these debts, because of dissatisfaction with the interest rate its advisors said would be necessary to place the issue—an interest rate described in the story as "usually associated with the sale of risky, speculative-grade 'junk bonds.'" The journalists writing the story abandoned journalistic decorum to remark: "That was evidently too onerous or embarrassing for the influential bank to stomach."⁸ The stream of the Thai baht's problem had become a major flood of an Asian financial crisis whose ultimate inundations could not be predicted.⁹

The financial world's leaders, public (Ministers of Finance, central bank governors) and private (leading figures in international banks, investment houses, and all other entities whose profits depend on international financial services), gathered in Davos, Switzerland for the privately organized World Economic Forum in February 1998 and the International Herald Tribune's report on the meetings is headlined: *Asia's Uncharted Economic Waters: World Leaders Don't Yet Have a Plan for Getting Through the Crisis*.¹⁰ The situation was and is all the more startling in that before the Thai devaluation in July, the Asian so-called "tigers" were considered exemplars of what liberalized (in terms of privatization of enterprise, removal of capital controls, not in terms of permitting access for foreign goods and services) emerging market economies could achieve of rapid economic growth.¹¹ The "tigers," while insisting on "Asian" values' contribution to their growth rates, had all followed the Western international economic institutions' prescriptions for emerging market growth, including the opening of their capital

5. Seth Mydans, *Indonesia Asks I.M.F. and World Bank Aid*, N.Y. TIMES, Oct. 9, 1997, at D2.

6. Timothy L. O'Brien & Andrew Pollack, *Korea Situation Deteriorates, Raising Specter of a Default*, N.Y. TIMES, Dec. 12, 1997, at A1.

7. *The Country That Invested Its Way Into Trouble*, FIN. TIMES, Jan. 15, 1998, at 6; Sheryl WuDunn, *Japan Presses Banks to Give Koreans Time*, N.Y. TIMES, Dec. 26, 1997, at D2.

8. O'Brien & Pollack, *supra* note 6, at A1.

9. For a detailed chronology of the Asian financial crisis in 1997 and January 1998, see *Asia: Chronology of the Asian Financial Crisis*, AAP Newsfeed, Feb. 2, 1998, available in LEXIS, News Library, AAP Newsfeed File.

10. See Jonathan Gage & Alan Friedman, *Asia's Uncharted Economic Waters: World Leaders Don't Yet Have a Plan for Getting Through the Crisis*, INT'L HERALD TRIB., Feb. 2, 1998, at 1 ("We are in uncharted waters," said Stuart Eizenstat, the U.S. Undersecretary for Economic Affairs. "There is no ready solution.").

11. Nicholas D. Kristof, *Seoul, Reluctantly, Asks IMF for Financial Aid; Crisis Shakes Faith in the "Asian Miracle"*, INT'L HERALD TRIB., Nov. 22, 1997, at 1.

markets to foreign portfolio investment and allowing their industrial and financial entities to borrow abroad,¹² both from financial intermediaries (banks and investment banking houses that have moved into commercial bank territory by direct extensions of credit, if only by acting as counterparties on derivatives) and by the issuance of debt obligations on foreign capital markets. The Mexican peso crisis at the end of 1994 had certainly served as a warning of what could happen with open capital markets¹³ and over reliance by emerging economies on what the Fund calls, in its amendment to its Principles of Surveillance made in its post-Mexican crisis review of the Principles, "unsustainable flows of private capital."¹⁴ Unfortunately, but rather predictably, since the Fund essentially was unable to give content to the term "unsustainable" (although it does seem to have tried to suggest to the Thais and the other Asian countries that a storm might be brewing,¹⁵ but without preventive effect since no one yet seems to have agreed on just how a warned country should get down to a storm cellar) and the international

12. For a description of the efforts of the Fund and the World Bank to bolster capital market access for developing countries on the theory that access to capital markets is a desirable source of hard currencies for newly industrialized countries, see Cynthia C. Lichtenstein, *The New Financial World of Cross Border Capital Movements; The International Monetary Fund Agreement in the Light of the 1994 Mexico Peso Crisis*, in WEBER, (HRSG.) WÄHRUNG UND WIRTSCHAFT, DAS GELD IM RECHT, FESTSCHRIFT FÜR PROFESSOR DR. HUGO J. HAHN, NOMOS VERLAGSGESELLSCHAFT 191 (1997). For a fascinating description of how pre-peso crisis Mexican officials conducted what are called in the investment banking business "roadshows" (public presentations by the securities issuer and its investment bankers to help "place" the securities) to flog their obligations, that is, getting capital inflows, see Aminio Fraga, *Crisis Prevention and Management: Lessons from Mexico*, in FROM HALIFAX TO LYONS: WHAT HAS BEEN DONE ABOUT CRISIS MANAGEMENT?, ESSAYS IN INTERNATIONAL FINANCE, No. 200, 46 (Peter B. Kenen ed. 1996).

13. The post Mexican crisis literature is voluminous. For a good collection of the materials in legal journals, see Francois Gianviti, *The IMF and the Liberalization of Capital Markets*, 19 HOUS. J. INT'L L. 773 (1997). Gianviti is prophetic when he concludes his article, written before the Thai devaluation, by saying, "Inevitably, as the trend toward liberalization of capital movements continues and as the prevention of crises will not necessarily be achieved, other debt crises will occur." *Id.* at 783.

The economic literature abounds with specific warnings. Typical is the *Introduction* by Lawrence Summers, Deputy Secretary of the U.S. Treasury, to FROM HALIFAX TO LYONS: WHAT HAS BEEN DONE ABOUT CRISIS MANAGEMENT?, *supra* note 12, at 1, in referring to "the most challenging problem facing the international financial system—the risk that a country experiencing large capital inflows will have suddenly to cope with large outflows when market participants revise their views about the country's prospects." *Id.* Or consider the view of another set of contributors to *From Halifax to Lyons*, *supra* note 12, Barry Eichengreen & Richard Portes, *Managing the Next Mexico*, in FROM HALIFAX TO LYONS: WHAT HAS BEEN DONE ABOUT CRISIS MANAGEMENT?, ESSAYS IN INTERNATIONAL FINANCE, No. 200, 26, 33-34 (Peter B. Kenen ed. 1996):

Unlike the direct foreign investments that had dominated the industrial countries' private investment in the developing world for much of the postwar period and the bank loans that had provided the vehicle for capital transfer in the 1970s, these stocks and bonds were highly liquid; they could be sold as easily as they had been purchased. Capital flows could now turn on a dime.

The author makes the same point in *The New Financial World of Cross Border Capital Movements*, *supra* note 12, at 192-93, distinguishing between direct foreign investment and portfolio investment, often flowing in through the intermediation of institutional investors such as global mutual funds and pension funds.

14. Lichtenstein, *supra* note 12, at 196 & nn. 22-24. For a good bibliography of the literature on Fund surveillance, see C. FRED BERGSTEN & C. RANDALL HENNING, *GLOBAL ECONOMIC LEADERSHIP AND THE GROUP OF SEVEN* 91 n.11 (Institute for Int'l Economics 1996).

15. See Stanley Fischer, *The Asian Crisis: A View from the IMF*, Address at the Midwinter Conference of the Bankers' Association for Foreign Trade, Washington, D.C., (Jan. 22, 1998) (transcript available as Stanley Fischer, *The Asian Crisis: View from the IMF* (visited June 30, 1998) <<http://www.imf.org/external/pubs/ft/survey/pdfs/012698.pdf>>).

community had not by the summer of 1998 concurred in any effective way on methods of prevention of such crises, the Asian crisis has struck the interconnected financial system. As noted above, at this moment, no solution is in sight.

Fortunately for the international financial system, at the moment of this writing the Asian "flu" does not seem to be very "contagious."¹⁶ Like the term "unsustainable capital inflows," the term "contagious" seems to have an indefinite content. Like so much else in any discussion of sovereign liquidity crisis, there is considerable disagreement as to whether "contagion" actually exists.¹⁷ Nevertheless, "[t]he fear of contagion is a primary motive in the policy search for a post-Mexico strategy in sovereign financial crises."¹⁸ It was the fear of contagion from future such crises that in part motivated the economic summit group of the industrialized western nations (the so-called G-7) at their meeting in Halifax in June 1995 to invite the slightly larger Group of Ten (G-10) to set up a Working Party to prepare a report on what the Executive Summary of the report, *The Resolution of Sovereign Liquidity Crises* calls "the complex set of issues arising with respect to the orderly resolution of sovereign liquidity crises."¹⁹ Note the word "resolution." What the Working Party focused on was how countries in crisis might be helped to get well before their flu infected others. It considered such issues as "temporary suspension of payments, IMF lending policies and, while rejecting the notion as neither 'feasible' nor 'appropriate,' international bankruptcy procedures."²⁰ Once again, there was no international agreement on appropriate resolution procedures²¹ and thus no "solution" in sight for the Asian crisis.²² Once again we are treated to the unedifying sight of academics criticizing the Fund's approach,²³ academics differing not only in academic debate, as is fruitful, but

16. The Financial Times wrote:

But the crisis now appears to have been contained. South Korea and Thailand, (and, until recently, Indonesia) are implementing sensible policies and are being rewarded by stability in their financial markets. Vulnerable countries such as Hong Kong, Brazil and Russia, have escaped contagion from Asia. A global slump looks highly improbable.

Welcome to the Party, FIN. TIMES, Feb. 14, 1998, at 10.

17. See, e.g., William R. Cline, *Crisis Management in Emerging Capital Markets 7*, in FROM HALIFAX TO LYONS: WHAT HAS BEEN DONE ABOUT CRISIS MANAGEMENT?, *supra* note 12. Cline, in this essay, is unconvinced about the risks of contagion and is skeptical that any future such crises will pose a systemic risk. *Id.* at 20. But see BERGSTEN & HENNING, *supra* note 14, at 99 ("The Mexico Crisis of late 1994-95 demonstrated that financial disruption in any one region can have pervasive 'contagion effects' around the world.").

18. Cline, *supra* note 17, at 13.

19. Group of Ten, *The Resolution of Sovereign Liquidity Crises: A Report to the Ministers and Governors Prepared Under the Auspices of the Deputies*, May 1996, at 1 (report available as Group of Ten, *The Resolution of Sovereign Liquidity Crises: A Report to the Ministers and Governors Prepared Under the Auspices of the Deputies* (visited June 30, 1998) <<http://www.bis.org/publ/gten03.pdf>>) (copy on file with McGeorge Law Review).

20. *Id.* at ii.

21. The essays in FROM HALIFAX TO LYONS: WHAT HAS BEEN DONE ABOUT CRISIS MANAGEMENT?, *supra* note 12, are in large part detailed critiques of the Report.

22. Gage & Friedman, *supra* note 10, at 1.

23. Michael Richardson, *Q & A*/Jeffrey Sachs, *IMF Prescribes "Wrong Medicine,"* INT'L HERALD TRIB., Jan. 15, 1998, at 17.

widely in policy prescriptions, therefore making an international consensus more difficult,²⁴ and finally to viewing the growth of a coalition in the United States Congress which could possibly block the U.S. from adding additional funding to the Fund to help meet future crises. The coalition is between those "free-market Republicans who dislike bail-outs on principle to left-leaning Democrats who think saving Asia will put American jobs at risk."²⁵

Yet with all the disagreement, and with all the lack of consensus on resolution of such crises, there seems to be considerable agreement on one point and complete agreement on a second. The first point is that the reinstitution of capital controls for countries facing an exchange crisis resulting from volatile outflows is not a solution.²⁶ With the integration of international capital markets, any emerging market economy will need access to those markets as part of its growth strategy. Whatever the architects of the Bretton Woods system may have envisioned for its members' capital accounts, in putting capital controls outside of the agreed upon rules of the Fund Agreement²⁷ and providing in Article VI, Capital Transfers, section 1(a) that in the event of a large or sustained outflow of capital, the Fund may request a member to exercise controls, the present thinking accepts that access

24. See Peter Passell, *IMF: Caught in Middle of Asia Blame Game*, INT'L HERALD TRIB., Jan. 16, 1998, at 11 (describing the differing views of Joseph Stiglitz, chief economist at The World Bank, and Rudi Dornbusch at MIT).

25. *Lex*, FIN. TIMES, Jan. 16, 1998, at 20.

26. After the Asian crisis was quite visible, the Managing Director of the Fund, Michel Camdessus, in his closing speech to the Fund and World Bank Annual meetings on September 25, 1997 stated firmly that the way to deal with volatile capital flows is *not* to restrict capital markets but to try to make them work better. 26 IMF SURV. 290 (Oct. 6, 1997). One set of commentators, Robert Wade and Frank Veneroso in a 1998 piece entitled *The Asian Crisis: The High Debt Model vs. The Wall Street-Treasury-IMF Complex*, (Mar. 1998) (available as Robert Wade and Frank Veneroso, *The High Debt Model vs. The Wall Street-Treasury-IMF Complex* (visited June 30, 1998) <<http://lepn.org/sage/imf24.html>> (copy on file with the *McGeorge Law Review*)), insist that at least in Asian countries where the usual financial structure for economic actors is highly leveraged, the capital account must remain closed. The statement in the text should also be qualified by noting that the most recent speeches by M. Camdessus and his First Deputy, Stanley Fischer, emphasize that emerging market countries should liberalize their capital accounts gradually as part of restructuring programs and should keep careful track of foreign borrowing. See also Stanley Fischer, *The Asian Crisis: A View from the IMF*, Address at the Midwinter Conference of the Bankers' Association for Foreign Trade (Jan. 22, 1998) (transcript available as Stanley Fischer, *The Asian Crisis: A View from the IMF* (visited June 30, 1998) <<http://www.imf.org/external/pubs/ft/survey/pdf/012698.pdf>> (copy on file with the *McGeorge Law Review*)) (stating that "excessive unhedged foreign borrowing by the domestic private sector" contributed to the crisis); Michel Camdessus, *The IMF and its Programs in Asia*, Remarks at the Council on Foreign Relations, (Feb. 6, 1998) (transcript available as Michel Camdessus, *The IMF and its Programs in Asia* (visited June 30, 1998) <<http://www.imf.org/external/np/speeches/1998/020698.htm>> (copy on file with the *McGeorge Law Review*)) (recommending as part of the new architecture for prevention of crisis "orderly capital account liberalization: this means neither a return to antiquated capital controls nor a mad rush to full immediate liberalization, regardless of the risks, but properly sequenced and cautious liberalization, so that a larger number of countries can benefit from access to the international capital markets").

27. For a history of the drafting of Article VI, Capital Transfers, of the Fund Agreement, see Lichtenstein, *supra* note 12, at 194-96.

to capital markets is a necessary concomitant to a modern liberal market economy²⁸ and that access and a full blown set of controls are incompatible.²⁹

The second point on which there is full agreement is what is now accepted as the *sine qua non* of *prevention* of currency crises in emerging market economies: financial sector reform and the creation of a *domestic* banking system that adheres to adequate (and internationally agreed upon) prudential standards and is regulated and supervised by an independent technically adequate supervisory system. Interestingly, not only is such financial sector reform the prescription for prevention, it is also almost universally agreed upon as the medicine for the existing Asian crisis. This is M. Camdessus speaking in Paris of the handling by the Fund of the Korean, Thai and Indonesian crises:

In each case [Korea, Thailand and Indonesian programs] the centerpiece of the program is a thorough restructuring of the financial sector. The goal is to ensure that owners and managers are genuinely more accountable for the prudent operation of their banks, that loans are made on the basis of objective commercial criteria, and that banks return to their essential role of mobilizing domestic savings and promoting sound investment.³⁰

Each newspaper story on the Fund programs to restabilize the countries in crisis has stressed the Fund's insistence on bank restructuring, the closure or merging of financial institutions that look too shaky to survive and the requirement of passage of legislation to set up what is hoped to be an adequate supervisory system.³¹

We have now reached the heart of this paper: the connection between domestic bank regulatory structure and currency crises in emerging market economies. Why, exactly, is a robust financial sector adequately supervised considered to be protective against a run on the currency? The concept was recognized in the G-10's

28. The Fund Agreement, *supra* note 3, Art. VI, § 1(a); Gianviti, *supra* note 13, at 779.

29. A few Asian leaders see this new thinking on the part of the Fund and the World Bank as simply an indication of the extent to which both institutions are integral to Wall Street. Seth Mydans, *Malaysia Taking Pledge of Austerity*, N.Y. TIMES, Dec. 16, 1997, at D11. Nevertheless, the same leaders do not willingly restrict borrowing by their major corporations from the West, if Western markets will lend at favorable interest rates.

30. Michel Camdessus, *The IMF and Good Governance, Address at Transparency International (France)*, (Jan. 21, 1998) (transcript available as Michel Camdessus, *The IMF and Good Governance* (visited June 30, 1998) <<http://www.imf.org/external/np/speeches/1998/012198.htm>>).

31. E.g., Andrew Pollack, *South Korea Halts Activity At 9 Banks*, N.Y. TIMES, Dec. 3, 1997, at D1. In one way, this prescription is quite remarkable. Volumes have been written on the Fund's "conditionality," the conditions it imposes upon countries receiving from the Fund financial aid over and above the currencies to which a country has access without question. Yet until recently, when the Fund began to become involved in "structural transformation" of countries in transition from centrally planned to market economies, (see Cynthia C. Lichtenstein, *Aiding The Transformation of Economies: Is the Fund's Conditionality Appropriate to the Task?*, 62 FORDHAM L. REV. 1943 (1994)), the Fund was careful to aim its conditions at macroeconomic policy, governmental action that arguably was related to exchange rate policy. Domestic bank regulatory structure in the past has been considered to be a matter only of internal concern. Richard W. Stevenson, *Greenspan Urges More Attention Be Paid to Banks Abroad*, N.Y. TIMES, Dec. 3, 1997, at D4.

Report on the Resolution of Sovereign Liquidity Crises: the Executive Summary of the Report notes at paragraph 7:

The Working Party recognizes that structural weaknesses in the banking systems of debtor countries could seriously aggravate liquidity crises and might pose difficulties for financial systems in lender countries. The Working Party concluded that further work should be undertaken in appropriate international forums to promote the strengthening of financial systems in emerging market economies and thus help to reduce such risks.³²

The text of the Report has a short section on “prevention” and comments:

Various committees and groupings meeting under the umbrella of the BIS and other international organizations are developing procedures for promoting the soundness of banks and other financial institutions and for strengthening financial markets so that the inevitable shocks and disruptions are not amplified and their systemic repercussions are contained. In order to avoid unnecessary duplication of this work, the Working Party welcomed such efforts but did not dwell on these dimensions of crisis prevention.³³

The subsequent summit of the G-7 at Lyons in June 1996 explored this view of the Working Party and “called for the adoption of strong prudential standards in emerging-market countries and urged international financial institutions and bodies to promote the development of effective supervisory arrangements in those countries.”³⁴

The remainder of this paper will now try to spell out the connection, describe briefly the efforts in international fora to develop an international standard for domestic application and, most important, to follow up on a suggestion of the Dennis Weatherstone Senior Fellow at the Institute of International Economics, Morris Goldstein, as to how *pre-crisis* emerging market economies³⁵ can be encouraged to adhere to any international banking standard so developed.

There are two strands as to why the strength of the domestic financial regulatory system is key to preventing sovereign liquidity crisis. The first is the ambiguous role of financial intermediaries in a liberalized market economy. Privately owned financial intermediaries are like private companies in any market system: their prime aim and their *raison d'être* is to make money for their owners

32. Group of Ten, *supra* note 19, at iii.

33. *Id.* at 12.

34. Summers, *supra* note 13, at 6.

35. Post-crisis economies are required to restructure their financial sectors as a condition to their Fund standbys so the question of enforcement of an international standard is less acute. See Camdessus, *supra* note 30.

so that their owners will reward their managers handsomely. To make money in a market system is to take risks: carefully calculated risks. (In the case of banks—to oversimplify wildly—the chief risk is the various gaps between a bank's funding, the interest rate at which it borrows, the currencies in which it borrows, the maturities of its borrowing, and the cost of its equity—and the bank's investments—the interest rate at which the bank lends, the currencies in which it lends, the maturities of its lending, and the amount of capital, equity or equity-like, it has to tide it over gaps that widen unexpectedly). In a market economy using private entities as its pistons, the control over the degree of risk incurred in the search for gain is the fear of failure and the owners' loss of their investment. However, private banks perform in market economies quasi-public functions: they are repositories for the savings of the public,³⁶ the administrators of the payments system and the levers by which macroeconomic monetary policy set by the government or by the central bank, if there is one, is transmitted. Simply stated, governments feel special constraints in allowing banks that misgauged risk to fail. The owners and managers of private banks are aware of this privileged position of banks and come to count on being "bailed out." And by definition the public placing its deposits in banks (that is, funding the banks) do not exercise an investor's discipline over the entities because the public does not have access to sufficient information about the relative riskiness of each individual bank's business to choose among them. And why should they in a system where the government, to give these quasi public entities preferred access to public saving, has guaranteed repayment of at least a portion of deposits?

This dilemma, of using privately owned entities to funnel household savings from the public to productive enterprise and so being reluctant to let these intermediaries fail, is known in the literature by the funny name of the problem of "moral hazard."³⁷ The dilemma exists for modern industrialized economies, as recently illustrated for the United States by the savings and loan debacle and for Europe by the Scandinavian banking crisis, but is particularly acute in emerging market economies that have liberalized their capital accounts and do not restrict or at least oversee hard currency borrowings by their intermediaries. (The exact structure of the financial sector varies from country to country; for example, Krugman suggests that in the Thai crisis it was Thai so-called financial companies

36. Particularly in emerging market economies or economies in transition where the domestic securities market is neither well-developed nor well-regulated for the avoidance of fraud, deposits in banks are the only way to get household savings from under the mattresses and into the economy.

37. The economist Paul Krugman has made available on the World Wide Web his January 1998 paper, Paul Krugman, *What Happened to Asia?* (visited Sept. 9, 1998) <<http://www.mit.edu/krugman/www/disinter.html>>, in which he explores the contributions to the Asian currency crises of "financial intermediaries (and of the moral hazard associated with such intermediaries when they are poorly regulated), and the prices of real assets such as capital and land." The paper contains, in its section on "Moral Hazard and Overinvestment," a detailed numerical example illustrating "the logic of moral hazard for guaranteed intermediaries" which will not be repeated here.

that played a crucial role.)³⁸ The financial commentator of the *Financial Times*, Martin Wolf, published a brilliant "Comment and Analysis" entitled *Why Banks are Dangerous*³⁹ which points out that a domestic lender of last resort—the "solution" for modern economies to banking liquidity crises—"[A central bank] cannot be a lender of last resort in a foreign currency. Neither can its government insure foreign currency deposits."⁴⁰ If an intermediary in an emerging market economy borrows in a foreign currency and then lends on, either in the national currency or in the foreign currency, so far as risk to the macroeconomy is concerned, it has incurred foreign exchange risk (sometimes called "transfer risk"). If it has on lent in the national currency, it (that is to say its government which has explicitly or implicitly guaranteed its liabilities) has run the risk that its borrower will repay in a depreciated or devalued national currency while it must repay its hard currency borrowing in now more expensive hard currency—or use up its government's reserves in allowing it to avoid default. If the intermediary has lent to a domestic borrower in the foreign currency, the domestic borrower's ability to pay both interest and principle is severely affected by the depreciation of the local currency.⁴¹

38. *Id.*

39. Martin Wolf, *Why Banks are Dangerous*, FIN. TIMES, Jan. 6, 1998, at 11.

40. *Id.*

41. Group of Ten, *supra* note 19, at 13, notes that sovereign liquidity crises are seriously aggravated by bank funding of longer-term domestic lending in the wholesale interbank markets of the main international financial centers. The Report points out that if the creditors do not roll over the interbank lending, a general domestic banking crisis can be generated. "If the debtor country government provided extensive support for the banking sector in such circumstances, its own financial position could deteriorate significantly." *Id.* Although it is too soon for the empirical data confirming the hypothesis to have been gathered, the author suspects that the joining of the OECD by South Korea aggravated the liabilities of the Korean banks to the wholesale interbank markets, liabilities denominated in hard currencies, not in won. Tim Shorrock, *S. Korea Joins the Club of the Rich*, J. COMMERCE, Oct. 25, 1996, at 1A. Because banks doing an international business are the indispensable underpinning for the movement of goods in international trade through issuance or confirmation of letters of credit, ever since the Central Bank Governors of the G-10 adopted a common system of risk-based capital requirements for international banks subject to their jurisdiction, the so-called 1989 Basle Accord (see J.J. Norton, *The Work of the Basle Supervisors Committee on Bank Capital Adequacy and the July 1988 Report on "International Convergence of Capital Measurement and Capital Standards,"* 23 INT'L LAW. 245 (1989); Cynthia C. Lichtenstein, *Introductory Note to Bank for International Settlements: Committee on Banking Regulations and Supervisory Practices' Consultative Paper on International Convergence of Capital Measurement and Capital Standards*, 30 I.L.M. 967 (1991); see also William R. White, *International Agreements in the Area of Banking and Finance: Accomplishments and Outstanding Issues 1996* (Bank for Int'l Settlements Working Paper No. 38, 1996) (last modified Sept. 2, 1998) <<http://www.bis.org/publ/work38.htm>> (copy on file with the *McGeorge Law Review*)) there has been a special capital requirement status for interbank lending to OECD banks. What this means is that for banks subject to regulators' capital requirements imposed by their regulatory jurisdiction in accordance with the Basle Accord, interbank lending to banks headquartered in OECD countries is more profitable whatever is the particular market rate on the form of interbank lending concerned. It may be assumed that the Basle Supervisors' Committee, the draftsman of the Basle Accord, chose the OECD grouping of countries as the easiest surrogate for a listing of bank regulatory jurisdictions following principles of comprehensive consolidated bank supervision so that it would be appropriate to require less capital backing for interbank lending to banks in those countries. Unfortunately, so far as is known, there is no review of the quality of prudential supervision of financial intermediaries when the members of OECD are making the decision to add a new country member. Thus, international standards for capital charges, the Basle Accord, created a perverse incentive to the interbank market to push hard currency funding to Korean banks even though in reality such funding was at least as risky for the creditor banks as lending to the banks of any other emerging market economy.

In either case, the uncovered foreign currency borrowing by the emerging market financial intermediaries has put the country whose currency may be entering a crisis (either because of speculative attacks on the currency or simply because foreign portfolio investment has begun to flow out again because higher returns are newly available elsewhere in the global capital markets⁴²) at risk of having to use its foreign currency reserves to support its domestic banking system just when it needs its reserves to support its exchange rate against the speculative attacks or the oversupply of its currency as the foreign investors sell out and go elsewhere.⁴³ The more the country has supported its domestic banking system with deposit insurance or other guarantees explicit or implied, the more it must act as if those guarantees will be honored to avoid adding a domestic run on financial institutions to the sudden outflow of foreign investment. As the *Financial Times* puts it: "Foreign direct investment is invaluable. But easy private-sector access to short-term borrowing can be lethal."⁴⁴

The second strand as to why the strength of the domestic banking sector is key to a government's capacity to deal with a currency crisis lies in an absolutely traditional remedy for meeting capital outflows, raising the domestic interest rate, thus meeting the competition from greater rates of return in other markets.⁴⁵ Unfortunately, this macroeconomic move puts severe pressure on weak banks trying to roll over their funding and severe pressure on struggling corporations with floating rate loans. Thus the robustness of the financial sector is key to the government's most useful tool to counter the effects of the volatile capital outflows.

42. A recent leader in the *Financial Times* has remarked:

A big part of the explanation [for the east Asian financial crisis] has to lie with the fickleness of external investors, who first behaved as if east Asian economies could do nothing wrong and, shortly thereafter, as if they could do nothing right. As the Washington-based Institute for International Finance notes, net private flows to Indonesia, Korea, Malaysia, the Philippines and Thailand jumped from \$48 billion in 1994 to \$93 billion in 1996—to collapse to an estimated *minus* \$12 billion last year.

East Asian Shipwreck, FIN. TIMES, Feb. 16, 1998, at 21 (emphasis added).

43. If an emerging market currency is freely convertible for capital transfers (and this is what is meant by "capital account liberalization" or, in other parlance, "removal of capital controls"), the country's hard currency reserves increase as foreign investors sell their currencies to purchase securities denominated in the domestic currency and equally, the country's supply of its own currency swells as selling investors try to exchange the domestic currency proceeds of their sales for the hard currencies they want to invest elsewhere.

44. *East Asian Shipwreck*, *supra* note 42, at 21.

45. The Remarks by Michel Camdessus at the Council on Foreign Relations, *supra* note 26, stressed that the Fund's prescription of higher interest rates in its East Asian programs was *not* to deflate the economies, but to reverse the deep unwarranted, in the Fund's view, depreciation of the currencies.

To reverse [the depreciation], countries have to make it more attractive to hold domestic currency, and that means temporarily raising interest rates . . . This is a key lesson of the "tequila crisis" in Latin America 1994-95, as well as from the more recent experience of Brazil, Hong Kong, and the Czech Republic, all of which have fended off attacks on their currencies over the past few months with a timely and forceful tightening of interest rates, along with other supporting policy measures.

Id.

As noted above,⁴⁶ the Lyon G-7 Summit in June 1996 called for coordinated international efforts to develop a set of "best practices" in the area of banking prudential regulation and supervision. A variety of international institutions responded, in particular the long-time locus of industrialized country banking supervision standards, the Basle Committee on Banking Supervision,⁴⁷ which in April 1997 released the preliminary version of its paper, *Core Principles for Effective Banking Supervision*, and in September 1997 released the definitive version which was submitted to the G-7 and G-10 Finance Ministers in preparation for the June 1997 Denver Summit.⁴⁸ Probably to avoid the charge that the Principles only applied to banking systems in the rich capital exporting nations, the Basle Committee prepared the document in a group containing representatives from the Committee itself and from Chile, China, Czech Republic, Hong Kong, Mexico, Russia and Thailand. "Nine other countries (Argentina, Brazil, Hungary, India, Indonesia, Korea, Malaysia, Poland and Singapore) were also closely associated with the work."⁴⁹ One wonders if the association turned out in the event of the crises in Indonesia, Korea and Thailand to have been useful in the training of civil servants familiar with the "technology," if you will, of the financial sector restructuring demanded by the Fund programs.

It is not the intent of this paper to set out the Principles here. In general they are completely unexceptional and quite what anyone familiar with the series of papers the Basle Committee has produced since 1988 would expect. For a most thoughtful analysis of both the politics and the practicalities of the production of an "international banking standard," the reader is referred to Morris Goldstein, *The Case for an International Banking Standard*, Institute for International Economics, April 1997.⁵⁰ What is interesting is the proposal of the Basle Committee that

46. See *supra* text accompanying note 34 (discussing the June 1996 G-7 summit).

47. See *supra* note 41 (discussing the Basle Accord).

48. Basle Committee on Banking Supervision, *Core Principles for Effective Banking Supervision* (Sept. 1997) (visited June 30, 1998) <<http://www.bis.org/publ/bcbs30a.pdf>> (copy on file with the *McGeorge Law Review*); also available in 37 I.L.M. 405 (1998).

49. *Id.* at 1-2.

50. Goldstein also covers in the book the connections between domestic bank weakness and the difficulties for the government concerned with handling foreign exchange crises, this before anyone predicted the East Asian financial crisis. It should be noted that attempting to strengthen emerging market banking systems in order to bolster financial stability in such economies is not the only theoretical approach to the problem of the integration of such economies into the global capital markets. In a paper originally presented to the European Institute of Asian Studies Seminar in Brussels on January 20, 1998, *The Contributory Role of Banks in Financial Crises*, Professor J. H. Dalhuisen, King's College London and University of Utrecht, argues that it is not in fact possible to adequately supervise banks so as to prevent their contributions to instability without having banking supervisors running the whole system "which comes basically down to a nationalization of the banking industry." J. H. Dalhuisen, *The Impact of the Asian Currency Crisis on European Growth Prospects*, 8 EUR. BUS. L. REV. 293 (1997). He, therefore, proposes a so-called "narrow bank" solution for both industrialized and emerging market economies where those semi-public institutions, providing the payments system and consumer deposits, would be limited to investment (presumably, although in this version of his paper Dalhuisen does not specify) in domestic government securities and all other financial sector institutions would be treated like ordinary business corporations competing for capital in the marketplace and allowed to fail.

implementation of the Principles will be reviewed at the International Conference of Banking Supervisors in October 1998 and biannually thereafter.⁵¹

This notion of coordinated review by an international gathering of supervisors of the progress made by emerging market economies in implementing (and presumably in practice adhering to) an international standard for banking regulation and supervision is the first hint of concern for the major issue of how to achieve compliance with an international standard when one is developed and agreed upon. The question will be the extent to which review of implementation by supervisory peers will be effective in shaming non-compliant countries to do better. Goldstein makes the point that an international banking standard such as the Core Principles "lends further credibility to banking reform efforts—much in the same way that IMF support lends credibility to national stabilization programs."⁵² Presumably the approbation of one's peers at the bi-annual meetings will aid the efforts for those countries honestly struggling to come up to the standard even if the shame does not act as a sanction for those not in fact trying to reform. The problem, of course, remains that at any such gathering of supervisors the reports of implementation are generated by the supervisors concerned. The laggards are just apt to keep silent.

Before, however, turning to this issue of achieving compliance with international norms of banking regulation with which this essay will conclude, it is necessary to mention another international study for avoidance of financial crises in emerging market economies, a study which in its reach went quite far beyond the work of the Basle Committee and its associates in developing the Core Principles for Effective Banking Supervision.⁵³ This study, circulated originally in April 1997,⁵⁴ is a Report entitled *Financial Stability in Emerging Market Economies*,

51. Unlike IOSCO, the International Organization of Securities Commissions, whose work is discussed at *infra* text accompanying notes 56-66, the International Conference of Banking Supervisors is a global group of supervisors who, while meeting biannually since the 1970s, I believe, have never allowed access to the papers of the biannual meetings or published communiqués. They carry on the grand tradition that the less the public knows about banks and their supervision, the less likely the public is to create runs. Unfortunately for the tradition, the confidentiality of all reports and supervisory discussions obviates any possibility of investors in banks exercising any leverage over managers' prudence. If one can assume that the survey of implementation of the Core Principles will be kept equally secret, then it is hard to see why the review will further compliance.

This is the same dilemma for the Fund concerning its surveillance and Article IV country reports. Concerning surveillance authority, see Article 4, Section 3, Amended Articles of Agreement of the International Monetary Fund, published in 4 ANDREAS F. LOWENFELD, *THE INTERNATIONAL MONETARY SYSTEM*, at DS-86 (2d ed. 1984). Traditionally the Fund keeps the reports secret and only releases them with the authorization of the member country concerned. Such secrecy, however, means that the Fund is unable to use the private capital markets as a source of discipline and speculative attacks thrive on rumor and insider leaks rather than accurate macroeconomic information. Goldstein, text accompanying *supra* note 50.

52. Goldstein, text accompanying *supra* note 50, at 32.

53. *Supra* text accompanying note 48.

54. Although, unlike the Core Principles, *supra* text accompanying note 48, the author has not seen any document indicating that the Report of the Working Party on financial stability in emerging market economies has been adopted or vetted by any group of officials having a hierarchical status higher than the Working Party as constituted, this may simply reflect the fact that with the Asian crisis beginning in July 1997 with the floating of the Thai baht, the G-7 has been absorbed with the handling of the crisis with no energy or political will left over for focusing on

A Strategy for the Formulation, Adoption and Implementation of Sound Principles and Practices to Strengthen Financial Systems,⁵⁵ prepared by a working party (under the chairmanship of Mario Draghi, Chairman of the Deputies of the Group of Ten) created in response to an initiative at the G-7 Lyon summit in June, 1996 to develop a strategy for fostering financial stability in countries experiencing rapid economic growth and undergoing substantial changes in their financial systems. The working party consisted of representatives of, among others, Hong Kong, Indonesia, Japan, Korea, Thailand and the United States. Representatives of IOSCO, The International Organization of Securities Commission, among other international economic organizations, attended the meetings of the working party and a collection of IOSCO's principles and past conclusions, guidelines and recommendations (in much less comprehensive and authoritative form, it must be admitted, than the Basle Committee's Core Principles for Effective Banking Supervision) is attached as Annex 3 to the Report. The Report covers not only the work of the Basle Committee and the contribution to financial stability of transparent, fair and efficient capital markets (the aim of IOSCO's principles), but also covers the need for high quality accounting systems, "sound and up-to-date systems for risk management by securities firms,"⁵⁶ suggestions for the role of the Fund and the World Bank and above all, the role to be played in the strategy for stability of market discipline and market access channels. The Report is of extreme interest and unfortunately could not have been absorbed and implemented by the international community in time to be a prophylactic for this summer's and fall Asian financial crisis. Events overtook the slow processes of international cooperation. One may only speculate, however, that the adoption of the strategy by the Working Party must have made the task of the International Monetary Fund in insisting upon its financial reform conditions in its Thai, Indonesian and Korean programs of aid a bit easier, in that those officials of those countries who had participated in the Working Party were already "on board," so to speak, in concurrence in the necessity of instituting the best practices of good governance, supervision and regulation suggested in the Report.

It is possible to argue that with the Working Party's Report, the international community has reached a consensus on what needs to be done by emerging market countries to allow them both to access the international capital markets (to achieve financial liberalization) and to withstand successfully the necessary volatility of such inflows, to sustain and strengthen financial stability while maintaining liberalization. The reaching of the consensus, while in no way yet formally adopted, has been signaled by Mr. Michel Camdessus' speech on the "new architecture" at

preventive strategies. However, M. Camdessus' remarks before the Council on Foreign Relations, *supra* note 26, listing six "pillars" of a "new architecture" for strengthening the international financial system, would seem to presage a refocusing of attention on preventative efforts.

55. REPORT OF THE WORKING PARTY ON FINANCIAL STABILITY IN EMERGING MARKET ECONOMIES 5 (Apr. 1997) (copy on file with the *McGeorge Law Review*) [hereinafter REPORT OF THE WORKING PARTY].

56. *Id.* at 42.

the Council on Foreign Relations,⁵⁷ as well as by the speech given by Mr. Alan Greenspan, Chairman of the United States Federal Reserve.⁵⁸ Now the question remains, how does the international community ensure that emerging markets *do* adopt the strategy?

The norms and best practices developed by the Basle Committee and IOSCO and the G-10 and whatever other grouping gets to work to build a consensus on international standards are *not* "international law." *The Report of the Working Party on Financial Stability in Emerging Market Economies*⁵⁹ is very clear on this point. The Report describes the consultative process by which, in the financial arena, norms of best practice are developed and then adds:

A formal endorsement may give the recommendations greater weight. However, they have no legal force until they are adopted by national authorities. They derive their authority from the expertise of those that have formulated them and their wide acceptance from the consultative manner in which they are prepared. They come to be applied because they reduce risk, improve market functioning and foster a level playing field. If the conventions or norms are not observed, market participants exact a risk premium.⁶⁰

How then is it possible to persuade national authorities to adopt an international banking standard, to provide for sufficient oversight of domestic capital markets, to ensure their transparency, fairness and efficiency, and to force domestic corporations to adhere to norms of good governance?

When the financial crisis has actually arrived, when the local stock market has plunged, the local currency has plummeted and the country is reaching the end of its reserves, then the international community has a method of insisting upon the adoption of the norms of financial structural reform, banking supervision and securities market oversight. The country, having by definition lost access to the capital markets, unable to pay its debts, turns to the Fund and the G-7 countries for aid and the Fund imposes, as a condition of the extension of its credit, the reforms the community has now agreed upon as the necessary concomitant of the return to financial health.⁶¹

57. *Supra* note 26 and accompanying text.

58. *Fed Chief Calls For Shake-Up Of Global Financial System*, FIN. TIMES, Feb. 28, 1998, at 1.

59. *Supra* note 55.

60. REPORT OF THE WORKING PARTY, *supra* note 55, at 51.

61. For the effectiveness of the threat to withhold Fund aid, see the stories on the attempt by Indonesia to adopt a currency board, the opposition of the Fund, and the eventual dropping of the plan by President Suharto: *see, e.g., Bad Plan for Indonesia*, INT'L HERALD TRIB., Feb. 19, 1998, at 8 ("Fortunately, the monetary fund has threatened to cut off the money if Mr. Suharto proceeds with his foolhardy idea."); Paul Handley, *Not What Indonesia Requires*, INT'L HERALD TRIB., Feb. 20, 1998, at 8 ("The reforms were to be carried out in exchange for emergency loans worth about \$43 billion organized by the IMF."); Sander Thoenes, *Suharto 'Drops His Currency Board Plans'*,

Fund conditionality, however, does not aid in the real purpose of the development of international norms of best practice banking, accounting and financial market supervision, that is, *prevention* of sovereign liquidity crises. There is no customary international law obligation on emerging market nations to follow whatever consensus develops on the best financial supervision practice; the Fund Agreement, as noted, in Article VI in its present form, assumes that countries will meet capital outflows with capital controls.⁶² Chairman Greenspan has called publicly for "sufficient preventative measures in place" to ward off crisis number three (Mexico being number one and Asia number two),⁶³ but such measures can only be *put in place* by national governments. *The Report of the Working Party on Financial Stability in Emerging Market Economies*⁶⁴ seems to believe that the desire to be able to access the international capital markets will encourage countries to adopt the standards. The Executive Summary of the Report lists as the Third Component of the strategy to encourage the "adoption and implementation of sound principles and practices needed for financial stability, . . . use of market discipline and market access channels to provide incentives for the adoption of sound supervisory systems, better corporate governance and other key elements of a robust financial system."⁶⁵ "Once principles for sound practices have been established, markets can provide important incentives for their adoption. For example, emerging market economies that implement widely accepted norms will gain improved access to the international capital market and may obtain sizable reductions in funding costs."⁶⁶

This may be true, but one needs to ask where markets get their information. The major international rating agencies did not downgrade the ratings for the public debt of Korea, Thailand and Indonesia until considerably *after* the crises had begun. It seems fair to say that whatever the agencies base their country analyses on, it is surely not an in-depth study of the quality of banking supervision in emerging markets. The global mutual funds are not a source of discipline; the aim of any such fund when sentiment shifts is to be first out the door. It is at this point that one must praise Morris Goldstein and his study, *The Case for an International Banking Standard*.⁶⁷ Mr. Goldstein has recognized the insufficiency of leaving compliance with international norms of supervision up to national regulations without more ("Who's supervising the supervisors?")⁶⁸ and has made in his study

FIN. TIMES, Feb. 24, 1998, at 4 ("President Suharto's apparent reversal lifts the threat of the International Monetary Fund canceling its \$43 billion rescue package:").

62. The Fund Agreement, *supra* note 3, Art. VI, § 1(a). Without doubt the Fund will be working on amendment of Arts. VI and VIII of the Agreement in the next several years, but the process of amendment of an international treaty is glacial.

63. *Supra* note 58.

64. *Supra* note 55.

65. REPORT OF THE WORKING PARTY, *supra* note 55, at 1.

66. *Id.*

67. Goldstein, text accompanying *supra* note 50.

68. *Id.* at 59.

a concrete suggestion for obtaining compliance⁶⁹ that strikes this author as exemplary.

Goldstein's suggestion begins with a reference to an already existing mechanism put in place by the Fund after the Mexican peso crises,⁷⁰ the Special Data Dissemination Standard (SDDS).⁷¹ The Mexican crisis brought home to the Fund the lack of access by the capital markets to reliable governmental data and it established a standard for the provision of countries' economic and financial data to the public by countries seeking access to international capital markets. (The Fund is also working towards completion of a General Data Dissemination Standard to guide all its members.) The most interesting aspect of the SDDS, however, is not the standard itself, but the system for trying to ensure that countries accessing the capital markets actually adhere to the standard in their provision of information to the markets. This is achieved by first, inviting subscription to the SDDS in early April 1996 by a letter from the IMF's Managing Director to all IMF members and Governors and secondly, by creating an electronic bulletin board listing subscribing countries together with their metadata—information about subscribers, data and their dissemination practices. There has been a transition period—from the opening of subscription in April 1996 until December 31, 1998—during which a Fund member may subscribe even if its dissemination practices do not fully meet the standard. At the present time, 43 countries have been listed as subscribers. The plan is to maintain the Dissemination Standards Bulletin Board (DSBB) and to not remove subscribers during the transition period “except for egregious nonobservance.”⁷²

The Fund then adds, “After the transition period, serious and persistent nonobservance will be cause for removal. Procedures for removal, which could involve a panel of independent experts and would require a decision by the IMF Executive Board, will be elaborated fully during the transition period.”⁷³ The implication is, of course, that removal from the DSBB would entail the imposition of a market premium on borrowing by the offending country.

This then is the basic structure suggested by Goldstein for ensuring that countries do adhere to whatever norms of best supervisory practice are worked out by the international consultative process. Once the norms are elaborated, he would have the Fund (and possibly the World Bank) create a similar list of subscribers to

69. *Id.* at 55-59 (discussing “How Should Compliance with an IBS Be Monitored and Encouraged?”).

70. Gianviti, *supra* note 13, at 779; Lichtenstein, *supra* note 12, at 197.

71. For full information about SDDS, see *International Monetary Fund, Special Data Dissemination Standard Overview* (visited June 30, 1998) <<http://dsbb.imf.org/A1/overview.htm>> (copy on file with the *McGeorge Law Review*).

72. *Id.* As of this writing, the procedures for removal have not yet been elaborated.

73. *Id.*

the international banking standard.⁷⁴ Since the Fund regularly has teams in all emerging market countries as part of its Article IV surveillance responsibilities,⁷⁵ Goldstein suggests that the teams could inspect the domestic banking supervision mechanisms for compliance with the standard. Since subscription to the standard would be voluntary (with the carrot being, presumably, a better rate for the country's interbank borrowing and other access to the capital markets), the Fund inspection of compliance could not be considered intrusive. Whether the subject is arms control, atomic energy control of the disposal of uranium or best practice banking supervision, inspection by an international agency is acceptable today in the greater interest of nonproliferation, whether it be nuclear material or financial instability.

There will, of course, be myriad details to be worked out, in particular, the exact procedures for de-listing, the serious penalty for noncompliance. It is even conceivable that there might have to be an appellate body created for reconsideration of the decision to remove a subscriber from the list. As of this writing, the detailed legalistic dispute resolution system of the World Trade Organization, including an appellate body, seems to be working just fine. Why should not the international monetary system benefit from novel ways to ensure national compliance with international standards as well?

74. There is no reason why, once there was agreement on the best practice in oversight of domestic securities markets, insurance supervision, and accounting standards, these standards could not be treated the same way.

75. Gianviti, *supra* note 13, at 778.

