Economic & Social Affairs

ST/ESA/2002/DP.23
DESA Discussion Paper No. 23

Strengthening Information and Analysis in the Global Financial System:

A Concrete Set of Proposals

Barbara Samuels, II

June 2002

United Nations

DESA Discussion Paper Series

Barbara Samuels, II

Barbara Samuels, II, is President of Samuels Associates, New York, and a Consultant to the Finance and Development Branch, Development Policy Analysis Division. The views and interpretations in this paper are those of the author and do not necessarily represent the views of the United Nations. Comments should be addressed to the author, care of Mr. Barry Herman, Finance and Development Branch, United Nations, Room DC2-2120, New York, NY 10017. Additional copies of the paper are available from the same address.

Authorized for distribution by **Ian Kinniburgh**, Director
Development Policy Analysis Division
United Nations

Acknowledgements

The recommendations in this paper were developed in discussions, interviews and written exchanges with almost 100 experts from the private and public financial sectors in several countries from July to November 2001, in addition to extensive consultations with over 250 investors in developing countries and policy makers as Project Director of the Council on Foreign Relations Roundtable on Country Risk in the Post-Asia Crisis Era in 1999 and 2000. As anonymity was a condition for the candid expression of views, I am unable to acknowledge any of them personally but am indebted to them for sharing their experiences and insights. I would also like to acknowledge the assistance provided by the United Nations Economic Commission for Latin America and the Caribbean and its Executive Secretary, José Antonio Ocampo, in arranging meetings for me with several experts in Latin America. I am especially grateful to the Development Policy Analysis Division of DESA for the support given to me in 2001, which allowed me to extend my research, and offer it as one of the proposals from the private sector for the International Conference on Financing for Development. I would also like to express my appreciation to the Division for organizing an expert group meeting on 5 November 2001 in New York, which brought 16 financial experts together to join with the Secretariat and myself to discuss an earlier version of the present paper. This work would not have been possible without the extensive and generous support from Barry Herman, Chief of the Finance and Development Branch, who provided both the inspiration and hard questions needed to develop these ideas, contributing generously his time, energy, and suggestions. Krishnan Sharma of the Financing for Development Coordinating Secretariat has consistently provided much needed guidance and thoughtful suggestions, bringing his own market experience to bear.

Abstract

Today, open and low-cost access to appropriate, timely and reliable information and analysis on emerging economies and international financial flows is of heightened importance to policy makers, investors and civil society. Despite enormous progress, serious failures persist in the information available (overload of some types and gaps in others relative to end-users' needs), uncertain credibility of public and private sources of information and analysis (including concerns of provider bias), and inadequate timeliness compared to market and media reaction speeds. This paper, drawing on extensive research, recommends four inter-related mechanisms to bridge these costly information and analysis gaps.

Key words:

information, emerging economies, investment decisions, credibility, financial markets, investor relations.

JEL classification code:

F21, F34, G14, G15, O16.

CONTENTS

I. Introduction

Financial crises continue to plague the global financial system and its country members. Major failures have occurred at all levels – international, regional, national, and local – ranging from insufficient policies to flawed lending and investment decisions, as well as miscalculated responses to the onset of crises. Despite widespread agreement that a major source of the problem is insufficient "transparency" of information and despite the subsequent progress in this area, the information and analysis used by private and official decision-makers continues to be inadequate.

In the wake of the Asian crisis, the international community and countries have invested extensive resources in improving the public flow of economic and financial information and analysis through governmental and international organization channels. The private financial sector has also contributed considerably to the global collection, analysis and dissemination of information and analysis. In spite of these substantial efforts and progress, the continued advent of large financial crises (most recently Argentina and Enron), are ample evidence of continued costly failures in both the public and private sectors. The shortcomings are two-fold: in information and analytical capabilities, as well as in the ineffective integration of information and analysis into the decision-making process itself. The objective of this study is to develop practical recommendations for mechanisms that help overcome these shortcomings. The overriding objective is to enhance transparency, risk management, and the quality of decisions made by both investors and policy makers. It is one thing to hold both investors and policy makers accountable for decision outcomes. It is another to give them the tools for making the most informed decisions possible.

Enhancing the capabilities of policy makers and investors requires investment to make existing information and analysis in the official and private sector more accessible, and fill critical gaps so as to improve the relevance, credibility and timeliness of information needed for decisions. The complexities of the issues facing policy makers and investors today require efficient means for harnessing the relevant expertise across the public and private sectors. This can be done by establishing networks of human intelligence that can effectively deliver needed information and analysis as inputs for better decision-making.

This discussion paper delineates recommendations for four specific networking activities as a basis to immediately build on the progress to date. It suggests specific mechanisms that would help re-engineer how analytical assessments are produced, distributed and used by investors and policy makers. The recommended networks would build new collaborative relationships between the private and public sectors. They would establish networks of expertise across geographical regions and institutions, as well as independent mechanisms that facilitate the identification of priority information needs and key problem areas. These mechanisms would help evaluate developments in key areas of concern to investors and policy makers. They would also facilitate evaluation of the performance of investors and policy makers against their stated objectives. The critical aim is to advance the effective and timely integration of relevant information and analysis into investment and policy decisions at national, regional and international levels.

II. Heightened Concerns about Information and Analysis

The starting point of this paper is that the quality of information relevant to investment decisions and the analysis of it are critical to policy and investment communities in meeting their responsibilities: policy makers to achieve development objectives and investors to achieve financial performance targets. The successes of policy makers and investors benefit countries, institutions and individuals alike. Increasing the capacity of the investment and policy development communities to produce and effectively use information and analysis will serve to reduce public and private decision failures and their potential consequences in systemic financial instability and massive economic and social dislocation. In a time of accelerating global interdependence, ease of access to high quality and timely information and analysis is a precondition for global prosperity.

Since the Asian financial crisis, a solid basis for progress in information and analysis has been established, with full consensus among all principal stakeholders on the value of accurate and timely information (sometimes summarized in the words "transparency" and "accountability" of the information providers). This was the context in which the Financial Stability Forum (FSF) was established in 1999 to bring together at the same table the national authorities from the most significant international financial centres who are responsible for financial stability in their own markets (namely, finance ministries, central banks, and supervisory agencies), along with major international financial institutions, in particular the International Monetary Fund (IMF), the World Bank and the Bank for International Settlements (BIS), international standard setting bodies and groups concerned with the smooth functioning of markets in the areas of banking, insurance, securities trading and accounting, and the Organization for Economic Cooperation and Development (OECD). These bodies have spearheaded work in setting and fostering implementation of standards and codes in a range of macroeconomic, financial and institutional policy areas for global adoption.

Despite these efforts, virtually all players acknowledge that major obstacles persist in realizing on a timely basis the objective of transparent information disclosure and in obtaining its desired benefits. Most recently evidenced by the Argentine crisis and the Enron scandal, these serious failures in information and analysis continue to threaten the welfare of countries, their citizens and the stability of the global financial system.

The reasons underlying these continuing failures in information and analysis can be gleaned from extensive interviews the author undertook with investors and policy makers concerned with development finance.[1] Those interviewed in the private and public sectors shared a number of common concerns about the information and analyses available in the "market" and from official sources. The problems interviewees characterized as critical include inefficiency (information overload), gaps (essential information unavailable), quality (lack of rigour), credibility (unknown reliability), relevance (utility to end-user's specific decision needs), and timeliness (relative to the speed of developments in the market and the media).

At the same time, research done by the Financial Stability Forum shows that the standards (financial sector "best practices" and internationally agreed standards and codes) do not fully overlap with the areas that investors require for decision making.[2] Despite extensive efforts on the part of international organizations and governments alike, information disclosure initiatives and investor outreach programmes were seen to fall short. A key source of the problem relates to the pressures, incentives and capacities of the different parties, which undermine both information disclosure and its integration into decision-making.

Governments of developing countries face the challenge of building a favourable climate for private-sector investment and capital accumulation, both domestic and foreign. Investors equally face the challenge of ensuring that their own investment and lending decisions are well informed and meet their fiduciary responsibilities to their clients in managing risk and meeting return targets. The key areas of critical shortcomings in information and analysis affecting policy makers and investors can be grouped in four general categories: countries, markets, global sources of risk, and the interface with decision-making. The concerns can be stated in summary form as follows:

1 Research for this paper included interviews and written exchanges with almost 100 experts from the private and public financial sectors in several countries from July to November 2001, in addition to extensive prior consultations with over 250 investors in developing countries and policy makers as Project Director of the Council on Foreign Relations Roundtable on Country Risk in the Post-Asia Crisis Era. For this paper, prospective interviewees were sent a common set of questions in advance of meeting with the author for a discussion of the issues outlined therein. Individuals included emerging market financial analysts and policy makers from around the world: 67 were from the private financial sector, comprising 26 from Latin America, 3 from Asia, 1 from Africa and 37 in global financial investment centers responsible for country analysis and/or asset allocation or lending decisions. Other experts interviewed were from governments or central banks of developing and developed countries and international institutions. Prior research also encompassed investors and policy makers in all geographical regions. Anonymity was promised to all the interviewees to promote candid discussions. The generalizations in this section represent the author's synthesis of the interviews, as well as prior research and professional experience. Although qualitative, the views cited here are believed to be generally indicative of financial sector experience worldwide.

2 See "Final Report of the Follow-up Group on Incentives to Foster Implementation of Standards," Meeting of the Financial Stability Forum, Basel, 6-7 September 2001 (www.fsforum.org/Reports/Incentives.pdf).

A. Information and Analysis on Developing and Transition Economy Countries

- Many governments of developing and transition economy countries are not providing adequate timely, relevant and reliable information on economic, financial, institutional, regulatory and political variables in their countries, including the extent of compliance with standards and codes related to transparency, financial supervision and regulation, and corporate governance. Investors are quite aware that many governments do not have the human resources to implement all of their commitments, nor do international financial institutions have the capacity to monitor on a timely and comprehensive basis the actual practice with regard to standards and codes.
- The explicit function of the fixed-income ratings of credit-rating agencies is to advise investors on the risk of bond default and, as such, they are not perceived as meeting the more specific and varied analytical needs of investors.
- International financial institutions are perceived as facing political pressures that impact upon the objectivity and timeliness of the information and analyses they disclose.
- The "sell-side" research of investment banks is perceived as being inherently biased. The research produced by investment banks on behalf of such clients as institutional investors, corporations and governments is not objective. For example, an investment bank that is promoting a large equity or debt transaction in a country has an interest in providing macroeconomic and market forecasts that assist in realizing that objective.

In sum, while there is much information from all the above sources, there is a shortage of credible information and analysis on critical issues for the vast majority of countries.

B. Information and Analysis on Markets and Related Private Financial Activities

- Both investors and policy makers cite the need to counter financial contagion more successfully. When trade and financial relations closely link one country to another, investors should be able to access timely and reliable information on developments in both national economies. Besides standard macroeconomic information, this involves a more detailed knowledge of the inter-linkages of the portfolios of large financial investors in both countries.
- More generally, all parties state the need to improve transparency in financial market transactions, including those engaged in by highly leveraged institutions, banks, institutional investors and direct investors. Many countries do not have adequate information on the composition of the inflow and outflow of capital from their economies. This is owing to the difficulty in tracking financial movements. It is an issue that international authorities have struggled with for decades,[3] and it still remains on their agenda.
- As with the flows, so too with the stocks. The internal financial reporting systems of a country need to be more transparent, with detailed knowledge of the "national balance sheet," i.e., the net international debt or asset position. This includes information on mismatches in maturity and currency of external obligations, significant issues with loan portfolios and non-performing loans, and systemic vulnerabilities, as well as the performance of the domestic debt and equity markets.

C. Information and Analysis on Global Sources of Risk

The triggers for large financial crises are often exogenous, relating to changes in key-currency exchange rates, commodity prices, export markets, and interest rates in international markets. However, "country risk"

3 Including individual and joint efforts of the BIS, IMF, OECD and World Bank.

analyses are often done with insufficient consideration of this possibility, in particular, without "stress-testing" of country vulnerabilities to such external factors.

4. Interface between Information, Analysis and Decision-Making

As evidenced in many financial crises, decision makers in both investor and policy making communities often do not use all the information and analysis available to them, reflecting both the incentive systems they face and the time pressures to come to decisions. Examples of the shortcomings are as follows:

- Large amounts of information can be as dangerous as insufficient information, as when information overloads the capacity to absorb it. Inability to process information can render it useless. Both policy makers and investors suffer from resource constraints on interpreting information, as well as in gathering and sifting it. They need better ways to select, retrieve and assess information so that it can be effectively used in decision-making.
- A common method for dealing with information overload is to exclude information. However, in doing this, biases may be formed, as when investors exclude countries from consideration for investment owing to their geographical neighbourhood, or when different countries are lumped together and assumed to be similar during a period of financial contagion.
- Competitive pressures on investors and investment advisors may override objective analysis of economic and business situations in a country, especially when there is considerable uncertainty, leading to market herding behaviour. Compensation and reward systems in the financial services industry may reinforce this tendency.
- Political imperatives may also colour the assessments and actions of international institutions.

Assessments of proposed investments have to be done regardless of the paucity of reliable information and analysis. Inadequate information and analysis are akin to the difficulty of walking through dense fog; without the fog, the pathway and objects can be discerned and risk avoided. When the quality of information is low, it becomes incumbent upon all parties to devise ways to improve it. Both the private and official sectors should commit the necessary resources to enhance the information environment as a basis for efficient evaluation of investment risks and in order to reveal a greater number and scope of investment opportunities.

Furthermore, in a more information-rich environment, the quality of the various techniques of risk appraisal would take on greater importance. To meet "due diligence" and fiduciary responsibilities, investors are expected to utilize best-quality risk assessments before committing to an investment. Yet guidelines on methodologies, standards, and best practices are sorely lacking. There is a nascent movement to institutionalize professional standards in risk appraisal and adopt a code of professional ethics, and it could well be boosted by the activities suggested below to strengthen information and analysis. That is, a professional association of country analysts could be formed to provide a forum for the development of such standards for assessment methodologies, as well as to support the development of independent, competent professional analysts, just as professional organizations have done for the accounting and legal professions.

The proposals that follow are thus aimed at dealing with the shortcomings noted above and build through them a process to systematically enhance the global information and analysis environment. This should, in turn, enhance the quality of policy maker and investor decisions and increase investment and economic growth in developing and transition economies.

III. Four Networking Proposals to Strengthen the Global Financial System

To meet the legitimate objectives of investors, policymakers and civil society, the national and international processes that provide core information and analysis should be disciplined and open. They should force recognition of priorities and the imperative of corrective action, even in sensitive areas, and include explicit means for measuring progress. These processes should engender market and regulatory rewards and penalties that foster compliance. The recommendations in this paper are intended to provide mechanisms to support these objectives and enable their realization. More specifically, the recommended mechanisms are intended to:

- Make more widely available all relevant official information and analysis, thereby strengthening decision-making and risk management of both investors and policy makers;
- Provide networking forums for constructive, cost-effective and open collaboration between the public and private sectors in identifying priority information issues and needs (including a modality for technical assistance);
- Establish performance benchmarks, which can serve as a basis for directing resources to different investments and programmes;
- Establish effective incentives for meaningful information disclosure and risk assessment; and
- Use leading technologies to facilitate timely, low-cost communication and analysis across experts in the public and private sector.

Adequate information and analysis will not exist as a basis to inform investor and policy decision making unless the organizations responsible have, in real terms, the capacity and will to provide it and use it. The four specific networking proposals offered here are intended to move decision-makers in this direction.

A. A "Global Clearinghouse" – an independent expert information initiative

Investors and policy makers sometimes face prohibitive costs of accessing the specific information needed for decisions on developing country investments. This problem is explicitly recognised in the Monterrey Consensus: "We encourage public/private initiatives that enhance the ease of access, accuracy, timeliness and coverage of information on countries and financial markets, which strengthen capacities for risk assessment" (A/CONF/198/3, paragraph 25).

A "Global Information Clearinghouse," an efficient central website, could act as a cost-effective bridge between information providers and decision-makers, helping to overcome the gap between existing information and user needs.[4] The Clearinghouse would reduce the cost of due diligence and risk management, and enhance investor capacity for analysis of investment in developing countries, thereby serving to increase the pool of potential investors, domestic and foreign.

The Clearinghouse would leverage the resources already invested by the public and private sectors in information, analysis and risk management by providing the missing links in dissemination to the investing public worldwide. Its basic function would be to provide a comprehensive "one-stop-shopping" information source that would be easily accessible, regularly updated, and would also carry reported concerns about information and analysis (e.g., on quality, timeliness, coverage, relevance). Although extracts might be printed in hard copy, the central value-added of the Clearinghouse would be its Internet real-time retrieval capacity, drawing upon leading-edge technology that would permit individual investors and analysts to customize the information they would regularly access according to their decision needs.

The Clearinghouse would bring together in one place on the Internet the data, information and analysis considered relevant to assessing investment risks and opportunities by actual and potential investors and policy makers. This would include official sector publications and data, private sector reports and ratings, and expert studies done by consultants, academics, and non-governmental organizations.

The scope of information and analysis on countries would aim to be comprehensive, covering the macro

4 As will be clear from the exposition below, the Clearinghouse would be quite different from the "Development Gateway" initiative of the World Bank. The "Gateway" is an Internet portal that seeks to offer "a common space for dialogue and exchange of experiences, knowledge, ideas, tools and other information resources … By enabling actors in the development field to communicate effectively and build knowledge-sharing communities, the Gateway provides new ways of using advanced technologies to support sustainable development and poverty reduction. Gateway content will … include: research findings, best practices, and case studies; procurement services and information on development projects; funding and commercial opportunities; news, online training, product reviews, job announcements, and directories of all sorts. Through individual Country Gateways, local government and civil society will play vital roles in content management and community-building" (from the Development Gateway web site, at www.developmentgateway.org/aboutus/q_a#q3).

environment (economic, financial, political, social), as well as the micro issues affecting business, such as the regulatory, legal, and policy frameworks affecting business risks and opportunities. It would pull together all information on national implementation of global codes and standards, rules and compliance, as well as the state of domestic capital markets, including the "national balance sheet," where such information exists.

The Clearinghouse could also increase transparency of international and domestic financial markets. It could bring together information on international and regional capital flows and investments, national balance sheets, and financial products and services (including credit enhancement schemes, derivatives, and put options on bond contracts). The Clearinghouse could serve as a tool for global or regional monitoring of investment flows to the extent that it carried comprehensive information on direct investment, portfolio flows, structured finance, etc. Where relevant, it could serve as a vehicle for making available to the global investing public the results of joint efforts by groups of countries to monitor their international financial flows, as in the Chiang Mai Initiative of the member countries of the Association of South East Asian Nations plus China, Japan and the Republic of Korea. Furthermore, a "stress-testing engine" could be designed and made available to users of the Clearinghouse which could facilitate their own "scenario testing" analyses.

The Clearinghouse could compile information on relevant risk management services and asset enhancement vehicles for investors (political risk insurance, guarantees, structured finance opportunities, etc). It could also list relevant experts on particular issues or countries and their backgrounds.

Information that is usually provided free would be available without any charge through the Clearinghouse, while reports that are sold would be available for purchase by download or in hard copy at their regular price. In this way, the Clearinghouse could serve as the direct distribution platform for individual country or market information and analysis, or it could simply hyperlink the user to the relevant website of the author institution.

The Clearinghouse would be operated by a small staff of professionals, who would design simplified formats for presentation of information, aimed to facilitate synthesis, cross-comparisons, dialogue and pre-emptive action. They could also provide feedback on the information to providers. Clearinghouse staff could, to the extent practical, point out inconsistencies in data, information, and analysis. In addition, the Clearinghouse could serve as an electronic forum for timely dialogue about critical issues and provide a unique, independent vehicle for information-related discussions on a "real-time" basis among domestic and foreign investors, country experts and government representatives.[5]

The Clearinghouse would not provide judgements of its staff in the form of risk conclusions or ratings. Rather, it would improve access to the risk judgements of an expanded range of experts on an expanded range of issues critical to investors and policy makers. Moreover, private-sector users of the Clearinghouse would include country and sector experts, macroeconomists and lawyers, including staff of ratings agencies, i.e., analysts whose assessments feed into risk management and due diligence. In this process, the Clearinghouse would provide the means to improve risk judgements, as experts will have a more cost-effective means to perform their research, access the research of others and test their assumptions.

By providing a wide range of information and analysis, the Clearinghouse would not only facilitate more detailed risk assessments by analysts, but it also would help them devise more specific risk judgements, customized to individual investors' particular interests and needs. The Clearinghouse would thus enhance the capacity of investors and policy makers to perform their own assessments and strengthen risk management. As a result, the Clearinghouse would encourage responsible investment, reducing over-reliance on sovereign

5 The Internet infrastructure of the Clearinghouse could also be drawn upon for direct government-investor exchanges, allowing for timely market surveys by a government or testing of opinion on government policies and market sentiment. Such functions would form part of country investor-relations programmes, which are discussed below, the point here being only that those functions could be attached to or aligned with the Clearinghouse.

fixed-income ratings and the tendency toward procyclical and herd-like behaviour.

However, given the inherent uncertainty in risk judgements, assessments by different analysts would continue to differ. Rather, the analysts would have the opportunity to be better informed and test the consequences of changes in more assumptions, all based on better information that was equally available to all. In this manner, the Clearinghouse would seek to serve the needs of domestic and international businesses, policy makers and civil society. Moreover, it would also seek to bridge the interests of both the private sector and governments, providing the former with a critical source of information and providing the latter with a channel to understand, in a timely fashion, the evolving information-related concerns of users of their information.

The Clearinghouse could best meet these objectives as a not-for-profit private-public partnership, expert-based and insulated from both political and business interests, supported at arm's length by a consortium of corporations, governments, development institutions, foundations, and individuals. As a neutral expert body, the Clearinghouse could leverage existing information and expertise from across the public and private sectors, openly identify potential risks and opportunities, and provide templates for evaluating performance in critical areas such as the creation of business-enabling environments and codes and standards. It should have an appropriate governance structure to reflect the services it provides to information users and providers, ensuring its professional integrity and independence from political and business influences in providing a wide range of information and analysis to support timely, quality risk management and the decision making of investors and policy makers.

The Clearinghouse would not duplicate any existing public or private service; nor could a wholly official entity or private sector company implement its objectives as stated above. Official entities are sensitive to the political interests of their member countries, and private sector entities use information for competitive gain. As the Enron case reminds us, moreover, it is critical to acknowledge the myriad political and business interests entwined within the global financial system, and that so-called independent analysis is sometimes obstructed. This is why an appropriate governance structure would be essential. In short, the Clearinghouse, by being neutral and independent, would perform important bridging and translation functions for official institutions, as well as improve the capacity of the private sector and governments to identify risks, opportunities, and strategies that enhanced the sustainability of development finance.

Finally, a realistic funding model for the Clearinghouse would be critical. As noted above, the Clearinghouse should not seek to operate as a for-profit enterprise, as that would contravene the public-good treatment of the information to be provided, which is fundamental to the realization of the objective of greater transparency. To establish its service, the Clearinghouse would require initial start-up funding from governments, international organizations and/or foundations.

On an ongoing basis, it is possible to envisage some form of public/private partnership, for example with technology companies that have long-term strategic interests in building relationships with governments and the private sector. The Clearinghouse could also earn commissions from distributing paid-for information to end-users in the same way as a bookstore or on-line vendor. In addition, it could earn fee income from related services, as described in ensuing sections. All in all, if the Clearinghouse succeeds in increasing the transparency of economies and financial markets and raises the quality of risk assessments and risk management, then governments and their international and regional institutions and investors could justify to their voters and shareholders making grants to the Clearinghouse as a warranted payment for an important service.

B. Government-Investor Networks

The second networking proposal is one that would strengthen an activity already undertaken by some emerging economies and facilitate its introduction elsewhere, namely investor relations programmes (IRPs). The crux of the idea is to draw upon leading Internet and communication technologies to bring together the key agencies of a country's government with a specified investor base (domestic and international), which would be identified through research in the receiving and key source countries.

Such networks could be one response to the call in the Monterrey Consensus for "… the development of consultation mechanisms between international and regional financial organizations and national governments with the private sector in both source and recipient countries as a means to create business-enabling environments" (A/CONF/198/3, paragraph 24).

The potential benefits of IRPs have been widely recognised by the official community in extensive assessments as well as by the private sector in industry forums and taskforces.[6] The identified benefits to governments of IRPs include providing a governmental forum for conveying macroeconomic objectives and explanations of policy measures, enhancing the decision-making processes of investors through the provision of key information and streamlining its dissemination, helping policy makers interpret market behaviour, and promoting the development of domestic capital markets. The positive experience of several governments in using IRPs provides a strong case for extending the use of government-investor networks to other interested countries as a means of systemically enhancing governmental capacity in influencing capital flows, and building business-enabling environments.[7]

For example, IRPs in Mexico and Brazil have reduced the risk of sudden, massive capital outflows and shortfalls on inflows through the provision of timely government explanations of country developments. In addition, direct contact between issuers and buyers of bonds and other instruments has facilitated more government understanding of market perceptions and potential investor responses to market developments, as well as their implications for the availability and cost of funding.

More generally, government policymakers can themselves become more effective risk managers when they have a more detailed understanding from their investors of the factors determining their capital flows and perceived vulnerabilities. This would require delineating the different types of investors in a country, their concerns and time horizon, and government objectives for shaping the investor base over time. In this respect, it would be important that local investors be effectively integrated into each investor relations programme, and that these programmes not be seen as something organized only to involve the foreign business community. Once operating, the IRP would facilitate direct contact of senior government policy makers with relevant investors, reducing the risk of costly misunderstandings, faulty analyses and outright losses.

The proposal here is to help IRPs work better by building a cost-effective interface between a government and its investor base, including domestic and international investors, and both equity and debt providers. While such interfaces could be designed from scratch, they could also be created as a limited-access Intranet, utilizing the technical infrastructure of the Clearinghouse. These Intranets would be customized for individual countries, based on their specific objectives and the particular profile of existing and targeted investors.

In developing their IRPs, governments have learned the value of instantaneous two-way communication with investors, as through teleconferences, arranging meetings of visiting investors with domestic authorities and undertaking overseas "road shows" to promote the country in general or to market specific investments or borrowings. The government-investor Intranet could greatly enhance this aspect of an IRP. Also, although IRPs typically use Internet web pages, they could deepen the way they use the Internet. In other words, it is proposed that a service be established and linked to the Clearinghouse once operating that would offer to design and support Intranets for individual countries which would bring together the key agencies of a country's government with a specified investor base at home and abroad (however, Clearinghouse staff would not be responsible for the accuracy of government disclosures through the Intranet).

---

6 See, in particular, IMF, "Investor relations programmes: Report of the Capital Markets Consultative Group (CMCG) Working Group on Creditor-Debtor Relations," 15 June 2001 (available at www.imf.org/external/np/cmcg/2001/eng/061501.HTM).

7 IMF and the Institute of International Finance have worked together in this regard, as on a jointly sponsored conference on the subject at IMF on 5-6 November 2001 (for a description and some of the papers presented, see www.imf.org/external/pubs/ft/seminar/2001/crisis/eng/index.htm).

In a cost-effective manner, such a government-investor network could significantly enhance the ability of a government to detect issues that could affect its access to capital markets, respond to investor concerns, and thereby enhance its ability to pre-empt a financial crisis. Such a facility could make it easier than under current practices to poll investor sentiment locally and internationally, as well as quickly disseminate to investors proactive official explanations of and discussions about policies and country developments.

Each government-investor network would appear to users as a stand-alone Intranet involving an individual country government and its specified investors. Governments would be responsible for defining the specific operating principles for their network exchanges with investors and other activities. Given the severe fiscal constraints faced by most developing countries, many of the governments using this service would need assistance to pay the fee to cover the cost of setting up the Intranet and for its maintenance. Ultimately, however, the costs of maintaining a country's Intranet should be absorbed by its IRP (recognizing that IRPs themselves may be supported by donors).

Finally, a distinction needs to be made between investor relations and investment promotion activities. Rather than just promoting a country, an effective IRP needs to help the government learn so that it may appropriately respond to views about it and the country by domestic and international investors. For that, the IRP needs to have a mechanism for effective two-way communication.

In this regard, it is important for decision-making by investors, domestic as well as foreign, that communication channels be opened for them with all parts of the government. The IRP should be seen as part of the general process of dialogue and consultation in open societies, and should not be a form of privileged access to the government by foreign creditors or investors. In other words, for governments to fulfil their objectives to create a "business-enabling environment" that mobilizes private sector capital for development, they need to proactively engage the domestic and international private sector in identifying impediments and possible remedies.

C. Support for Independent Expert Advisory Groups

A third networking proposal is to create a service that would support independent advisory groups which could provide technical expertise on development finance. Governments or investors could ask this service to identify professionals from disparate places across the public and private sectors, which the client could harness together into specific groups in order to develop options for resolving specific issues. The service that organized and supported the expert groups could operate as another affiliate of the Clearinghouse.

The desirability of an independent capacity to convoke highly technical expert groups in finance arises from the unprecedented complexity and speed of international economic and financial developments facing policy makers and investors. Few governments, especially in emerging market economies, have sufficient internal analytical resources to adequately inform their decision-making processes. Also, official decision makers are often pressured by vested interests with short time horizons and inherent biases. Investors too are subject to short-term interests, and often do not have internal resources to research complex issues. One response of governments, international organizations on their behalf, and investors has been to seek the views and advice of independent experts. These experts have been drawn from a variety of sources around the world, including consultancy firms, local and internationally active academic institutions, official international organizations and donor country governments. It is not always clear where to find the best advice or how to be assured of its independence (a point that is hardly controversial after the scandal of Enron and its accountants).

Creating an independent service to form and support such expert groups could give the world a new, neutral policy research and development mechanism. Individuals could be invited to join specific groups from sources anywhere in the world in response to requests from investors, policy makers and others. Non-governmental organizations that are a source of relevant expertise could be involved in the service and use it to build their outreach for clients and funding. The service would keep a database of experts and organizations with ranked fields of expertise, as well as team leadership and other organizational qualities. The experts would be available to advise governments (local and provincial/state, as well as national), regional bodies, international organizations and investors on technical issues relating to finance.

Members of the independent expert groups would include private-sector professionals with significant expertise in a particular identified issue area, as well as a range of other experts in the official sector and research organizations. Staff of the service would be responsible for comprehensive "due diligence" on the individuals and the areas in which they would be deemed expert. The service would also establish benchmarks for the reports to be prepared. For example, the reports could be expected to document all aspects and possible ramifications of a particular policy issue, including identification of possible trade-offs through scenarios and simulations.

The specific teams or groups would be formed in response to requests from potential clients with the intention that they should be available to respond on relatively short notice. A presumption of diversity of experiences within a group would help ensure that no one background or viewpoint had excessive influence, and that the policy issue at hand had been thoroughly defined and all options explored.

Participation of individual experts in these groups could be on a part-time or full-time basis. Currently employed experts might be allowed leaves of absence from their firms to serve on such groups. Some participation could be treated as *pro-bono* work in the public interest by firms, reflecting on its "good corporate citizenship," while raising the standing of the individual within his or her profession. It could also draw upon academics, government and international-organization employees on a similar basis.

Examples of expertise that might be in demand include the development and regulation of financial markets, fiscal and monetary policy, debt management, crisis prevention, and techniques for sovereign bond restructuring, as well as privatization, regulation and competition policy. Teams could also be formed to undertake projects at the global level, such as developing innovative financing techniques for developing countries, suggestions for improving the effectiveness of multilateral financing programmes, techniques for enhancing availability of affordable financing and fostering local investment and saving, enhancing bondholder democracy, strengthening market incentives in the productive allocation of capital, and promoting the use of equities in capital structures.

As with the Clearinghouse proposal discussed earlier, the funding of an independent expert service is a policy question. If fees paid by clients had to cover operating expenses, it would limit access to the small number of countries or institutions able to mobilize sufficient resources. Intergovernmental and foundation underwriting of the facility would thus be critical. In short, if there were to be meaningful recommendations on critical issues from independent expert groups, then financial resources from governments, foundations and the international official community would be needed.

D. Support for Independent Audits and Performance Benchmarks

The fourth networking proposal is that a service be created to provide on request independent audits—in the broad sense of evaluations of performance—of private and official entities. Such audits could be useful to bridge credibility gaps that could emerge when investor or public confidence becomes a concern. As with the expert advisory service above, the auditing service could be affiliated with the Clearinghouse. It should be a neutral mechanism that assembles teams to carry out audits and, through an appropriate governance structure, identifies areas for audit.

The global system of financial markets operates on credibility, which demands that the public and private operators in the system be transparent, reliable and accountable. National economic crises and major corporate failures and scandals over the past five years have challenged the credibility of various components of the system. Private, governmental and international organizations have worked to rebuild credibility, a process that continues. One mechanism is adoption of performance standards, but they must be accompanied by independent auditing of operations against those benchmarks. This applies to both private and public entities, and to global, regional and local organizations. Existing efforts in this regard can be usefully strengthened internationally and an independent auditing network could contribute to those efforts.

A first case in point is the auditing of government functions of critical importance to investor confidence. In this regard, the creation and formal adoption of sets of international standards and codes in several policy areas have been a major focus of intergovernmental activity. However, country situations differ and to be most effective, implementation of codes and standards needs to be sequenced in a manner appropriate to the country, and in a way that will yield the most benefits. It is often not obvious which standards or how much of a standard should be implemented by any particular country and international agreements usually do not solve the problem, even when acknowledging, "one size does not fit all." For example, regarding provision of information per se, IMF has established two standards (the Special Data Dissemination Standard for countries seeking financial market access and the General Data Dissemination System for all countries).[8] However, one may conceive of additional specialized standards or even of transition standards that individual countries might wish to set up and be measured against. Credible measurement of progress towards compliance with such benchmarks would be valuable.

The main mechanism utilized thus far by the official international community to monitor compliance with the set of internationally approved standards and codes is the Review of Standards and Codes under the auspices of IMF and the World Bank.[9] While these assessments help sharpen policy discussions, they are not used extensively by private-sector analysts. An alternative assessment mechanism, focused on those aspects of standards and codes considered critical by investors, would usefully complement the Bretton Woods approach. When done credibly, such assessments are likely to result in direct rewards and penalties in financial markets.

Moreover, governments typically adopt economic development objectives against which they would like to be measured and that can have more domestic immediacy than implementation of international standards and codes. Such objectives include the development of domestic capital markets, provision of affordable finance to private sector companies (in particular small and medium-sized enterprises), institutionalization of key governmental functions, and crisis-prevention and risk management strategies, among others.[10] Although "development planning" has long since fallen out of favour with international organizations and official donors, some such standardized presentation of government intentions can be useful to investors and to the citizens of the country. In addition, just as corporations use annual and quarterly reports to communicate with their shareholders, governments could use regular "disclosure reports" to communicate with their citizens and investors (they could be disseminated through the Clearinghouse). Many countries already provide such reports, or components of such reports, as in budget statements, background to the budget analyses, etc. In the public as in the private sector, it is essential that such "disclosure reports" be credible, follow a standardized presentation over time, and embody a professional assessment. One approach to so doing is to conceive these reports as international audits, measuring performance against stated development goals.[11]

Another potential subject for international audit is the information provided to the public by international financial institutions, with open disclosure to the public and discussion of audit results. All the main actors in the global financial system could be audited in this way, such as IMF, the World Bank Group, regional development banks, etc. While intergovernmental oversight of such

8 See the IMF web page at http://dsbb.imf.org.

9 For background, see the IMF web site at http://www.imf.org/external/np/rosc/rosc.asp.

10 While countries under IMF Stand-by arrangements or World Bank structural adjustment programmes formally commit themselves to explicit policy reforms and measure their progress against specific policy targets, all countries may find it useful to develop explicit development strategies with specified objectives that can be measured and bench-marked.

11 For an elaboration of the concept of "country disclosure reports", see "Roundtable on country risk in the post-Asia crisis era: identifying risks, strategies and policy implications", Key recommendations of Working Group discussions, Council on Foreign Relations, New York, September 2000 (on the Internet at www.foreignrelations.org), section entitled "Debtor government accountability".

institutions has increasingly included "external" evaluations of their activities,[12] the proposal here focuses more specifically on their role as providers of information to the global public. That is, independent experts could periodically audit all such information for accuracy, timeliness, completeness and consistency (both internal and across institutions).

Another critical area for independent audits pertains to international capital market activities, including instruments, practices, and concentrations of the banking, insurance, securities and related markets. Some areas of international financial activity are actively monitored and others largely lack meaningful scrutiny (such as over-the-counter derivative markets). Independent teams of financial market auditors could complement official efforts and thereby enhance the international capacity to identify systemic risks in a timely manner, such as those related to excessive concentrations of lending exposure (country, industry, maturity), instrument structure (such as "exotic" derivatives), and mismatches in maturity and currency. The auditors would also work on developing or strengthening mechanisms to enhance public information about these international markets.

As noted above, the auditing functions proposed here could be collected into a network of expertise and operated as a service in association with the Clearinghouse. The service could both arrange specific audits and convoke experts on methodological issues relevant to its different auditing activities. In this sense, it could become an international centre of expertise on auditing information-intensive activities. It might also be related to the network of expert advisory groups proposed earlier, although the recent experience in the United States of potential conflicts of interest between the consultancy and auditing functions of the major accounting firms, highlighted by the Enron scandal, suggest special care be given to separating consultancy and auditing services.

IV. Organizational Requirements for Success of the Clearinghouse Networks

Several critical factors for insuring the success of the four initiatives proposed above can be derived from best practices that have evolved in the field of country risk assessment and related professional disciplines:

- **User-oriented:** Information and analysis yield no benefit if not used by policy makers and investors. Despite extensive efforts to establish "market outreach programmes," official providers of data and information very often do not successfully interface with investors. Among the issues requiring greater attention are learning actual investor information needs and presenting information in user-friendly formats, not to mention adequately informing potential investors of risk management services, such as insurance and guarantee programmes. Closing such user-orientation gaps is critical to achieving benefits from the massive investments already made in information and analysis.
- **Expertise-driven:** Historically, the effective provision of information and expert analysis of risk has been undercut by bureaucratic inefficiency and vested interests, political and business. Like other professional endeavours such as medicine, law and accounting, the key operating principle in support of effective risk assessment must be to safeguard as much as possible the neutrality of expertise over business, political and personal interests. In this context, the proposed networks could serve as independent neutral "bridges" in making available experts from across the public and private sectors and in supporting their independence.
- **Technologically sophisticated:** Contemporary market and media services employ leading

12 For the activities of the Operations Evaluation Department of the World Bank and the recently established Independent Evaluation Office of IMF, see the respective web pages (www.worldbank.org and www.imf.org). In addition, the major regional development banks, World Bank and International Finance Corporation are cooperating on evaluation matters through their Evaluation Cooperation Group (see http://www.worldbank.org/html/oed/ecg).

technologies to deliver their information to decision-makers, who see these modalities as most effective. In being responsive to the demands of their targeted users in the investor and policy-making communities, official providers of information must compete with these media. For cost-effectiveness, as well as "market appeal", the proposed networks should use leading Internet and communication technologies to create their information and analysis "platforms".

- **Entrepreneurial staff:** A small entrepreneurial core of managers would be needed to ensure that the four proposals were carried out. They would need to recruit country participation in the Clearinghouse, individuals to be on the roster of experts for the advisory groups, and so on. The staff would also need the capacity to take management decisions that reflect the broad guidance of the organization's mandate for professional integrity and neutrality, keeping political or business interests at bay.
- **Adequately funded:** The start-up of the Clearinghouse would require significant official and/or foundation funding. However, its activities are expected to be perceived as adding significant value to both investors and policy makers, and therefore, once completed, would earn significant revenues over time. For example, one key source of revenue would be commissions that the Clearinghouse could collect for distributing paid-for information and analysis, much like Reuters or Bloomberg. Another source of revenue could be "market outreach fees" that might be collected by the Clearinghouse from individual official institutions for enhancing their data delivery interfaces with users. However, it is important to note that some developing countries, especially low-income ones, are likely to need donor funds to pay for these services. For example, expenses related to providing developing countries with Clearinghouse services could be paid directly by the developing country governments as "user fees" in recognition of the value of the Clearinghouse service, utilising funds provided through donor countries. If needed, supplementary funding assistance could include grant financing by foundations and private sector companies interested in fostering financing for development. In addition, private companies could be asked to contribute the professional time of some of their experts, which they might willingly do as the proposals made here could strengthen the financial and information technology sectors.

V. Conclusion

To date, information and analysis has not met the decision-making requirements of policy makers and the global pool of investors in emerging economies. The private sector will not meet these needs by itself: they embody significant research costs with limited scope for profitability from the public provision of the information. Investors will pay, but only for exclusive access to information that is perceived as yielding competitive advantage. In essence, information is treated as a weapon for outperforming competitors. Therefore, if high-quality, timely information for independent analysis is deemed critical to the well being of the global financial system and its participants, it should be considered an "international public good" requiring official and foundation funding.

The four proposals delineated above are specific mechanisms that would strengthen information and analysis in the global financial system, enhancing the effectiveness of finance, and reducing the frequency and depth of financial crises. They could promote greater policy maker and investor confidence, resulting in increased and more sustainable private financing for investment, advancing the prosperity of both developing and developed countries. These four networking mechanisms could provide a platform for experts from across the private and public sectors of the world to harness their expertise, formulate effective investment strategies, and evaluate results. These mechanisms would advance the public provision of information and analysis in a pragmatic manner, while also giving vent to private sector interest in strengthening technical assistance for capacity building and crisis prevention. In the spirit of the new century, these mechanisms would open up new opportunities for real public/private partnerships.

Implementing the four networking proposals, however, does require a plan for funding, including significant not-for-profit contributions, especially in the start-up phase. Funds could come from foundations, governments, multilateral banks, or even grants in the form of financial resources or *pro bono* staff time from enterprises. Eventually, all or a considerable part of the overall operating cost might be offset by income from those specific services that could be offered on a fee-for-service basis, as noted earlier. However, such considerations lay in the future. The objective of this paper was limited to outlining the proposals on a conceptual level. If there is sufficient international interest, the next step would be to cost the proposals and seek interested country participants and financial support.

DESA Discussion Papers

No. 1 ***Public versus Private Provision of Pensions***, By Larry Willmore, December 1998

No. 2 ***Inefficiencies of Global Capital Markets***, By Hugh Stretton, December 1998

No. 3 ***Greening the National Accounts: Approach and Policy Use***, By Peter Bartelmus, January 1999

No. 4 ***Unpaid Work and Policy-Making Towards a Broader Perspective of Work and Employment***
By Joke Swiebel, February 1999

No. 5 ***Trends in Consumption and Production: Selected Minerals***, By Oleg Dzioubinski and Ralph Chipman, March 1999

No. 6 ***Trends in Consumption and Production: Household Energy Consumption***
By Oleg Dzioubinski and Ralph Chipman, April 1999

No. 7 ***Promoting Sustainable Production and Consumption: Five Policy Studies***
By Tarcisio Alvarez-Rivero, Ralph Chipman and Erik Bryld, April 1999

No. 8 ***Regulation Policies Concerning Natural Monopolies in Developing and Transition Economies***
By S. Ran Kim and A. Horn, March 1999

No. 9 ***Tourism development in the Lao People's Democratic Republic***, By Sayo Yamauchi and Donald Lee, June 1999

No.10 ***Import Elasticities Revisited,*** By Pingfan Hong, September 1999

No.11 ***Resources for Social Development: Additional and Innovative Resources,*** By Anthony Clunies-Ross, March 2000

No.12 ***Export Processing Zones in Cuba,*** By Larry Willmore, May 2000

No.13 ***Three Pillars of Pensions? A Proposal to End Mandatory Contributions,*** By Larry Willmore, June 2000

No.14 ***The Underlying Constraints on Corporate Bond Market Development in Southeast Asia***
By Krishnan Sharma, September 2000

No.15 ***Bank-firm Cross-shareholding in Japan: What is it, why does it matter, is it winding down?***
By Mark J. Scher, February 2001

No.16 ***The Supply of Credit by Multinational Banks in Developing and Transition Economies: Determinants and Effects***
By Christian E. Weller, March 2001

No.17 ***Global Implications of the United States Trade Deficit Adjustment,*** By Pingfan Hong, February 2001

No.18 ***Price Stability in a Monetary Union,*** By Stefania Piffanelli, September 2001

No.19 ***The Instrument of Monetary Policy for Germany. A Structural VAR Approach,*** By Stefania Piffanelli, September 2001

No.20 ***Preventing Civil Strife: An Important Role for Economic Policy,*** By Henk-Jan Brinkman, September 2001

No.21 ***Government Policies toward Information and Communication Technologies:***
A Historical Perspective, By Larry Wilmore, October 2001

No.22 ***Postal Savings and the Provision of Financial Services: Policy Issues and Asian Experiences***
in the Use of the Postal Infrastructure for Savings Mobilization, By Mark J. Scher, December 2001

No.23 ***Strengthening Information and Analysis in the Global Financial System:***
A Concrete Set of Proposals, By Barbara Samuels, II, June 2002

DESA Discussion Papers are posted on the DESA web site:http://www.un.org/esa/papers.htm