2. G20 Working Group Issues: Role of International Institutions

This section looks at reform of global economic governance, assessing the remit of G20 Working Group III: 'Reforming the IMF/International Financial Institutions' and Group IV: 'The World Bank and other Multilateral Development Banks'.

Executive Summary

Brian Henderson

The deterioration of the global economy has intensified and accelerated discussion about the role of the international institutions which govern the global economy. The IMF's role as a global stabilizer has been reinvigorated as economies facing acute balance-of-payments difficulties have required intervention. The Financial Stability Forum (FSF) has suddenly been propelled to the forefront of international mechanisms to promote coordination and common assessments of financial policies.

At the same time, there remain serious and unresolved questions about the governance and scope of these institutions. Addressing these issues is essential to reaching global consensus on key short-term issues, such as a coordinated fiscal stimulus package. The experts assembled in Washington, DC and London devoted considerable time to evaluating the strengths and weaknesses of these organizations and developed a set of recommendations designed to increase the role and resources of the IMF to conduct surveillance and monitoring of global fiscal stimulus packages and support increased liquidity; balance voting weight and representation within the IMF governance structure to ensure that they effectively and accurately represent emerging and developed economies; and increase the scope and membership of the FSF to improve its ability to serve as a cross-sectoral forum for discussion on financial regulatory issues.

Participants agreed that given the impact of the crisis on emerging economies, the G20 should announce full support and reaffirmation of the IMF and FSF as the preeminent multilateral financial and monetary institutions with the capacity and experience to assist member governments to address the current economic challenges. The G20 should concurrently announce a substantial increase in IMF resources, with a doubling or even tripling of current financing to assist countries in immediate crisis. The IMF and multilateral development banks should also announce an immediate commitment to increase public financing through the international capital markets. Brian Henderson suggests that the regional multilateral development institutions could receive extra funding from the sovereign wealth funds of some of their most prosperous members.

Domenico Lombardi, Susan Schadler and Andrew Baker present different strengths of the IMF, FSF and WTO to tackle the immediate challenge of resurrecting global demand and guarding against protectionism. All participants agreed that the G20 must provide a strong mandate to the IMF, the FSF and the WTO to work together to evaluate scenarios of immediate and long-term effects of varying and competing stimulus packages. The capacity to effect both crisis alleviation through liquidity support and policies against protectionism is fully within the competence of these institutions. Raghuram Rajan recommends that the multilateral institutions should encourage dialogue on policy coordination, particularly in the case of crises, but also ensure that policies implemented do not result in unfair competitive advantage.

Over the longer term, our experts broadly agree that the G20 should commit to reforms of the governance and voting structure to reflect 21st-century economic reality. Ralph Bryant stresses that G20 leaders should reopen negotiations on IMF reform. This would help to increase the credibility of the institution as well as encourage greater financial participation in capitalizing the IMF. He goes on to argue for greater transparency and inclusiveness in the selection of IMF leadership. Rajan recommends that the size of the IMF Executive Board be reduced and that regional representation be balanced in order to increase its effectiveness. This should include a reduction in the number of European representatives, as both Lauren Phillips and Andrew Baker have outlined, and the allocation of seats to representatives from within the G20, including the Middle East, Asia, Latin America and Africa. Many of the panellists agree on the need for European consolidation, not just at the IMF, but in general at the institutions governing the global economy.

The G20 meetings should also increase the IMF's mandate for macro-prudential surveillance. According to Susan Schadler, the IMF, with its deep expertise and large secretariat, is well positioned to carry out this function, but will require a greater mandate to do so. Andrew Baker outlines how the IMF and FSF should work together to ensure that their relative areas of expertise reinforce each other.

The combined force of these recommendations will revitalize the core of the Bretton Woods organizations. It has been clear to many for some years that such adjustments are critical to ensure that these institutions, which were designed to ensure global financial stability, become more relevant and effective. Making bold reforms now will rebuild badly needed confidence and trust in the integrity of the international financial system.

The World Economic and Financial Crisis: Next Steps for G20 Cooperation

Ralph C. Bryant[1]

The worst of the contraction in world output and employment is yet to come. Financial turmoil may well continue. Government cooperation to mitigate the effects of the crisis and to avoid beggar-thy-neighbour policies is badly needed. The meeting of G20 heads of state in London on 2 April is a crucial opportunity for leaders to agree on actions that will combat the crisis.

Failing to cooperate could weaken confidence further and worsen the crisis. The disaster of the 1933 London World Economic Conference, occurring at a similar time of worldwide economic distress, is a reminder of the damaging effects that can occur if leaders fail to act cooperatively.

The needed cooperation is of two sorts. With fires already raging, the existing fire brigades must fight the short-run acute problems. But because the existing fire stations, their equipment and fire regulatory safety codes (i.e. our financial infrastructure) are inadequate, efforts to rebuild are required to assure that fires can be better fought over the medium and long run. One's first thought may be to concentrate solely on the acute problems, postponing rebuilding agreements for later. Agreements on how to fight the acute fires of today, however, will not be reached without credible commitments to rebuild the fire stations and regulatory codes for tomorrow. As G20 leaders plan their 2 April meeting, they should focus on agreed actions to address the immediate emergency but also on specific commitments to enhance intergovernmental cooperation over the longer run.

If far-sighted, the G20 leaders will strengthen the powers and stature of international institutions as conduits for their cooperation. For now, the most critical needs are at the International Monetary Fund, the Financial Stability Forum and groups charged with responsibilities for supervision and regulation of financial institutions (such as the Basel Committee on Bank Supervision). Such strengthening is very much in the interests of all countries – large and small, rich and poor. Yet few governments are strongly committed. The United States has not acted as though an effective IMF is essential for supporting its goals and prosperity. The Europeans have been preoccupied with maintaining their disproportionately large share of IMF voting rights and Executive Board seats, rather than promoting a stronger, more effective institution. Emerging-market nations such as China, India, Brazil and Mexico likewise do not perceive the IMF as an institution serving their fundamental interests. Yet those national views are all short-sighted. They underemphasize, if not ignore completely, the fact that appropriate strengthening of the international institutions can advance the collective interests of all nations.

International institutions have not always functioned effectively. They have not been given sufficient authority to conduct multilateral surveillance, and have been timid in exercising the limited powers they do have. Their analytical capacities are not strong enough. For today's world, their governance has major flaws. Despite their weaknesses, however, they can and do play a positive role. In the current crisis, the world community has no better choice than to rely on these institutions and needs to strengthen them as quickly as possible.

A collective bargain among all nations is required to support near-term actions and to reform the institutions for the longer run. It is true that some needed reforms are a zero-sum game. For example, the share of voting rights of many developed countries, particularly in Europe, must fall so that the share of under-represented countries such as China, India and Brazil can rise. But many other aspects of needed reforms are a positive-sum game. Most notably, major developed countries and large emerging-market countries could join together to negotiate a strengthening of the IMF, the Financial

1. This is a slightly modified version of the author's paper published by Brookings on 11 March 2009, at http://www.brookings.edu/opinions/2009/0311_g20_bryant.aspx.

Stability Forum and other institutions that would prove mutually beneficial to all countries in the world.

The specific short-term commitments detailed below could be an initial instalment of that collective bargain. Judged from the perspective of the London summit meeting, each component is a short-term 'deliverable' for the summit communiqué on 2 April.

The G20 leaders should:

(1) ***agree on a cooperative package of macroeconomic policies, highlighting especially fiscal stimulus programmes***. The package should contain a fiscal stimulus programme for each country that has policy space to implement fiscal expansion. The programmes should contain specifics for each country. Equally important, the IMF should be charged with monitoring the implementation of the specific programmes and prominently identifying countries that are not adequately pulling their weight. The leaders should pledge that they want the IMF monitoring to have 'teeth.' A credible commitment to support IMF monitoring is a promising step that leaders can take to bolster confidence that cooperative policies will mitigate short-run contractions in output and employment. The commitment would also be a down payment on strengthening the IMF's multilateral surveillance of countries' macroeconomic and exchange-rate policies over the longer run.

(2) ***negotiate a counterpart agreement for monitoring the commitments of countries to avoid beggar-thy-neighbour policies***. The WTO and perhaps also the IMF should be given an explicit mandate to report regularly on the entire range of countries' policies affecting cross-border transactions. Countries that sail too close to the wind with policies that have protectionist effects, either for goods-and-services trade or for financial transactions, should be named and shamed. G20 leaders must credibly indicate that they support this monitoring and will not undermine the international reports even if their own countries are criticized.

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(3) ***urgently plan to provide additional resources for IMF lending and to ask for revisions in its terms and conditions***. Substantially larger resources are needed in the short-run emergency, and for the medium term as well. Access and conditionality provisions for IMF lending facilities will require changes. The needs are especially acute for low-income countries and for some emerging-market countries experiencing a severe shortfall in net capital inflows.

The preferred method by far for increasing the IMF's resources is to expand aggregate quotas. An expansion of the New Arrangements to Borrow (NAB) is also warranted. But those desirable changes cannot be adopted quickly because they must be preceded by time-consuming negotiations and be accompanied by a major reform in the governance of the IMF (point 4 below).

For the immediate future, therefore, the G20 leaders have only two practical choices. One is to ask for approval under existing IMF procedures for (3a) ***a large one-time immediate SDR allocation*** – at least the equivalent of $200 billion. As an interim step, a large SDR allocation could be implemented promptly without any change in the IMF articles (it would require an 85 per cent voting majority). An SDR allocation is an imperfect, blunt instrument for an immediate expansion in world liquidity. The largest fraction of an allocation, some two-thirds, would go to countries for which the direct benefits would be small or non-existent. Nevertheless, the effects for the world as a whole would be unambiguously positive. Because the world financial and economic system faces a severe emergency, the effects of an SDR allocation could help substantively and as a way of boosting short-run confidence.

The other short-run choice for increasing IMF lending resources is (3b) ***augmented bilateral borrowing from particular IMF members***. The recent special borrowing of $100 billion from Japan is an initial example that the IMF Managing Director hopes to supplement with analogous borrowings from other high-reserve countries. This approach can help provide immediate resources. But ad hoc borrowings from individual countries are at most an interim step. A major difficulty is that several of the other candidate countries for bilateral borrowings – China being the most prominent – may justifiably prove reluctant to lend in the absence of a greater voice and representation in the IMF to better reflect their weights in the world economy.

(4) ***pledge to reopen international negotiations about the financial resources available to the IMF and about the entire range of IMF governance reforms, because of the inevitably close links between the two***. A commitment to negotiate comprehensive reforms is primarily a matter of rebuilding the IMF fire station rather than fighting this year's fires. But that commitment is essential to encourage the necessary cooperation for this year's firefighting (in particular the active participation of China and other large emerging-market nations). Although a reform package was agreed by the IMF membership in April 2008 after three years of negotiations, those reforms were timid and inadequate. Further government and legislative consideration of that package should be deferred. Instead, G20 leaders should commit the IMF and their finance ministers, deputies and staffs to renewed negotiations over the coming year. The leaders should set an explicit timetable and ask for definite progress by the annual meetings of the IMF and World Bank in autumn 2009.

The bold package to be negotiated should:

- provide a major increase in the size of aggregate quotas (at least a doubling);
- review and expand the arrangements for borrowing under the NAB;
- refine the terms for member borrowing from the IMF's Short-term Liquidity Facility;
- revise the terms for members' access to other IMF facilities;
- incorporate an improved formula to serve as a basis for determining quota and voting-rights shares;
- revise the composition of the Executive Board and of member constituencies, reducing the number of Executive Directors to no more than 20;
- eliminate the provision that prohibits split voting within constituencies;
- reduce from 85 per cent to 80 per cent the required special-majority vote for many key decisions;
- retain the tripling of basic votes agreed in the April 2008 package;
- enhance the mandate for IMF multilateral surveillance and macroeconomic oversight of the world economy, including exchange rates;
- strengthen the analytical capacities of the IMF staff for conducting such surveillance.

(5) ***announce an agreement that leadership selection at the IMF and World Bank will henceforth be solely based on merit, with candidates considered from any nationality***. This would be a credible down payment on the comprehensive IMF reform to be negotiated in the coming year and as a step to bolster short-run confidence. Leadership selection should require a double-majority voting approval (analogous to that required for approval of amendments to the IMF and World Bank Articles of Agreement). This agreement would render obsolete the long-standing but now inappropriate convention that European governments designate a European to be Managing Director of the IMF and the US government designates an American to be President of the World Bank. (A joint US and EU statement reiterating the agreement could be timed to coincide with the G20 communiqué.)

(6) ***reiterate commitment to reforms of the international institutions with responsibilities for catalysing cooperation about prudential oversight (supervision and regulation) of financial institutions***. Insufficient time exists before the 2 April meeting to negotiate sound, specific measures in this area. Most such measures in any case pertain to the longer-run task of rebuilding the fire station and designing better fire safety codes. An immediate step can be taken to broaden the country participation in the Financial Stability Forum and restructure the arrangement of the seats around the table. Expansion should likewise occur in the countries participating in the Basel Committee on Banking Supervision, the International Accounting Standards Board, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors. The primary responsibility for improved financial standards and prudential oversight, it is true, necessarily resides within individual nations. But the G20 leaders should build on their November 2008 agreement by credibly committing their countries to intensified cooperation to develop agreed world minimum standards and to provide monitoring and enforcement of those standards.

Some Principles for a New International Architecture

Raghuram G. Rajan

The objectives of a new global economic architecture are to (i) reduce the barriers to trade, and as a country's capacity to handle them increases, capital flows; (ii) ensure that a country's policies or regulations do not, through the route of trade or capital flows, give them an unfair competitive advantage or destabilize other countries; and (iii) have a system to discuss policies and coordinate some of them in case of crisis, as well as supply pooled funds to countries that are willing to make the necessary adjustments.

The current crisis has highlighted a number of important deficiencies in this system, perhaps reflecting the fact that many of its structures were set up in a different era. The ongoing global crisis is as much a consequence of macroeconomic imbalances, resulting in both large sustained trade deficits and surpluses, as it is of poor governance in financial markets and inadequate regulation. We need an effective, high-level, inclusive and even-handed mechanism through which unstable situations are identified, a dialogue is initiated with relevant countries, and countries are persuaded to alter the policies that lead to imbalances. The current system is neither sufficiently high-level when it is inclusive, nor perceived as even-handed enough, to be effective.

In addition, when a crisis hits, the system for coordinating responses across countries and across multilateral organizations is ad hoc and incomplete. Finally, while the existing system provides funds to countries under International Monetary Fund programmes of varying rigour, in order to deter countries with responsible policies from building excessive individual reserve hoards, we need to create a system of pooling reserves where funds will be available to such countries on demand.

If the ongoing discussion on global architecture is to make a difference, it should address these important issues. The problems with the current system and possible avenues for exploration are briefly outlined below.

Architecture

The Executive Board of the IMF is representative of countries around the world but is probably too large and staffed at too low a level to take important decisions; this deficiency in turn spawns parallel bodies such as the G20, which slows decision-making. Two changes could transform this board into a world Economic Committee that is effective, high-level and inclusive. First, its size could be shrunk, in particular by reducing the number of representatives from Europe. Second, the permanent board could be disbanded (which would also free up resources that are engaged in making routine reports) and replaced by a regular quarterly meeting at the ministerial level (with meetings at the deputy-ministerial level for more routine tasks, and meetings twice a year at the head-of-state level). Instead of discussing every country's Article IV, or every application to borrow, the Economic Committee would focus on issues of policy spillovers that have collective macroeconomic impact, and involve large allocations of Fund resources.[1]

The IMF would both be governed by the Economic Committee and serve as its secretariat. Its own functioning would be key to making the Economic Committee appear even-handed. Among the necessary reforms are:

- making the selection of IMF management transparent, not contingent on nationality, and broadly representative of the membership;
- making the Fund self-financing so that it does not have to keep going back to key shareholders;

1. Fund management would review Article IV reports and routine progress of IMF programmes, and only flag issues of systemic concern for the Economic Committee.

- eliminating any country's official veto power over major decisions;
- allowing the Fund's agenda to be set by the Economic Committee rather than outside bodies.

The important development role of the Economic Committee would be to identify and reduce structural impediments to cross-border investment, consistent with countries' ability to absorb flows. Its role in ensuring stability would be to identify and remedy situations where large countries run sustained large deficits or surpluses that can make the system more fragile, cause the volume of damaging political rhetoric to increase, and impose the burden of adjustment on others. It should also play a role through the Financial Stability Forum and the IMF in monitoring financial sector regulation and coordination among regulators. Finally, in times of global stress, crisis management (including the disbursement of resources) would be coordinated by the deputies, who would have built relationships with one another in normal times.

Facilities

In addition to existing facilities, in the event of inevitable policy mistakes, we need a process by which global reserves are pooled and responsible countries given credible commitments that they will have easy access to funds when in need. Indeed, the expectation of access can reduce the need for a country to run the large, sustained trade surpluses that have contributed to global imbalances. Given the opprobrium attached to borrowing from the IMF, it is worth considering whether a separate facility, advised by the Fund but governed by members (possibly a subset of Fund membership who contribute their own money to the pool), is needed.

Penalties

What if a country, following policies that are not in the collective interest, refuses to be persuaded? Before any discussion of penalties, it is important that the above reforms to make the system even-handed are undertaken so that assessments identifying problem countries can be seen as unbiased. Even so, macroeconomics is not an exact science, so any attempt to prove beyond reasonable doubt that a country's policies violate international norms is fraught with difficulty. For instance, countries with different levels of income and different demographic profiles would naturally have different levels of imbalances, though the correspondence is not exact. Judicial processes along the lines of those followed by the World Trade Organization are unlikely to be effective.

One option might be to continue relying on peer pressure and the threat of bilateral political action. This has not worked so far, though international dialogue has rarely progressed to the point where sustained peer pressure can be exerted. Alternatively, transparent rules might be devised – for instance on the maximum size of the imbalance a large country at a certain level of development and with a certain demographic profile is allowed to run for a sustained period – along the lines of the deficit rules in the Eurozone. Countries would be given time to get their imbalances in order, and if problems persisted after this period an increasing scale of trade or monetary penalties would kick in.

Developmental issues

A number of developmental issues, such as global food security, resource sufficiency and global warming, are best tackled by the World Bank and have therefore not been addressed here. While the governance of the World Bank needs to change in tandem with that of the IMF, there might be less need to replace the Executive Board, since the pace of policy development there can be more measured. Nevertheless, it is worth asking whether routine oversight by a permanent board is needed on so many matters.

Final concerns

This crisis offers an opportunity to undertake serious reform of the global architecture to make it more effective and fair. If we emerge from the crisis with the existing architecture intact, and only a few additional steps to coordinate financial regulation, we will have missed that opportunity. It is to be hoped that crises like the current one are few and far between. We should take full advantage of it.

Enhancing International Institutions

Brian Henderson

The global financial crisis has exposed or revived the great need for the international institutions created to provide for the proper functioning of the global economy and to assist countries facing acute balance-of-payments difficulties. The IMF in particular has been extremely active recently in coordinating financing in many of the emerging countries and small economies hit hardest by the global economic downturn. Its role as global 'fire-fighter' has been reinvigorated. The Bretton Woods institutions will be of great importance as we work to revive the global economy. The G20 countries must empower these institutions further to more effectively play their role in global economic revival. The G20 can take steps to encourage the multilateral financial institutions to accelerate their access to the market; reach consensus on increasing special drawing rights (SDR) for qualified member countries and/or those in need of support; let the regional multilateral development institutions (MDIs) encourage their member states to motivate their more prosperous members to allocate a portion of their sovereign wealth funds (SWFs) towards assisting in funding the regional MDIs, and use the IMF and World Bank as the 'clearing institutions' for benchmarking the economic and monetary performance of all member countries.

The multilateral financial institutions which constitute the institutional result of the Bretton Woods agreements of over sixty years ago remain in solid financial condition and are viewed by the international capital markets as high-quality financial risk, meriting continuing credibility and 'AAA' ratings. In most markets the 'Group' are able to command 'best pricing' for their bonds and are viewed as the better credits in the sovereign/government asset class. The level of issuance is still significant for the markets, providing credible alternatives for investors across the entire spectrum of the yield curve. Many institutions, including pension funds, government agencies, financial institutions, insurance companies, foundations and individual investors, view the risk of these agencies as safe and of the highest stability and return on investment. Indeed, in today's market, these are viewed as 'safety nets' or proxies for benchmarking other financial risks in the sector or in managing liquidity across all asset classes.

By the end of February 2009, all the AAA-rated multilateral institutions combined have been able to access public markets with an excess of $33 billion in issuance, compared with a total for 2008 of $136 billion. The single largest issuer has been the European Investment Bank, representing in the first two months of 2009 as much as 77% of the total for 2008 and 88% of issues for the asset class. While the market exists and is receptive, even these institutions have had to 'pay up' on spreads, as the global credit crisis has put a premium on any sort of placement, given the sclerotic condition of the market. In this context, these immediate short-term recommendations are offered.

First, the multilateral financial institutions should be encouraged to accelerate their access to the market as a means to provide liquidity, to pre-finance initiatives on as long-term financing terms as the market will bear, and to announce such an initiative publicly. The IMF would signal this as a challenge to the associated regional institutions to join in the initiative to accelerate regional support for continuing development and structural and emergency aid to member states and/or infrastructure projects. As a collateral benefit of the announcement, the private-sector financial institutions would have the incentive to compete for the underwriting business, and to continue to intermediate the liquidity of such accelerated issuance volumes and sustain the market for this asset class.

Second, a consensus must be reached immediately on increasing SDR for qualified member countries and/or those in need of support. This would reduce the foreign exchange burden on those countries that can least afford this additional risk in the current environment.

As the challenge for both credit and capital will remain in the markets for at least the next 18 months, the regional MDIs should, in turn, encourage their member states to motivate their more prosperous members to allocate a portion of their SWFs towards assisting in funding the regional MDIs. Specifically, the African Development Bank, Asian Development Bank and Inter-American Development Bank should be able to receive from those member states with sizeable SWFs an allocation of funding, either through the capital structure directly or through specifically defined facilities, which would be allocated to structural adjustment and/or regional projects of benefit to both the 'donor' state as well the region as a whole. There are a number of infrastructure projects, including ports, airports, roads, railways and environmental projects across the globe, which could benefit from such an accelerated commitment of resources. The benefits of the broader world economy would also be significant in terms of trade and services. The European Bank for Reconstruction and Development should immediately announce an increase in capital resources and commitments from the EU to further assist central and east European states in addressing the economic dislocation of the current economic challenges for the region, as well as providing more conventional longer-term development financing for accelerated regional infrastructure projects.

Lastly, the IMF and World Bank should be used as the 'clearing institutions' to benchmark the economic and monetary performance of all the member countries, and specifically to accelerate the availability of dedicated teams of experts who would provide immediate assistance to those countries in most need of expert counsel. A majority of underdeveloped countries do not have the human resources available to focus properly on immediate priorities and develop rational plans for managing the current global crisis. The wealthier countries should channel their foreign assistance programmes, especially their professional and technical expertise, through coordinated efforts with both the IMF and the World Bank.

After the Fall: Reasserting the IMF in the Face of Global Crisis

Domenico Lombardi

Under the pressure of the current crisis, the international community is carving out a new role for the International Monetary Fund. But this is not the first time. Every decade or so, the institution has slightly changed its role in the global system. In the 1970s it relinquished supervision of the Bretton Woods exchange rate system and lost its role as forum for global economic coordination. Ten years later it assumed the role of manager of the emerging debt crisis. When international financial risks related to the debt crisis waned, the IMF targeted the task of 'systemic transformation' in Russia and its former satellite states. That function, too, became obsolete, and the Fund reasserted itself in the face of the Mexican, East Asian and other financial crises of the 1990s by engaging in large-scale emergency lending. Once that was no longer needed, the institution underwent a period of inactivity, leading many to wonder if there were any role at all left for the IMF in the international monetary system.

Now, once again, policy-makers are looking to the IMF to define a new, more meaningful role for itself. What exactly that should be is currently the subject of discussion in various groups such as the G7 and, especially, the G20. It is also what the Manuel Commission is working on (the report of this group of experts chaired by the South African Finance Minister Trevor Manuel is expected to be made available by April 2009).

In what follows, I shall draw some lessons from the current economic crisis, deduce the implications for IMF reform and, finally, share some concrete proposals.

Lessons from the current crisis

This financial crisis can be attributed to the past seven years of low interest rates and high world growth. While macroeconomic forces were at work in the guise of low interest rates driving investors to seek out higher returns, the financial system, partly in response to this, came up with new structures and financial instruments offering higher risk-adjusted returns, instruments in fact far riskier than they seemed. It was not long before market discipline fell short, as optimism prevailed and due diligence was outsourced to credit rating agencies.

In this setting, there has been fragmented surveillance with policy debates scattered across various fora such the Bank for International Settlements, the G7 and G20, the Financial Stability Forum, and, of course, the IMF. And there has been insufficient cooperation among national financial regulators, as well as lack of engagement of world economic decision-makers in time to make a difference.

Implications for IMF reform

Not even amidst the red flags and distress signals was any real system of collaborative global action set in motion. For instance, the disorderly unwinding of global imbalances had long been recognized as a major systemic risk. Yet collective action in that regard proved less than satisfactory: the IMF's Multilateral Consultation of 2006–07 produced only the slightest interest on the part of its participants. Once the crisis was in full swing, the policy response remained neither very collaborative nor very coordinated.

To be fair, this has been pretty much in line with the traditional response of the international community to the episodes of instability affecting the world's monetary and financial system since the 1980s, and for which the response has been conducted on a case-by-case basis, with an emphasis on domestic factors rather than on systemic determinants.

This just happens to reflect the underlying contradiction in the vision of the IMF that the international community has held since the 1970s, following the end of the Bretton Woods era. On the one hand, powerful members of the Fund have been pushing for it to have a stronger surveillance role; on the other hand, these same members have not delegated to the institution enough powers to do so in ways that might be more effective. They have provided it with neither adequate authority nor effective instruments of enforcement. They have been reluctant to endow the IMF with political capital, making it ineffective as a forum for multilateral solution-finding.

For instance, in the latest round of IMF reform in the aftermath of the Asian crisis, it was asked by key shareholders to devise the Financial Sector Assessment Programme (FSAP) with the aim of stepping up its financial sector surveillance. Yet to date neither the US nor China has undergone such an assessment. That same round of reform sought to close the loopholes in the financial regulatory regime, prompting the IMF to focus on offshore financial activity on small islands, rather than on the toxic assets and financial vulnerabilities being accumulated in systemically relevant economies.

Though the need for cooperation is now finally recognized, there is no central body to assume leadership for responses to systemic risks in the global economy, while the debate has shifted to smaller and more flexible groups. The IMF has not been effective in this debate so far, partly owing to the lack of a truly representative and effective Executive Board and International Monetary and Financial Committee (IMFC).

Reforming the IMF

Against this background, the G20 leaders' meeting in Washington in November 2008 set off a process that could lead to a fundamental reform of the world's monetary and financial system. It is not clear yet how much they will be able to achieve.

But whatever they come up with has to be assessed against the yardstick of whether or not their decisions provide the international monetary system with a credible institutional anchor, i.e. whether or not the IMF will come out of these discussions with an enhanced mandate from its shareholders.

With that principle in mind, the following proposals have benefited from discussion with my colleagues of the Bretton Woods Committee. The thrust of these recommendations is first to make the decision-making system of the IMF, but also of the World Bank, far more transparent and inclusive. An obvious way to institutionalize this requirement is to introduce the double majority requirement for major decisions. (This would also, incidentally, end Euro-American dominance of the Bretton Woods institutions, since smaller and poorer countries would have a stronger say in the leadership selection process.)

Inclusiveness and a greater sense of ownership of the Bretton Woods institutions also require a more balanced distribution of voting power between developed and developing economies. In this regard, it is important that the IMF continue to simplify its quota formula, making it more responsive to the changing economic realities of the 21st century.

The ensuing reallocation of voting power will spur a change in the composition of the Executive Boards – that is, the policy-making organs of the IMF and the World Bank, with developing countries enjoying a broader representation than is currently the case. That said, such changes in quotas and representation are not mechanically correlated. A more representative and effective board requires one key reform: that European countries consolidate their representation. This could be accomplished in a number of ways – for instance, having one chair representing Eurozone countries and another chair representing all the other EU members.

The representation of the Eurozone chair(s) could be entrusted to the European Central Bank and the EU Commission, or be a multi-country constituency where the concerned member states would agree on their internal representation. Whatever the variant chosen, the two basic premises are that: (i) the Europeans must bring consistency in their representation on external monetary affairs, as they have done, for instance, with trade policy; and (ii) France, Germany, and the UK should commit, either for Europe or for the world at large, to relinquish the 'exorbitant privilege' of holding single-country appointing chairs.

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Seizing the Moment at the London Summit

Susan Schadler

Comparisons of the London Summit of 2009 with the failed summit of 1933 abound. Picture this failure scenario for 2009: driven by the highly commendable objective of reforming the International Monetary Fund (or indeed the overall institutional architecture), G20 leaders succumb to political manoeuvring that blindsides the summit to the four priorities for immediate action: agreeing on approaches to sharing the burden of demand creation, preventing demand diversion (i.e. protectionism), repairing banks' balance sheets and financing crisis support. In short, the risk for the 2009 summit is that it gets lost in global governance reform, a goal which, even if pursued successfully, will not pull the global economy back from the precipice.

As far as the IMF is concerned, G20 leaders should focus on how to deploy immediately the institution's three great and distinctive strengths: a sizeable (and in principle apolitical) secretariat with deep expertise in advising on macroeconomic policies to alleviate crises; a pot (albeit limited) of financial resources to support countries in crisis; and an established surveillance mechanism, which through direct contact with every country every year can deliver information on and assessments of macroeconomic policies.

Surveillance – assessing the burden of demand creation, monitoring demand diversion

Alongside repairing banks' balance sheets, coordinated demand stimulus is the most pressing requirement for getting the global economy back on track. The process has started, but at this juncture there are major risks of popular backlashes based on perceptions that one or a few countries are doing too much of the heavy lifting – taking on too much of the future tax burden of stimulus. A slow or weak recovery will compound these risks. At the same time, it will be a small step from these concerns to public pressure for all manner of tactics to divert demand in the countries with the biggest stimulus programmes to their domestic markets.

To resurrect global demand and prevent protectionism, a central arbiter and watchdog is essential. The IMF is the only international institution with the capacity right now to perform both these roles. The G20 needs to provide a strong mandate to IMF staff to work through scenarios of medium- and long-term effects of various distributions of demand stimulus. These will be the foundation for discussion and agreement within the G20 at the earliest date possible (ideally no later than June 2009) on the burden-sharing of demand stimulus. After an agreement has been reached, IMF staff surveillance should report quarterly to the G20 on its implementation. This responsibility would sit squarely within existing staff competences.

The second contribution IMF surveillance can make is monitoring demand diversion. This time around, protectionism is unlikely to occur predominantly through flat-footed measures such as raising import tariffs. More likely are measures that subtly redirect demand, for example through changes in tax codes, product standards, financing mechanism or government procurement practices. Should this not be an issue for the World Trade Organization? Ideally, yes, but not in its present state. The WTO's very small secretariat has infrequent reviews of individual countries' trade policies and a constrained mandate for assessing those policies. IMF surveillance – entailing annual visits to every country in the world – is the only option readily available. That said, the IMF's disengagement on trade policy issues during the past decade means that it has little. if any, expertise on trade policy issues. It will therefore need substantial support from the WTO, as well as the World Bank and OECD. But for the important and urgent monitoring task at hand, there is little choice but to use the existing infrastructure of IMF surveillance.

Rescuing countries in crisis – principles and financing

Lending programmes are being put together in global conditions without historical precedent in the IMF's experience. Also, they are being constructed in the shadow of a severe backlash against the intrusion of IMF conditionality into structural policies, particularly during the Asia lending operations in the late 1990s. These two facts mean that the IMF stands to get things wrong unless members agree on basic principles quickly.

The IMF's approach to conditions on its loans in crises is essentially designed for 'atomistic' cases – where one country, through bad policies and/or bad luck, cannot meet its external payments obligations without a crippling compression of demand, but where the rest of the world economy is still growing. On occasion, crises have hit regions; but even then growth in other regions has been normal. The IMF's conventional prescription is a blend of adjustment and financing: cut domestic demand, strengthen competitiveness so that the country can export its way out of the crisis, and use IMF financing to buy some time, smoothing the imposition of austerity measures and thus softening their impact. All of this is fine if markets for the country's exports are growing. If not, unpleasant surprises about how much demand contraction is needed to stabilize debt will be in the offing. And while the countries that have come to the Fund have so far been those whose crises were precipitated by particularly bad fiscal and financial sector policies (where contractions are unavoidable), the next batch will come from higher up the food chain. Should countries that had sustainable policies and may even be large in the global economy follow the route of demand contraction?

Two aspects of the approach need changing. First, the IMF's retreat from conditions on structural changes for economies in crisis needs to be reversed. Less reliance on immediate demand contraction is possible only with more financing or confidence-boosting reforms that will position crisis countries to weather a potentially lengthy period of weak global growth and limited external financing. The IMF (helped by the World Bank and OECD) needs to re-engage in structural issues. Countries with looming pension or health-care imbalances, barriers to productivity growth and competitiveness, and poor environments for doing business need to come up with concrete commitments to change. The IMF is not equipped to do this on its own. Rather, crisis teams including the World Bank and OECD will need to work off the example of collaboration on Financial Sector Assessment Programmes to construct structural recovery programmes.

Second, realism on financing requirements is needed. So far, the IMF's over-optimistic forecasts for the global economy mean that financial backing of crisis countries' programmes is likely to be insufficient. There needs to be at least a doubling of the IMF's financial resources. This will not happen through quota increases within the relevant timeframe. Diverse funding procedures are essential and urgent. Ideally, countries with large reserves and/or strong fiscal positions would come to the G20 meeting ready to put money on the table, following the Japanese example, and commit to other innovations. For example, the Federal Reserve and other central banks already have swap lines with some emerging markets, and the Chiang Mai Initiative[1] makes swap lines available to Asian countries. Financing of programmes backed by the IMF could certainly be bolstered by co-financing through these swap lines (with arrangements for automatic rollovers and repayment at the same rate as for IMF resources).

Reform of IMF governance – set work towards the goal in motion

Improving the outmoded and haphazard IMF governance is critical to its viability. Its Independent Evaluation Office recently completed an evaluation of governance that points to the need to reallocate voice and quota, raise the level of representation of members in the Fund and strengthen oversight of management. A critical addition to

1. The Chiang Mai Initiative refers to the agreement between the ten members of the Association of South-East Asian Nations (ASEAN) plus Japan, China and South Korea to make bilateral currency swap arrangements available to each other. This regional emergency reserve fund is currently worth $120 billion.

this list should be to rethink the roles of rules and discretion in guiding international monetary cooperation. These are necessary changes for the organization to regain its footing, but they will take time. Committing to an agenda for accomplishing this change should be the governance goal for the London summit.

The IMF can be immensely useful as a tool for helping the world through the crisis. True, it would be even more useful with better governance. But the G20 can use the IMF – even with its flaws – if it takes charge of the deployment of the Fund's attributes. Two caveats are needed, however. First, time is of the essence. The IMF needs immediate guidance and oversight from the G20. Second, the Fund should not be overloaded. Contrary to perception, it is not an institution adept at multitasking, particularly outside its expertise in macroeconomic policy, and its infrastructure must be immediately guided to the urgent tasks at hand.

The UK, the G20 and IMF Reform

Lauren M. Phillips

This contribution argues that now is the moment to collapse European representation in the International Monetary Fund into a smaller number of constituencies, and that the United Kingdom should lead on this issue by volunteering to give up its seat – not because it is the 'right thing to do' from a fairness or development standpoint, but because it can derive specific political and material advantages from doing so.

As I have written elsewhere,[1] reorganizing (or 'rationalizing') the votes of European Union member states has been central to most proposals for IMF reform. Authors with a more sympathetic view of the EU and its member states have focused on how this change would enhance European power in the Fund, while others have focused on how this would help achieve greater legitimacy for the IMF and give a greater voice to developing countries.

Despite the centrality of this idea in the literature on IMF reform, the topic was 'off the table' in recent negotiations on quota reform that culminated in the package announced in April 2008. Nonetheless, pressure for greater European coordination has increased rather than decreased. Policy-makers in the US and China, and even within the EU, continue to stress the importance of changing EU representation in the IMF.

For example, the US Treasury Under Secretary for International Affairs, David McCormick, advocated a reduction in the number of seats on the IMF Executive Board, by having fewer European seats.[2] The Chinese Premier, Wen Jiabao, commented that the IMF 'should increase the voting share, the representation, and the say of developing countries' before China will consider making additional contributions to the Fund.[3] Alan Beattie of the *Financial Times* interpreted the statement to mean that 'Europeans may have to make prior commitments to a shift in voting power – at the very least accelerating the next discussion of IMF quotas from its planned date of 2013 to 2010 or 2011 – if they want to attract contributions [from China and other emerging-market countries]'.[4] Finally, European policy-makers themselves have acknowledged that 'achieving a single euro area chair in international fora has so far been considered an objective for the longer term. But the world is moving faster and we need to reconsider our timetable.'[5]

Given this broad-ranging support, the idea of rationalizing European representation seems to be an inevitable next step in IMF reform. It is better for the UK to lead the charge on this topic than follow a reform agenda set by other European states, by the US or by large developing countries.

There are five advantages in using the UK's current leadership of the G20 to focus on a change to EU representation in the IMF.

First and most importantly, unilateral action by the UK during the 2009 G20 summit on this critical issue of Bretton Woods reform will allow it to set the scope of the reform, and to frame the issue in the most favourable light to achieve its interests. Being the agenda-setter is an advantageous position in international negotiations.

Second, the UK will accrue a massive amount of goodwill from developing countries, development-oriented civil society and the United States, which is keen to see a change in European representation. The UK will enhance its credentials as a pro-development, pro-reform member of

1. Phillips, L., 'Lead, Follow or Get Out of the Way: The Role of the EU in Reform of the Bretton Woods Institutions', XXVI G24 Technical Meeting, Geneva, 16–17 March 2006.
2. David H. McCormick, US Treasury Secretary for International Affairs, 'IMF Reform: Meeting the Challenges of Today's Global Economy', Washington DC, 25 February 2008.
3. http://www.ft.com/cms/s/0/795d2bca-f0fe-11dd-8790-0000779fd2ac.html.
4. Beattie, A., 'A gap to fill', *Financial Times*, 2 March 2009.
5. Joaquín Almunia, European Commissioner for Economic and Monetary Policy, 'Reinforcing EMU after the first decade', Brussels, 17 January 2008, Speech on the occasion of the 20th anniversary of the Representative Office of the Österreichische Nationalbank.

the international community, consistent with its behaviour on topics such as multilateral debt relief, the voice of low-income countries in global governance, the Millennium Development Goals and broader issues of aid allocation.

Third, a shift in the UK position opens up many possible permutations for European representation in the IMF. As the positions of smaller EU countries have often been framed *vis-à-vis* the positions of the UK and other single-member constituencies, this unexpected move would provide a large degree of flexibility.

Fourth, from a material standpoint, moving towards more rationalized European representation in the Fund will create possibilities for greater financial contributions from China and other countries with high foreign reserve levels. Given the probability of upcoming financial distress in Europe and on Europe's fringes, the UK would do well to find alternative financing for IMF support in order to minimize the ad hoc contributions it will be asked to make.

Fifth and finally, by framing the context of negotiations, the UK can ensure that the restructuring of European constituencies does not require changes in the formal delegation of competencies to the European level. Although EU policy-makers have argued that the underlying European architecture on financial and monetary issues must be changed before representation in the IMF is addressed, there is no legal reason why this is the case. The UK could advocate a change in its own and other countries' representation without delegating further monetary or financial authority to Brussels.

The domestic political costs of moving on this issue appear to be relatively minor. While the Conservative Party opposition in the UK might attempt to characterize this move as delegation of authority to Europe, it would be hard to do so for at least two reasons. First, representation in the IMF is a highly technical issue, about which the average voter understands little and probably cares less. It would be difficult to achieve great traction on this issue as a serious point of domestic political contestation. Second, by leading on this issue, the UK can ensure that the negotiation does not ultimately lead to greater authority on monetary or financial issues being passed to Brussels (point 5 above). This should help to neutralize any potential criticism from eurosceptic voices in the UK parliament.

The other perceived cost of this move is loss of influence and prestige in the IMF. But the actual costs of merging European representations are relatively low for at least three reasons. First, as has been demonstrated in a number of studies, the divergence in preferences on IMF lending among large European states is limited.[6] Second, as coordination mechanisms among Europeans in the IMF already exist, the move would only serve to formalize that existing *de facto* coordination. Third, the UK, unlike smaller European countries that have seats in the IMF, can exercise power on financial issues in numerous other international fora. The G8 and G20 are just two examples.

No specific potential proposals on changes to European representation are outlined here. But it is worth noting that as IMF constituencies have no uniform rules about leadership and elections,[7] there are several possible realignments that would maintain UK leadership of a European constituency. To reinforce the earlier point, achieving such realignment may be dependent on the UK leading on this issue, as an initiative from another European state (e.g. Germany) may result in a far more centralized role for the European Central Bank or the European Commission.

Conclusions

The UK should use its chairmanship of the G20 to take the lead on IMF governance reform by volunteering to give up its seat on the Executive Board. This action will certainly surprise many observers, will be a tangible announcement at a summit where expectations are running high, and will enhance the UK's credentials as a serious reformer of global governance while simultaneously affording it a number of benefits in terms of negotiation and material gains. If pursued in this manner, the costs are minimal. Allowing this inevitable aspect of IMF reform to go ahead without British leadership increases the risks for preserving UK interests in the Fund.

6. See Copelovitch, M., 'Master or Servant? Agency Slack and the Politics of IMF Lending', Working Paper, University of Wisconsin-Madison, 2006. Available online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1307414.
7. Lombardi, D. and N. Woods, 'Uneven Patterns of Governance: How Developing Countries are Represented at the IMF', *Review of International Political Economy* 13 (3) (2006), pp. 480–515.

Reform of the Financial Stability Forum: Four Considerations

Andrew Baker

Four considerations or rationales should inform the reform of the Financial Stability Forum (FSF). These are:

(1) *Realizing cross-sectoral potential* – the need to build on the original innovative institutional features and strengths of the FSF as a multi-agency forum with the capacity to facilitate cross-sectoral and inter-regulator dialogue, so as to enhance appreciation of the synergies that tie different financial markets and sectors together.

(2) *Bolstering sight lines and the field of vision* – the need to equip the FSF to consider not just questions of 'high' global finance, but also to ensure that its membership reflects a recognition that global financial stability is linked to and depends on the integrity and viability of 'everyday' credit practices and products, in ways that enable the Forum to respond to and anticipate problems in consumer and household finance that might have broader systemic implications;

(3) *Country representation* – the need to enhance the representation of important emerging markets and developing countries in the FSF;

(4) *Accountability relationships* – the need to clarify the accountability relationships between the FSF and other bodies;

My intention in what follows is not to go into the detail of the precise representation and numbers within the FSF, but to paint with a broad brush and identify guiding principles, rationales and objectives, which should the inform the work of the G20 working group on reform of the FSF.

Fully realizing cross-sectoral potential

The initial rationale behind the creation of the FSF in 1999, according to the G7 communiqué announcing its inception and to its creator Hans Tietmeyer, was to ensure that national authorities, multilateral institutions, relevant international supervisory bodies and expert groupings could more effectively foster and coordinate their responsibilities, pool information and develop early-warning indicators of crises. The FSF was an attempt to create a one-stop shop that brought a variety of systemically important national regulators and international regulators and bodies under one roof in a common shared space for dialogue and exchange, at least partially reflecting the ways in which different financial markets were becoming tied together with significant systemic implications. Joined-up governance (regulatory and market analysis) for the global financial system was the aspiration. In this respect, the FSF was a spectacularly good idea and an important institutional innovation – at least in terms of its conception. It has been less successful in overseeing the execution of these objectives. In the intervening period, not least in the context of the current crisis, the importance of inter-regulatory dialogue across sectors and an advanced appreciation of the synergies linking contemporary financial, credit and debt markets has become more, not less, important. The FSF as a cross-sectoral forum remains a good idea; it should be central to the response to the current crisis, but to date it has not realized its potential. The reasons for this underperformance need to be understood and addressed.

In part, each of the three following headings address some of the existing problems in turn, but FSF reform also calls for some serious soul-searching on behalf of those currently involved. What does each national agency contribute to the broader objectives of the FSF and what purpose does their participation serve? The FSF cannot afford to carry passengers. Positive, active contributions are required. Question marks remain over the number of finance ministry representatives in the FSF, for example, not least because many finance ministries have little in the way of regulatory reach, responsibility or expertise. In their reflections on the operation of the FSF, former participants Howard Davies and David Green conclude that the Forum has helped to educate ministries of finance on financial stability issues.[1]

But this observation raises the question of why the finance ministries are there in the first place if they have relatively little expertise or focus in this area. Is their presence now a luxury that can be ill afforded? Do they need to be directly involved in the FSF, or are they taking up valuable seats that would be better occupied by other agencies with specific regulatory responsibilities?[2] Would it be more efficient for the finance ministries to play a monitoring role of the FSF, one step removed from direct participation? These questions need to be answered candidly and openly. If the cross-sectoral potential of the FSF is to be realized, states need to debate and rethink which agencies would best represent them in the Forum, so as to create the best possible potential overview of the different markets contributing to overall global systemic financial stability and the best possible understandings of the relationships between these markets. Of course, it should be added here that there is a connection between the supervision of certain sectors, risk management strategies and macroeconomic stability. Global imbalances and their management through macroeconomic strategies affect the liquidity of different markets in different ways at different times. There is a strong case for saying that the FSF is the obvious venue for monitoring how global imbalances impact on market sectors, in a way that involves national regulators. In such instances there is an obvious case for representation from finance ministries of large countries that are important for the handling of global imbalances. It is less clear that smaller G7 countries should continue to send finance ministry representatives to the FSF.

Bolstering sight lines and fields of vision to include knowledge of everyday credit and financial products

The current financial crisis has highlighted the unprecedented relationships between everyday saving and borrowing and the capital markets we know as 'global finance'. Extraordinary transformations of global finance are intimately related to transformations in seemingly mundane savings and borrowing, while recent huge gyrations and disruptions have arisen out of ruptures in the ordinary payment routines of mortgagors.[3] Any body purporting to have responsibility for, or to contribute to, systemic financial stability needs to recognize these linkages, have the analytical capacity to examine them in greater detail, consider the regulatory implications of such linkages and assess their implications for systemic stability. In the context of the current crisis, focusing solely on securitization, risk management techniques, credit rating agencies, the activities of hedge funds and structured investment vehicles, prudential oversight, the dangers of procyclicality (Basel II), or what we conventionally conceive of as 'global finance' will constitute a job only partly done.

Global bodies such as the FSF need a better appreciation of how everyday credit practices and procedures relate to some of the products and activities listed above. This will require dialogue and relationships to be built with agencies involved in or overseeing these activities. That might involve greater outreach to, or powers for, the FSF to elicit testimonies and contributions from agencies in the United States such as the Federal Deposit Insurance Corporation, the Federal Trade Commission, the Department of Housing and Urban Development, the Federal Housing Association, and even Fannie Mae and Freddie Mac, and for these agencies to participate in FSF working groups on a selective basis. At the very least, a clear dialogue and relationship between these kinds of bodies (and national

1. Davies, H. and D. Green, *Global Financial Regulation: The Essential Guide* (Cambridge: Polity Press, 2008), p. 118.
2. The Securities and Exchange Commission represents the US in the FSF but has a far from exhaustive regulatory reach, while the Commodities Futures Trading Commission remains excluded, as is the Options Clearing Corporation. The Treasury Department, with little in the way of regulatory responsibility, participates in the FSF. The European Commission has expanded its regulatory role in Europe, but still does not participate in the FSF. The Commission could play a key role in rationalization of European representation in the FSF. My purpose here is simply to ask the question whether the current membership in terms of national representatives in the FSF is the most rational, efficient and effective that could be achieved.
3. Langley, P., *The Everyday Life of Global Finance: Saving and Borrowing in Anglo-America* (Oxford: Oxford University Press, 2008).

equivalents elsewhere) and the FSF ought to be established. The current crisis has revealed that the activities these agencies are involved in, or have oversight of, have global reverberations, yet they are excluded from the global financial architecture and global policy dialogues. It has also revealed that this situation is unsustainable, and efforts at reform should attempt to address this by inserting their voice, perspective and expertise into global debates, in some way, shape or form. The multi-agency nature of the FSF makes it the obvious venue for such efforts. Failure to address this issue will constitute a wasted opportunity.

Country representation

Country representation is the most obvious and publicized issue facing FSF reform. G7-centric membership of the FSF is unsustainable, and damages its legitimacy, credibility and reputation. It is important that systemically important countries become FSF members. China, whose banking sector accounts for 9 per cent of the world total and whose banks are increasingly active internationally, should be given representation on a par with the biggest countries. Generally, it is important that the systemic significance of different locations is monitored and that the FSF shows a willingness to adjust its membership in recognition of the changing importance of different financial centres such as Mumbai, Dubai and São Paolo. The effectiveness and relevance of the FSF will be enhanced by such a stance.

Clarifying and specifying accountability relationships

Accountability relationships represent an enormous and important challenge for the FSF, but one that could be obscured by the clamour for emerging-market representation. This issue touches on many of the problems that have prevented the FSF from realizing its full potential. The real value added of the FSF is as a cross-sectoral, inter-regulator space (not as an out-and-out apex forum like the G7 or G20). It has the potential to act as a knowledge-generation network by enhancing understanding of the linkages and synergies between different financial markets and the implications of this for systemic stability. It can do this by tracking and monitoring market developments and innovations that have cross-sectoral implications (including liaising with market participants and experts), identifying areas of systemic vulnerability by preparing targeted reports on specific issues, particularly those of a cross-cutting, cross-sectoral nature. One of the laments of former participants in the FSF is that after an initial period of quite intense activity, the FSF was prevented from commissioning its own work and simply reported on developments going on elsewhere.[4] The FSF should be given a clear mandate to identify areas in need of urgent attention and where collaborative work between different regulators could usefully be undertaken, and then convene inter-regulator working groups to do so. This might allow the FSF to carve out a distinctive position and integrate the various perspectives of a diverse membership, something it has largely failed to do thus far.[5]

Institutions such as the Basel Committee, the International Organization of Securities Commissions (IOSCO) and the International Accounting Standards Board (IASB) have jealously guarded their independence, have engaged with the FSF somewhat selectively and generally have regarded it as something of a sideshow. The FSF should be given a formal mandate to commission individual and collaborative work from these bodies, to identify priorities for them, based on its own cross-cutting findings. The FSF should also be made formally accountable to one of the finance ministers' and central bankers' forums, probably the G20 now that the G7's status as an apex forum is being challenged. This would entail reporting and testifying to ministers and their deputies, while giving the G20 a formal agenda-setting or directional mandate that would allow it to set priorities and deadlines for FSF work.

While the FSF should be encouraged to commission its own work and identify its own priorities, for reasons of

4. Davies and Green (2008).
5. Ibid.

accountability and legitimacy it would make sense if proposed agendas and initiatives were formally approved and endorsed by the G20. The work undertaken by the FSF would ideally enable it to identify vulnerabilities and predict or anticipate problems of a potential systemic nature. This could involve a colour-coded system of warnings about vulnerabilities to indicate to the G20 the urgency of issues and the type of remedial action required.

Finally, the FSF should send delegates to the IMF and the World Bank to disseminate the findings of FSF reports and work to their staff. These two bodies should be mandated to respond to FSF work and have an obligation to adjust their own assessment (Reports on the Observance of Standards and Codes and Financial Sector Assessment Programmes) and technical assistance programmes in ways that take into account the priorities identified by the FSF work on vulnerabilities. The FSF should also be given a means to feed into and inform the IMF's Global Financial Stability Report. The FSF should not be able dictate to the IMF and the World Bank, but they should be required to take account of it as an information and knowledge resource.