

**PICKING UP (AND REARRANGING) THE PIECES:  
THE POLITICS OF GLOBAL FINANCIAL GOVERNANCE IN THE WAKE OF THE GREAT RECESSION**

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An updated version will be published in *Governance Challenges and Innovations: Financial and Fiscal Governance*, The Hertie School of Governance (ed.). Oxford: Oxford University Press in 2013.

**ABSTRACT**

The Great Recession has triggered a wave of new proposals calling for reform of the rules and institutions of global financial governance, including the International Monetary Fund (IMF), the Group of Twenty (G-20), and the Financial Stability Board (FSB). To date, however, actual progress on reform has been quite modest. Moreover, the broad consensus on the need for reform among G-20 governments at the April 2009 London summit has given way to stark divisions over the scope, substance, and speed of further policy changes. What explains this relative lack of successful international cooperation in the wake of the global financial crisis? I argue that reform presents policymakers with a set of difficult tradeoffs, and that choices over these tradeoffs are determined primarily by political rather than economic factors. Consequently, the variables emphasized by IPE scholars – including power, ideas, collective action, problems of bargaining and enforcement, and domestic politics – are the most critical factors shaping the evolution of global financial governance. Unfortunately, this point has been largely overlooked in the current policy debate, which has been dominated by academic and policymaking economists. Thus, there is an urgent need for IPE scholars to engage more actively in the reform debate. At the same time, the crisis also highlights several new research questions on the political economy of global financial governance that scholars should pursue in the years ahead.

Keywords: global financial governance, international financial institutions, International Monetary Fund, Group of 20, international cooperation, financial crises

## **Introduction**

The Great Recession has triggered renewed interest in reforming the rules and institutions of global financial governance. As starkly illustrated by the calamitous events of the last three years, financial globalization has been accompanied by a corresponding increase in the frequency, severity, and global scale of financial crises (Bordo et. al. 2001, Reinhart and Rogoff 2009). Indeed, it has become the norm, rather than the exception, for financial distress in one country to transform rapidly into broader regional and global financial instability. In the current crisis, for example, the collapse of cross-border interbank lending in 2007--8, primarily as a result of the subprime mortgage crisis in the US, led directly and rapidly to the failure of Northern Rock (the eighth-largest bank in the UK) and the dramatic collapse of Iceland's economy. The sharp decline in international trade in 2008--9, along with the subsequent spread of financial instability to Eastern Europe, Greece, and Ireland, further underscores the severe negative externalities of international financial integration.

In light of these developments, it has become clear that the existing rules and institutions of global financial governance – what has come to be known as the “international financial architecture” (Rubin 1998) – are in urgent need of reform. Broadly, this architecture consists of three key pillars: 1) the informal “steering committee” of major economic powers, embodied for the last three decades by the G-7 summits but now supplanted by the Group of Twenty (G-20); 2) the main formal international financial institutions (IFIs): the International Monetary Fund (IMF) and the World Bank; and 3) the less visible but critically important global committees of financial regulators and central bankers, such as the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB), most of which are headquartered at the Bank for International Settlements (BIS) in Basel, Switzerland.

As with previous global financial crises, scholars and policymakers have responded to the Great Recession with a wave of new proposals calling for far-reaching reform of the international financial architecture. To date, however, actual progress on reform has been quite modest. Moreover, the momentum for change now appears to have stalled, and sharp divisions have emerged among the world's leading economic powers over the extent, type, and timing of further reforms. This is most clearly

evident within the eurozone – where internal tensions between surplus and deficit countries have raised serious questions about the long-term sustainability of the single currency – and in the ongoing tensions between the US and China over global imbalances and the undervaluation of the renminbi.

What explains this relative lack of progress on reforming the rules and institutions of global financial governance? In this article, I argue that reform presents policymakers with a set of difficult tradeoffs, and that choices over these tradeoffs are determined primarily by political rather than economic factors. Consequently, IPE scholars are uniquely situated to analyze and explain the causes and consequences of governance reform in global finance. In fact, the variables emphasized by IPE scholars as key determinants of variation in international economic cooperation – including power, ideas, collective action, problems of bargaining and enforcement, and domestic politics – are perhaps the most critical factors shaping policy responses to the Great Recession. Unfortunately, this point has been almost completely overlooked in the current reform debate, which has (as in previous crises) been dominated by economists. This was starkly illustrated last month, when an entire IMF conference on the policy lessons of the global crisis failed to mention any of these key political factors, let alone to invite any scholars with expertise in IPE.<sup>1</sup> Unless greater attention is paid to how these variables shape international economic cooperation, further reform is unlikely to occur, let alone to be effective in restoring and maintaining global financial stability.

The remainder of the paper proceeds as follows. First, I discuss the fundamental “governance problem” of international finance – namely, that markets are global and rapidly evolving, while the rules and institutions remain primarily national and have not kept pace with economic and geopolitical changes to the system. Second, I discuss three key tradeoffs confronting governments as they choose from a menu of possible policy responses to the Great Recession. These tradeoffs highlight the political tensions that pose the most serious barriers to effective and coordinated global responses to the Great Recession. With these tradeoffs in mind, I then consider the progress and prospects for reform of each of the three

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<sup>1</sup> Macro and Growth Policies in the Wake of the Crisis, Washington DC, March 7-8, 2011 (<http://www.imf.org/external/np/seminars/eng/2011/res/index.htm>).

aforementioned pillars of global financial governance. Finally, I conclude with some thoughts on particular research questions that IPE scholars might pursue in order to deepen our understanding of the politics of global financial governance in the years ahead.

### **The governance problem in international finance**

Given the severity, duration, and geographic reach of the Great Recession, one hardly needs to look far for reasons to justify pursuing reform of the international financial architecture. Nonetheless, it is useful to begin any discussion of the politics of global financial governance by acknowledging the fundamental governance problem of international finance. On the one hand, financial markets and crises are now global and changing rapidly. Indeed, as evidenced by the multiplicity of newfangled financial instruments (e.g., collateralized debt obligations, credit default swaps, structured investment vehicles) with which we are all now familiar, global financial markets continue to evolve and become more complex. On the other hand, the rules and institutions governing international markets have not kept pace with these rapid and substantial changes. Although the IMF has returned to prominence and is once again playing a central role in the world economy, we still lack a true international lender of last resort (LOLR) in the global financial system.<sup>2</sup> Likewise, we are now entering our fifth decade of the “post-Bretton Woods era” without a formal international monetary system, with individual countries and regions instead choosing a wide variety of exchange rate regimes ranging from free floating to monetary union. In addition, despite the emergence of the BIS-based regulatory institutions and the recent negotiation of “Basel III,” financial regulation and supervision remains almost exclusively the domain of national authorities. Finally, power and representation within the key IFIs is increasingly outmoded, given the rising clout of China, India, Brazil, and other emerging market countries in the world economy.

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<sup>2</sup> Strictly speaking, the IMF is not a true lender of last resort (LOLR), as it cannot issue its own currency and its loans do not meet Walter Bagehot’s (1873) classic criteria. Nonetheless, the IMF is the closest substitute to a LOLR in the current world economy, and its lending programs serve much the same purpose for sovereign borrowers as crisis lending by a national central bank does for distressed private financial institutions (Kenen 2001).

In short, the existing pieces of global financial governance are incomplete, outdated, and not well suited to addressing the fundamental problems facing the world economy in the wake of the Great Recession. At the same time, unilateral/national policies are unlikely to be successful and raise the specter of the sort of “beggar thy neighbor” policies that ultimately undermined the global economy in the interwar period. Thus, there is a strong case for reforming, extending, and redesigning the international financial architecture. As the Great Recession entered its darkest hours in 2009, policymakers appeared to recognize the urgency of finding solutions to this fundamental governance problem in the global economy. At its April 2009 summit in London, the G-20 reached broad agreement on a three-pronged reform agenda that would address the most pressing problems in global finance. These included: 1) coordinating national fiscal, monetary, and trade policies in order to accelerate a global economic recovery; 2) strengthening supervision and regulation of financial institutions at both the domestic and international levels; and 3) reforming the resources, lending policies and governance of the IFIs.<sup>3</sup>

However, as evident from the stark tensions at the November 2010 G-20 summit in Seoul, countries’ general agreement on the need for more effective global financial governance has not been matched by consensus on the specific policies to be adopted in practice. For example, the need for macroeconomic policy coordination so enthusiastically embraced in London has given way to fears of “currency wars” between the world’s major economies and the resurgence of protectionist policies aimed at stimulating domestic demand at the expense of international stability.<sup>4</sup> Likewise, as illustrated by the acrimonious debate in the United States over the Dodd-Frank bill and international tensions over the design of Basel III, widespread consensus on the need for stronger international financial regulation has yielded to sharp debates over the specific content of such regulations (e.g., over appropriate capital adequacy regulations and whether hedge funds should be regulated globally), as well as tensions over which international institutions, if any, should be delegated authority to design, implement, and enforce

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<sup>3</sup> “Global Plan for Recovery and Reform: The Communiqué from the London Summit” (<http://www.londonsummit.gov.uk/en/summit-aims/summit-communicue/>).

<sup>4</sup> See, for example, Arvind Subramanian, “American Cannot Win the Currency Wars Alone,” *Financial Times*, October 20, 2010; and Martin Wolf, “How to Fight Currency Wars with Stubborn China,” *Financial Times*, October 5, 2010.

such new rules. Finally, even in the area of IFI reform, tensions are rising over the allocation of votes and seats within the IMF Executive Board and the process for appointing future leaders of the Fund and World Bank. In sum, despite general agreement on the need to reform global financial governance, the world's economic powers remain far apart on the specifics of such changes.

### **Difficult tradeoffs: The politics of global financial governance**

If there is widespread consensus on the broad reform agenda in global financial governance, why is cooperation so difficult and elusive? The answer is that reform presents international policymakers and national leaders with a set of difficult tradeoffs. I will focus here on the three most salient: 1) liquidity vs. moral hazard, which confronts the IMF and other actors when lending to countries hit by financial crises; 2) accountability/legitimacy vs. effectiveness, which underpins many debates about delegating authority and resources to the IFIs; and 3) domestic politics vs. international commitments, which in many ways encompasses the two previous tradeoffs and is perhaps the most critical factor shaping current debates and tensions over the scope, speed, and substance of reform.

#### *Liquidity vs. moral hazard*

The tradeoff between liquidity and moral hazard sits at the heart of debates about how much the IMF (or other institutions, such as the EU, in the case of Greece and Ireland) should lend to countries experiencing financial crises. This tradeoff arises since any “bailout” package has two simultaneous and inextricable effects. On the one hand, crisis lending directly benefits a country by providing it with the financing (liquidity) needed to service its debts. Indirectly, it may also enhance global financial stability by preventing a crisis in one country from becoming a larger systemic problem. On the other hand, IMF-led rescues also create moral hazard – incentives for borrowers and lenders to assume additional risk in

the expectation of future bailouts (Crockett 1997).<sup>5</sup> This tradeoff presents the IMF and its co-lenders with a difficult choice: lend freely (large amounts on lenient terms) at the risk of increasing future demand for such bailouts, or limit current lending (smaller loans with more extensive conditionality) at the risk of having a country default and triggering a broader financial crisis.

From a purely economic perspective, choices over this tradeoff depend on whether a borrower is insolvent or illiquid – that is, whether the country is effectively bankrupt due to bad economic policies, or whether it faces a temporary liquidity problem caused by an unforeseen macroeconomic shock or a “financial panic” (Chang 1999). In this view, deciding the size and terms of “bailouts” is a largely technocratic exercise: Fund economists design loans based on country-specific macroeconomic indicators that determine a borrower’s financing needs and the amount of policy adjustment necessary to ensure its long-term debt sustainability. To be sure, macroeconomic factors play a large role in IMF decision-making: past studies have found that loans are larger and contain more conditions when a country has fewer foreign exchange reserves, higher levels of external debt, and a record of past Fund borrowing (Knight and Santaella 1997; Bird and Rowland 2003). Nonetheless, the empirical record of this technocratic view of IMF lending is mixed: many key macroeconomic variables have weak or indeterminate effects on IMF lending (Joyce 2004).

More importantly, a well-developed literature in IPE has made clear that political factors also heavily influence the Fund’s choice over the liquidity/moral hazard tradeoff. In general, this literature offers two competing explanations of Fund behavior. On the one hand, many scholars argue that the IMF is the servant of the United States, which utilizes its position as the Fund’s largest shareholder to direct credit toward countries it deems economically or geopolitically important (Thacker 1999, Stone 2002/4/8, Oatley and Yackee 2004, Barro and Lee 2005, Vreeland 2005, Broz and Hawes 2006, Dreher and Jensen 2007). On the other hand, scholars in the public choice tradition argue that bureaucratic politics, rather than powerful states’ interests, is the key political factor in IMF lending (Vaubel 1991, Willett 2002,

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<sup>5</sup> The classic example of moral hazard is in insurance, where insurers assume two types of risk: the “real hazard” (for example, auto accident/theft) and the “moral hazard” arising from risky actions an individual may take once he is insured (for example, more reckless driving/not locking one’s home).

Dreher and Vaubel 2004). Drawing on principal-agent theory, studies in this vein have found that IMF lending behavior is influenced by the Fund staff's bureaucratic incentives to engage in "rent-seeking" and/or to exploit "agency slack" in order to maximize its autonomy, budget, or the likelihood of program success.<sup>6</sup> Other scholars have argued that culture and ideas within the IMF bureaucracy have also driven key changes in Fund lending policy over time (Barnett and Finnemore 2004, Weaver 2008, Chwieroth 2009). Most recently, Copelovitch (2010) has argued that the relative influence of both powerful states and Fund bureaucrats varies over time and across cases, based on the intensity and heterogeneity of national economic interests among the IMF's key shareholders, as well as the composition of private international capital flows to developing countries.

As this literature highlights, choices over the liquidity/moral hazard tradeoff at the heart of IMF-led crisis lending are as much about politics as economics. This fact has only been reinforced by the Fund's lending behavior during the Great Recession: it has provided generous financing and terms to several countries (Latvia, Greece, Iceland) with strong economic and geopolitical ties to the US and EU member-states that enjoy substantial influence within the Executive Board. As illustrated by the current tensions over the terms of Ireland's bailout, however, even these powerful states may disagree over the terms of a Fund rescue package, and these disagreements are often driven more by domestic politics than by real disagreements over the borrower country's economic or financial need.

#### *Accountability/legitimacy vs. effectiveness*

A second critical tradeoff confronting policymakers weighing global responses to the Great Recession is the tension between accountability/legitimacy and effectiveness. This tradeoff is strongly intertwined with debates about national sovereignty and the domestic political costs associated with delegating authority and resources to the IFIs. The underlying issue here is that the most effective institutions of global financial governance – in terms of maintaining financial stability or managing and

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<sup>6</sup> The "rents" accruing to the staff in this approach are defined broadly to include all of these factors; strictly speaking, staff members do not receive personal financial gains from more extensive IMF lending or conditionality.



resolving crises – are quite likely to be the least accountable from the standpoint of democratic legitimacy and state sovereignty. For example, a “global financial regulator with real teeth,” as Kenneth Rogoff has advocated, would probably be extremely effective in regulating and supervising international financial markets and minimizing cross-border regulatory arbitrage by globally active banks.<sup>7</sup> Similarly, creating a WTO-style dispute settlement mechanism within the IMF to address questions of currency manipulation would also likely be very effective at resolving the global macroeconomic imbalances that have been a key contributing factor to the Great Recession.

However, creating such powerful new international organizations (IOs), or delegating further authority to existing ones, presents a direct challenge to national sovereignty and democratic accountability. This tension generally is visible most frequently in the US, where voters and policymakers are particularly concerned about delegating full authority over sensitive economic policy areas to supranational bureaucracies. Thus, despite renewed calls to create a World Financial Authority (along the lines of Eatwell and Taylor’s (2000) proposal that emerged in the aftermath of the Asian financial crisis) that would promulgate and enforce international financial regulations, such elaborate new governance institutions are unlikely to emerge in global finance in the near future. Indeed, as Barry Eichengreen has written, “it is unrealistic to imagine that the US and for that matter any country will turn over the conduct of national financial regulation to an international body” given that “regulation of financial markets is a valued national prerogative” (2009).

#### *Domestic politics vs. international commitments*

The final key tradeoff shaping the politics of global financial governance is the one most perhaps most familiar to IPE scholars – namely, the tradeoff governments face between domestic politics and international commitments when considering whether or not to coordinate macroeconomic policies. One can readily identify many recent and historical examples of this tension between the trade, monetary, and financial policies maximizing a government’s domestic political support and those most conducive to

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<sup>7</sup> Floyd Norris, “The Upside to Resisting Globalization,” *New York Times*, February 5, 2009.

international economic stability. Perhaps the most well-documented of these is the debate over adherence to the gold standard during the interwar era. As the Great Depression wore on during the interwar era, governments faced severe domestic pressure to engage in “beggar thy neighbor” policies – including competitive devaluations, capital controls, and protectionist trade policies – that directly contradicting their international monetary commitments to fixed exchange rates under the revived post-WWI gold standard (Eichengreen 1992, Simmons 1994, Frieden 2006).

In the current crisis, governments are wrestling with similar tensions. Calls for the use of trade protection have increased and a growing number of countries have begun to actively manipulate their exchange rates in order to alter the terms of trade and enhance domestic producers’ competitiveness in global markets. In Japan, the government recently intervened in foreign exchange markets for the first time since 2004, spending approximately \$20 billion in an effort to drive down the yen’s value from its 15-year highs against the dollar in order to bolster the country’s export competitiveness.<sup>8</sup> Other countries, including South Korea and Taiwan, have followed suit in their own efforts to enhance export competitiveness. European and American policymakers have decried these unilateral attempts at currency depreciation, and some observers spoke of the need for a new Plaza Accord to prevent competitive devaluations and address exchange rate imbalances through international coordination.<sup>9</sup> Even Brazil – whose Finance Minister, Guido Mantega, was the first to warn of an impending “currency war” in the global economy – has imposed capital controls and threatened direct intervention in order to suppress further appreciation of the real.<sup>10</sup>

Above all, this tension between domestic politics and international commitments is evident in the strident debate over China’s exchange rate policies. In the United States, an increasingly vocal chorus argues that China’s massive trade surplus with the US is due primarily to the Chinese government’s active intervention to prevent all but the slightest appreciation of the renminbi (RMB) against the US

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<sup>8</sup> Lindsay Whipp and Peter Garnham, “Tokyo Currency Move Surprises Markets,” *Financial Times*, 15 September 2010.

<sup>9</sup> Alan Beattie, “Steep Path to a Modern-day Plaza Accord,” *Financial Times*, 16 September 2010.

<sup>10</sup> Jonathan Weasley, “Brazil Raises Taxes on Foreign Inflows to 4%,” *Financial Times*, 4 October 2010.

dollar. Although economists differ on the precise degree to which the RMB is undervalued, most analysts estimate that it would appreciate by 20-25% if China were to allow it to float freely (Bergsten 2006).

At this point, few serious observers question whether China is manipulating its exchange rate. As Martin Wolf recently noted in the *Financial Times*, “If a decision to invest half a country’s gross domestic product in currency reserves is not exchange rate manipulation, what is?”<sup>11</sup> Rather, the focus has shifted toward the question of what the US government and the international community should do in response to China’s exchange rate policies. The Obama administration has found itself under increasing pressure from Congressional leaders to label China a “currency manipulator” and to impose retaliatory trade measures in order to offset China’s “predatory exchange rate policies.”<sup>12</sup> Some observers have suggested that the US should also contemplate the use of “countervailing currency intervention” – direct purchases of RMB to counter China’s purchases of dollars.<sup>13</sup> Others have argued that the US should pursue a case against China within the World Trade Organization (WTO), on the grounds that China’s exchange rate policies constitute an export subsidy and/or violates Article XV of the WTO Charter, which forbids countries from “frustrating the intent of the provisions of this Agreement by exchange rate action.”<sup>14</sup> Still others have proposed that the IMF adopt a WTO-style dispute settlement mechanism to address disputes over exchange rate policies.<sup>15</sup>

Whether or not any of these unilateral or international measures will prove effective remains an open question. What is clear, however, is that countries on both sides of the debate are wrestling with the tradeoff between domestic politics and international commitments. As Chinese policymakers readily admit, China’s exchange rate policy is driven primarily by concerns about maintaining economic growth and employment at home and protecting the competitiveness of Chinese exporters in the face of rising

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<sup>11</sup> Martin Wolf, “How to Fight Currency Wars with Stubborn China,” *Financial Times*, October 5, 2010.

<sup>12</sup> Sewell Chan, “Geithner to Signal Tougher Stance on China Currency,” *New York Times*, 15 September 2010.

<sup>13</sup> Ibid. Estimates suggest that Chinese purchases of dollars now total ~\$1 billion per day in order to artificially increase demand for dollars (and decrease demand for RMB).

<sup>14</sup> On the legality and effectiveness of this, see Marc L. Busch and Philip I. Levy, “The Case Against a China Currency Case,” *The American*, October 7, 2010 (<http://www.american.com/archive/2010/october/the-case-against-a-china-currency-case>); and Joel P. Trachtman, “Yuan to Fight About It? The WTO Legality of China’s Exchange Rate Regime,” April 30, 2010 (<http://www.voxeu.org/index.php?q=node/4880>).

<sup>15</sup> Michael Waibel, “Retaliating Against Exchange-rate Manipulation Under WTO Rules,” April 16, 2010 <http://www.voxeu.org/index.php?q=node/4881>.

competition from other Southeast Asian economies. Equally clearly, US domestic concerns about job losses and economic stagnation at home have undoubtedly influenced American policymakers' more aggressive stance on the dollar-RMB exchange rate. At the same time, neither the US nor China has (yet) been willing to risk a full-blown "currency war." US Secretary of the Treasury Timothy Geithner has repeatedly delayed issuing a report that would formally label China as a "currency manipulator" and open the door to retaliatory US tariffs on Chinese imports.<sup>16</sup> Likewise, Chinese officials have yet to act substantially on their threat to shift the composition of their massive foreign exchange reserves away from dollars into other assets – a shift that would undoubtedly lead to a sharp drop in the dollar's value and potentially send shock waves through the international monetary system. Thus, both countries are seeking to balance domestic political interests against their international interests as the two largest economies in the world and key members of the G-20.

*Weighing tradeoffs: the primacy of politics*

How do policymakers weigh each of these tradeoffs, and how might these choices shape the future evolution of global financial governance? IPE scholars are ideally suited to answer these questions, since the most important answers emphasize the very political factors that are the bread and butter of modern political economy. Indeed, while economic factors such as macroeconomic imbalances, stocks and flows of international capital, and levels of growth and unemployment unquestionably play a key role in shaping national and global policy responses to financial crises, choices over the three tradeoffs outlined above are equally (if not more) influenced by five key political factors: 1) power and geopolitics; 2) collective action problems; 3) bargaining and enforcement problems; 4) domestic interests and institutions; and 5) norms, ideas, and ideology. In the following section, I provide a brief overview of the progress and prospects for the reform along each of the three "pillars" of global financial governance

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<sup>16</sup>Greg Stohr and Phil Mattingly, "Geithner Delays Currency Report, Urges Flexible Yuan for China, April 4, 2010 [http://www.bloomberg.com/apps/news?sid=azQRzn\\_a9eP8&pid=newsarchive](http://www.bloomberg.com/apps/news?sid=azQRzn_a9eP8&pid=newsarchive).

outlined earlier, with an emphasis on illustrating how these key political variables help us to grasp the key tradeoffs and tensions shaping this process.

### **Summits: from G-7 to G-20**

For three decades, the G-7 (Group of Seven) unofficially held the role of global economic “steering committee.” The group first met in France in 1975, to ratify the *de facto* move to floating exchange rates following the collapse of the Bretton Woods system, and it subsequently became the key forum in which finance ministers and chief executives of the leading economic powers met to discuss key issues. The G-7 – encompassing Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States – cooperated most effectively on monetary matters in the 1980s, via the Plaza and Louvre accords, which resulted in coordinated foreign exchange intervention to stem and reverse the dollar’s sharp appreciation in 1985, and to halt its depreciation in 1987. In recent years, however, it became clear that the G-7’s influence had diminished, due in large part to its members’ declining relative prominence in the global economy compared to the BRICs and other fast-growing emerging market countries (Table 1). Although Russia was admitted to an enlarged G-8 in 1997, the continued exclusion of the remaining BRICs (particularly China), as well as several other major economies (e.g., Australia, Saudi Arabia, Mexico, and Korea) rendered the G-8 increasingly illegitimate and ineffective.

[TABLE 1 HERE]

As the G-7 declined in importance, attention shifted to the G-20 as a potential replacement. The G-20 was established in the wake of the Asian financial crisis of 1997-99, as a finance-specific G-20 supplement to the G-7: the former would address issues concerning the global financial system, while the latter would remain the central forum for broader issues of security and international cooperation. Effectively, the G-20 expanded the “guest list” to include 12 major economies: Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa,

South Korea, and Turkey. In addition, the European Union (EU) gained a formal seat at the table, with both the member-state holding the European Council Presidency and the chief of the European Central Bank (ECB) represented. The heads of the IMF and World Bank (as well as the chairs of the Fund's International Monetary and Financial Committee and the Bank's Development Committee) also participated.

For most of the last decade, the G-20 confined its work to important but low-profile technical issues, such as increasing coordination in the fight against terrorist financing and tax evasion, and fostering the adoption of a variety of global financial regulatory standards. However, the current crisis marked a clear turning point for the group: at the 2009 London Summit, it became clear that the G-20 was now the world's preeminent forum for international economic cooperation. This transition was formally acknowledged in October 2009, when the G-7 decided to end its regular summits by 2011, thereafter meeting only on an informal, ad hoc basis as deemed necessary. As Alastair Darling, British Chancellor of the Exchequer, noted, "the main focus will be the G20 for some time to come."<sup>17</sup>

Although the elevation of the G-20 has given the major emerging market countries their long-desired seats at the table of global economic governance, it remains to be seen whether and how this matters at both the international and domestic levels. Internationally, the key question is whether the G-20 is really more than a "talking shop." To date, not much has been accomplished in concrete terms: aside from formally anointing itself as the G-7's replacement and agreeing to substantially augment the IMF's resources, the G-20 has not taken any major, substantive policy decisions. On one level, this is not particularly surprising: aside from the Plaza/Louvre accords, the G-7/8 rarely agreed or implemented major policy reforms, so the lack of G-20 initiatives was likely to be expected. On another level, however, the lack of progress by the G-20 bodes ill for its future relevance on key global financial matters. It remains to be seen, for example, whether the G-20 will work in normal (non-crisis) times, or whether it will remain primarily a figurehead organization,

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<sup>17</sup> Larry Elliott, "G7 elite group makes way for G20 and emerging nations," *The Guardian*, October 5, 2009, 27.

with key, substantive policy reforms being decided and implemented within the IMF, through the various BIS-oriented regulatory bodies, or perhaps by *ad hoc* cooperation between the US and China. Moreover, the lack of agreement on how to respond to the current crisis highlights the central and most worrying problem with the G-20: it is simply too big and diverse to be a forum in which major policy decisions are negotiated and agreed. This problem of large numbers and collective action is only likely to get worse, as additional countries push for seats at the enlarged table of global economic governance.<sup>18</sup> Going forward, therefore, we are quite likely to see sub-groups of the G-20 – whether in the form of the old G-7, or (more likely) a “G-2” or “G-4” consisting of some combination of the US, China, Japan, and the European Union – agreeing to new initiatives and then bringing them to the G-20 forum for *de facto* “ratification” and implementation.<sup>19</sup>

Nevertheless, the elevation of the G-20 does have a possible upside. If its members can overcome these collective action problems and reach agreement on a meaningful set of new initiatives to enhance global financial stability, these new policies will have substantially greater credibility around the world – particularly among developing countries. Simply put, it will no longer be the case that the US and its G-7 partners are dictating the rules of the global economy to the rest of the world. Rather, by virtue of the full participation of the leading emerging market countries, the G-20’s policies should enjoy greater legitimacy than those of its G-7 predecessor in the developing world. Of greater concern than *who* should participate in the G-20, then, is *what* the group should be doing. Aside from bolstering the IMF’s resources, a wide variety of issues have been placed on the G-20’s agenda, including: coordinating domestic macroeconomic stimulus packages, spearheading global regulatory initiatives, deciding on further IMF reform, and addressing broader issues such as climate change and the stalled Doha Round at the WTO. Which

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<sup>18</sup> We have seen this already: Spain and the Netherlands, which were initially excluded from the G-20, have been invited as *de facto* members to the summits in the last two years.

<sup>19</sup> There is substantial precedent for this. For example, the 1980s Basel Accord on capital adequacy for internationally-active commercial banks originated as a bilateral agreement between the US and the UK before it was officially agreed by the Basel Committee on Banking Supervision as a multilateral standard. See Singer 2007.

of these goals, if any, will become the key issue around which G-20 cooperation will coalesce in the near future remains very unclear.

### **The IMF: resources and governance**

While the rise of the G-20 has grabbed headlines, the revitalization of the IMF's fortunes has been the most important development in global financial governance in the wake of the Great Recession.<sup>20</sup> After a decade in which many forecast its imminent demise, the IMF has once again assumed its central role as the *de facto* lender of last resort in the global financial system. Over the last three years, the Fund's lending commitments have soared from less than \$2 billion in 2007, to nearly \$200 billion today, including the large bailouts of Greece, Hungary, Iceland, Ireland, and the Ukraine. This resurgence in IMF lending represents a sharp reversal from the start of the decade, when few countries borrowed from the Fund and many observers questioned the continued need for the IMF in an apparently stable global economy awash in private international capital flows. Yet while the crisis has rescued the IMF from near-irrelevance, the Fund still faces several serious challenges in the coming years. These fall, broadly, into two categories: resources and governance.

#### *Resources: ensuring the IMF has enough money*

Thus far, the main efforts at IMF reform in response to the current global financial crisis have addressed the question of resources. Simply put, the IMF does not have enough money to do its primary job of providing lender of last resort financing to countries experiencing financial crises. When the current crisis boiled over in September 2007, the IMF's lending capacity was roughly \$200 billion from regular quota resources and an additional \$50 billion from established borrowing arrangements with the advanced economies. Given the magnitude of private capital flows in today's global financial system,

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<sup>20</sup> There are also a variety of reform issues related to the World Bank. While critically important, these issues are more closely related to development rather than questions of global financial stability and crisis management. Consequently, I limit my focus here to the IMF. For excellent overviews of the issues related to World Bank reform, see Birdsall 2006 and Woods 2006.



this is woefully inadequate: global holdings of international debt securities now total \$20.7 *trillion*, while new debt issues in 2007 alone reached almost \$400 billion (IMF 2008, 146). Likewise, the Fund's quota resources relative to world trade have fallen by more than a factor of ten since its creation in 1944 (Buirar 2004). In short, the IMF's available resources are now dwarfed by the sheer magnitude of international trade and capital flows. Thus, the first major challenge confronting the Fund is the urgent need for more money.

For this reason, the G-20 countries' commitment to substantially increase the Fund's available resources has been the single most significant reform of global financial governance in the wake of the Great Recession. In February 2009, the Japanese government committed an additional \$100 billion to bolster the Fund's \$250 billion in lendable resources. Soon after, Dominique Strauss-Kahn, the IMF's Managing Director, announced plans to seek a doubling of the Fund's coffers to \$500 billion, a plan subsequently endorsed by the new US Treasury Secretary, Timothy Geithner. In March, the European Union (EU) responded with its own commitment to provide \$100 billion in resources to the Fund. At the G-20 summit in London in April 2009, these pledges were reinforced by a formal commitment on the part of G-20 governments to triple the Fund's resources to \$750 billion, through a mix of \$500 billion in loans and a one-time issuance of \$250 billion in Special Drawing Rights (SDRs), the IMF's notional currency.<sup>21</sup> Proposals are now on the table to formally index IMF quotas to the expansion of global trade and financial flows, so that the Fund's resources increase in line with the future growth of the world economy. Nevertheless, some economists estimate that the Fund would require an additional \$750 billion to \$1.75 trillion in order to be fully equipped to handle "a systemic emerging market crisis" in the coming years (Buitar 2008). Who will provide these resources – and how this will affect power and influence within the IMF – leads to the second major challenge facing the Fund: the need to reform its governance structures and decision-making rules.

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<sup>21</sup> Mark Landler and David E. Sanger, "World Leaders Pledge \$1.1 Trillion for Crisis," *New York Times*, April 2, 2009. The SDR, or Special Drawing Right, is the Fund's unit of account. Its value is derived from a basket of major international currencies. Currently (as of March 15, 2011), one SDR equals \$1.5739 (<http://www.imf.org>).

*Governance: reforming IMF voting and representation*

Although it deserves its fair share of blame for not addressing the underlying issues that caused the global economic crisis (e.g., the problem of global imbalances and the surge in capital inflows to Eastern Europe), The IMF has received generally high marks for its policy responses once the crisis began in full. In contrast to the vociferous criticism directed its way following the Asian financial crisis, the Fund has been praised by many knowledgeable observers for its effective role in stabilizing the faltering Eastern European economies in 2008--9, for adopting a strong, visible stance in favor of fiscal stimulus to counteract the global recession, and for its efforts to modify its lending programs to address longstanding complaints by borrowers countries about the stringency and excessiveness of IMF conditionality (Subramanian 2009). In spite of these policy successes, however, the IMF continues to suffer from basic governance anomalies that hamper its legitimacy and threaten to undermine its future effectiveness if not addressed in the coming years. How to address these issues and reform the rules and institutions of IMF governance is, like enhancing the Fund's resources, a pressing topic in the debate about how to reform the international financial architecture.

The core governance problem facing the IMF is the widely held belief that the Fund and its policies are biased toward the interests of the United States and the major European shareholder countries. This belief, as it turns out, is well grounded in reality. Since its creation in the 1944, the IMF's Managing Director (MD) – the Fund's CEO – has always, by convention, been a European national, just as the United States has always appointed the President of the World Bank. Second, the United States and other large shareholders – in particular, the “G-5” countries holding their own seats on the Fund's Executive Board (US, UK, Germany, France, Japan) – exercise disproportionate influence over IMF policies and lending decisions. Since member-states' voting power within the IMF Executive Board is directly proportional to their quota contributions to the Fund's general resources, the advanced industrialized countries' preferences carry the most weight in Fund decision-making. As the five largest shareholders, the “G-5” countries (United States, United Kingdom, Germany, Japan, France) are entitled to appoint their own Executive Directors, who hold a combined 38.4% of the votes, while Directors from

constituencies encompassing the G-7 (G-5 plus Canada and Italy) cast a combined 46.1% of EB votes, and those representing the G-10 (G-7 plus Belgium, the Netherlands, Sweden, and Switzerland) collectively cast nearly two-thirds (62.3%).<sup>22</sup>

Table 2 shows the current distribution of voting power within the EB. Since many of the Fund's non-lending decisions require EB super-majorities of 70-85%, this voting structure gives the advanced industrialized countries collective (or the United States, with 16.77% of the votes, unilateral) veto power over a wide range of Fund policies, including quota increases, the sale of IMF gold reserves, and amendments of the Articles of Agreement. This veto power does not extend to IMF lending decisions, however: formally, approval of an IMF loan requires the support of only a simple majority of EB votes, rather than a super-majority. Moreover, the Board's norm is to avoid formal votes on lending decisions whenever possible. Rather, lending decisions are made on a "consensus basis with respect given to the relative voting power of the states" (Mussa and Savastano 1999, Van Houtven 2002).

[TABLE 2 HERE]

Ultimately, these formal rules and informal decision-making norms give the IMF's largest shareholders *de facto* control over lending decisions. In fact, as Table 2 illustrates, the G-5 must garner the support of only three other rich country Directors assemble a Board majority and control IMF lending decisions.

Empirically, there is substantial evidence that these governing rules bias IMF lending policies in favor of countries with close economic or geopolitical ties to the US and its G-5 counterparts.<sup>23</sup> This fact is widely recognized by countries throughout the developing world, many of whom have become reluctant to seek IMF assistance as a result. In particular, the East Asian countries have complained loudly that conditionality imposed by the IMF during the Asian financial crisis was too onerous, and they

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<sup>22</sup> The Group of 10 comprises the 11 countries that participate in the major global financial regulatory institutions at the Bank for International Settlements and have made supplementary credit commitments to the IMF through the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB): <http://www.imf.org/external/np/exr/facts/gabnab.htm>.

<sup>23</sup> See \_\_\_\_\_ for both a review of the extensive empirical literature on the political economy of IMF lending, as well as a detailed argument about the extent of G-5 influence over time and across cases.

point to their lack of voice within the IMF's decision-making process as evidence that the Fund is really a "Euro-Atlantic" Monetary Fund, which treats countries backed by Brussels or Washington more leniently than other borrowers (Subramanian 2009). The IMF's recent "kid glove" handling of Latvia has only perpetuated this view.<sup>24</sup> As a result, governments throughout the developing world view the IMF as both ineffective and illegitimate, and many emerging market countries, including Korea, Taiwan, and India, have sought to "self-insure" themselves against future crises by building up large war chests of foreign reserves (Summers 2006).

For this reason, many observers have proposed changes to the Fund's internal decision-making rules, with a particular emphasis on increasing the voice of the largest emerging market economies. Although the details of these various reform proposals vary, all start from the standpoint that IMF lending is excessively influenced by political pressure from the United States and other large shareholders, with countries closely allied (either geopolitically or economically) to these states receiving more preferential treatment from the Fund. Therefore, the proponents of reform argue, changing the quota allocations and voting weights in the EB to give emerging market and developing countries a greater say in IMF decisions and would lead to more efficient and equitable policy outcomes. In short, advocates of governance reform see the redistribution of "chairs and shares" within the EB as a way to both democratize and de-politicize IMF decision-making, with a corresponding increase in the Fund's legitimacy and effectiveness (Truman 2006).

Recently, these governance reform proposals have led to concrete changes. The IMF's shareholders approved a modest redistribution of voting rights and quotas within the Fund in April 2008. Under the terms of these reforms, approximately five percent of IMF quotas (and therefore, EB votes) would be reallocated in order to increase developing countries' voice within Fund decision-making.<sup>25</sup>

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<sup>24</sup> The Fund allowed Latvia to avoid devaluing its currency in the face of a 24% current account deficit, presumably on the grounds that the Latvian government is actively seeking to join the eurozone in the near future. Such a policy would, quite likely, not be tolerated by the IMF when lending to a Latin American or Asian country facing similar financial and macroeconomic difficulties.

<sup>25</sup> For a detailed analysis of these reforms, see "Experts Critique Proposal for International Monetary Fund Quota Reform," Brookings Institution, April 9, 2008 ([http://www.brookings.edu/opinions/2008/0409\\_imf\\_linn.aspx](http://www.brookings.edu/opinions/2008/0409_imf_linn.aspx)).

The G-20 countries reaffirmed this shift in voting power at its Pittsburgh summit in September 2009. In August 2010, the United States pushed further for this reallocation of votes to be linked to a consolidation of the European countries' seats and a reduction in European EB voting shares.<sup>26</sup> In September, Germany responded with its own demand that the US give up its unilateral veto over those IMF decisions that require 85% supermajorities.<sup>27</sup> Subsequently, European Union finance ministers approved a proposal that would share two of Europe's current seats on the EB, on a rotating basis, with emerging market countries.<sup>28</sup> At the Seoul G-20 summit last November, leaders agreed on a more extensive proposal, including the doubling of IMF quotas, the reallocation of two European Board seats, and a shift of more than 6% of voting power toward under-represented countries.<sup>29</sup> As expected, the largest beneficiaries of this proposal would be the BRIC economies, all of which would now be among the IMF's ten largest shareholders (with China rising to third, with an increase from 3.72% of votes to 6.07%).

As geopolitical theater, this reform debate and process is certainly entertaining, at least for those of us who study international relations and IPE. Indeed, Alan Beattie of the *Financial Times* described the ongoing debate between the US and EU over IMF reform, with tongue only partially in cheek, as a "Tolstoyan familial saga" and a "Stieg Larsson race-against-time thriller."<sup>30</sup> The truly important question, however, is whether this reallocation of "chairs and shares" within the IMF Executive Board actually matters. In other words, will voting reform actually change the politics and policies of the Fund? Likewise, will reform – as most proponents argue – actually increase the voice of developing countries and enhance the Fund's legitimacy?

Unfortunately, the short answer to both questions, in my view, is "not really." So far, the reforms that have been either implemented or proposed are largely symbolic. They neither fundamentally alter the balance of power within the IMF nor change the basic politics of Fund lending, in which the US and a

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<sup>26</sup> Sewell Chan and David Jolly, "U.S. Pressures I.M.F. to Expand Role of Growing Economies," *New York Times*, September 9, 2010.

<sup>27</sup> Alan Beattie, "Germany Asks US to Give Up Its IMF Veto," *Financial Times*, September 14, 2010.

<sup>28</sup> "EU's Offer To Give Up IMF Board Seats Likely To Be Denied," <http://online.wsj.com/article/BT-CO-20101001-713754.html>.

<sup>29</sup> "G-20 Ministers Agree 'Historic' Reforms in IMF Governance," *IMF Survey*, October 23, 2010.

<sup>30</sup> Alan Beattie, "IMF Governance Turns Into a Giant Sudoku Puzzle," *Financial Times*, September 26, 2010.

small group of other advanced industrialized countries exercise *de facto* control over IMF lending decisions. Even if the Fund implements all of the proposed reforms, the US and other OECD countries will retain a sizeable governing majority within the Executive Board when it comes to making decisions about IMF loan size and conditionality. In fact, even the consolidation of European Board seats and the elevation of the BRICs into the list of ten largest IMF shareholders will do little to alter this fundamental distribution of power: these reforms will still leave 57% of the votes in the hands of the US, Japan, Western Europe, and Canada. Under this scenario, it is difficult to imagine that the substance of IMF lending decisions will significantly change in the future, since the newly-empowered countries within the Fund still will not, on their own, be able to summon a majority within the Board. More likely, IMF loans will continue to reflect the domestic financial and political interests of the US and its G-5/7/10 counterparts, just as they have throughout the last thirty years. In the absence of more extensive governance reform, there is little reason to believe that this pattern will change in the future.

In sum, the current IMF reform debate, at least in terms of its effect on the politics of Fund lending, appears to be much ado about nothing. Since the reform proposals thus far do not address the key concern of most developing countries – namely, the fact that IMF lending is frequently politicized and excessively influenced by the national interests of the US and other rich countries – they are unlikely to enhance the Fund’s legitimacy in the eyes of its member-states. Even more extensive reforms, however, would not entirely eliminate politics and powerful states’ interests within the IMF. Instead, redistributing voting power from the advanced industrialized countries toward large emerging markets would simply replace Western countries’ national interests and influence with the domestic political and economic concerns of other member-states, such as China and other large emerging market countries. Consequently, just as countries such as Mexico and Argentina received favorable treatment from the IMF in the 1990s, due in part to G-5 governments’ strong financial stakes in these countries, future borrowers might also receive bailouts if they have close ties to those countries with newly-enhanced voting power within a reformed IMF. One can think of this outcome as a further manifestation of the moral hazard problem: emerging market borrowers, wielding their newly-acquired influence within the IMF, might

secure larger loans with less stringent conditionality than they currently could obtain under the existing voting structures.

Simply put, no amount of voting reform will completely purge politics from IMF lending. So long as the Fund's member states have the final say over IMF policies, their domestic political and economic interests will invariably shape the Fund's lending behavior. In the long run, this means that the real impact of IMF reform may be the elevation of Chinese (and Brazilian, Indian, and Korean) domestic interests into the equation, at the expense of American, European, and Japanese interests. Ultimately, the question is about *whose* political interests IMF lending serves, rather than whether the Fund can be transformed into a purely technocratic, apolitical institution. This point has been largely ignored in the current reform debate, which has almost entirely overlooked these issues concerning the politics of IMF governance and lending.

That said, certain other governance proposals do stand to enhance the Fund's legitimacy and would reduce the degree to which politics shape IMF lending decisions. One such proposal is the idea, suggested by several experts, to require IMF lending decisions to be approved by "double majorities" (a majority of board votes, plus a majority of board members) (Birdsall 2006, Woods 2006). Under this system, the G-5 countries would still retain their disproportionate influence as a result of their quota contributions, but they would require the support of at least eight other Board members in order to approve a Fund program. As Woods argues, "This reform would immediately create an incentive for the powerful members of the board to forge alliances with a larger number of borrowing countries – large and small. Equally, it would give borrowing members an incentive to participate more actively, more constructively, and with greater input into the strategic decisions made [in the IMF]" (Woods 2006).<sup>31</sup> Another intriguing idea is James Vreeland's proposal to transform the Executive Board into an independent body – akin to the governing board of a national central bank – at least for the purposes

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<sup>31</sup> Under one proposal, advanced by Eswar Prasad, existing IMF quotas would be shrunk by 20% across the board, and this 20% would then be auctioned, with an upper limit on any country's share. This would give more voice, effectively, to those countries most willing to contribute more resources to the IMF. See *Economist*, "The IMF: Mission: Possible," April 8, 2009.

individual lending decisions (Vreeland 2006). Finally, adopting a merit-based appointment process for the positions of IMF Managing Director and World Bank president would be an important symbolic step toward enhancing the IMF's legitimacy. The next test of this is likely to arrive soon, as rumors abound that the current MD, Dominique Strauss-Kahn, will resign before his term ends in November 2012, in order to return to France and become the Socialist candidate for president against Nicolas Sarkozy.

### **Global financial regulation**

While the G-20 and IMF have dominated recent discussions about global financial governance, some of the most important changes have taken place behind the scenes. Since the 1980s, a web of international financial regulatory bodies has coalesced around the BIS in Basel, Switzerland. The BIS, established in 1930 to administer German war reparations from World War I, has long been a forum for central bank cooperation. Its membership now includes 55 countries, and the BIS hosts the secretariats for a number of important committees that bring together financial regulators from the world's leading economies. These include the Basel Committee on Banking Supervision (bank regulation), the Committee on Payment and Settlement Systems (payments and clearing), and the Committee on the Global Financial System (market stresses and systemic stability). In addition, the BIS also hosts the secretariat for the Financial Stability Forum (FSF), an umbrella organization formed, like the G-20, following the Asian financial crisis to bring together regulatory and financial authorities in major economies with representatives of the IFIs and the aforementioned BIS-hosted committees. The FSF has been the main institution linking this growing list of regulatory bodies, and it has spearheaded technical work on a number of key topics (e.g., offshore financial centers, deposit insurance systems, and highly leveraged institutions) of importance in recent crises.

Together, these regulatory bodies have made substantial progress in developing numerous international financial standards and harmonizing financial regulation across the world's major markets. As with the G-7 and the IMF, however, these less visible but important institutions have, until recently, been comprised only of representatives from the advanced industrialized economies. This changed at the



April 2009 G-20 summit in London, where the FSF was elevated in status to the Financial Stability Board (FSB) and membership was extended to the entire G-20, along with Spain and the EU Commission.<sup>32</sup> In the ensuing months, talks have accelerated among the FSB's participants on a number of key topics, including enhancing regulators' ability to "unwind" large cross-border financial institutions in the event of failure, strengthening adherence to international financial standards, and the imposition of a potential global levy on internationally-active banks. These are important, if less visible, developments in global financial governance, since the central bankers and regulators involved in the FSB and the other Basel-based institutions meet regularly and have the direct ability to implement policies at the national level.<sup>33</sup>

Nonetheless, we should not overestimate these institutions' role and effectiveness, for several reasons arising from the tradeoffs and political variables emphasized above. First, given the market power of the US, UK/EU, and Japan in the global financial system, it is still the case that these countries' national policies – rather than internationally-negotiated standards – have the greatest impact on the activities of internationally-active financial institutions. Therefore, the outcome of the current regulatory reform debates in the US and UK (e.g., the implementation of the Dodd-Frank bill, and the ramifications of the Cameron government's decision to dismantle the UK Financial Services Authority and return regulatory power to the Bank of England) will largely determine the contours of the future agenda within these global regulatory institutions. Second, the lack of enforcement power in the FSB and the BIS-related committees makes implementation of new financial regulation difficult at the global level, even if G-20 officials can reach agreement on the substance of reform. For global regulatory rules and standards to be effective, national regulators and central bankers must enforce them, and this raises difficult problems of credibility, particularly in some large emerging market economies (Russia, China) where the independence of central bankers and regulatory officials is less clear and institutionalized than in the advanced industrial democracies.

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<sup>32</sup> [http://www.financialstabilityboard.org/press/pr\\_090402b.pdf](http://www.financialstabilityboard.org/press/pr_090402b.pdf).

<sup>33</sup> See Helleiner 2010 for a more extensive treatment of the FSB's evolving role.

Third, the expansion of these global regulatory bodies to include the full G-20 membership plus additional “guests” once again raises the problem of global collective action. Although this enlargement makes sense from the standpoint of bringing all of the key borrower and creditor countries in the global financial system to the table, it makes agreement on global standards on new regulations substantially more difficult to achieve. This collective action problem is further exacerbated by the fact most members of the FSB have multiple representatives at the table, depending on how regulatory responsibility is divided among their respective domestic agencies. For example, the US government is represented at the FSB by officials from the Federal Reserve, the Securities and Exchange Commission (SEC), and the Department of the Treasury, while the German government is represented by the Bundesbank, BAFIN (the Federal Financial Supervisory Authority), and the Finance Ministry. In contrast, some countries (e.g., South Africa, Indonesia, Singapore) send only a single finance ministry or central bank official, given that this domestic agency holds consolidated national authority over regulation. In reality, then, the FSB consists of 53 members representing 24 countries, in addition to the representatives from six other IFIs (the BIS, ECB, European Commission, IMF, OECD, and the World Bank) and all seven of the aforementioned Basel-based regulatory committees. While such a large membership roster is comprehensive, it raises serious doubts about the likelihood that the FSB will become a real originator of strong and effective global regulatory standards in the coming years.

Finally, questions about the future evolution of international financial regulation cannot be seriously discussed without also considering cross-national variation in ideas and ideology. In particular, as evidenced by the very different national responses to the banking crises of the Great Recession, there is substantial diversity in national governments’ perspectives about the appropriate balance between states and markets, as well as about the legitimacy and efficacy of Keynesian economic ideas concerning countercyclical demand management and economic stimulus packages. For example, while the British government effectively nationalized most of its banking sector at the height of the crisis and the Irish government rapidly moved in to guarantee the debts of its largest banks, the US opted for an alternative series of proposals (e.g., TARP, the “Geithner plan”) aimed at avoiding a banking collapse without full

nationalization or assumption of private debts by the government. More generally, domestic opposition to new financial regulation has been notably more vocal in the US than in Europe – an outcome that is not surprising but further reminds us that even countries engaged in extensive attempts at international harmonization of policies find themselves wrestling with differences of opinion over the general idea of regulation. At the same time, we have also seen how economic ideologies have contributed to global tensions over the content of regulation, with French and German officials decrying the “freewheeling Anglo-Saxon” model of capitalism and calling for more extensive regulation of the hedge fund and “shadow banking” sectors than their American and British counterparts.<sup>34</sup> Indeed, such tensions over ideas have also emerged in intra-European debates over the merits of fiscal austerity, as well as whether (and on what terms) the EU should provide bailouts to the Ireland and Greece.

### **Looking ahead: a policy and research agenda**

The severe impact of the Great Recession has triggered renewed interest in reforming the rules and institutions of global financial governance. Within each of the three key pillars of this international financial architecture (summitry, the IMF, global regulatory bodies), we have seen some modest progress toward institutional and policy reform. In order to explain these developments, as well as to understand the barriers to more extensive reform, I have focused on the difficult tradeoffs confronting policymakers as they wrestle with questions about crisis lending, financial regulation, and macroeconomic policy coordination in the wake of the world’s worst economic crisis in seven decades. Governments’ choices over these tradeoffs, I have argued, are heavily influenced not only by economic factors, but even more so by the political variables (power, collective action, bargaining and enforcement problems, domestic politics, and ideas) that IPE scholars have long recognized as the key determinants of both national economic policies and international economic cooperation. Unfortunately, the centrality of these factors, let alone thoughtful discussion of how policymakers might take them into account in order to formulate more feasible and effective governance reforms, has been largely overlooked in current debates, which

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<sup>34</sup> Yann Le Guernigou, “City Fears as Sarkozy Hits Out at Anglo Saxon Model,” *The Scotsman*, December 2, 2009.

have spent far too much time focusing on grandiose reform proposals that are quite likely infeasible due to the very tradeoffs and political variables discussed above. Thus, there is an urgent need for IPE scholars to engage more actively in these discussions to make clear the wealth of insights our research can contribute to the ongoing debate about the future of global financial governance.

At the same time, the issues discussed above also point to the need for more scholarly research on the politics of global financial governance. In particular, two key research questions stand out as being worthy of further attention by IPE scholars. First, with respect to the G-20 and the debate about global imbalances and impending “currency wars,” more research into the conditions under which states are able to successfully coordinate macroeconomic policies would be extremely useful. An older literature on policy coordination and the G-7 summits does exist (e.g., Putnam and Bayne 1984), along with a fairly extensive body of work on policy coordination in open-economy macroeconomics (e.g., Drazen 2000). Likewise, the rich, general literature on international cooperation and institutions certainly offers insights into this question. However, there is relatively little direct work to date on the specific question of what explains variation in the scope, success, and timing of monetary, fiscal, and regulatory coordination in the aftermath of financial crises. The tradeoffs and variables outlined above may offer a useful starting point for such research, which would lead to a clearer understanding of how, when, and to what extent each of these political factors shapes the ability and willingness of governments to cooperate and coordinate economic policies in times of crisis.

Second, with respect to both IMF reform and international regulatory cooperation, the current rush to reform IMF governance and to rapidly complete the Basel III negotiations raises the question of whether these current international responses to the crisis will have as-yet-unforeseen, adverse effects on long-term global financial stability, even if they succeed in their intended purposes. This possibility that reforms to global financial governance may have long-term, unintended consequences is worthy of further study. Indeed, one can make a reasonable case that two of the most important short- to medium-term policy responses to the Asian financial crisis (East Asian countries’ self-insurance strategy of building up massive foreign exchange reserves to avoid future IMF borrowing; the Basel II reworking of the original

Basel capital adequacy rules) became, in the longer-term, two of the most important causes of the Great Recession (the global imbalances; the “big freeze” in global credit arising from the greater risk sensitivity of international banks’ cross-border portfolios under Basel II). Research that sought to test whether and to what extent such long-term causal relationships exist would substantially improve our understanding of the true costs and benefits of institutional and policy reform in the wake of major financial crises. Such research would also address the uncomfortable but important policy question of whether the “cure” is worse than the “disease” in some cases of governance reform in global finance.

Clearly, these are merely two of an almost endless number of pressing and unanswered questions about the politics of global financial governance in the wake of the Great Recession. Thus, there is much work to be done and plenty of opportunity for IPE scholars to break new theoretical and empirical ground in the coming years. Having been “blessed” to live in such interesting times, we should seize this opportunity to deepen our understanding of the politics of global financial governance and to contribute to the ongoing policy debate about how best to reform the international financial architecture. As Rahm Emanuel, President Obama’s former Chief of Staff, notably remarked: “You never want a serious crisis to go to waste.”<sup>35</sup> For IPE scholars, this serves as a call to redouble our focus on these pressing research and policy questions on the politics of international finance.

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<sup>35</sup> Jeff Zeleznny, “Obama Weighs Quick Undoing of Bush Policy,” *New York Times*, November 9, 2008.

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**TABLE 1: COUNTRY SHARES OF TOTAL G-20 OUTPUT (PERCENT)**

<b>Country</b>	<b>1960</b>	<b>1980</b>	<b>2002</b>	<b>2025p</b>	<b>2050p</b>
<b>Industrial countries</b>					
United States	46	31	33	24	15
EU-4	26	30	25	16	7
Japan	15	21	20	11	4
Others in G-20 <sup>1</sup>	2	4	4	3	2
<i>Total</i>	89	86	82	54	28
<b>Emerging markets</b>					
China	1½	1	4	15	20
India	1½	1	2	5	15
Korea <sup>3</sup>	½	1	2½	6	10
Brazil	2½	3	3	4	5
Russia	–	3	3	4	3
Others in G-20 <sup>2,3</sup>	5	5	5	13	20
<i>Total</i>	11	14	18	46	72

p=projected by Goldman Sachs, Global Economic Paper No. 99, October 2003.

1. Australia and Canada.

2. Argentina, Indonesia, Mexico, Saudi Arabia, South Africa, and Turkey.

3. Projected using growth rates of other G-20 emerging market economies.

SOURCE: Bergsten 2004

**TABLE 2 – IMF EXECUTIVE BOARD VOTING SHARES, OCTOBER 2010**

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United States	16.74
Japan	6.01
Germany	5.87
France	4.85
United Kingdom	4.85
<i>“G-5” total</i>	<i>38.32</i>
Italy	4.10
Canada	3.63
<i>G-7 total</i>	<i>46.05</i>
Belgium	5.13
Netherlands	4.77
Denmark	3.43
Switzerland	2.78
<i>G-10 total</i>	<i>62.16</i>
China	3.65
Saudi Arabia	3.16
Russia	2.69
<i>China/Saudi Arabia/Russia total</i>	<i>9.50</i>
Spain	4.44
Thailand	3.51
Korea	3.44
Egypt	3.19
Sierra Leone	3.01
Iran	2.42
Brazil	2.41
India	2.35
Argentina	1.95
Rwanda	1.34
<i>Other countries’ total</i>	<i>28.06</i>

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SOURCE: Copelovitch 2010, International Monetary Fund