Report of a Roundtable Discussion on

The Changing Global Financial Architecture: Environmental Threats and Opportunities

Hosted by the
International Financial Flows and the Environment Project,
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Introduction

The Asian, Russian and Brazilian financial crises and the subsequent concern about the vulnerability of the international financial system has spawned a flurry of activity by policy-makers, academics and activists. Various proposals for reform have been put forward, which aim to provide stability to the international financial system and to enhance the effectiveness of global capital markets. While the international environmental advocacy community is eager to have a voice in these ongoing discussions, little intellectual energy has, as yet, been brought to bear on examining the environmental interests at stake in the various proposals being advanced.

The World Resources Institute (WRI) convened a roundtable discussion on February 17, 1999 to consider the implications of proposed changes in the international financial architecture for environmental objectives, and to identify gaps in policy analysis on the nature and significance of those implications. The roundtable was designed to assist WRI and the environmental community more generally to define a policy research agenda related to proposed changes in the global financial architecture. A secondary goal was to challenge scholars who work on financial issues to incorporate an environmental dimension into their analysis.

The narrative below summarizes the discussion. A list of participants is appended to this report.

How do we understand the current financial architecture?

1. The large volume of current global capital flows are a significant cause of financial crises. These flows have dubious social utility. Financial flows no longer serve the purpose of acting as a lubricant for the “real” economy, but are based on speculative interests. As a result, national policies are dictated by the need to appease external, speculative actors instead of to address domestic agendas. Consideration of alternative exchange rate regimes are secondary to the central issue of exercising controls over global capital flows.

2. The crisis-prone nature of the current global financial system is exacerbated by the approach taken by the international financial institutions and particularly the IMF in reaction to crises. Currently, the burden of adjustment is placed entirely on the borrower country.

3. A political analysis of the current financial system points to the powerful role of the finance and banking sectors in industrialized countries (parallels were drawn with the dominant role of banks in the 1920s). Within government, these interests appear to be represented by the U.S. Treasury as reflected in the recent coining and use of the phrase “Wall Street-Treasury complex” in professional journal articles.

What are the environmental stakes in reform of the global financial architecture?

1. In the context of repeated financial crises, the coping strategies of crisis-affected communities and economies could have severe environmental implications, such as rapid depletion of natural resources for subsistence and export.

2. Changes in the global financial architecture could shift the time horizon for investments, with implications for the degree to which environmental pay-offs and costs are factored into investment decisions.

3. Discussion over the global financial architecture are tied to broader issues of the global investment climate and the relative attractiveness of different countries as recipients of investment capital. There is a danger that this logic will lead to a "race to the bottom" in terms of environmental (and labor) standards.

4. Rapid fluctuations in macro-economic variables could destabilize institutions for management of natural resources, especially common property management regimes.

The current proposals for reform of the global financial architecture and the strategic implications of these proposals

The current set of proposals were briefly reviewed for the group by Robert Blecker, professor of economics at American University. The proposals were grouped under five broad categories which are presented below followed in each case by reactions to the proposal from the discussion group.

1. Proposals to make capital markets more efficient: measures to enhance national information gathering and dissemination, to better manage financial risk, to enhance prudential regulation and increase the effectiveness of IMF surveillance activities.

While reform of capital markets had the greatest political momentum, the proposed reforms represented marginal changes. Consequently, while it is important to follow the progress of these proposals and utilize the opportunities they present, they should not distract progressive forces from more fundamental reform.

2. Proposals to regulate capital flows: taxes on short term capital flows, regulations to limit either capital inflows or outflows, and institutions to stabilize and direct development finance.

Following from the broad agreement that large volumes of highly mobile capital are a large part of the problem, it was noted that forms of capital controls are an important component of the solution. However, there was also recognition that more work needed to be done to understand the environmental implications of different kinds of capital and hence of different forms of capital controls.

3. Proposals to reform the international financial institutions: new global institutions and ideas for fundamental reform of the IMF.

There was discussion of whether review of the IMF's surveillance function allows for insertion of "green accounting" ideas. The challenge will be to participate in the process of reform without ceding too much power to the IMF, which is currently a highly non-transparent institution. In this context, the current disagreement between the World Bank and the IMF over the latter's role and policy advice during the Asian crises affords a strategic opportunity for engagement with these institutions.

4. Proposals for exchange rate management: proposals span the range from fixed to floating rate regimes, as well as compromise systems.

Alternative exchange rate regimes are a technical matter, and are secondary to the more significant issue of speculative capital flows. Moreover, this is an issue that does not fall within the current competence of the environmental community.

5. Proposals for international macroeconomic policy coordination that would allow for independent national fiscal policy.

Coordination of macroeconomic policy is a composite proposal that combined elements of the others listed above.

Additional significant points of discussion

1. An important common goal for different sectors of civil society is to create space for domestic policies that could be targeted to progressive ends. While national sovereignty is not a sufficient condition for progressive outcomes, it is a necessary condition.

2. There was a discussion on whether civil society groups should ally themselves with the sub-set of prominent mainstream economists – Krugman, Sachs and Stiglitz (dubbed the "Keynesian B team") – who have advocated capital controls. It was noted that it is by no means clear that their view will prevail over the anti-capital control view advocate by Rubin, Summers and Fischer. Moreover, while there may be some agreement with the first group on capital controls, there are several other substantive grounds of difference around a progressive agenda. Specifically, the "Keynesian B team" would likely advocate short run capital controls in conjunction with a free trade agenda and "greenfield" foreign direct investments over the long run.

3. In the broad context of a changing financial architecture as part of an ongoing process of globalization, there was a discussion as to the utility and viability of a progressive strategy that relies on the upward harmonization of environmental and labor standards. Three central points emerged. First, there was disagreement over whether labor and environmental standards are always complementary or if they can, at times, be in conflict. Second, it was argued that there may be trade-offs in the short run between developing country interests and environmental standards. Third, it was suggested that broad progressive goals, such as equity considerations, cannot be addressed through the upward harmonization of standards alone.

4. Discussion of the previous point led to the question: if the strategy of standard setting does not lend to strong coalitions, and if it is ineffective in reaching certain ends, then should the progressive community argue for a "slowdown" in the process of globalization? This was not a position that found much support; participants noted that protectionist arguments have little political currency, and that the political moment is ripe for insertion of progressive ideas into debates over global integration. A final point in this debate was that the choice of language used to discuss globalization is significant. Rather than talking of a blanket "slowdown", the progressive community's emphasis should be on limiting volumes of speculative flows, and on appropriate allocations of productive capital.

5. It was observed that while Wall Street interests are served by the current financial architecture which gives free rein to speculative capital, the interests of corporations that undertake foreign direct investment are hurt by the resultant macroeconomic instability. There followed a discussion on whether it was feasible and desirable to enlist segments of the corporate sector as allies in forging a financial architecture that favors longer time horizons. However, other participants noted that the

broader interests of corporations engaged in FDI may run counter to progressive goals, making any alliance both infeasible and undesirable.

Avenues for further analysis and next steps

A central concluding theme was that more work needed to be done on defining the environmental interests embedded in the various proposals for reform of the financial architecture. Among these, three areas emerged as likely candidates for future work:

- an analysis of the environmental impacts of different forms of capital flows and capital controls;
- the threats and opportunities presented by an expansion of the mandate of international financial institutions; and
- the environmental implications of different response strategies to financial crises, especially the design of “bail-out” packages offered by the IMF.

There was agreement that the environmental community should seek to take on these questions in the debate around the global financial architecture. Three broad arenas of engagement emerged from the discussion. First, it is important to engage industrialized country governments. In this context, it was noted that in the discussions over the recent financial crises, a schism appears to be developing between the EU and the Japanese government on the one hand, and the U.S. government (particularly the Treasury Department), on the other. Political debates in each of these major financial powers will bear watching in the coming months. In particular, it will be useful to follow domestic European discussions around financial issues and forge closer ties with civil society groups in Europe active on these topics. The debate among these powers will likely be played out in upcoming arenas such as the G-8 meeting. Second, direct engagement with the international financial institutions, particularly the IMF and the World Bank, should continue to be a focus of environmental activism around these issues. Third, the United Nations and the international environmental conventions negotiated under UN auspices will be significant fora for promotion of environmental interests.

Finally, there was broad agreement in the group that the discussion was a useful first step, and that the environmental community should concern itself with the discussions over financial architecture, while continuing to define environmental interests at stake in these discussions.