

Economic Development and the New Order in the International Financial System¹

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1. Introduction

At the beginning of the current decade, let us say in 2002, the insertion of the emerging market economies into the global financial system that had been evolving since the mid-seventies seemed to have turned into a burden for economic growth and a source of instability. There was little room for optimism with respect to the prospects of those countries. Five main stylized facts supported this view.

Firstly, financial and currency crises in emerging market economies were increasingly frequent and intense. Considering only the main episodes since the early nineties⁴, the sequence encompassed the cases of Mexico and Argentina in 1995, the five East-Asian economies in 1997-98, Russia and Brazil in 1998-99, and Argentina and Turkey in 2001. Even the most favourable observers of the financial globalization process, like the Managing Directors of the IMF at that time, assumed the continuity of that trend and the emergence of new crises in emerging market economies, as an intrinsic characteristic of the global financial system (Camdessus, 2000, Köhler, 2002).

Secondly, there was striking evidence on the volatility of capital flows and the propensity to international contagion. These characteristics were first observed with the repercussions of the Mexican crisis in 1995 and gained wide recognition with the strong global financial impacts of the Asian and Russian crises.

Thirdly, the extreme cases of highly indebted countries, like Argentina and Brazil, weighed heavily in the diagnosis. At the end of the nineties both economies were locked in financial trap situations (Frenkel, 2008), with high country risk premiums,

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⁴ In fact, the sequence of crises in Latin American had started much earlier. Many of these countries had been participating in the process of financial globalization since its first steps, in the second half of the seventies. All of the Latin American economies that were financially integrated at that time (i.e. Argentina, Bolivia, Brazil, Chile, Colombia, Mexico, Uruguay and Venezuela) suffered external and financial crises in 1981-82 (the so-called Latin American external debt crisis). The smallest economies (Bolivia, Colombia and Chile) began to recover a few years later, but for the biggest economies (Argentina, Brazil and Mexico) the recovery had to wait until the early nineties.

slow growth (e.g. Brazil) or recession (e.g. Argentina) and great external financial fragility. The Argentine crisis erupted in 2001 and was followed by the default of the external debt. Brazil had experienced the currency crisis in 1998-99 without defaulting on its external debt; however, even though the Brazilian exchange rate policy became more flexible after the episode, the economic policy and the economic performance was still locked in a financial trap at the beginning of the present decade.

Fourthly, most of the emerging market economies seemed to have entered into the global financial system in a segmented form (Frenkel, 2008). The phenomenon was evident in the highly indebted countries. However, several emerging market countries that had managed their policies in order to avoid high debts and financial traps also experienced a segmented integration. After participating in the financial globalization process for a long time (almost three decades in the case of the Latin American economies), their financial assets constituted a “class” of assets whose yields included a considerable country risk premium. The country risk premiums had reached a minimum level in 1997, just before the devaluation in Thailand took place. But since then the country risk premiums have increased and they were still high at the beginning of the current decade. Hence, given that the sum of the risk-free international rate and the country risk premium sets the floor for domestic interest rates, the financial integration seems to have condemned emerging market economies to systematically higher interest rates than those of the developed countries, with negative consequences on growth and income distribution.

There is one last negative feature regarding the situation at the beginning of the current decade that it is worth mentioning. It is the reversal of the initiatives for international coordination that had followed the crises of the late nineties. At that time, some initiatives were taken in order to improve the so-called “international financial architecture”, to reduce volatility and contagion, to prevent crises and to improve the international management of the potential future crises. However, since 2001, the new US administration and the novel authorities in the IMF have held the perspective that the very existence of multilateral support mechanisms set incentives for over-indebtedness and increased the probability of crises. At the same time, the IMF began to work on the Sovereign Debt Restructuring Mechanism (Krueger, 2002), but this initiative, originally suggested by the new US administration, was abandoned some time after. Simultaneously, the interest in the “international financial architecture” also faded. By

the early 2000s, the stability of the international financial linkages of emerging markets became more reliant on the spontaneous behaviour of the markets than ever before.

In sum, far from achieving the promise of greater stability and growth formulated by the promoters of financial liberalization and opening, the process of financial globalization seemed to have resulted for most emerging market economies in a new source of volatility and a burden for growth. In order to deal with the volatility that resulted from financial globalization, these countries had to implement their own preventive and defensive measures without the support (and in many cases even against the orientation) of multilateral financial institutions. As already mentioned, these circumstances did not leave much room for optimism.

By that time, one of the authors of this paper (Frenkel, 2002) attempted to synthesize the difficulties confronted by emerging market economies as follows: “A country that intends to implement capital market and capital account regulations to avoid an unsustainable financial integration path has to confront with the IMF and the pressure of financial markets. It is a difficult task, but some countries have managed to do it. With regard to this issue, the target is well defined. We should put our efforts into promoting the appropriate changes in the rules and conditionality of the IMF and other multilateral institutions.

In contrast, without an important effort of international cooperation it seems difficult to find ways out of the highly indebted emerging market countries’ situation, and more generally, to establish an institutional context capable of neutralizing the segmented integration. The essence of the problem lies in that there is an inconsistency between the Nation States and an international financial system that lacks most of the institutions that have been developed over time at national systems to improve their stability and the way they work”.

The diagnosis was not wrong, given the evidence we had in 2002, but the pessimism was not justified *a posteriori*. Actually, in the following years the countries found unforeseen ways to avoid unsustainable paths and high debt financial traps without confronting with the IMF. On the other hand, the segmentation of emerging market assets almost vanished in the following years without any improvement in the international institutional setting. Those unforeseen novel trends have been associated with a remarkable change in emerging market economies’ financial integration and in the global system; in particular, the fact that developing countries started to become less dependent on foreign saving and that many of them actually became net suppliers of

savings. This change started to become apparent precisely in 2002 and more clearly from 2003 onwards.

This paper aims to describe and discuss the main characteristics of this new way emerging market economies found to participate in the global financial markets, as well as its implications on their economic performance. The section following this introduction describes the recent economic performance of emerging market economies associated to the changes in their way of insertion into global financial markets. It also surveys empirical evidence on the relationship between foreign saving, reserve accumulation and economic growth. Section 3 discusses the role of competitive real exchange rates (RER) in the recent developments and surveys empirical evidence regarding the relationship between RER and economic growth. The major theoretical explanations for the RER-growth link are evaluated at the light of the disposable evidence. Section 4 concludes by arguing how the agenda for global capital markets reform should aim to incorporate the lessons from recent experience. The main message here is that a deep reform should pursue an international agreement on real exchange rates levels and exchange rate regimes that help developing countries to follow export-led growth paths.

2. The new trends in global financial markets

The changes of the global financial system with respect to the previous trends are well represented by two facts. Firstly, there were no new crises in emerging market economies, in spite of the emergence of various episodes of financial turmoil with contagion effects in the following years. Remarkably, the subprime crisis in the US did not trigger (so far) a financial crisis in any emerging market country. Secondly, country risk premiums have followed a declining trend since early 2003 and from mid-2005 they fell below the minimum value registered in the pre-Asian crises period. In early 2007 country risk premium reached their historical minimum, significantly lower than the minimum level of the pre-Asian crisis period and also significantly lower than the spread of US high-yield bonds. The country risk premiums rose after the subprime crisis, but even in the worst moments of the recent period the emerging markets' risk premiums were similar to the best moments of the pre-Asian crises period. Finally, it should be mentioned that simultaneously with these two developments in the global financial system, it has also been observed a substantial acceleration of developing

countries growth rate. From 2002 to 2008 developing countries' GDP has been growing at an average annual rate of 6.7%; a substantial acceleration compared to the growth rate of 4.8% during the period 1991-2001.

These two changes have been associated with a shift in the exchange rate regimes of emerging market economies. Flexibility is the most general characteristic shared by the exchange rate policies of most of these countries. Traditionally, flexibility has meant that the exchange rate is determined in the foreign exchange market and that there are no commitments regarding the interventions of the monetary authorities in this market. But in the present context of developing countries, flexibility also means that the monetary authority keeps for itself the possibility of intervening in the foreign exchange market, in different ways and more or less frequently. Hence, on the one hand, flexibility refers to the behaviour of the nominal exchange rate, but on the other hand, it also refers to the behaviour of the monetary authority in the foreign exchange market.

One advantage of this regime is its preventive role, since it cannot be a victim of speculative attacks. The regime combines the advantages of a floating regime with the degrees of freedom of the monetary authority to react to alterations in the context, and to adjust the exchange rate behaviour and the monetary policy to the changing needs of economic policy. In practice, if not de jure, in the recent experience of most of emerging market countries we find the described exchange rate regime, which is generally called "managed floating" (Williamson, 2000 and Bofinger and Wollmerhäuser, 2003).

The movement toward greater exchange rate flexibility by many developing countries have certainly contributed to the development of the mentioned facts. In our view, however, the main change in the process of financial globalization has been another one; namely, the reversal of net capital flows now moving from developing to developed countries⁵. Many of the emerging market countries, which had initially inserted into the system as recipients of capital inflows financing current account deficits, have recently started to generate current account surpluses –or to reduce significantly the previous deficits– and to persistently accumulate international reserves.

⁵ In the eighties, there was also a process of net capital flows moving from low income to high income countries. But this was a transitory consequence of the external sector adjustments of Latin American economies after their crisis. In the sequence of renegotiations of Latin America's defaulted external debts, which lasted from 1982 to 1990, there was no voluntary lending from private sources and most of these countries went through current account adjustments in order to pay some proportion of the due interests.

In a set of 29 emerging market economies⁶, only four showed current account surplus in 1997. In the same set, the number of current account surplus countries was 14 in 2001, 18 in 2004 and 14 in 2006. In the same set of countries, the ratio between the aggregate amount of the surpluses and the absolute value of the aggregate amount of the deficits was 0.35 in 1997; 1.40 in 2001; 3.93 in 2004 and 4.64 in 2006. Excluding China, the ratio was 0.04 in 1997; 1.13 in 2001; 2.73 in 2004 and 2.15 in 2006.

There was a turnaround in the international financial insertion of these countries: by shifting from being external-savings users to performing as savings exporters and intermediaries of international capital flows, these emerging market countries changed their position in the financial system.

What are the channels, if any, through which a reduction on foreign saving dependence helps countries reduce the chances of facing external crisis, lower the risk premium and enhance economic growth?

Current account surpluses and the availability of large amounts of international reserves are indicators of external robustness, as they indicate a low probability that the country will confront difficulties in accomplishing its external commitments. These indicators are used by international investors in their portfolio decisions. Research has also shown that they perform well at predicting the probability of balance of payment crises (Kaminsky, Lizondo and Reinhart, 1998). It is therefore not difficult to see why both the perceived risk and the risk premium followed downward trends in the cases in which the current account turned into surplus.

The emergence of a number of surplus countries also brings beneficial effects to those cases where current account deficits still persist and to the workings of the whole system. A lesser number of deficit countries, in a context where many emerging market countries show surpluses, diminishes the risk of herd behaviour and contagion and thus reduces the perceived risk of the deficit countries. The emerging market asset class is more heterogeneous, and many of these assets correspond to robust economies. This configuration benefits the risk perception of deficit countries and the risk perception of the whole asset class.

Let us illustrate with two Latin American cases how the new trends in the balance of payments helped developing countries to find ways to overcome the hard

⁶ The data set comprises 24 out of 25 countries included in the Emerging Markets index elaborated by MSCI Barra (Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Thailand and Turkey) in addition to Bulgaria, Ecuador, Panama, Ukraine and Venezuela.

constraints confronted at the beginning of the present decade. The strong improvement in Brazil's current account was the key factor that allowed the country to leave behind the financial trap in which it was locked-in at the beginning of the new century. This improvement reduced the external financial fragility and induced a reduction of the country risk premium. The consequent fall in the international interest rate confronted by the country contributed to decelerate the growth of its external and public debts and to improve their sustainability prospects. Therefore, the shift from current account deficit to surplus led to a virtuous circle instead of the vicious circle configured by the financial trap.

Argentina's debt restructuring illustrates the case of a country which benefits from the emergence of a group of economies with current account surplus. The default on the external debt was declared in December 2001, before the improvement in the international financial context. In early 2003, the government launched an offer that implied a 75% haircut on the face value of the original debt. More than 76% of the debt under default accepted the swap. The success of the restructuring was surprising, given both the dimension of the restructured debt and the level of the haircut; the highest in the recent globalization period. It is clear that the novel international financial conditions contribute to this result. The debt swap took place while country risk premiums in emerging markets were falling, thus making sufficiently attractive an offer, which has been considered "unacceptable" just a few months before.

The emergence of current account surplus (or reduction in current account deficits) and the accumulation of foreign reserves have affected developing countries performance not only by reducing risk premiums and the perceived risk of crises. A recent and increasing series of comparative international studies suggests that these variables are key factors explaining recent economic growth acceleration in developing countries. This empirical literature shows that current account and foreign reserves are positive correlated with economic growth. For instance, the influential work by Prasad, Rajan and Subramanian (2007) has shown that there is a positive correlation between current account balances and economic growth among non-industrial countries for the period 1970-2004. Similar results have been obtained by Bosworth and Collins (1999) and UNCTAD (2008). On the other hand, the positive correlation between foreign reserve accumulation and economic growth has been documented by Polterovich and Popov (2002) and Levi Yeyati and Sturzenegger (2007), among others.

Even when the positive correlation between these variables seems to be a well documented empirical fact, the mechanisms through which both current account surpluses and foreign reserves accumulation favour economic growth are not necessarily obvious. One possible channel is related to the discussion above. International capital markets suffer from many imperfections that make finance to developing countries volatile and subject to sudden stops. This feature can affect growth in at least two ways. Massive capital outflows may lead to external crises with negative long-lasting effects on the economic structure and thus undermine long-run growth (Stiglitz, 2000). Even if crises could be avoided, the inherent volatility of capital flows may affect investment decisions and growth. By reducing volatility and the probability of crises, current account surpluses (or lower deficits) and foreign reserve accumulation may contribute to economic growth. These seem plausible stories. In fact, the work by Prasad, Rajan and Subramanian (2007) suggests that one of the reasons why higher growth is observed in countries that relied less on external savings is that they did not suffer from external crises. However, their study also indicates that the association between growth and the current account does not follow exclusively from avoiding crises, provided that the correlation also holds for sub-periods in which no crises were observed. This result suggests that the effects of current account surplus and reserve accumulation on economic growth operate not only by reducing volatility and the chances of crises.

3. Foreign savings, real exchange rate and economic growth

In the previous section, we argued that developing countries have found a novel way to insert into the international financial markets by becoming net suppliers of capital. The consequent improvement in their current account balance has led to an acceleration of their rate of foreign assets accumulation. There seem to be a wide consensus that the main motivation behind this strategy is countries' willingness to maintain competitive real exchange rates or at least to avoid overvaluations. The findings of the literature quoted above corroborate that both current account surpluses and reserve accumulation are highly and positively associated to competitive (or undervalued) real exchange rates (see, for example, Prasad, Rajan and Subramanian, 2007). One hypothesis that has recently gained an increasing number of advocates is that the effect of both current account surpluses and reserve accumulation on economic

growth is by making the RER competitive. The results by a new series of research on the RER-growth link provide substantive support to this view.

In an early work, Razin and Collins (1997) show that competitive (undervalued) real exchange rates appear to be associated to more rapid economic growth for a sample of 93 countries over the period 1975 to 1992. Aguirre and Calderon (2005) use dynamic panel data techniques for a data set of 60 countries between 1965 and 2003. They find that moderately undervalued real exchange rates enhance economic growth. A recent work by Rodrik (2008) uses a panel data of 184 countries for the period 1950 to 2004 and also finds that these two variables are positively correlated. The estimated coefficients are significant for the whole period and for different sub-periods, which indicates that the relation is independent of the period under consideration. Using a two-stage panel growth regression, Rodrik also finds that competitive real exchange is associated with growth in industrial economic activities, and that the expansion in this sector correlates positively and significantly with aggregate economic growth. The result suggests that the effects of the real exchange rate on growth operate (at least partially) through the expansion of industrial (tradable) activities. The result is also important because it is free from reverse causation problems; at a firm level the real exchange rate can be interpreted as exogenous, something that cannot be assumed in aggregate cross-country analyses. With a similar objective, Eichengreen (2007) finds in a sample of 28 industries for 40 emerging markets countries in the period 1985-2003 that undervalued real exchange rates are positively correlated with growth of industrial employment. Other studies obtaining similar results between competitive (undervalued) RER and growth are Bhalla (2008), Gala (2007), Hausman, Pritchett and Rodrik (2005), and Prasad, Rajan and Subramanian (2007)

The literature reviewed so far suggests that the novel way that countries found to insert in the international capital markets via the generation of current account surpluses and the accumulation of reserves enhances economic growth, not only by reducing volatility and the risk of external crises, but mainly through its effect on the level of the real exchange rate. This seems to be a widely shared view in academia and policy circles. What remains under dispute are the channels through which the real exchange rate affect economic growth.

At the macroeconomic level, the debate revolves around whether economic growth in developing countries is supply or demand constrained. Under the former view, whose intellectual roots go back to the neoclassical growth model (Solow, 1956),

growth acceleration requires an increase in the saving rate, which will then be transformed into higher investment rates and capital accumulation. Ideally, in an open economy it would not matter whether the sources of savings are domestic or foreign. Moreover, if neoclassical production functions are a good description of the real world, one would expect saving flowing from rich countries with high capital-labour ratios to poor countries with low capital-labour ratios. Evidence has systematically run counter to this prediction. A common explanation for this “paradox” (Lucas, 1990) points to the existence of multiple imperfections in both domestic and international capital markets. As already mentioned, it is usually admitted that because of imperfections in the international capital markets flows of finance to developing countries are volatile and prone to sudden stops. Similarly, it is argued that underdeveloped domestic financial markets typically do a poor job at intermediating foreign savings and channelling them to productive uses. If these premises are reasonable enough, advocates of the supply-constrained view plausibly expect that countries with higher *domestic* saving rates would grow faster. The relevant question then concerns with the causal channel going from more competitive real exchange rates to higher domestic saving rates.

Levi Yeyati and Sturzenegger (2007) -following the well-known result of the standard Kalekian-structuralist model- point to the redistributive effect of devaluations. The transition to a more competitive real exchange rate implies a transfer of income from workers to firms via a decline in real wages. In an economy with financially constrained firms higher saving rates, capital accumulation and growth would follow.

Inspired in the recent Chinese experience, Doodley, Folkerts-Landau and Gaber (2004a and 2004b) suggest another possible channel. An undervalued real exchange rate implies a subsidy to exports relative to imports, which generates an increase in domestic saving relative to absorption, and consequently a current account surplus. In order to maintain the internal balance, a rise in the domestic interest rate is needed. In a financially repressed economy, the government would be able to set the domestic interest rate to restrain absorption and increase the saving rate. The resulting current account surplus and reserve accumulation in turn serve as collateral required to support the flows of foreign direct investment that sustain rapid growth.

Irrespective of the validity of the theoretical arguments, the RER-saving link seems to find little empirical support. Montiel and Serven (2008) test the correlation between the two variables for a set of 94 countries over 1975-2005. Using the (log) GDP deflator from the Penn World Tables as a proxy for the RER, the unconditional

correlation analysis shows that a higher saving rate is strongly associated with a more *appreciated* real exchange rate. When they control for the level of income per capita, the correlation coefficient changes sign; namely, higher savings correlate with undervalued RER. However, the coefficient is very small and statistically significant only for 10-year frequency, and not for the 30-year frequency. The authors conclude that “saving is unlikely to provide the mechanism through which the real exchange rate affects growth.”

Proponents of the demand-constrained view are inspired by the Keynesian vision in which effective demand is the main driver of economic growth in economies with unemployed and/or underemployed workers. In an open economy, a competitive real exchange rate would lead to an increase in the demand for exports and import substitutes, and the additional demand to additional domestic production and income. Higher production would in turn lead -through the accelerator principle- to higher investment and growth. Additionally, the acceleration in aggregate demand growth has a reinforcing feedback effect on labour productivity growth, sometimes called the “Kaldor-Verdoorn law” (Frenkel and Taylor, 2007). Furthermore, it is not difficult to show within the Keynesian framework that a depreciation of the real exchange rate leads to higher saving and investment rates together with an improvement in the current account. This result fits the stylized facts.

In a closed system the source of the aggregate demand pull is not as relevant as in an open one. This distinction is well known in many parts of the development world, where economic growth has been recurrently constrained by shortages of foreign currency. This is a key aspect of the export-led growth strategy: the demand-pull is obtained simultaneously with a relaxation of the external constraint. Proponents of the export-led growth view, with John Williamson (2003 and 2006) as a notable example, have been pointing out for a long time about the importance of a competitive real exchange rate as a key element in a development strategy that seeks to overcome the foreign exchange constraint.⁷ Interestingly, Keynesian economists of the balance-of-payment (BoP) constraint school have largely undermined the possibility that a competitive RER could contribute to relax the external constraint. A key assumption for such a conclusion is that income elasticities of exports and imports are fixed in the long-run (Thirwall, 1979). This assumption may be too stringent if one is willing to consider

⁷ Not to mention the late Bela Ballasa (1971) and Carlos Díaz Alejandro (1975). UNCTAD (2008) is also worth to mention.

relatively long RER departures from “equilibrium”. Barbosa-Filho (2006) suggests that with the reasonable assumption that trade elasticities can be altered by changes in the real exchange rate, the BoP constraint is no longer immutable as suggested in the standard model.

Levi Yeyati and Sturzenegger (2007) are sceptical about export growth and import substitution being the factors explaining the positive correlation between competitive real exchange rate and growth. Their view rests on the finding that exports are negatively (and imports positively) correlated with reserve accumulation.

A third line of argumentation emphasizes the existence of positive externalities associated to the production of traded goods. Many appealing stories are possible, but all share the notion that a temporary undervaluation of the real exchange rate may solve the standard private-vs.-public benefit dilemma. With higher profitability, tradable firms would find incentives to invest. Capital accumulation and productivity growth arising from the positive externality would follow. If this process is long enough the tradable sector would have acquired a productivity level that would turn it profitable at the original relative prices. This type of idea has long tradition in development economics. For instance, the use of competitive RER to protect infant industry can be explained along these lines. The Dutch disease problem shares the same logic but it is applied to the opposite case: real appreciation and shrinking the tradable sector.⁸

Rodrik (2008) is notable example of this third line of argumentation. He shows that a competitive real exchange can function as a second best solution to compensate for the institutional and market failures that inhibit tradable firms to exploit positive externalities. In his explanation, however, it is not clear why these failures affect tradable activities more proportionally than non-tradable ones. Probably more challenging for Rodrik and the advocates of this tradition is the fact that empirical work has so far had hard times at documenting the existence of positive externalities in tradable activities (Eichengreen, 2007).

It seems fair to conclude this section by stating that our state of knowledge indicates that there is robust evidence that current account surplus and reserve accumulation foster economic growth by maintaining real exchange rates at competitive

⁸ Dutch disease models with these characteristics have been used to illustrate deindustrialization processes, such as in England under Mrs. Thatcher’s government (Krugman, 1987) and in Latin America during 1990s (Ros and Skott, 1998).

levels. However, we still need more research to assess with higher precision which are the channels through which the competitive RER-growth link operates.

4. Broadening the pending agenda of reforms

Under the light of the evidence reviewed in the previous section, the recent phase -with numerous developing countries exhibiting current account surpluses, financial robustness and accelerating rates of growth- can be seen as an amplification of a historical pattern. In the recent phase, more developing countries have followed paths that showed both current account surpluses and higher rates of growth. In some cases, those outcomes resulted from policies explicitly oriented to foster growth through the management of competitive exchange rates that simultaneously contribute to generate higher rates of growth, current account surpluses and the accumulation of reserves. In other cases, those outcomes resulted mainly from international factors that were exogenous to the countries' economic policies (i.e. low international interest rates, high expansion of the US economy, rising commodity prices). However, in many countries, even in the cases in which the outcomes cannot be attributed to domestic policies, policies were implemented aiming to generate additional external robustness throughout the accumulation of reserves. Thus, the recent pattern followed by numerous developing countries seems to have been an *a posteriori* confirmation of the policy lessons implicit in the above mentioned studies.

Beyond the effects of the new pattern at the individual country level, an important feature of the recent phase has been the beneficial effect of the new configuration on the workings of the global financial system vis-à-vis the whole set of emerging market countries. At least, the new configuration has significantly alleviated the most negative aspects that financial globalization had showed until the early 2000's.

The advantages for developing countries derived from the new configuration of the global financial system have not been recognized by the multilateral financial institutions. The official doctrine of the IMF does not seem to see the virtues of this new context in terms of financial solidity and growth. For instance, the institution continues officially recommending macroeconomic policies based on pure floating and inflation targeting. In the present context, pure floating would likely mean to let the exchange rates appreciate and to cease accumulating reserves. Consequently, it would likely imply a reduction in current account surpluses and economic growth.

This suggests that the pending agenda of institutional reforms of the global financial system should be broadened. The pending agenda was focused on the most prominent failures of the financial globalization process in the first three decades of its existence. The agenda claimed for institutions capable of preventing, managing and compensating for the instability of the system, because instability was perceived as its most important negative characteristic vis-à-vis developing countries. This agenda is still valid, particularly because the system should be better prepared to digest abrupt changes in the present configuration, as for instance, an important fall in commodity prices. But at present, instability does not seem to be the most threatening feature of the system for the developing countries.

One important lesson of the recent developments in the international system underlines the crucial role of markets for developing countries' exports. The experience of financial globalization tells us that capital inflows and external savings are by no means a substitute for growth-cum-exports. Therefore, together with institutional reforms aimed at stabilizing the workings of the global financial system vis-à-vis the developing countries, these countries should also claim for a deeper reform, intended to consolidate the positive features of the new configuration. For instance, they should pursue an international agreement on real exchange rates and exchange rates regimes that would allow developing countries to follow paths of high rates of growth-cum-exports⁹.

Certainly, the implementation of this deeper reform is not an easy task. Working in the international arena with this orientation would require reviving the spirit of Bretton Woods in a setting in which developing countries should have the voice and the weight they do not have presently within the international financial institutions. But every journey begins with a first step. In this case, the first step should be the acknowledgment of the lessons provided by the history of financial globalization and of the beneficial effects that an agreement on exchange rates would have both on developing and developed countries.

⁹ Suggestions for the implementation of an international agreement on real exchange rates have recently presented by John Williamson (2006).

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