Glossary of Financial Terms
What are derivatives, hedge funds and lenders of last resort? Check out our glossary of financial terms.

accounting standards** - the main global accounting standards are the International Financial Reporting Standards of the International Accounting Standards Board (IASB). In the US however the Generally Accepted Accounting Principles (GAAP) are used. Harmonization of these two standards is a key reform demanded by the G20 and expected by 2011-12.

advanced market commitment – through Advanced Market Commitments (AMCs), donor governments agree to pay, for example, a pre-determined price for a future vaccine when and if the vaccine is developed. The AMC acts as an incentive for pharmaceutical companies to develop vaccines for diseases that might not otherwise be produced because the concentration of users are in developing countries, where there is no profitable market for such vaccines. Developing countries must contribute a small amount per dose for the final vaccine but are not committed to buying the vaccine if they do not need it. In February 2007, Canada was one of five countries to support a pilot AMC to develop a cheap pneumococcal vaccine.

aviation solidarity levy – the levy represents a small solidarity tax on airline tickets. The proceeds from the levy are intended to support international development efforts, are pooled and coordinated through UNITAID, and are donated to existing national and international development institutions (e.g. Global Fund to Fight AIDS, Tuberculosis and Malaria and the Clinton Foundation). It is estimated that a world-wide ticket tax of 2.5 per cent could yield up to $10 billion annually. As of 2008, eight countries had put in place legislation to implement the levy and 15 other countries are in the process of following suit.

article IV consultation – every year the International Monetary Fund assesses every member country’s economy to ensure the member is providing a sound macroeconomic framework and corresponding policies to promote financial stability, economic growth and free exchange rates. These consultations aim at forestalling possible future financial crises. The fund also operates the IMF Institute, a department that provides training in macroeconomic analysis and policy formulation for officials of member countries.

articles of agreement – the operations of both the World Bank and International Monetary Fund are defined by the procedures established under their respective articles of agreement or an equivalent founding document. These documents outline the conditions of membership and the general principles of organization, management, and operations.

Asian Monetary Fund – also East Asian Monetary Fund. See “Chiang Mai Initiative”

ASEAN - ASEAN includes Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam. ASEAN+3 adds China, Japan and South Korea.

bailouts - a common name for the IMF-coordinated emergency rescue loans to economies in crisis. The most immediate beneficiaries of bailouts are typically foreign investors, while citizens are left holding the IMF debt bill.

balance of payments (BOP) - the total of all international transactions undertaken by a country during a given time. Sales to foreigners are recorded as credits while purchases of goods, services or assets are recorded as debits. The BOP statement includes summaries of both the current account and the capital account.

Bank of the South – the “Banco del Sur” was established on December 9, 2007 in Buenos Aires when
Presidents from Argentina, Bolivia, Brazil, Ecuador, Paraguay, Uruguay and Venezuela signed the Founding Act. When it is launched in 2008, the Bank is expected to have an initial capital base of between $5 and $7 billion, and it will act as a development bank dispensing loans for infrastructure projects and regional integration plans. The Bank will have its headquarters in Caracas, Venezuela, with offices in Bolivia and Argentina.

**Bank for International Settlements (BIS)** - BIS serves as a bank for central banks, and exists to foster international monetary and financial cooperation. It conducts research in areas of interest to central banks, supports the work of the Basel Committee, and assists central banks and other monetary institutions in the management of their foreign exchange and gold reserves. Approximately 6 per cent of global foreign exchange reserves are invested by central banks with the BIS. By March 2008, total currency deposits amounted to $348 billion. The banking services of BIS focus on stability and liquidity provision.

The BIS currently has 55 member central banks, all of which are entitled to be represented and vote in the general meetings, though voting power is disproportionate. Established in 1930, the BIS employs 557 staff, and is headquartered in Basel, Switzerland. See also “Basel Committee on Banking Supervision”.

**The Basel Committee on Banking Supervision (BCBS)** - As part of its monetary and financial stability services, the BIS hosts the Basel Committee, which provides a forum for regular cooperation on banking supervisory matters. Its key concern is to ensure the adequate capitalisation of banks. As banks’ operations were increasingly internationalised, rich countries launched the committee in 1974 to create comparable and thus compatible systems of supervision to prevent financial instability. The committee created the controversial Basel I and Basel II sets of capital adequacy standards.

The committee is governed independently of the BIS. Committee members come from the G10 (the G7 plus the Netherlands, Switzerland, Belgium, and Sweden). There is no member from a developing country. The BCBS reports to a joint committee of central bank Governors and (non-central bank) heads of supervision from the G10 countries. The IMF, through its Financial Sector Assessment Programme (FSAP), monitors countries using the Basel committee’s core principles. See also “Bank for International Settlements”, “Basel I”, “Basel II” and “G-10”.

**Basel I** – the first round of deliberations by central bankers from around the world. In 1988, the Basel Committee (BCBS) in Basel, Switzerland, published a set of minimal capital requirements for banks. This is also known as the 1988 Basel Accord, and was enforced by law in the Group of Ten (G-10) countries in 1992, with Japanese banks permitted an extended transition period. Basel I is now widely viewed as outmoded, and a more comprehensive set of guidelines, known as Basel II, were implemented in 2004.

**Basel II** - the second of the Basel Accords, published in 2004. These are recommendations on banking laws and regulations. Basel II has three pillars; 1 is minimum capital requirements, 2. Supervisory review and 3. Market discipline. The purpose of pillar 1 is to create an international standard that banking regulators can use when creating regulations about how much capital banks need to put aside to guard against the types of financial and operational risks banks face. Pillar 1 is the lowest common minimum applied to all Basel compliant banks. Pillar 2 is the discretionary room available to regulators at the national level to impose higher standards on their institutions than the global minimum (in reality most countries have higher national standards than the minimum level) and pilar 3 is to monitor market conduct, principally the self policing discipline of the markets when necessary information disclosure is mandated. Advocates of Basel II believe that such an international standard can help protect the international financial system from the types of problems that might arise should a major bank or a series of banks collapse. In practice, Basel II attempts to accomplish this by setting up rigorous risk and capital management requirements designed to ensure that a bank holds capital reserves appropriate to the risk the bank exposes itself to through its lending and investment.
bonds - are a type of loan where borrowers (governments or corporations) receive cash and lenders (investors) receive a guarantee of repayment upon maturity plus interest. Over the past twenty years, bond issues have replaced bank lending as the major source of developing country finance. The trading value of a bond on global bond markets is inversely related to its perceived riskiness (i.e. the likelihood that the government or corporation issuing the bond is likely to default on its repayment agreement).

BRICs - this term originates from a 2003 Goldman Sachs paper in which the authors predicted that the economies of the emerging markets of Brazil, Russia, India and China (BRICs) will overtake the world's wealthiest countries by 2050.

capital - wealth available for input into the economy. Real capital is invested in equipment, buildings and production. Finance capital is stored in banks or invested in financial instruments. Human capital is the economic value of people's knowledge, skills and physical work.

capital account - the section of a country's balance of payments statement which totals all international purchases and sales of assets including foreign direct investment, portfolio investment, bank loans, other securities and foreign currency holdings.

capital account liberalization - the process by which countries, often at the behest of the IMF, remove restrictions on the flow of foreign capital into and out of their countries.

capital controls - measures enacted to control foreign exchange transactions in order to manage capital flows.

capital flight - the process by which individuals or companies shift funds and other assets to offshore sites (see "tax havens") rather than depositing them in the banks of their host country. The corresponding income is consequently not declared in the host country, often to the detriment of state budgets.

capital flows - the movement of foreign exchange from one country to another. The types of transactions used to move money internationally include: loans and loan repayments, bond issues and payments, foreign direct investment and capital repatriation, and portfolio investment such as stocks, bonds and derivatives.

central bank - is a country's bank, controlled by the national government. It is responsible for issuing currency, setting monetary policy, interest rates, exchange rate policy and the regulation and supervision of the private banking sector.

Chiang Mai Initiative – an effort to strengthen economic ties between ASEAN +3 countries (see above), the CMI is an agreement to collectively pool a portion of ASEAN +3 hard currency reserves, and lend a portion of these reserves ("currency swaps") to member countries to address short term (90 day) balance of payments problems and to fend off speculative attacks (see below). It is seen by many as the first step towards establishing an (East) Asian Monetary Fund.

Committee on the Global Financial System (CGFS) ** - chaired on a rotating basis by a central bank governor (as of July 1, 2010, by Governor of the Bank of Canada, Mark Carney), the CGFS monitors developments in global financial markets for central bank governors. The Committee has a mandate to identify and assess potential sources of stress in global financial markets, to further the understanding of the structural underpinnings of financial markets, and to promote improvements to the functioning and stability of these markets.
concessional loan – a loan that is offered with longer repayment terms and lower interest rates than might otherwise be offered by the market, often geared towards low-income countries.

conditionality - the set of conditions that must be met before creditors disburse any loans. Since the early 1980s, for example, the vast majority of IMF and World Bank loans have required recipient countries to commit to 'fiscal austerity' measures which include: the privatization of state-owned enterprises, the removal of restrictions on foreign imports and investment, and the weakening of the state through budget and programme cuts. These requirements are known as structural adjustment conditions.

contagion (financial) ** - the factors by which crises transmit from market to market or country to country. High levels of leverage by a number of banks create increased risk of ‘common creditor’ contagion. This explains why uncorrelated, seemingly unrelated markets, or assets (or for that matter countries) get tangled up in the same crisis cycle. Often behind such contagion is a highly leveraged creditor who needs to sell assets to meet requirements. In this sort of a situation the said creditor will sell into a falling market whatever she/he can, thus deepening the spiral and increasing correlation between fundamentally unrelated assets and markets.

contingent capital – scheme to protect banks against reduced credit that may arise during a financial crisis, whereby banks set aside capital, classified as a debt obligation, which would be converted into equity in the event of financial difficulties.

contercyclical buffers (or countercyclical provisioning) ** - most financial institutions are required to hold capital buffers; these are additional buffers above the minimum requirement, but built in a countercyclical manner, i.e. putting aside more capital in good times for use in a downturn.

counterparty risk** - the risk of failure by one party due to the failure of a close financial associate. During the 2008 global financial crisis this sort of risk became apparent when a large financial institution such as AIG collapsed, threatening fallout that would consume other players like Goldman Sachs and other big US investment banks. Stemming this cycle was the main reason AIG had to be bailed out with enormous taxpayer resources.

credit default swaps (CDS) ** - is a form of insurance bought on the probability of default on a debt security. The unregulated nature of the CDS market exacerbated the 2008 global financial crisis, as CDS’ are a very non-transparent market with a small number of large players active in the market, like AIG. The global CDS market grew from under $1trillion in 2001 to over $57trillion by 2008 –almost entirely unregulated. The global crisis has sparked calls for CDS trading to be moved from over-the-counter to centralized counterparties (CCP). The CDS index has become a key barometer of the health of credit markets.

Cross border Bank Resolution Group (CBRG) ** - a key subcommittee at the Bank of International Settlements (BIS), the CBRG is comparing the national policies, legal frameworks and the allocation of responsibilities for the resolution of banks with significant cross-border operations.

currency transactions tax - measures implemented at the national level to tax foreign exchange transactions with a goal of reducing volatility and volume of flows. See also financial transaction tax.

current account - the section of a country's balance of payments statement which totals international transactions for import and export payments, interest on debts, profits from foreign direct investment and aid grants. The current account is a broad measure of a country's trade balance (a negative current account balance = a trade deficit).

debt standstill - the temporary cessation of debt repayments designed to allow countries to reorganize and reschedule their debt repayment obligations.
derivatives** - complex securities used by institutions to hedge (‘protect themselves against the risk of price changes) against market fluctuation. They are financial instruments whose value is derived from the price of an underlying security (e.g. stocks). Primarily they comprise three instruments, futures, options and swaps. While their intention is to hedge against risks, the rapid growth in derivatives trading has played a major part in the growing volatility of the global financial system, heightening risks substantially. The over-the-counter (OTC, see below) derivatives market notional value in 2009 was 12 times the size of the global economy.

devaluation - the drop in the value of one currency relative to another. Developing countries have often been encouraged to devalue their currency as part of IMF/World Bank structural adjustment programs as a means of increasing the costs of imports and decreasing the cost of exports, thereby increasing competitiveness.

Doha – while references to Doha often refer to the Doha Development Round of trade negotiations through the WTO, on November 29-December 2, 2008, Doha will host the follow-up to the Monterrey Consensus (see below) and review of its implementation.

East Asian Monetary Fund – also Asian Monetary Fund. See “Chiang Mai Initiative”

economic partnership agreements – are a scheme to create a free trade area (FTA) between the European Commission of the European Union (EU) and the Group of African, Caribbean and Pacific (ACP) countries. They are a response to continuing criticism that the non-reciprocal and discriminating preferential trade agreements offered by the EU are incompatible with WTO rules. The EPAs are a key element of the Cotonou Agreement, the latest agreement in the history of ACP-EU Development Cooperation. They took effect as of 2008.

efficient market hypothesis** - developed in the Chicago school tradition by theorists like Eugene Fama, Fischer Black, Robert Merton and taken up by Myron Scholes, Modligiani, Miller, Malkiel and others, EMH underpins modern financial theory. The principal idea is that market prices reflect available information about the priced entity. In other words, markets are informationally efficient. Belief in the EMH-centric finance paradigm in policy circles has been argued as a major contributor to the recent crisis, as the theory underplays the possibility of bubbles or momentum in markets and justifies speculation. Economists Stiglitz and Grossman have show EMH to be flawed and psychologists Daniel Kahneman, Amos Tversky & Richard Thaler have furthered the challenge underscoring the importance of cognitive and information biases.

embedded contingent capital – see “contingent capital”

exchange rates - the price of one country's currency relative to another (e.g. $1 Cdn = $.67 US. Exchange rates can be managed according to three basic systems - floating, fixed or pegged.

export credit - an export credit arises whenever a foreign buyer of exported goods or services is allowed to defer payment. As a result, the buyer is required to pay interest on top of the loan. When export credits are provided to buyers in developing countries and emerging markets, companies selling those goods and services often take out export credit insurance to insure themselves, among other things, against buyer insolvency.

export credit insurance - also known as accounts receivable insurance, this insures companies for up to 90 per cent of their losses if their buyers default on a payment, refuse to pay or go bankrupt. This helps ensure that companies get paid for their goods and services. See also ‘risk insurance'.

export credit agency - commonly known as ECAs, export credit agencies are public financial institutions that help companies conduct business overseas in developing countries and emerging markets. They do this by providing government-backed loans, guarantees and insurance to
corporations in the home ECA country.

**Export Development Canada** - commonly known as EDC, it is a federal crown corporation that was set up in 1944 through the Export Development Act (EDA) 'for the purposes of supporting and developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities.' As such, it is the main source of publicly-supported export financing in Canada, and was designed to complement financial support provided by private sector banks and financial institutions. It is regulated by both the EDA and the Financial Administrations Act.

**EDC Corporate Account** - the regular account through which EDC provides loans, guarantees, insurance and other financial services.

**EDC Canada Account** - EDC uses the Canada Account for projects that fall outside the scope of its Corporate Account. This may be because of the size of a transaction, market risks, borrower risks or financing conditions. For example, the loan may exceed the amount EDC wants to expose itself to in a specific market, it may be in excess of what EDC is willing to loan to a single borrower, or it may simply be too risky a venture. Nevertheless, the project may receive funding because it is deemed by the Federal government to be within Canada's national interest. National interest covers such issues as the economic benefit the project brings to Canada and the importance of the market to Canada. Projects funded by the Canada Account are approved by Cabinet (through the Trade Minister with concurrence from Finance), rather than by EDC. Exporters using the Canada Account must pay a fee for these services. Exporters pay premiums for Canada Account insurance coverage, and fees for financing and guarantee services.

**financial activities tax (FAT)** - a tax on profits and remuneration, equivalent to a value added tax for the financial sector, proposed by the IMF in response to a request at the September 2009 G20 Pittsburgh summit to the IMF to review “the range of options countries have adopted or are considering as to how the financial sector could make a fair and substantial contribution toward paying for any burdens associated with government interventions to repair the banking system.” Final IMF Report (June, 2010). See also Financial Stability Contribution.

**financial architecture** - refers broadly to the framework and series of measures at the international level that are deemed necessary to prevent future economic crises and help manage these crises when they occur. It refers to the structures, practices and rules under which international capital flows take place, the way countries interact with the international financial system and the role of international financial institutions. Increasingly, because of the interconnectedness of global financial markets, it is recognized that international financial stability also relies on the existence of both regional and national systems.

**financial stability board** - The Financial Stability Forum was created in response to the 1999 Asian financial crisis, and became the Financial Stability Board in 2009 following the April G-20 Leaders meeting in London. It aims to promote financial stability, improve financial market workings and lessen the effects of contagion. It does this by assessing the vulnerabilities affecting the financial system, identifying ways to address these, improving information exchange and co-ordination amongst authorities responsible for financial stability. It has no executive authority or powers to force reform.

It is composed of the G7 (with a tripartite membership consisting of the finance ministry, the central bank and a regulator) and one representative from five other major financial centres (Singapore, Switzerland, the Netherlands, Australia and Hong Kong), as well as representation from the IFIs (two each from the World Bank and IMF, one each from the OECD and the Bank for International Settlements (BIS)) and from international standard and regulatory groupings (two each from the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO), the International Accounting Standards Board (IASB) and the International Association of Insurance Supervisors (IAIS)). It has in the past been chaired by the general manager of the BIS. It is
financial stability contribution (FSC)** - a contribution by systemically important financial institutions (SIFI) to a fund established to recoup fiscal costs of bailing out financial institutions. It was proposed by the IMF in response to a request at the September 2009 G20 Pittsburgh summit to the IMF to review “the range of options countries have adopted or are considering as to how the financial sector could make a fair and substantial contribution toward paying for any burdens associated with government interventions to repair the banking system.” Final IMF Report (June, 2010). See also Financial Activities Tax.

financial transaction tax (FTT) – broader than the Tobin tax, this is a proposed global tax that would be levied on all financial market transactions – for example, bonds, equities and derivatives, not merely foreign exchange. It would be based on the gross value of the assets, thereby helping to discourage the creation of asset bubbles. Unlike a currency transaction tax, that would impose a 0.005 per cent levy on currency transactions in major economies, an FTT would impose a 0.05 to 1.0 percent levy on financial transactions, sufficient enough to have some impact on dissuading speculative financial trading. While estimates for how much revenue an FTT would yield, there is considerable uncertainty with respect to the impact of an FTT would on the market and speculative activity. Civil society organization are calling for 50 percent of the funds generated from such a tax be used for the Millennium Development Goals and climate change mitigation and adaptation in developing countries.

financing - see ‘trade financing’ and ‘project financing’.

Financing for Development or FfD – see “Monterrey Consensus”

fiscal policy - government macroeconomic policy that seeks to influence general economic activity through control of taxation and government spending (see also ‘monetary policy’).

fiscal space – a hotly debated term that essentially refers to the room a government has to make policy decisions with respect to how it manages its own budget. It has emerged as an issue because of the tight fiscal and monetary policies the World Bank and IMF impose on countries to ensure first and foremost they are able to manage debt service payments. According to the Bank, more space can only be created through more efficient public expenditures, increased revenue or attracting more loans and grants. Public expenditure is sacrificed at the expense of productive expenditure and short-term considerations played off against long-term gains.

flexible credit line (FCL)** - an IMF credit line extended to only three countries Colombia, Poland and Mexico to date (as of 2010) to safeguard against crisis contagion. The main difference in this sort of lending is that conditionality is not applied ex-post (or after the fact) but ex-ante (i.e. to qualify for FCL countries need to have met stringent criteria).

foreign direct investment (FDI) - the purchase of land, equipment or buildings or the construction of new equipment or buildings by a foreign company. FDI also refers to the purchase of a controlling interest in existing operations and businesses (known as mergers and acquisitions). Multinational firms seeking to tap natural resources, access lucrative or emerging markets, and keep production costs down by accessing low-wage labour pools in developing countries are FDI investors. Classic examples of FDI include American banks taking over Korean ones or Canadian mining companies building mines in Brazil (see also ‘portfolio investment’).

foreign exchange - is currency issued by a foreign government. Foreign exchange is required to pay for imported goods and to meet foreign debt repayment obligations. Most of the trade in foreign currencies occurs between large international banks. Unlike stock markets, the ‘foreign exchange market’ does not exist in any specific location.
G-7/G-8 - originally composed of a group of five Finance Ministers from Britain, France, Germany, Japan and the United States, in 1975 it added heads of state and government, and Italy became a Member. Canada's entry in 1996 made it the G7, and with Russia's involvement in 1997 it became the G8. This should not be confused with the G-77, born at the height of the Cold War. It represented 77 developing countries non-aligned with either the US or former Soviet Union. It now numbers more than 130 countries.

G-10 – In 1962, eight IMF members agreed—Belgium, Canada, France, Italy, Japan, the Netherlands, the United Kingdom, and the United States—and the central banks of Germany and Sweden agreed to make resources available to the IMF under the General Arrangement to Borrow (GAB) for drawings by participants, and, under certain circumstances, for drawings by nonparticipants. The GAB was strengthened in 1964 by the association of Switzerland, then a nonmember of the Fund. The Group of ten (G-10) still consult and co-operate on economic, monetary and financial matters and meet once a year around the annual meetings of the International Monetary Fund (IMF) and the World Bank. The G-10 signed the Smithsonian Agreement in December 1971, replacing the world's fixed exchange rate regime with a floating exchange rate regime. The Bank for International Settlements (BIS), the European Commission, IMF, and the OECD are observers. See also "Bank for International Settlements".

G-20 - is a group composed of the Finance Ministers and central bankers of the following 20 countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States and the European Union. The IMF and the World Bank also participate. The G-20 was set up to respond to the financial turmoil of 1997-99 through the development of policies that ‘promote international financial stability’.

G-24 – the Inter-governmental Group of 24 on International Monetary Affairs and Development, formed in 1971, represents the interests of developing countries in negotiations on international monetary and development finance matters. It brings together countries from Africa (Algeria, Côte d'Ivoire, Egypt, Ethiopia, Gabon, Ghana, Nigeria, South Africa and the Democratic Republic of Congo), Asia (India, Iran, Lebanon, Pakistan, Philippines, Sri Lanka and Syrian Arab Republic) and Latin America and the Caribbean (Argentina, Brazil, Colombia, Guatemala, Mexico, Peru, Trinidad and Tobago and Venezuela). Finance Ministers of the G-24 meet twice a year prior to the World Bank and IMF’s Spring and Fall meetings.

GAVI Alliance – a public-private partnership of multilateral institutions, government, industry, civil society organizations, research institutes and private foundations who coordinate Alliance activities in the health-care sector, in particular for vaccines and immunizations.

globalization - refers to the increasing economic integration and interdependence of countries. Economic globalization in this century has proceeded along two main lines: trade liberalization (the increased circulation of goods) and financial liberalization (the expanded circulation of capital).

global reserve system – in the foreign exchange market and international finance, a world currency, supranational currency, or global currency refers to a currency in which the vast majority of international transactions take place and which serves as the world’s primary reserve currency. This is currently the US dollar. In March 2009, as a result of the global economic crisis, there has been significant pressure for urgent consideration of a global currency and a UN panel has proposed greatly expanding the IMF’s Special Drawing Rights to act in this capacity (See also Special Drawing Rights).

guarantees - insure a portion of a loan against a default. This gives commercial banks an incentive to lend money to private exporters or investors. Sovereign governments back these guarantees and the government of the ECA that issued the guarantee assumes the liability in the case of default (see also 'Canada Account'). Occasionally the ECA recovers its losses through the government that hosts the
project or borrower. In this case, the loss becomes part of the official debt owed to the country that issued
the guarantee, essentially transforming a private loan into a public debt. In exchange for the loan
guarantee, companies provide ECAs with a guarantee fee, often a portion of their profits for a project.

**hedge fund** - is a private, unregulated investment fund for wealthy investors (minimum investments
typically begin at US$1 million) specializing in high risk, short-term speculation on bonds, currencies,
stock options and derivatives.

**hedging** - the purchasing of foreign exchange in anticipation of future price changes. Hedging is an
increasingly necessary business expense in times of high exchange rate volatility.

**herd behaviour** - the tendency of investors to behave as a pack in response to rumoured market
changes. This leads to panic in moments of crisis and the sudden withdrawal of enormous quantities of
investment from countries suddenly perceived to be vulnerable to collapse (a phenomenon known as
'capital flight').

**Imbalances** - the adjustment of macroeconomic imbalances between surplus "saving" and deficit
"spending" countries is seen as a major contributing factor in the global financial crisis that began in
2008. The adjustment of the imbalances would comprise increasing domestic demand in surplus
saving countries like China and increased saving in deficit countries like the US and parts of W Europe.
See also “Global Reserve System”.

**International Accounting Standards Board (IASB)** - The IASB aims to create a single set of
international financial reporting standards for companies. Accounting standards govern how companies
report their accounts. Weak accounting standards are blamed for the ease with which global
companies have been able to avoid and evade tax. It is a private institution, governed by a group of 22
trustees from businesses and accounting firms in major industrialised countries. It also includes
trustees from the private sector in China, South Africa, Poland, Brazil and India.

**International Bank for Reconstruction and Development (IBRD)** – together with IDA, the two are
more commonly known as the World Bank. See ‘World Bank’ and ‘World Bank Group’ for details.

**International Development Association (IDA)** – together with IBRD, the two are more commonly

**IDA Replenishment** - the IBRD raises most of its funds by posting bonds on the world's financial
markets. In contrast, IDA is funded in part by income generated through the IBRD and the International
Finance Corporation ('transfers') by countries repaying previous IDA credits ('reflows'), and for the
most part by contributions from the richer member countries ('donors'). Each replenishment covers a
three year period. For IDA 15, which covers the period July 2008 – July 2011, the donor replenishment
contributions accounted for $25.1 billion of the $41.6 billion fund. Canada agreed to contribute
CDN$1.3 billion to IDA over the three year period.

**International Finance Corporation (IFC)** – along with the IBRD, IDA and MIGA, makes up the World

**IIRSA** - the Initiative for the Integration of Regional Infrastructure in South America is an attempt to link
the twelve countries of Latin America through a common transportation, energy and
telecommunications network that will help to promote greater regional trade, and physical and
economic integration.

**International Monetary Fund (IMF)** – the IMF is an international organization established in 1944 to
provide short-term financial assistance to countries needing to stabilize exchange rates or alleviate
balance of payments difficulties. Since the 80s the IMF has become increasingly involved in the economic decision-making of nations through the conditionality associated with its loans.

**International Centre for the Settlement of Investment Disputes (ICSID)** - the World Bank forum for the arbitration of international investment disputes between private investors and governments. It was established in 1966 when the Convention on the Settlement of Investment Disputes between States and Nationals of Other States came into force. ICSID was created primarily to encourage long term investment in developing countries. The rationale was that companies would be more inclined to invest in the global South if an international institution were created to mediate potential disputes. The Centre is perhaps the least known entity of the World Bank Group.

**innovative financing for development** – in response to declining Official Development Assistance (ODA) or aid figures among Northern donors – something explicitly recognized at the Monterrey meeting on Financing Development - various countries are exploring a number of innovative mechanisms for funding development projects. Examples include the following: Aviation Solidarity Levies, Advanced Market Commitments, Currency Transaction Taxes and the International Finance Facility for Immunization. See also “Leading Group on Solidarity Levies to Fund Development” and “Monterrey Consensus”.

**International Finance Facility for Immunization (IFFIm)** – established by the G7 in 2005, IFFIm, like advance market commitments (AMCs), is an example of a new and innovative mechanism for financing vaccine and immunization programmes. By committing participating donor countries to pledge 10-20 years of aid to the facility upfront, and borrowing against these pledges to sell bonds on international capital markets, it is able to raise funds to support immunization initiatives in developing countries. The funds are then disbursed through the GAVI Alliance (see “GAVI Alliance” above).

**Leading Group on Solidarity Levies to Fund Development** – an informal group established in 2006 with strong support from France and Brazil whose main objective is to move ahead with discussions around innovative financing mechanisms. Some of the initiatives to have come from this are: an international airlines levy and UNITAID; an International Finance Facility for Immunization (IFFIm – see above); a working group on combating tax havens and capital flight; studies on a currency transaction development levy (CTT) and migrant’s remittances; and progress on advanced market commitments (AMCs – see above) on vaccine development. These are alternative resources for financing development beyond official development assistance (ODA).

**lender of last resort** - an institution, usually a central bank, that can step in and lend funds to a bank facing a panic (sudden withdrawal of funds by depositors) or when no other institutions will lend to an institution considered high-risk or near collapse.

**leverage (or capital-asset ratio, or capitalization, or leverage ratio)** **-** the amount of borrowed capital or debt, supporting equity capital. The most common gauge of this is the capital-asset ratio (but more sophisticated measures such as tier-1 capital to risk-weighted assets are used in practice). It is also used interchangeably to simply indicate the amount of indebtedness in the system.

**liquidity (or liquidity coverage ratio-LCR)** **-** cash is the ultimate form of liquidity. Liquidity refers to how fast and cheaply an asset can be converted into its most fungible form or cash. When an asset can only be converted into cash after a long search for a buyer it is called illiquid. Liquidity is a key feature of John Maynard Keynes’s General Theory. Keynes argued interest is a reward for parting with liquidity. Three factors motivate demand for liquidity in Keynesian analysis: transaction motive (liquidity to make purchases), precautionary motive (in case of unexpected needs), and speculation of interest rates (lower interest rates imply greater demand for money). Modern financial theory and neoclassical
economics have a very different understanding of liquidity, in that they consider it abundant. Financial crises are often liquidity crises, caused by imbalances between liquidity suppliers and demanders.

**living wills** - requirement that large and interconnected financial institutions keep orderly resolution and wind-down plans in case of crisis. One of the major lessons from the subprime crisis in 2007-2008 was the need to have orderly resolution plans for financial institutions so that tax payers do not get saddled with the cost of winding down unviable but systemically important entities.

**low income country** – classification created by the World Bank, calculated according to Gross National Income (GNI) per capita. Low income countries are those with a GNI per capita of $975 or less.

**market stabilization funds** - see FSC

**micro and macro-prudential regulation** - micro prudential regulation focuses on risk factors as they relate to an individual institution. Macro-prudential regulation on the other hand posits that systemic risks are greater than the sum of their parts. And that focusing on individual rationality may serve to underplay important systemic risks such as counterparty risks (above) and other system driven factors. The lack of attention to macro-prudential risk is seen as a major weakness of the Basel capital standards (see above), and the absence of such regulation is thought to have amplified the impacts of the global financial crisis f 2008.

**middle income country** – classification created by the World Bank, calculated according to GNI per capita. Middle income countries are divided by the World Bank into two sub-categories: lower middle income, $976 - $3,855 and upper middle income, $3,856 - $11,905.

**Millennium Declaration** – adopted by 189 nations and signed by 147 heads of state and governments at the UN Millennium Summit in September 2000, the Declaration reaffirms the world’s commitment to the most pressing development challenges and outlines eight key objectives codified in the MDGs.

**Millennium Development Goals (MDGs)** – a set of eight development goals that 189 signatory nations have agreed to achieve by the year 2015. They are: 1. Eradicate extreme poverty and hunger; 2. Achieve universal primary education; 3. Promote gender equality and empower women; 4. Reduce child mortality; 5. Improve maternal health; 6. Combat HIV/AIDS, malaria and other diseases; 7. Ensure environmental sustainability; and, 8. Develop a global partnership for development. The eight MDGs are further broken down into 18 quantifiable targets that are measured by 48 indicators.

**monetary policy** - government macroeconomic policy that seeks to influence general economic activity by controlling credit and interest rates and the domestic money supply (i.e. the amount of currency in circulation).

**Monterrey Consensus** – the 2002 United Nations-led Financing for Development process in Monterrey emerged from a need to examine the internationally supported development goals adopted over the past decade at previous UN summits - and at a minimum the MDGs - and to determine how to mobilize and increase the effective use of financial resources to be able meet these goals. The conference led to the Monterrey Consensus which focuses on six key areas: 1. Mobilizing domestic financial resources for development; 2. Mobilizing international resources for development, foreign direct investment and other private flows; 3. International trade as an engine for development; 4. Increasing international financial and technical cooperation for development; 5. Debt sustainability and cancellation; and, 6. Enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development.

**moral hazard** - a term based on the principle that if actors are allowed to escape the consequences of their risky actions, they are more likely to engage in reckless behavior in the future. The moral hazard
argument is often used to argue against the forgiveness of legally contracted debt; it has also been used to criticize IMF rescue packages, which bail out reckless bankers and private investors.

**mutual fund** - a collection of stocks, bonds or other securities owned by a large group of often-small investors and managed by a professional fund manager.

**Multilateral Investment Guarantee Agency (MIGA)** - Along with the IBRD, IDA and IFC, makes up the World Bank Group. See ‘World Bank’ and ‘World Bank Group’ for details.

**off-balance-sheet** - exposure to investments and risks not directly related to the asset or liability side of financial institutions balance sheets. Often securitized (see below) assets are held off-balance sheet.

**Official Development Assistance (ODA)** – Traditionally, official development assistance or aid has been given by members of the Development Assistance Committee (DAC) of the OECD to Part I List of Aid Recipients, i.e. Developing countries. ODA is geared towards the promotion of economic development and welfare of developing countries, is concessional (see “concessional loans” above) in character with a grant element of at least 25 percent, and comprises contributions of donor government agencies to developing countries (“bilateral ODA”) and to multilateral institutions. ODA receipts comprise disbursements by bilateral donors and multilateral institutions.

**over the counter (OTC) derivatives** - those derivatives not traded on formal stock or futures exchanges or through a centralized counterparty, but over the counter or in bilateral transactions amongst the major parties. The global OTC derivatives market lacks transparency. In 2008 the value outstanding in the global OTC market was around $650 trillion or about 12 times the size of global GDP. Interest rate and currency swaps (along with CDSs) dominate global OTC trading.

**Paris Declaration** – building on high-level meetings in Rome and Marrakech, the 2005 Paris Declaration set out a series of common and monitorable actions to enhance aid effectiveness. The five principles of the Declaration, which lay out commitments for both donors and partner countries, are as follows: 1. Ownership; 2. Alignment; 3. Harmonization; 4. Managing for results; and, 5. Mutual accountability. The Paris Declaration promises to increase the impact of aid by going beyond previous agreements, setting out 12 results-oriented indicators and creating strong mechanisms for donor-recipient accountability.

**pension fund** - like a mutual fund, except that the investors are long-term and bound by some common workplace affiliation (such as a union). In many countries, pension funds represent the largest single institutional investors.

**portfolio investment** - refers to the purchase of foreign stocks, bonds or other securities. In contrast to FDI, foreign portfolio investors have no controlling interest in the investment, which is typically a short-term one. The relative ease with which portfolio investment can enter and exit countries has been a major contributing factor to the increasing volatility and instability of the global financial system.

**project finance** - in addition to trade financing, there is also project financing which provides longer term loans to overseas projects. This often brings together a large number of investors, from commercial banks, regional development banks such as the Inter American Development Bank (IDB), the World Bank Group or export credit agencies (such as Export Development Canada) where the project sponsor is from the ECA country. The initial provision of equity to a project by one of these investors often helps to attract additional financing from other investors.

**quota** - according to the IMF’s Articles of Agreement, each member country is required to have a minimum subscription of quotas in the total capital stock of the institution. The amount of the minimum subscription is roughly proportional to the absolute size of the country’s economy in the world. Member
countries are then allocated a certain number of votes according to the size of this subscription. See also "shares".

remittances are personal cash or in-kind transfers by overseas or migrant workers to their home countries. Remittances often far exceed aid transfers to countries and constitute a large source of revenue for many developing countries. The World Bank estimated that around 150 million migrant workers sent around US$300 billion home in 2006. Recorded remittances to developing countries are estimated to reach $240 billion in 2007 according to the World Bank although the true size of remittances and unrecorded flows tends to be much larger.

reserves - the amount that banks are legally required to keep 'on hand' to meet short-term repayment obligations (for instance, if a large percentage of depositors suddenly decide to withdraw their money). The amount banks are required to keep in reserve varies by country and has generally declined over time through the process of financial liberalization.

risk insurance - a type of export insurance. This insulates exporters from various losses stemming from a broader set of commercial and political risks, including buyer insolvency, default on payments, repudiation of goods, contract termination, foreign exchange conversion or transfer payment difficulties, war, revolutionary insurrection preventing payment, cancellation of government import-export permits, wrongful calls on bid/performances letters of guarantee, and inability to repatriate capital or equipment due to political problems. See also 'export credit insurance'.

Securities and Exchange Commission (SEC) ** - the main securities regulator in the US.

securitization** - Securitization is the process of taking an illiquid asset, or group of assets, and through financial engineering, transforming them into a security. The best examples are packaging and repackaging receivables such as mortgage, credit card, or student loan interest into securities, and then selling them to investors. Securitization is said to dramatically increase liquidity in credit markets, but during the 2008 global financial crisis served to increase concentration of risky assets like subprime linked mortgages.

shares - according to the World Bank's Articles of Agreement, each member country is required to have a minimum subscription of shares in the total capital stock of the institution. The amount of the minimum subscription is roughly proportional to the absolute size of the country's economy in the world. Member countries are then allocated a certain number of votes according to the size of this subscription. See also "quota".

Special Drawing Rights - an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. Its value is calculated by averaging a "basket" of four major world currencies – the US dollar, UK pound, euro, and Japanese yen – in a weighted formula that is re-evaluated every five years to ensure it represents the relative importance of each. When issued, SDRs are allocated relative to a country's IMF quota.

SDRs can be converted into cash and used to accumulate savings, for development projects, stimulus packages, or debt payments. But while the SDRs are interest free if they remain part of a country's reserves, once converted into cash, countries must then pay market interest rates for borrowing that hard currency (be it yen, dollars, euros, or pounds) until the currency is converted back into SDR. Currently market interest rates are low, but should they increase, this cash conversion could become a burden to countries. Consequently, some civil society groups are calling for a fixed interest rate, flat fee, or no charges to convert SDRs into cash, enhancing the ability of developing countries to access the resource.

Technically, developed economies, with higher SDR allocations, can grant or loan their SDRs to countries that need them.
solvent** - solvency is the long-term equivalent of liquidity. It is the degree to which current assets can meet current liabilities, or the ability of the entity to meet long term expenses and other obligations.

**Glossary of Financial Terms (June 2010)**

Systemically Important Financial Institutions (SIFI)** - see TBTF

**securities** - these are financial instruments (such as bonds or stocks) that can be traded freely on the open market. ‘Securitization’ refers to the pooling of loans or assets for subsequent sale to investors.

**speculation** - the act of betting on changes in exchange rates in hopes of profiting. A speculative ‘attack’ occurs when a large number of investors anticipate a reduction in currency values and sell off large quantities of their holdings thereby often creating the price crash they predicted.

**tax haven** – a place with nominal or no taxes where individuals/companies can mitigate their tax burden. Onshore tax havens include financial centres which are important members of the IMF, such as Luxembourg, Switzerland, the United Kingdom and the United States. Offshore tax havens include jurisdictions which have been monitored by the IMF in its Offshore Financial Sector Assessment Program. Tax havens often lead to capital flight and tax evasions by individuals/companies, which often results in the erosion of state budgets, among other things.

**tier 1 capital (or capital standards)**** - is the highest quality capital banks are required to hold. It comprises common equity (shareholder equity) and retained earnings (share of profits), net or various allowances or deductibles (such as corporate goodwill).

**Tobin tax** - a proposal by Nobel-prize winning economist James Tobin to place a small tax (.1 -.5%) on all foreign exchange transactions as a means of stabilizing currency markets. Tobin's tax would also generate hundreds of billions of dollars annually.

**too big to fail (TBTF)**** - term used for mega financial institutions whose failure threatens the stability of the overall economy. These include the likes of AIG, Fannie and Freddie in the US, all of which were bailed out. Mervyn King, Governor of the Bank of England, was purported to say, “If it is too big to fail, then it is too big.”

**trade finance** - trade financing consists of a series of financial services to facilitate the export (or import) of various equipment and services. Export financing includes a range of financial and risk management services, including: 1) Export credit insurance, 2) Financing to foreign buyers of Canadian goods and services, 3) Guarantees and 4) Working capital. See also 'project finance'.

**transfer pricing** – refers to the pricing of contributions (assets, tangible and intangible, services, and funds) transferred within an organization. For example, goods from the production division may be sold to the marketing division, or goods from a parent company may be sold to a foreign subsidiary. Since the prices are set within an organisation (i.e. controlled), the typical market mechanisms that establish prices for such transactions between third parties may not apply. The choice of the transfer price will affect the allocation of the total profit among the parts of the company. This is a major concern for fiscal authorities who worry that multi-national entities may set transfer prices on cross-border transactions to reduce taxable profits in their jurisdiction.

**trillion** - how much is a trillion? A trillion is a thousand million. A million dollar pile of stacked $100 bills would be two metres tall; a one trillion dollar pile would be two kilometres high.

**UNITAID** - this International Drug Purchase Facility was founded in 2006 on the initiative of Brazil, France, Chile, Norway and the UK (currently has 34 member countries). UNITAID's mission is to provide people in the developing world with long-term access to quality drug treatment for diseases such as malaria, tuberculosis and HIV and AIDS at the lowest price possible. In order to fulfill this
mission, a source of long term predictable funding is required – an aviation solidarity levy (see above). The UNITAID budget for 2007 is $300 million, and already there are indications that its interventions have helped to reduce drug prices. Canada is not currently a member of UNITAID; the UK and Spain provide budgetary contributions.

**Vertical fund** – an emerging source of global development finance that is vertically earmarked towards a single issue, such as fighting HIV-AIDS, malaria or tuberculosis, rather than horizontally towards a programme area, such as building better health care systems. Since the late 1990s and the arrival of the Global Fund to Fight AIDS, tuberculosis and malaria, there has been a boom in such funds, primarily geared towards disease prevention and control. This has come from both the public sector, for example, the US President’s Emergency Plan for AIDS Relief, and through private philanthropy, for example, the Bill and Melinda Gates Foundation.

**volatility** - the tendency of financial markets to change abruptly at the whims of investors. As national control over financial markets fall as a result of capital account liberalization and the volume of portfolio investment skyrockets, volatility is increasing in financial markets. While unstable markets are profitable for speculators (see ‘speculation’), the real economy cannot function properly when exchange rates are fluctuating wildly and capital is flowing in and more often out of a country in tidal waves.

**Volcker Rule** - separation of proprietary trading (i.e. riskier capital market activities) from federally funded deposit taking activities. Similar to Glass-Steagall separation, named after Paul Volcker, the proponent of the idea in the Obama administration.

**Vulture fund** – a company that buys up foreign debt at low prices from creditors who do not expect to be paid back in full and wish to cut their losses. The vulture funds often take the debtor government(s) to court and demand payments many times larger than the amount the funds paid to acquire the debt. For example, Donegal bought US$40 million worth of Zambia’s debt from Romania for just US$3.2 million and proceeded to sue Zambia in a British court, demanding payments of US$55 million.

**World Bank** - an international institution established in 1944 to assist with the reconstruction of post-war Europe. Today, it is the largest public development institution in the world providing long-term loans to governments for development projects in a variety of sectors (see ‘conditionality’). World Bank total lending for the 2007 fiscal year was $24.7 billion. This amount included loans, credits, guarantees and grants and exceeded 2006 Bank lending by 4%.

**World Bank Group** - The largest multilateral group of institutions providing international development financing to developing countries and emerging economies. It includes four agencies: the International Bank for Reconstruction and Development (IBRD or ‘World Bank’) which provides hard loans to countries for projects (with relatively high interest rates and shorter repayment periods); the International Development Association (IDA) which provides soft loans or grants to countries (with low or no interest and long repayment periods); the International Finance Corporation (IFC) which is the private sector arm of the World Bank and encourages private business and investment in developing countries; and, the Multilateral Investment Guarantee Agency (MIGA) which guarantees funds that private investors direct to developing countries.

*indicates definitions developed by the Bretton Woods project – [http://www.brettonwoodsproject.org](http://www.brettonwoodsproject.org).  
**indicates definitions developed by with Aniket Bhushan of The North South Institute – [http://www.nsi-ins.ca](http://www.nsi-ins.ca).

All other definitions developed by the Halifax Initiative.