



After the Crisis: Reforming Global Financial Governance

Mark S. Copelovitch

Assistant Professor of Political Science & Public Affairs

University of Wisconsin - Madison

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Overview

- Global finance: the governance problem
- The reform agenda
- Difficult tradeoffs: the politics of global financial governance
- Looking ahead: (un)likely outcomes

Financial Globalization: The Governance Problem

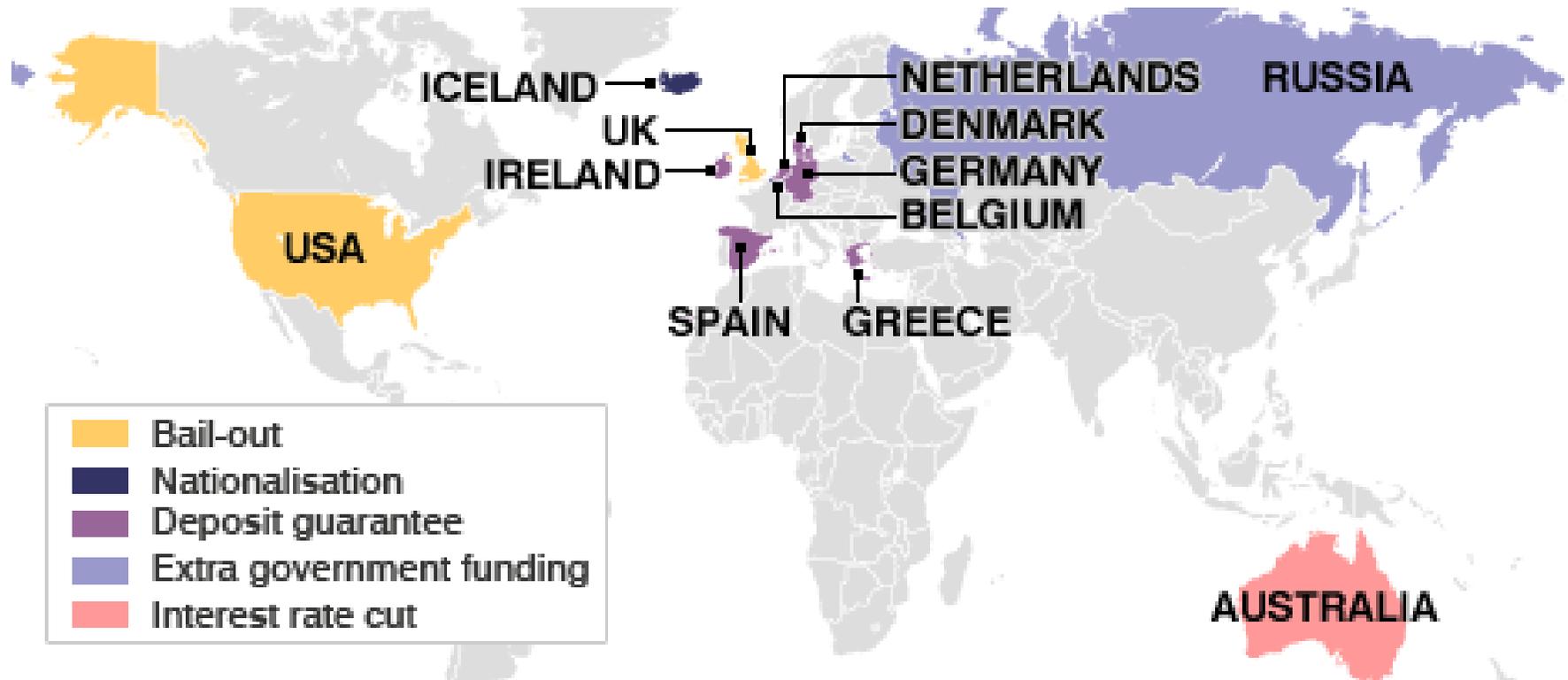
Markets and crises are global and rapidly changing...

- Unprecedented scale and scope of global markets
- Shifting balance of economic/financial power

...but rules and institutions (“governance”) have not kept pace

- No international lender of last resort
- Regulation/supervision remains exclusively national
- No formal international monetary system
- Outmoded power dynamics in key global institutions (IMF, G-7)

Thus Far: Global Crisis, National Responses



- Unilateral efforts unlikely to be successful
- Threat of “beggar thy neighbor” policies

The Rationale For Global Governance

Functionalism

- Scope of politics inevitably adjusts to match scope of economics
 - “Globalization requires global governance”
 - Why? Need to address **spillovers/externalities**

Limits

- *Ex post* justification
 - Doesn't tell us what the **politics** actually look like
 - Doesn't tell us what **form** governance will take
 - Many possible institutions perform the same function
 - Example: international lender of last resort

The Reform Agenda: Consensus on *Broad Goals*...

Strengthen international supervision and regulation

- Bridge the gap between global markets and national regulation

Reform existing institutions

- International Monetary Fund (IMF)
- The “Basel” institutions (Financial Stability Forum, BIS)
- G-7 / G-20

International policy coordination

- Macroeconomic stimulus
- Exchange rates / global imbalances
- Trade policy

...But Not on *Specific* Policies & Institutions

Strengthen international supervision and regulation

- Which financial institutions and regulations?
- What institutional form?

Reform existing global institutions

- The IMF debate: resources, conditionality, votes
- New “G” groups: who should be in/out?

International policy coordination

- How much? For how long?
- Sharp disagreements on trade and exchange rates

Why No Agreement? Difficult Tradeoffs

IMF lending

- Liquidity vs. moral hazard

Regulation/supervision

- Confidence vs. competitiveness

Institutional reform

- Accountability/legitimacy vs. effectiveness

Policy coordination

- Domestic politics vs. international commitments

The IMF's Tradeoff: Liquidity vs. Moral Hazard

- Loans (“liquidity”) help a borrower country pay its debts
- But, they create “moral hazard” for borrowers and creditors



How to choose?

- A liquidity or solvency problem?
- No clear economic answer → ultimately, a **political** question

Tradeoffs: The Primacy of Politics

No optimal economic solutions

- Many possible policies, institutions, and regulations
- Conflicts between “good economics” and “good politics”

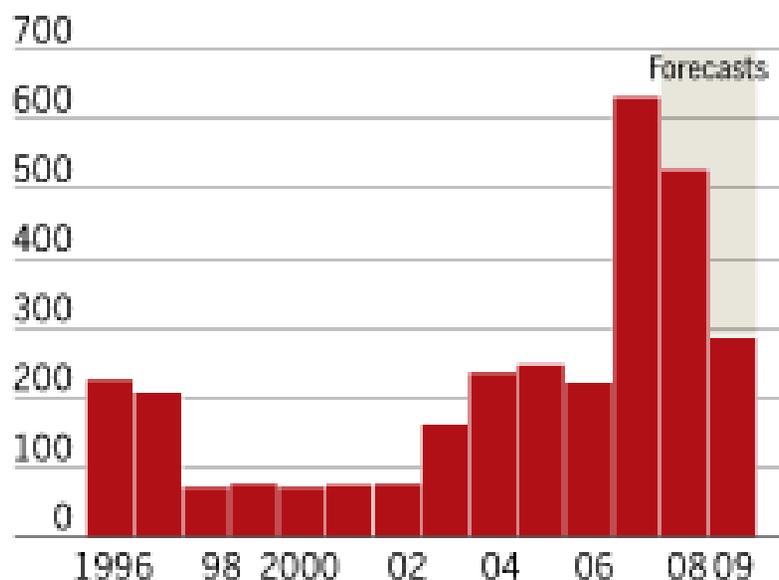
Key political factors

- Power and geopolitics
- Collective action problems
- Bargaining and enforcement problems
- Domestic politics (interests, institutions)
- Ideology

Reforming the IMF - More Resources

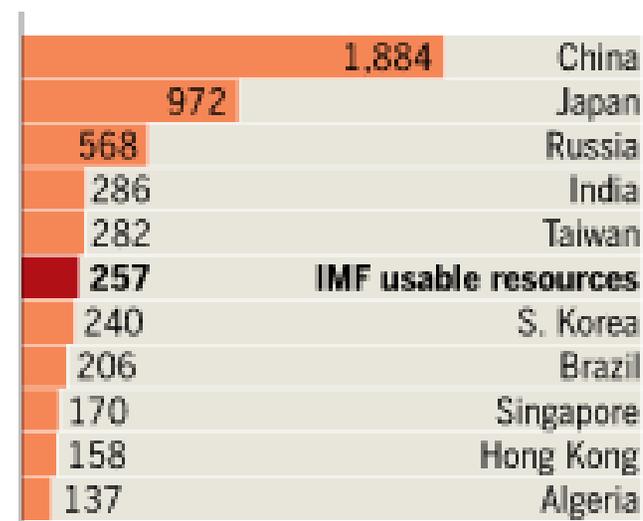
Capital flows to emerging markets

Net private flows (\$bn)



IMF resources and countries with largest foreign exchange reserves

\$bn, Aug 2008



- IMF needs ~ \$750 billion - \$1.75 trillion to be effective
- New type of loan: Short-term Liquidity Facility (SLF)
- *Will new resources lead to governance reform?*

Looking Ahead: (Un)Likely Changes & Reforms

No

- World Financial Organization
- Ambitious IMF reform
- Collapse of globalization
- Elimination of G-7 influence

Yes

- New regulatory standards and further harmonization (Basel III?)
- Increased IMF resources and new lending policies
- Selective capital controls
- Expansion of G-20 role and membership of Basel institutions (Financial Stability Forum)



GLOBAL
ECONOMY

AN IMPRESSIVE DISPLAY
OF INTERNATIONAL
COOPERATION.
DID ANYONE REMEMBER
THE PARACHUTES?

T.S.

10/2/00 THE WASHINGTON POST

AND SLOW DOWN
ALL THIS PROGRESS? -

10/2/00



SOURCE: *The Australian*