

5. Promoting Financial Stability in a Globalized Economy

There is a need to ensure that the economic advantages made possible by integrated, flexible financial markets can be enjoyed around the world while, at the same time, more effectively managing financial developments with potentially broad economic implications. In the past, this challenge has been met through a network of institutions and arrangements, which include the IMF, BIS, G-7, G10 and OECD. These groups have significantly strengthened cooperation and information-sharing among policy makers and financial market supervisors and regulators. They have also developed a complex set of formal and *ad hoc* financial facilities that have been used to respond to financial market crises which threatened to have major economic consequences.

The international community must also improve its ability to address the risks inherent in the dramatic growth in private financial flows, the increased integration of domestic capital markets, and greater recourse to financial innovations. Episodes of financial market distress, as most recently experienced in Mexico, illustrate both the potential dangers and challenges these institutions must be prepared to meet.

A number of interrelated elements are required to effectively deal with these challenges:

- An improved **early warning system** is needed to avoid financial shocks where possible. This requires, *inter alia*, an effective ongoing system of surveillance of national economic policies and developments.
- When potential problems are identified, there is a need to ensure that the capacity exists to induce **appropriate policy responses** at an early stage.
- Appropriate and adequate multilateral **financing mechanisms** are required that can, when needed, be brought to bear on a scale and with the timeliness required to overcome the consequences of external shocks that may arise from the increased mobility of international capital. Crucially, there is a need to ensure that these mechanisms operate in such a way, in terms of conditionality, as to quickly restore market confidence and access to private sector money.
- An effective system of **cooperation** among the major industrial countries and multilateral financial institutions is needed, which allows a rapid and concerted response to external shocks.
- There may also be a need to look at other mechanisms that might usefully be considered in situations of financial crisis.