REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE: THE NEW POLITICAL AGENDA

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ABSTRACT

In light of recent financial crises involving Asia, Russia and Brazil, the most radical overhaul of the international financial architecture since 1945 has occurred. I argue that this development reflects a significant shift in thinking about the political prerequisites of governance in the global financial system. Most importantly, it signifies that emerging market economies must be more fully integrated into the decision-making structures of the global economy. The search for appropriate mechanisms of inclusion, however, has re-opened what have been long-settled political questions about global financial governance. These include most crucially (1) how to address the core-periphery divide within the global financial system; and (2) how to fashion an acceptable balance between public responsibility and private gain within the context of a more inclusive international decision-making structure. Resolving these political questions is now an integral part of the reform agenda, and their explicit consideration will help to determine the future effectiveness of the international financial architecture.

REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE: THE NEW POLITICAL AGENDA[1]

It is odd how just a a few financial crises can make the annual meetings of the International Monetary Fund (IMF) and World Bank (together with the World Trade Organization) hotbeds of activism and protest. Where once these were staid affairs attended by top-level bureaucrats and finance ministers from around the world, they have recently become prime sites for protesting against the role which powerful international economic institutions play in the world today. One of the key demands voiced by demonstrators at these meetings is to make the decision-making structure of the global economy more democratic and accountable. Yet, few of these activists would probably accept just how radically one key element of this structure has changed since its formation in the closing days of World War II.

Back in 1945, it was assumed that the international financial architecture would be associated primarily with the IMF and International Bank for Reconstruction and Development (as the World Bank was then known). With the inability of the IMF to assume its planned role in the early years of the postwar period, however, the onus of leadership fell to (or was seized by, depending on your point of view) the United States, which remained at the centre of international decision-making for the next fifty years. Over this period, despite the weakening of monetary discipline in the US and the stupendous growth of international financial markets, the history of decision-making within an increasingly globalized financial system remained firmly US-centred. Every significant architectural development, successful or unsuccessful, revolved around American efforts to shape the global context within which financial transactions occurred. As a result, the world entered the last few years of the 20th century with an international financial architecture firmly centred on US wants and demands. [2]

It is this US-centred international financial architecture that is now being recast in terms of its decision-making structures, lines of accountability, and legitimating processes. What began in 1998 as a purely technical response to a string of financial crises with global implications _ principally Mexico, east Asia, Russia and Brazil, but

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[1] This research has been supported by a grant from the Nuffield Foundation, which allowed me to undertake confidential interviews with senior officials in finance ministries, central banks and regulators across a number of G-7 countries, as well as at several international financial institutions, during 1999/2000. I am grateful for the time these individuals took to participate in my research. I would also like to acknowledge the helpful comments of Andrew Walter, Michael Williams, Tony Porter, Guy Scuffham, Rorden Wilkinson and Stephen Hughes, together with seminar participants at the Forum on Globalization, Bishop s University (Canada), the University of Warwick, and the Engaging Global Governance workshop at Manchester University, where versions of this work were presented. Finally, I am grateful to Elaine Lowe for her help in constructing Figure 1. I of course remain entirely responsible for the views expressed below.

[2] The last few years have witnessed a number of book-length accounts which highlight the political or architectural dimensions of the post-1945 global financial system. See in particular Tony Porter, *States, Markets and Regimes in Global Finance* (Basingstoke: Macmillan, 1993); Andrew Walter, *World Power and World Money* (London: Harvester Wheatsheaf, 1993); Philip Cerny, ed., *Finance and World Politics* (Aldershot: Edward Alger, 1993); Eric Helleiner, *States and the Reemergence of Global Finance* (Ithaca: Cornell University Press, 1994); Andrew Sobel, *Domestic Choices, International Markets* (Ann Arbor: University of Michigan Press, 1994); Barry Eichengreen, *Globalizing Capital* (Princeton University Press, 1996); Geoffrey Underhill, ed., *The New World Order and International Finance* (Basingstoke: Macmillan, 1997); Louis Pauly, *Who Elected the Bankers?* (Ithaca: Cornell University Press, 1997); Randall D. Germain, *The International Organization of Credit* (Cambridge: Cambridge University Press, 1997); Benjamin Cohen, *The Geography of Money* (Ithaca: Cornell University Press, 1998); and Susan Strange, *Mad Money* (Manchester: Manchester University Press, 1998).

including others as well[3] _ has acquired an unmistakeable political agenda preceisely in order to bring on board emerging market economies, provide a stamp of legitimacy for the often painful initiatives required to meet these crises, and deliver the complex technical improvements demanded by contemporary international financial transactions. At the same time, this agenda has re-opened long-settled questions regarding the defining principles of global financial governance.

I examine this new political agenda in three steps. First, I briefly consider the reform debate, arguing that what began as a rather technical affair has quickly evolved into a substantial political agenda that recasts significant aspects of the international financial architecture. The next section identifies the key questions which this agenda reopens, and explores how these questions relate to current developments. These questions are (1) how to attenuate the core-periphery divide which currently plagues the international financial architecture, and (2) how to recast the public/private balance within finance more generally. Finally, I close by delineating the politics of reform highlighted by this new agenda. In a nutshell, my main claim is that the measure of success for the reform effort is now indistinguishable from how well it deals with this agenda, and that the debate should move on to emphasize this development.

Shock-proof?

Given the depth of international financial turbulence in the 1990s, we should be quite impressed with the underlying strength of the international financial architecture. Designed originally for a world of relatively segmented markets and insulated national financial systems, it has adapted to the brave new world of global finance with much aplomb: the regulatory framework for currency, credit and capital markets has been regularly updated; the system of international settlements — the unseen plumbing through which most international financial transactions flow — has been made progressively more robust; mechanisms and procedures to manage individual crises on the periphery of the global financial system have been fashioned; and 'best practice' to reduce distortions and ensure an efficacious flow of capital around the globe has been developed and disseminated. As recently as 1996 these achievements led one seasoned observer to speculate that the global financial system had become 'shock proof'.[4]

Less than a year after that conclusion, however, the onset of financial crisis in Asia sparked an important re-examination of the basic structure of the international financial architecture.[5] The largely unpredicted arrival of currency devaluations,

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[3]The litany of financial disasters with potentially global repercussions must also include the implosion of the European exchange rate mechanism in 1992/3, the sudden collapse both of long-established investment banks such as Barings in 1995 and new hedge funds such as Long Term Capital Management in 1998, the long simmering banking malaise in Japan, and a near-run stock market meltdown among the G-7 economies in October 1998. And we should not forget that a brand new international currency was launched by the European Union in 1999, complete with a new and untried institution at its heart.

[4]Ethan Kapstein, 'Shock Proof',*Foreign Affairs*, Vol. 75, no.1 (1996): 2-8. The bulk of Kapstein s analysis draws on his *Governing the Global Economy* (Cambridge, MT: Harvard University Press, 1994).

[5]The Bretton Woods institutions themselves had already begun to be re-examined in the early 1990s as part of the general celebration of fifty years of relative monetary stability. See for example Michael Bordo and Barry Eichengreen, eds., *A Retrospective on the Bretton Woods System* (Chicago: University of Chicago Press, 1993); and Peter B. Kenen, ed., *Managing the World Economy Fifty Years after Bretton Woods* (Washington: Institute for International Economics, 1994). This rather detached scholarly process was matched by a more focussed international debate set off by the Mexican peso devaluation, and can be traced through the official communiqu s of the G-7 summits, beginning in Halifax in 1995 and following

government financial crises and systemic banking failures in a number of countries pointed to a set of common problems which if combined could herald disaster. These problems included currencies pegged at unsustainable exchange rates, government liquidity difficulties exacerbated by excessive short-term borrowing on international markets, and ill-supervised banking systems. In many instances these problems were compounded by massive short-term corporate and/or bank borrowing on international capital markets. Assessments of how these problems arose have evolved over time to produce a clear consensus both that reform of the international financial architecture is necessary and in what direction it should tend.

Early assessments viewed the problems largely as a result of the crisis-countries own making. Morris Goldstein, for example, argued that the Asian countries did not manage their currency pegs astutely, given deteriorating capital accounts; their government financing was not robust enough to withstand a sudden deterioration in revenues; and, most importantly, their banking systems were inadequately supervised and ill-served their economies. The Asian crisis, from this point of view, was a much-needed wake-up call to national policy-makers and international investors alike to put right government finances, banking systems and ultimately entire developmental trajectories.[6] At this stage of the debate the role of global finance was considered generally to be a secondary factor _ amplifying national defects rather than causing them _ and therefore reforming the international financial architecture meant principally augmenting the oversight powers of the IMF and providing better assistance to developing economies so that they can reform their economies along the lines of best practice.

As the spiral of financial crises continued throughout 1998 and into early 1999, however, a second wave of assessments began to acknowledge _ without playing down the severe problems within crisis countries _ the crucial role played by international capital markets in the transmission of crisis from one country to another.[7] Barry Eichengreen, for example, pointed to the disastrous consequences of highly volatile short-term capital movements on crisis countries, and on the way these forms of capital have contributed to the contagion effect.[8] He suggested encouraging the implementation of Chilean-style taxes on short-term capital inflows as a necessary third-line of defence against financial crisis for certain countries.[9] Where these authors go beyond the first wave of assessments is precisely in recognizing that full capital account liberalization, and indeed the admonition to move towards full capital mobility under all circumstances, can sometimes be unwise. Rather, they argue that we need to get right the timing and

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through to K ln in 1999. The website of the G8 Information Centre at the University of Toronto contains an extensive archive of these communiqu s: http://www.G7.utoronto.ca.

[6] Morris Goldstein, *The Asian Financial Crisis: causes, cures and systemic implications* (Washington: Institute of International Economics, 1998). See also Leif R. Rosenberger, Southeast Asia s Currency Crisis: a diagnosis and prescription , *Contemporary Southeast Asia*, Vol. 19, no. 3 (1997): 223-51; and the various contributors to Miles Kahler, ed., *Capital Flows and Financial Crises* (Ithaca: Cornell University Press for the Council on Foreign Relations, 1998).

[7] See for example Steven Radelet and Jeffrey Sachs, The East Asian Financial Crisis: diagnosis, remedies, prospects , *Brookings Papers on Economic Activity* 1 (1998): 1-90; Jason Furman and Joseph Stiglitz, Economic Crises: evidence and insights from east Asia. *Brookings Papers on Economic Activity* 2 (1998): 1-135; Alan S. Blinder, "Eight Steps to a New Financial Order", *Foreign Affairs*, Vol. 78, no. 5 (1999): 50-61; and Brigitte Granville, Bingo or fiasco? The global financial situation is not guaranteed , *International Affairs*, Vol. 75 No. 4 (1999): 713-728.

[8] Barry Eichengreen, *Toward a New International Financial Architecture: a practical post-Asia agenda* (Washington: Institute for International Economics, 1999), esp. ch. 4.

[9] The first and second lines of defence are improved risk-management techniques for financial firms and strengthened regulation of financial firms. Eichengreen, *International Financial Architecture*, ch. 4.

degree of liberalization if the fruits of capital mobility are to be better distributed in the future.

These largely technical assessments provide a powerful argument for reform. Given widespread support for high levels of capital mobility, we must pay more attention to the nuts and bolts of managing the interface between national financial systems and the global financial system. Better regulation is crucial, but so too is recognizing the many ways in which finance and money (understood here as the way in which exchange rates interact with capital markets) can combine to produce a volatile and explosive economic situation, as in Indonesia. Producing adequate standards and regulations and ensuring that they are adequately enforced may be a complex and highly technical process, but it is one in which the world's so-called mature financial systems have as great a stake as those in the developing world.

Over the course of 1999, this realization produced a consensus among financial experts about the direction of reform. It centres on what might be called the 'three S's': strengthening transparency, strengthening support and strengthening regulation. Standards for data dissemination and transparency _ the SDDS (Special Data Dissemination Standards) _ are being improved and implemented, led by the IMF in consultation with a myriad of more specialised international bodies. These standards should enable investment decisions by market participants to be made on the best available information. Also at the IMF, a new credit facility has been approved, the Contingent Credit Lines (CCL), designed specifically to provide funds ahead of a financial panic to support countries with sound economic fundamentals but nevertheless experiencing contagion. Finally, a new regulatory initiative, the Financial Stability Forum (FSF), has been created to bring together key national and international regulators in an attempt to eliminate the perceived regulatory gap which enables financial contagion to spread.[10] This should further bolster economies that are basically sound yet susceptible to contagion. The bottom line here is on finding ways of strengthening the financial systems of potential crisis-countries by offering more international protection in return for changes at the national level. As one recent blue-ribbon task force argued: "If we are to make real headway in improving crisis prevention and management in the developing world, we must put primary responsibility back where it belongs: on emerging economies themselves and on their private creditors". [11]

This bottom line also makes it clear why a political agenda has become a vital part of the reform effort. To make substantial progress, emerging market economies must

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[10] The decision to create the FSF was taken in 1999. It was suggested by Hans Tietmeyer (then head of the Deutsche Bundesbank) in a report commissioned by the G-7 to examine the appropriate response of the international community to global financial contagion. He noted that effective financial regulation depended upon adequate flows of information that spanned international borders and cut across different financial sectors or markets, and proposed a forum within which central bankers, financial regulators and ministry of finance officials could meet to discuss issues of mutual concern. The initial report called for 35 members, three each from G-7 countries with the remaining members drawn from committees and institutions of relevance to cross-border and cross-sectoral financial regulation, such as the IMF, Basle Committee of Banking Supervisors (BCBS), International Organization of Securities Commissions (IOSCO), etc The membership has since been extended to include representation from the Netherlands, Hong Kong, Australia and Singapore. Andrew Crockett, currently the General Manager of the Bank for International Settlements (BIS), is its initial Chairman. Both the Tietmeyer Report and the activities of the FSF can be found on its website (http://www.fsforum.org).

[11] *Safeguarding Prosperity in a Global Financial System: the future international financial architecture*, Council on Foreign Relations Task Force, co-chaired by Carla Hills and Peter Peterson (Washington: Institute for International Economics, 1999), p. 3.

both agree with the conclusions of the reform debate and buy into the actions which they will have to implement. ‘Ownerhip’ is the new buzzword in these circles. Governments of emerging market economies will have to legitimate the reform effort and be accountable to their own citizens for the economic and social pain of reform. This in turn means that the reform effort itself requires changes in the decision-making structure of the international financial architecture for it to become both more accountable and more legitimate in the eyes of the broader international community. The reality of this new political agenda is plainly visible in two important recent developments.

First, throughout 1998 a series of meetings took place, sometimes at the behest of the United States or its G-7 partners, and at other times occasioned by calls from outside the G-7, in which a collective international response to financial crisis was developed. These meetings occurred on an *ad hoc* basis, and were known by their participants variously as the Willard Group, the G-22 and G-33.[12] One result of these meetings was the formation of a new international grouping of countries known as the G-20. This group was formally announced at the September 1999 meeting of the G-7 Finance Ministers, as part of the annual autumn meetings of the IMF/World Bank, and is under the leadership of Paul Martin, Canada’s Minister of Finance.

The G-20 brings together Finance Ministers and key central bank officials from Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa, South Korea, and Turkey, together with their G-7 counter-parts and a representative from the European Union. Its agenda certainly includes technical issues such as transparency and the rest, but more fundamentally it provides a mechanism for bringing the emerging market economies into the decision-making structure of the global financial system. In this sense the G-20 represents a potentially new and radical addition to the international financial architecture. For the first time the international decision-making structure has expanded beyond the G-7 countries.

Second, the IMF has itself undertaken a change in its form of governance with the transformation of the long-standing ‘Interim Committee’ into the new ‘International Monetary and Financial Committee’ (IMFC). Beyond the name change is an important new principle at work in the IMFC, namely that all countries can raise _ as a matter of international governance _ the role which the IMF itself plays within the global financial system. Through the IMFC’s constituency system, countries will be able to raise issues without in principle being hampered by their allocation of votes on the IMF’s Executive Board. It is important to stress here that the IMFC will not be able to stop the IMF from engaging in bad or misguided policy _ that will still depend upon the system of checks and balances contained within the IMF’s Articles of Agreement and the triangular relationship between the Board of Governors, Executive Board and Fund staff. Rather, the significance of the IMFC from this perspective is that it allows the role which the IMF plays within the international financial architecture to be subject for the first time to input and negotiation on behalf of the broader international community.

Taken together, these developments indicate that a new political agenda has emerged in global finance. This agenda has centred on one question: how to enable the formerly excluded countries to acquire a genuine stake in the decision-making structure

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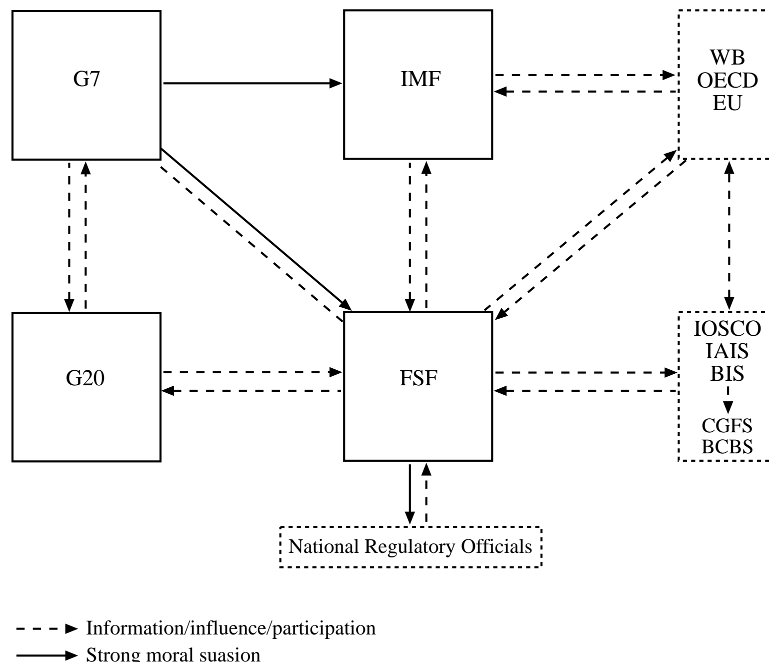
[12] The Willard Group of finance ministers deputies was struck after the 1997 APEC meeting in Seattle when the Prime Minister of Malaysia s call for such a group was picked up by US President Bill Clinton. Subsequent meetings of this group, initially representing about 20 countries, grew into the G-22 and G-33 (i.e. meetings in which representatives from 22 and then 33 countries participated). They met over the course of 1998 to discuss possible reforms to the international financial architecture.

of the global financial system. The mechanisms of inclusion have centred on three specific institutional developments, in descending order of significance. First, the G-20 is meant to provide more accountability to the reform efforts and to foster increased legitimacy for the kinds of initiatives that will be required to strengthen the global financial system. Second, the FSF, despite its technical origins, has acquired a politicized mandate by virtue of its efforts to develop a raft of standards that are to provide international benchmarks for regulating sound and prudential financial systems throughout the world. And finally, the IMF has inserted into its own governance structure a new mechanism of accountability to the international community, the IMFC. This new body will enable members of the IMF to debate and shape the international role of this institution beyond what was previously possible.

We are now in a position to identify with some precision the decision-making structure that is the international financial architecture. It is composed of four main pillars, each with their own supports but also buttressed by interlocking connections. One pillar is the G-7, still the engine room of the global economy, but which now increasingly recognises the fundamental dependence between its economies and the more remote bits of the global economy. Another pillar is the new G-20, which is the only purpose-built institution in which the industrialised and emerging market economies can meet to discuss financial issues of mutual concern. A third pillar is the FSF, which is another new and purpose-built institution designed to meld the interests of industrialised and emerging market economies concerning regulatory issues. The final pillar is centered on the IMF but extends via information links to the entire nexus of international financial institutions (IFIs) which comprise the highest level of technical expertise regarding global financial issues: the World Bank, the BIS (together with the even more specialised committees operating under its roof, such as the Basle Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), and the Committee on the Global Financial System (CGFS)), and IOSCO. Figure 1 provides a schematic representation of this new international financial architecture.

Figure 1. International Financial Architecture



This view of the architecture identifies it squarely as a structure of consensual decision-making. Why consensual? One of the remarkable attributes of the emerging international financial architecture is the absence of channels of explicit command and control. As will be discussed below, the move towards standards of behavious and codes of best practice as the guiding strictures for global finance mean that the capacity of any one pillar to command another is muted. Rather, each pillar must use a range of carrots and sticks to entice other pillars towards their preferred mode of operation. The FSF, for example, cannot command insurance supervisors in other countries to adopt the rules and procedures which they desire; rather they have to convince these countries of the appriopriateness of doing so. Similarly, the G-7 cannot command the G-20 to undertake an initiative which members of the G-20 feel inappropriate to their circumstances. Power, influence and moral suasion are not absent from the financial architecture, of course, but they are played out within a structure of decision-making which I would characterize as consensual rather than coercive.

In this way I would distinguish the international financial architecture from a more generalised understanding of the ensemble of rules and procedures by which international financial transactions are carried out. We may reserve such a general definition for the global financial system itself, which is the sum total of rules and arrangements through which financial transactions connect one national economy to another.[13] Rather, I find it more helpful to consider the international financial architecture as the mechanisms and structures by which these rules and arrangements get made: it is the set of institutional arrangements which determine who gets what, when and how. This view of the architecture stresses its political nature, and sees in the current reform effort a clear political agenda which is re-opening political questions that have been dormant for the past thirty years.

The new political agenda

At the heart of the new political agenda is the realisation that international politics and international economics are more tightly bound together than ever before. This is of course not a new revelation for some. There is a small but growing literature within the disciplines of international relations and international political economy that has long advocated this point of view. Confining ourselves simply to the reform debate, for example, Susan Strange maintains that it is the underlying power relations between states and markets which make possible and indeed encourage volatile financial transactions. [14] She argues that the genesis of the Asian crisis lies firmly in the increasing liberalization of global finance, and in particular in the ill-fated attempt to liberalize the capital account

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[13] This is a long-standing definition that many have worked with in the past: see Benjamin Cohen, *Organizing the World s Money* (New York: Basic Books, 1977), p. 3; and Barry Eichengreen, *Elusive Stability: essays in the history of international finance* (Cambridge: Cambridge University Press, 1990), p. 271. For a critical discussion see Germain, *International Organization of Credit*, ch. 1.

[14]Susan Strange, *Mad Money* (Manchester: Manchester University Press, 1998); see also her *States and Markets* (London: Pinter, 1988) and *Casino Capitalism* (Oxford: Blackwell, 1986). In a similar vein are Stephan Haggard and Andrew MacIntyre, The political economy of the Asian economic crisis , *Review of International Political Economy*, Vol. 5, no. 3 (1998): 381-92; Walden Bello, East Asia: on the eve of the great transformation? , *Review of International Political Economy*, Vol. 5, no. 3 (1998): 424-44; and Louis Pauly, Good Governance and Bad Policy: the perils of international organization overextension , *Review of International Political Economy*, Vol. 6, no. 4 (1999): 401-24. Other analyses which I would categorise as political in orientation but which stop short of blaming 'mad money' for the recent spate of crises include Martin Feldstein, "Refocusing the IMF", *Foreign Affairs*, Vol. 77, no. 2 (1998): 20-33; and Devash Kapur, "The IMF: a cure or a curse?", *Foreign Policy*, No. 111 (Summer 1998): 114-29.

before gaining full control over domestic and international financial institutions active in the crisis-country. Losing control over capital movements would not be so significant, Strange argues, if money behaved rationally and responsibly, but it has never done so. Far too many other influences determine where, on what scale and for how long capital moves, and the determination of politicians and regulators not to regain control over internationally-mobile money means that Asia will by no means be the last 'crisis'. It is mad money rather than bad management that lies at the root of most financial crises.

Looking to the broader implications of the Asian crisis, Stephen Gill has recently argued that the international response to it reflects a fundamental tension over the particular way in which Asia will be inserted into the global economy.[15] This geopolitical tension revolves around the conflicts between America and Japan plus its protégés over developmental trajectories in Asia, on the one hand, and between the shifting strategic implications of military and economic imbalances in both China and America. The result, Gill argues, is both a brutal reassertion of American power in the region and the surprising exposure of the contested basis of American power. Just how international structures of power will evolve under this condition is for him an open question.

We need not accept the entire thrust of either of these analyses in order to appreciate the centrality of a political agenda in connection with both international financial crises and the responses to them. Since my focus here is on the politics of inclusion, I want to draw attention to the way in which this political agenda has reopened two long-settled questions. First, the search for appropriate mechanisms of inclusion has once again focused attention on the question of attenuating the core-periphery divide within the global financial system. Why is this question now relevant? It is important precisely because of who is being asked to pay the costs of reform and who will receive the benefits. One of the starkest consequences of the Asian financial crisis has been the cost which the periphery has been forced to pay simply in order to weather the storm of devaluation and debt overload (much of which has been caused by the private sector).[16] Working out the costs of financial crisis is not of course a simple proposition, but on whatever grounds one chooses (commercial, economic, political, social) it is clear that the crisis-countries have borne the lion's share of the burden. To now turn around and require of them painful reforms to right their banking systems, reduce fiscal expenditure and balance budgets is in effect to ask them to pay twice for their mistakes: once for the crisis and once again to ensure it is not repeated. Paul Krugman is surely correct to assert that this is a return to the type of Depression-era economics that would be refused point blank in the industrialised economies of the world.[17]

Beyond this is the simple fact that, as a recent independent Council on Foreign Relations task force understood, it is the emerging market economies – i.e. the former periphery – which are being asked to pay for the cost of reform. It is they who must join

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[15] Stephen Gill, The Geopolitics of the Asian Crisis , *Monthly Review* , Vol. 50, no. 10 (March 1999): 1-10. See also Robert Wade and Frank Veneroso, The East Asian Crisis and the Wall Street-IMF Complex , *New Left Review*, no. 228 (1998): 3-22; and Robert Wade and Frank Veneroso, The Great World Slump and the Battle Over Capital Controls , *New Left Review*, no. 231 (1998): 13-42.

[16] Blinder, Eight Steps to a New Financial Order , p. 50-52; Goldstein, *The Asian Financial Crisis*, ch. 2; Wendy Dobson, Fallout from the global financial crisis , *International Journal*, Vol. LIV, no. 3 (1999): 376; and more generally Richard Higgott and Nicola Phillips, Challenging triumphalism and convergence: the limits of global liberalization in Asia and Latin America , *Review of International Studies* , Vol. 26, no. 3 (2000).

[17] Paul Krugman, *The Return of Depression Economics* (London: Allen Lane, 1999).

the “Good Housekeeping Club” and meet its criteria of so-called ‘best practice’.[18] But how to get at least the ‘systemically significant’ emerging market economies to join up? This is where the core-periphery question re-emerges after a long hiatus, because it is now recognised 1) that emerging markets are systemically significant; and 2) that they must be enticed to join the ‘Good Housekeeping Club’.[19] They can no longer be written off as unimportant parts of the global financial system, suitable only for the benefit of the centre. The periphery now represents a cost to the centre, and a more equitable sharing of this cost requires a more equitable sharing of the benefits. Adapting the international financial architecture to this new equation means in principle being open to recasting the existing distribution of costs and benefits between core and periphery. Perhaps not today or even tomorrow, but certainly over the medium term.

The second question which the search for appropriate mechanisms of inclusion has reopened is striking a more acceptable balance between public responsibility and private gain. This question, which for many has been resolved over the past three decades in favour of the socialisation of the costs of meeting financial crises and the privatisation of the benefits of unfettered capital mobility, has resurfaced within the context of how to bail in the private sector to share the burden of adjustment. While these discussions have largely been carried out in highly technical terms, they connect to the question of attenuating the core-periphery divide precisely because the public/private balance is far more precarious and contested in emerging markets. Consider simply the question of regulating financial institutions. In developed or what many now call ‘mature’ financial systems such as in the US and UK, regulation is in fact exercised largely through the market, by ensuring that risk management systems are robust, information provision is transparent and legal systems are independent and able to enforce contracts. In other words the imprint of the state is considerably lightened because the economic infrastructure permits the state to work through the market. Contrast this situation with that of most emerging market economies, where risk management systems are antiquated if they exist at all, information is a private rather than a public good (and clearly not transparent and available to all in a timely and useful manner), and independent legal systems are a future objective to work towards rather than an established fact of life.[20] The state looms larger in the economic fabric of emerging markets simply because their under-developed economic infrastructure demands it.

Opening up the international financial architecture to even a more limited participation of formerly peripheral countries will inevitably reopen the debate over the appropriate balance between public responsibility and private gain. This will not, however, be a straightforward conflict, since it will occur most often within the context of highly technical issues. Nevertheless, this political agenda will slowly assert itself. Consider once again the question of regulation. Across the G-7 countries, banking regulation, despite the variation in financial systems, is largely carried out with an eye to establishing sound prudential practices for the largest internationally-active firms (which theoretically should encourage smaller firms to adopt these ‘best practices’). In each G-7 country this amounts to scrutinising at most a handful of firms which are often concentrated within one major financial centre. Compare this to Brazil, India or South Africa, where the major banks are scattered around the country. The main point here is

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[18] *Safeguarding Prosperity*, pp. 93-97.

[19] The case of Thailand was crucial in prompting the acceptance of this stark fact, as no one in mid-1997 would have believed that the devaluation of the baht could set off a chain reaction engulfing much of east Asia and drawing in the G-7 countries.

[20] Hong Kong, Singapore and Australia are significant exceptions to this generalisation, which helps in part to explain their resistance to the worst effects of the Asian financial crisis.

that a public/private balance which is contested albeit acceptable for countries at one stage of development may be entirely inappropriate for countries at different stages of development. How this disjuncture works itself out will constitute one part of the new political agenda of reform.

We can see the new political agenda at work most clearly in the attempt to construct viable international standards to be used as benchmarks to guide international financial transactions. These standards address activities such as supervising banks, making budgets, managing public debt, and releasing public information in a timely and useful manner.[21] Most of this work is being done by international bodies in which the actual role of non-G-7 countries is growing. In the FSF, for example, emerging markets like Singapore, Hong Kong and Australia are now included as formal members, and the *ad hoc* technical committees struck by the Forum for specific purposes include a broader cross-section of emerging market economies.[22] For all of these standards, in whatever fora they are being developed, the same question is being faced: how to construct standards that are appropriate for all so that all can work towards achieving them.

The growing role of international standards as part of the governance structure of the global financial system, I argue, will over time increase the salience of 'inclusion'. Standards only work if they are accepted and internalised on the part of those at which they are targeted. They are accepted to the extent to which governments can actually contribute to their construction, and they are internalised to the extent to which governments feel that they 'own' them. It is in this sense that the political agenda of inclusion will ultimately provide formerly excluded countries with a genuine stake in the governance structure of the global financial system: it is their Trojan horse. The G-7 countries, which at the moment have an undeniably large influence in configuring international financial issues, have been forced to admit emerging market economies into the international financial architecture precisely because it cannot function effectively without them. From this point forward international decision-making will involve these economies; or to put it more bluntly, international decision-making will not be able to be exercised without them. This does not mean that the enormous international leverage of the G-7 countries, and especially the United States, will cease to operate. Rather, it is to acknowledge that the decision-making structure itself has changed. No longer is it a closed club whose rules are made only by insiders. Now it is a more open club in which the former outsiders have an actual say.

The politics of reform

The new political agenda will provide for a complex and inter-related politics of reform over the medium term. This will revolve around three axes: (1) the 'European' question; (2) the 'Malaysian' question; and (3) the 'overstretch' question. But before exploring these axes, it is worthwhile considering challenges to this argument. On one hand it might be argued that the reform effort has been almost entirely the preserve of the United States, or the G-1 as it is sometimes called. The argument here is that the governance structure of global finance has not changed dramatically if at all over the past decade. It is still controlled largely by the US, whose material and ideological resources have been fully deployed to usher in a brave new world of neo-liberal globalism, where

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[21] A compendium of these standards is now available on the FSF s website.

[22] Thus far five technical committees have been struck (and subsequently disbanded) to deliver reports on various aspects of international financial stability. Membership on these committees has ranged broadly in terms of emerging market representation. These committees and their reports are all available on the FSF website.

the US and its corporate elite maintain their unparalleled advantage.[23] A prime example of this continuing control would be the vetting process used by the G-7 to put together the membership of the G-20, which some might argue was used by the US to hand-pick the members of this new institution: why Indonesia and not Malaysia, they ask, or why Turkey and not Poland?

There is of course much truth in this view of recent changes in the international financial architecture, especially if one examines closely the rather imperial views of people such as Lawrence Summers, US Secretary of the Treasury during the final years of the Clinton Administration and a long-time participant in these developments. Nevertheless, what this view underplays is the shift in the fulcrum of governance today. Even though the pendulum may still be well within a neo-liberal arc, the focal point for the pendulum has shifted from a US-centred structure of governance to a wider and more genuinely international structure centred on a complex inter-meshing of states and international institutions. In short, those who are overly impressed by the ideological and material power of the US today are ignoring the way in which that power will be constrained by the emerging governance structure itself. In order to get its way the US will have to put up for negotiation the very kinds of standards it previously imposed on others by dint of it being at the epicentre of global financial governance. This is the key point to emphasise in the new architecture: it is wider and more inclusive than previously, even if at the moment American views predominate.

A second line of objection might focus on the extent of reform and argue that in its details it is more rhetoric than reality. For example, some might object to the view that the FSF is actually an inclusive institution. It has, after all, accepted only three permanent members from formerly excluded countries, one of which has been a member of the BIS for years.[24] More significantly, these critics might point to the work of the technical committees and note how similar many recommendations are to recent G-10 reports. Once again, although there is a grain of truth in these charges, they too can be faulted for underplaying the significance of creating new institutions over which the initiators will have an increasingly limited sway over time. In the case of the FSF, after less than a year of operation it has already expanded its membership from the original 35 to 39, and it has both created and dissolved technical committees (not an insignificant achievement considering how long-lived international committees are once established: consider just how long the so-called ‘Interim Committee’ of the IMF lasted). The point to emphasize here is not how the power and influence of the formerly excluded countries has been restricted under an exclusive structure of governance, but rather how their place and/or role will be open to adaptation under the new structure of governance.

What then are the axes of tension within this new structure of governance? The first axis of tension involves Europe. Specifically, with the creation of the European Central Bank (ECB) and the resulting ambiguity over who speaks for Europe on global financial issues, a vacuum has developed that temporarily provides the US with a wider latitude to shape the international financial agenda. Whereas previously the Deutsche Bundesbank provided both a global counterweight to the US Federal Reserve/Treasury combination and a focal point for European views on global finance, the arrival of the ECB has emasculated this role without providing in its place an institution of similar stature. This would be less of a political problem were it not for the genuine confusion

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[23] For example, see the arguments advanced concerning the consequences of the Asian financial crisis by Strange, *Mad Money*, and Gill, The Geopolitics of the Asian Crisis .

[24] Moreover, these three members plus a fourth (the Netherlands) might be considered second class members, as they are allowed only one member each whereas G-7 members have three.

surrounding the place of the ECB within the international financial architecture.[25] Not only is there ambiguity over Europe's voice within the architecture, therefore, there is continuing uncertainty about how this ambiguity will be resolved. The 'European' question will reverberate within the architecture for some time yet.

The second axis of tension may be labelled the 'Malaysian' problem. By this I do not mean how to contain Malaysia the country, but rather how to respond to Malaysia the example. Malaysia has taken a very different road in response to the Asian crisis, namely limiting the convertibility of its currency and severely restricting the role of international capital markets in the working of its economy.[26] In effect, Malaysia has challenged the general IMF prescription for Asia, and continues to hold out the prospect of pursuing a more 'traditional' Asian developmental trajectory. And while it is not without its darker political overtones, the example of Malaysia challenges the way in which capital account liberalization can be held out as a panacea to financial crisis and development. To this end it has already had a positive effect, in that Malaysia's so-called 'bad' example of how to respond to financial crisis has highlighted the much 'better' example of Chile, especially now that Chile has embarked on a sustained programme of democratization. In other words the 'Malaysian question' has already helped to shift the consensus view on the merits of unfettered capital mobility. Read as a proxy for the ambiguous benefits of capital mobility, the 'Malaysian' question will continue to exercise the international financial architecture into the medium term.

Finally, the 'overstretch' question is a problem for the structure of governance in two respects. First, there is the amazing profusion of international committees that has emerged in response to the past decade of financial instability. Figure 1 gives a hint of the plethora of committees, but no more than that. Each of the institutions named on it, for example, has a further set of sub-committees which meet regularly and have their own specific mandates. Equally, this figure ignores (for the sake of simplicity) both the existence of other world organizations with an interest in financial governance, and the myriad of regional organizations also involved. The WTO, for example, has an interest in the provision of financial services, while the ILO has an interest in the provision of pensions. South America has a central banker's association, as does Central America and Asia. The Inter-American Development Bank has an interest, as does the European Bank for Reconstruction and Development. All of these institutions have a stake in the development of international standards, and all are consulted on some level at some point in the process. To keep this road show on the go is no mean feat.

At the same time, the actual number of people involved in all of these various committees and institutions is less than meets the eye. It is the case that at the moment this structure of governance is top-heavy with G-7 participation. Yet, even with the comparatively lavish resources of the G-7, the number of people involved in architectural issues from all of the finance ministries and central banks and regulatory agencies of these countries would perhaps scarcely top two hundred.[27] International institutions fare

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[25] For considerations of this problem see C. Randall Henning, US-EU Relations after Inception of the Monetary Union: cooperation or rivalry? in C. Randall Henning and Pier Carlo Padoan, *Transatlantic Perspectives on the Euro* (Washington: Brookings Institution Press, 2000), and Randall D. Germain, The European Central Bank and the Problem of Authority , in Michael Williams and Morten Kelstrup, eds., *International Relations Theory and European Union* (London, Routledge, forthcoming 2000).

[26] Helen Nesadurai, In defence of national economic autonomy? Malaysia s response to the financial crisis , *Pacific Review*, Vol. 13, no. 1 (2000): 73-113.

[27] This rough calculation is made by multiplying the average number of people involved in international issues per relevant agency by the number of G-7 countries. At about 5 or 6 people per agency and three

no better. The BIS, for example, may employ about 400 people in total, but fewer than perhaps 75 concern themselves with international matters more generally, and even fewer with architectural questions. And by international standards the BIS is awash in knowledgeable people. Such limited numbers of people is precisely how they come to know each other so well: they meet on a regular basis at different spots around the world, and as a result come to rely on each other for information, support and ultimately trust.

But this intimacy can be stretched only so far, for there are rarely more than a half dozen people in any one institution (outside of organizations like the BIS, IMF and World Bank) who are responsible for international affairs. It may seem an odd point to make, but in today's cosmopolitan and global age, most people in most governments are concerned primarily with the home front.[28] As a result, there is a serious question of overstretch and under-resourcing. Governance structures cannot run efficiently on peanuts, and the extent to which they are forced to do so means that crisis prevention and architectural strengthening will often take a back seat to other more pressing problems. And as serious as this problem is within the G-7, it is far worse in the emerging market economies, which can only constrain their initial participation in the new structure of governance.

All of these questions come together when we consider the construction of international standards in light of the political agenda of 'inclusion'. Relying on international standards as benchmarks for undertaking and regulating international financial transactions is attractive precisely because it provides both a level playing field for private sector participants and guideposts for what regulators should be doing. Theoretically it should be as attractive to the US as Mexico, to Hong Kong as well as Indonesia. Practically, however, there are pitfalls. One pitfall concerns how the standards are actually put together. What is the level of input from those countries outside of the G-7 which do not have as highly developed an infrastructure (social, economic, political) as the G-7 countries? The reports by the three working groups struck by the G-22 at their April 1998 meeting, and delivered in October 1998, are encouraging on this front.[29] Each was co-chaired by a member of the G-7 and a member of what was to become the G-20. Beyond that, the composition of the working groups was split roughly evenly between non-G-7 membership and G-7/G-10 membership. This pattern was broadly replicated within the technical committees which reported recently to the FSF. This is one example of the new structure of governance at work, and a strong indication that as these standards are being constructed they will in fact be better 'owned' by emerging market economies than in the past.

At the same time, these standards must be implemented if they are to work as they are meant to, and here the widely varying levels of resources available to different governments has a bearing in terms of how far governments in emerging market economies can actually commit themselves to realising these standards. This reality also has a bearing on the amount of time and effort the individuals in these ministries, central banks and regulators can devote to convincing their political masters of the need for and legitimacy of these standards. Prudential regulation may be a plausible argument to a

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agencies per G-7 country, we arrive at a total of about 125 people directly involved in these issues, plus another 60 or 70 scattered throughout associated agencies in the G-7 area.

[28] For example, the secretariats of both the FSF and the G-20 comprise no more than a few individuals who oversee and coordinate the work of a thinly stretched and far-flung group of people.

[29] These were the working groups on Transparency and Accountability , Strengthening Financial Systems and International Financial Crises . The reports are available from the websites of the BIS, IMF, OECD and World Bank.

central banker or regulator in São Paulo, or Pretoria or New Deli, but the implications of ensuring that banks are run along western lines will certainly mean less money for development and other government spending in these countries. This is where the G-20 must work towards legitimating a certain amount of flexibility in reaching these standards. One of the key roles of the G-20 lies in providing a forum in which emerging markets can take their case for economic and social differentiation within the global financial system, or in other words for a variegated balance between public responsibility and private gain rather than a single global standard. All financial systems require benchmarks, it is true, but how these benchmarks are interpreted and achieved depends to a great extent on local or national contexts. Continued ownership of these benchmarks will be a matter of ongoing negotiation and compromise.

The final way in which the construction of international standards reflects the problems of the new political agenda of inclusion lies in the way in which progress towards achieving these standards will be judged. At the moment, judgement – such as it is – appears to lie with the IMF, which has thus far carried out a number of experimental country audits on the observance of those standards and codes which are clearly within the remit of the IMF.[30] These audits are expensive, complex and technical affairs with much scope for mishandling information and/or misinterpreting the significance of data. They are also at the moment run to a template which does not distinguish particular country circumstances, even though the IMF assessment teams rely on the countries themselves to provide much of the required information. Designed as learning exercises, they have indeed provided much food for thought to the IMF.

Nevertheless, the critical question here is who should be judging and how should this take place. It is not at all clear that the judges should come from a single international institution, although it does seem appropriate that the people carrying out these assessments should not come from national governments. And neither is it clear that penalties should be attached to non-achievement of standards, as for example was advocated recently by the independent Council on Foreign Relations task force on the international financial architecture.[31] Penalties compromise ownership, and they do so more completely if it is the centre (read here as IMF) which is in charge of imposing the penalties. It cannot be overemphasised that international standards require constant negotiation if their legitimacy is to be maintained over time, and rendering judgements is a potential flashpoint in that process.

Conclusion: the 'technical' as 'political'

Mobilizing thousands of people to face a phalanx of armed police officers defending massive concrete and marble bunkers in the world's putative capital city requires enormous levels of energy and enthusiasm coupled with a sense that something is not right in the world. No less an effort has moved those involved in reforming the international financial architecture. Over the past three years, they have addressed a complex set of inter-related issues without the benefit of a centralized authority structure and under the shadow of unpredictable financial turbulence. And in the process they have embarked on the most radical overhaul of the structure of global financial governance since 1945.

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[30] Versions of these are available on the IMF website under the subtitle Standards and Codes .

[31] The taskforce argued that access to IMF resources should be tied more tightly to achieving these international standards. *Safeguarding Prosperity*, pp. 93-97.

What makes this development so remarkable is that it began as a technical exercise in fine-tuning the rules of the game: strengthening international financial regulation; offering more support for international adjustment; putting in place clearer rules for the dissemination of information. Along the way, however, it became clear that technical adjustments, no matter how intrinsic to sound and prudential finance, could not carry the day. Questions of accountability, legitimacy and rule-making took their place alongside questions of transparency, standards and codes. International politics and international economics once again became visibly entwined, and indeed inseparable. The end product is a new political agenda.

In order for this new political agenda to bear fruit, however, it needs to be nourished. The best way to do this is to acknowledge more explicitly that the political dimension of reform lies at the heart of the debate. Just as with the debate over European monetary union, it is the political dynamics which will make or break the reform effort, and not the achievement of specific economic indicators or internationally-recognised standards.[32] If the G-20, FSF and IMFC work as envisioned and enable a genuine sense of legitimacy, accountability and due process to emerge within the international financial architecture, tremendous progress will be possible in the fight against financial crisis and instability. Achieving a genuine sense of legitimacy, accountability and process will do far more to facilitate the achievement of stability than another homily on the need for adequate information to be published in a timely and useful manner. This is not to deny the utility of transparency and any one of the hundreds of other technical details necessary to the smooth operation of the global financial system. They are important, and crucially so. But it is a reminder that we must get the big political questions right before the technical details can have their effect. We must know more about the political prerequisites of good governance before the reform debate can deliver on its promise.

Developing the political dimension of the reform debate, I believe, will make it clear just how far we have already come. Rather than seeing the capitalist or American devil lurking behind the current round of initiatives, I have argued that a significant turn has been made in our understanding of what constitutes good governance in global finance. It consists in inclusive decision-making structures which provide mechanisms not only for the creation of international standards and processes, but which also allow a certain flexibility in how those standards are interpreted so that emerging market economies can work towards them without being unduly penalised. This means most importantly recognising the different balances between public responsibility and private gain that will need to be struck across economies with different needs and developmental trajectories. It also consists in a decision-making structure which can begin to address the distributional distortions consequent upon the existing core-periphery divide within the global financial system. These distortions will not be attenuated overnight, but in order to bring emerging market economies on board there must be a sense that these issues are open to negotiation. This key insight is what makes the recent turn in the international financial architecture towards a more inclusive model of global financial governance such an important development. And only by more explicitly considering the new political agenda can we strengthen this turn and thereby help to make the global financial system safer for all.

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[32] For an argument along these lines, see Randall D. Germain, In Search of Political Economy: European monetary union , *Review of International Political Economy*, Vol. 6, no. 3 (1999): 390-98.