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Global Macroeconomic and Financial Governance

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GLOBAL MACROECONOMIC AND FINANCIAL GOVERNANCE

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I. Introduction

The recent financial crisis placed the issue of global macroeconomic and financial stability at the center of the international agenda. Macroeconomic governance has, of course, old roots, which trace back to the creation of the Bank of International Settlements (BIS) in 1930 and the Bretton Woods Institutions (BWIs) in 1944. The BWIs experienced important transformations in later decades: in the case of the International Monetary Fund (IMF) as a result of the collapse of the original dollar exchange standard in the early 1970s, and in the case of the International Bank for Reconstruction and Development (IBRD) by adding new institutions to what is now called the World Bank Group. Two of them are particularly relevant for this paper: the International Finance Corporation (IFC), created in 1956, and the International Development Association (IDA), in 1960.

To these institutions, an array of regional, sub-regional and inter-regional development banks was added, starting with the European Investment Bank (EIB) in 1958 and Inter-American Development Bank in 1959. In the area of financial regulation, the Basel Committee on Banking Supervision (Basel Committee in short) was created in 1974, and similar institutions were put in place a decade later to coordinate the regulation of insurance and capital markets. In turn, the crisis of emerging economies in the late 1990s gave rise to the creation of the Group of 20 (G-20) and the Financial Stability Forum (then a G7 institution), both aimed at preventing the traumatic events of the Asian and succeeding emerging country crises. They were transformed during the recent global financial crises into a leaders' forum and the Financial Stability Board, respectively; the latter was given the task of coordinating global financial regulation.

Viewed as a system, global macroeconomic and financial cooperation has three basic objectives. The first is global financial stability, which should be understood as the prevention of

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financial crises and better management of them when they occur. The second is international macroeconomic stability, and should be understood as guaranteeing an adequate supply of liquidity at the international level and the global coherence of macroeconomic policies that are designed at the national level (regional in the case of monetary policy in the Eurozone), particular those of major economies. The third objective is channeling financing to development functions, particularly to developing countries which do not access to private financing or during those periods in which private financing dries out; an additional function which has been added to these institutions is their contribution to the financing of global and regional public goods.

This paper analyzes the nature of global cooperation in these areas. It is divided in six sections, the first of which is this introduction. The three following sections deal, in a consecutive manner, with the three objective of global macroeconomic and financial cooperation just mentioned, the advances that have been made in recent years and the gaps that remain. The fifth analyzes institutional issues of global governance in these areas. The last draws some brief conclusions.

II. Financial Stability

The deficit of financial regulation and supervision that has characterized the world's liberalized financial markets that developed over the past decades has been remarkable. The result has been a series of major crises. Strengthening financial regulation and supervision has thus been at the center of the management of crises, both in emerging economies and in those developed countries that experienced deep domestic financial crises in the past (the Scandinavian countries, for example). The most shocking fact that the recent financial crisis revealed was that a similar deficit in regulation had come to characterize other developed countries and, particularly, those that host the major global financial centers (the United States and the United Kingdom).

Under the coordination of the Financial Stability Forum, but also as the result of various national or regional initiatives (particularly in Europe in the latter case), re-regulation of finance has been going on an unprecedented scale in the industrial world in recent years, though plagued by delays in implementation, insufficient coordination and political economy pressures to weaken the reform efforts. The fact that emerging economies had undertaken similar steps after their own financial crises was one of the reasons why they were able to avoid domestic financial meltdowns this time; the exceptions were some emerging economies of Central and Eastern Europe that had not been involved in similar efforts in the past.

The major reforms were adopted by the Basel Committee in September 2010 and came to be known as Basel III (Basel Committee, 2010; Caruana, 2010). The major elements of that reform were, on the one hand, strengthening the capital base, the quality of that capital and the liquidity requirements for banks and, on the other, the recognition that financial risk has an important macroeconomic component and, therefore, should be accompanied by the design of macroprudential policies. Some analysts, notably from the Bank of International Settlements and the United Nations, had emphasized the role of macroeconomic risks, but they were broadly ignored, except by a handful of countries.[1]

Basel III increases the core capital requirements made up from common shares and retained earnings from 2 to 4.5% of the risk-weighted assets, raising in turn the total tier 1 capital from 4 to 6%. It also raises the quality of all assets that can be computed within the total capital requirement of 8%. To these it adds a capital conservation buffer of 2.5% that should also be made of common equity –thus raising the total capital requirements to 10.5%–, and a countercyclical capital requirement that would fluctuate between 0 and 2.5% according to national conditions. These two buffers help to absorb the risks that banks accumulate during periods of credit booms and can be used during crises to absorb the associated losses. In turn, it adds a new leverage ratio that determines that capital has to be at least 3% of gross assets. Basel III also makes explicit the liquidity requirements for banks, which had been practically absent in previous rules; these requirements were, nonetheless, softened in late 2012 under the pressure of major banks. All these norms would be introduced gradually in 2013-19. Some analysts consider these requirements, particularly the leverage ratio, too low and the implementation period excessively long. Finally, the Financial Stability Board also proposed in 2011 rules for the "too big to fail" financial institutions, that include higher capital and liquidity requirements as well as rules that simplify the structure of financial conglomerates.

[1] See a review of the debate in Griffith-Jones and Ocampo (2010).

In the U.S., the 2010 Frank-Dodd Act was also the major step in the direction of strengthening regulation in the major global financial center. One of its novelties was the "Volcker rule" that places limits on the amounts that banks can invest in riskier assets (primarily in investment funds) –up to 3% of tier 1 capital. This was the alternative to the sharp separation between investment and development banking that the U.S. had in the past.[2] In the case of Europe, the major step was the adoption of the first element of the "banking union" in December 2012: a single supervisory mechanism, with the European Central Bank as the center, though with the participation of non-eurozone countries and the complementary responsibility of national central banks to supervise the smaller institutions (under €30 billion). Other elements of the banking union, particularly the common regulatory and resolution framework are still pending. In the latter case, some countries, notably Germany, have made it clear that the resolution mechanism (including the eventual contributions from the European Financial Stability Mechanism to the capitalization of financial institutions in trouble) should apply only for the future, with national governments being responsible for absorbing the costs of past crises. This has contributed to the segmentation of the Eurozone financial market, one of the most troublesome outcomes of the recent crisis.

As part of efforts to introduce macroprudential policy frameworks, the European Union put in place an European Systemic Risk Board, and the Dodd-Frank Act created in the U.S. the Financial Stability Oversight Council, which also coordinates the multiple regulatory agencies that characterize this country. The fact that these as well as other major initiatives are adopted with some independence of each other, means that the regulatory systems being put in place may have divergences in design and even conception, and could lead to competitive distortions.

Two remarkable absences from this agenda have been the regulation of cross-border capital flows and the lack of initiatives to introduce better international debt workout mechanisms. The first of these issues has been dealt with, nonetheless, in the framework of the IMF, and in this sense as part of global monetary reform. In late 2012, the IMF Executive Board endorsed a new "institutional view" on capital account liberalization and the management of capital flows (IMF, 2012). This view recognizes that capital flows carry risks, which are

[2] The historical separation was introduced by the Glass-Steagall Act in 1933 but was eliminated by the Gramm-Leach-Billey Act in 1999, which was an initiative of the Clinton administration but which some analysts consider had already been violated in practice..

particularly severe for countries that have not reached a certain threshold of financial and institutional development. It acknowledges that, under certain circumstances, regulation of cross-border capital inflows and more exceptionally outflows may be appropriate, though after other macroeconomic policies have been adopted, avoiding discriminations based on residence, and in a "targeted, transparent, and generally temporary" manner. It finally points out that source countries should pay more attention to the potentially negative spillover effects of their macroeconomic policies on recipient countries, and that the new view may be at odds with other international commitments, including OECD rules and free trade agreements that restrict the ability to regulate cross-border flows.

Overall, this "institutional view" is certainly a more nuanced than the previous IMF positions on the subject, but it only goes half way in the direction of those who claim that capital account regulations should be a central element of global financial regulation (see, in this regard, the papers included in Gallagher et al., 2012). It does not eliminate, in any case, the capacity that countries have to regulate capital flows according to the IMF Articles of Agreement, an issue that was settled in 1997 when a proposal to introduce capital account convertibility into the Agreement was not endorsed by the necessary majority of member countries.

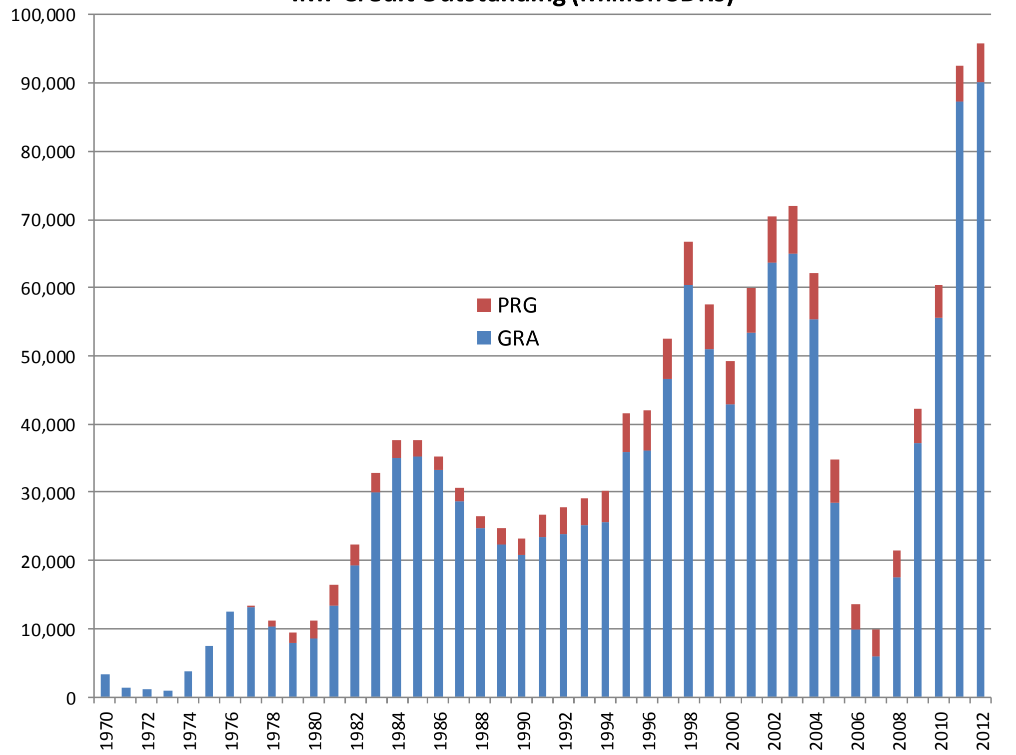
In the second area, the need to go beyond the ad-hoc and uncoordinated renegotiations of individual countries' debt overhangs now in place had been the subject of attention after the 1994 Mexican and, particularly, the sequence of emerging country crises that started in East Asia in 1997. The most important initiative was the 2001-03 IMF proposals to create a Sovereign Debt Restructuring Mechanism, which failed, but one important outcome of the discussion was the rapid spread of collective action clauses in debt contracts. The Eurozone has agreed to include collective action clauses in all debt issues starting in 2013.

III. Macroeconomic stability

The reform of the global architecture for macroeconomic stability has received less attention in recent years than global financial reform. Such architecture may be said to include two major issues: the way international liquidity is provided (the global reserve system), both on a regular bases and in crisis conditions, and the management of the macroeconomic linkages among different countries and regions, particularly among the systemically-important economies. The latter may be understood as having as its major objective avoiding the major global imbalances and includes, in turn, three separate issues: the consistency in the way different national authorities (regional in the case of the monetary policy in the Eurozone) run their macroeconomic policies, the exchange rate system and rules on cross-border payments and capital flows (an issue already dealt with in the previous section).

The most important advance during the recent crisis was made in the redesign of emergency IMF credit lines. This includes the creation of contingency credit lines –particularly the Flexible Credit Line (FCL) and the use for contingency purpose of stand-by facilities—, the much larger levels of financing relative to quotas, and the reforms of facilities for low-income countries. This led to a significant increase in lending which, for the first time since the 1970s, included high-income (European) countries. Figure 1 shows that active countercyclical function played the IMF, and in fact underestimates that role as it does not include the contingency credits approved but not disbursed.

Figure 1
IMF Credit Outstanding (Million SDRs)



Notes: PRG Trust: Facilities for low-income countries
GRA: General Resource Account
Source: International Monetary Fund (http://www.imf.org/external/np/fin/tad/extcred1.aspx)

It should be added that these reforms also led to a significant reduction in the conditionality attached to IMF lending, as the FCL is free from ex-post conditionality and the relationship between IMF disbursements and structural conditionality was eliminated in 2008. The U.S. Federal Reserve also operated as a significant provider of dollar liquidity, not only to developed countries but also to emerging economies. Four of them –Mexico, the Republic of Korea, Singapore, and Brazil– were given access to Fed swap lines in October 2008 for up to $30 billion, which of course are clearly superior to IMF loans in terms of flexibility and lack of conditionality.

The G-20 also launched in 2009 and the IMF Board approved the largest issue of SDRs in history: US$250 billion (SDR 161.2 billion). This was made together with another allocation for SDR 21.5 billion, which had been approved by IMF members in 1997 but which had not been effective as it lacked the approval by U.S. Congress of the Amendment of the IMF Articles of Agreement of which it was part. Given current IMF quotas, this allocation went primarily to developed countries: 62.9% to high-income OECD countries and 5.9% to high-income non-OECD (particularly Persian Gulf) countries (Erten and Ocampo, 2012, Table 2).

However, this has not been followed by any attempt to place SDRs at the center of the global reserve system. In this regard, proposals have been made for some time to move toward a more active SDR allocations, either issuing them in a counter-cyclical way (United Nations, 1999; Camdessus, 2000; Ocampo, 2002) or making regular allocations, reflecting the additional global demand for reserves (United Nations, 2009, ch. 5). The two approaches can be complementary, as regular allocations could be withheld during booms until the world economy goes into a downturn, following preset criteria. Most estimates indicate that allocations for the equivalent of US$200-300 billion a year would be reasonable.[3]

Indeed, the most relevant (and, in fact, simpler) reform that could be made in this regard would involve financing *all* IMF lending and in fact all IMF operations with SDRs, an idea that was suggested by the IMF economist Jacques Polak (1979) three decades ago. One alternative that I have suggested would be to treat the SDRs not used by countries as deposits in (or lending to) the IMF that could then be used by the institution to lend to countries in need (Ocampo, 2010

[3] See a survey of different estimates in Erten and Ocampo (2012).

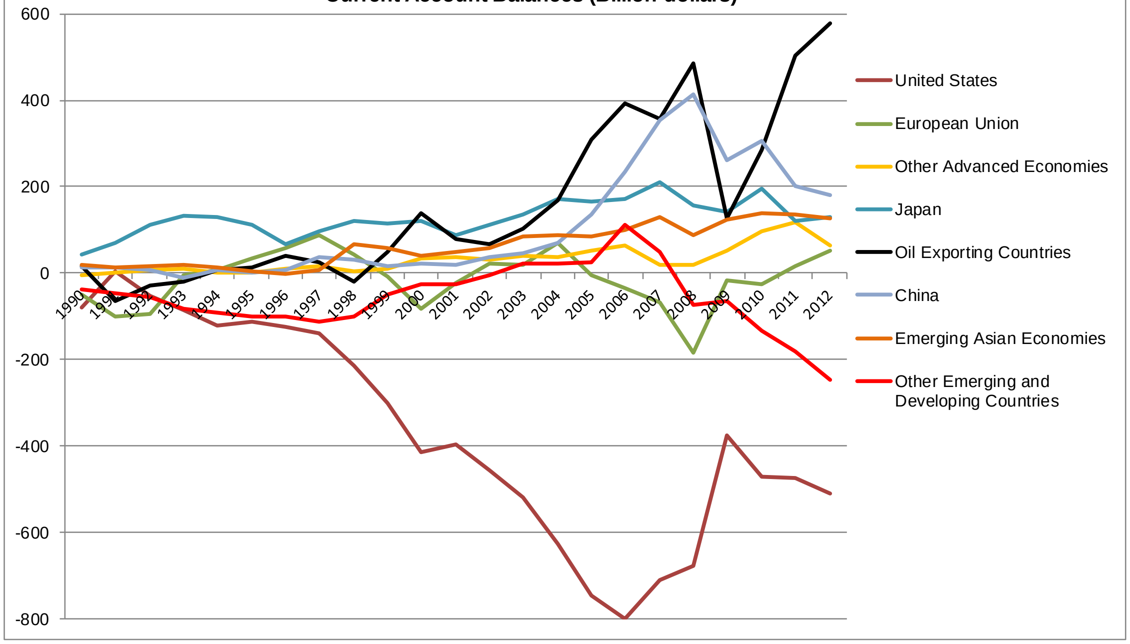
and 2011). This would also eliminate the need for the IMF to get financing from its members in the form of the "arrangements to borrow" or the bilateral credit lines that have been actively used during the recent crisis.

Prominent voices have been heard in recent years to reform the global monetary system in a more ambitious way, particularly those of the Chinese central bank governor (Zhou, 2009), the Commission of Experts convened by the President of the UN General Assembly on Reform of the International Monetary and Financial System and chaired by Joseph E. Stiglitz (United Nations, 2009 –referred to below as Stiglitz Commission), and the Palais Royal Initiative (2011) promoted by the French government. An ambitious reform should aim at correcting or at least mitigating the three basic deficiencies of the current global reserve system: (i) the recessionary (or, in traditional terminology, deflationary bias) generated by the asymmetric burdens of adjustment to payments imbalances between deficit and surplus countries; (ii) the problems associated with the use of a *national* currency as a *global* currency, generally known as the Triffin dilemma; and (iii) the inequity bias generated by the need for emerging economies to "self-insure" themselves against crises by accumulating massive amounts of foreign exchange reserves.[4] A realistic reform would include the reinforcement of the role of the SDRs, perhaps as a complement to a multicurrency global reserve system. In the latter area, the major initiative has been that taken by the Chinese government to internationalize the use of the renminbi, but its effects have been limited so far (Yu, 2012).

The main challenge of macroeconomic policy coordination is, as already indicated, avoiding massive global imbalances. The world economic system generated massive imbalances since 1997 the Asian crisis and, particularly, during the 2003-07 boom (Figure 2). Rapidly rising U.S. deficits –which experienced nonetheless a moderate correction at the end of the boom, thanks to the depreciation of the dollar—were matched by the change in the net position of the European Union from a current account surplus in 2002-04 to a deficit at the end of the boom. The counterpart of these deficits were massive and rising surpluses in China, the oil exporting countries and, to a lesser extent, Japan and the other East Asian emerging economies. Other emerging economies also went from a deficit at the time of the Asian crisis to a surplus at the end of the boom.

[4] For a fuller discussion of these issues, see Ocampo (2010 and 2011) and Padoa-Schioppa (2011).

Figure 2
Current Account Balances (Billion dollars)



Source: IMF, *International Financial Statistics* .
Oil exporting countries: Angola, Bahrein, Iran, Iraq, Joran, Kwait, Lybia, Omar, Qatar, Russia, Saudi Arabia, United Arab Emirates and Venezuela
Emerging Asian Economies: Hong Kong, Republic of Korea, Singapore, and Taiwan POC

The crisis led to major changes in this regard. The U.S. deficit fell significantly and the European Union went from a deficit to a surplus position. After an initial reduction of their surpluses, the oil exporting countries became in 2011-12 the major source of surpluses. The result is that the pressure to adjust in the opposite direction fell on emerging economies, as reflected in the sharp reduction of the Chinese surplus and the change in the non-East Asian emerging economies from a surplus to a significant deficit in 2012.

As this indicates, there is no single cause of global imbalances. Furthermore, they reflect both structural as well as short-term phenomena. The former include the pressure for the U.S. to run persistent deficits in order to provide global dollar liquidity (the factor underscored by the Triffin dilemma), the surplus of oil exporting countries (which also has a cyclical dimension) and the surpluses of East Asia, including Japan (which may be the result of high savings rates). The asymmetric adjustments of deficit vs. surplus countries have been particularly reflected in the pressure of the European peripheries (Western and Eastern) to adjust vs. the stability of the high surpluses of Germany and other Northern European countries.

To manage these complex issues, the world lack adequate mechanisms of macroeconomic policy dialogue and cooperation. Most mechanisms cooperation have operated outside the IMF and have not been particularly effective. The included the ad-hoc agreements of the 1980s to facilitate an orderly depreciation of the U.S. dollar and appreciation of the Yen: the Plaza and Louvre accords of 1985 and 1987. The dialogue then shifted to the G-7 and, during the recent crisis, to the G-20. It has been complemented by the informal coordination among leading central banks, which was critical during the two year or so after the outbreak of the subprime crisis in the U.S. in mid-2007.

G-20 cooperation was successful in the early years, when it assumed the form of a "Keynesian consensus", which led to fairly coordinated expansionary monetary and, to a lesser extent, fiscal policies. In particular, it avoided the Great Recession from transforming itself into a new Great Depression. The consensus broke down in the June 2010 G-20 Toronto meeting, when several countries decided to give priority to public sector debt sustainability. The consensus on monetary policy has been more persistent, except for the lapse of the European Central Bank, which temporarily reversed its monetary stimulus in 2011 before shifting again to an expansionary policy at the end of that year. The need for continued monetary stimulus in all advanced economies has led to a sharp contrast with emerging economies that renewed growth soon after the Great Recession, with several of them moving into a less accommodative monetary policy. The incentive to shift capital toward the emerging world induced by these asymmetries in monetary policies has generated a tendency for the currencies of several emerging economies to appreciate and the deterioration of the current accounts mentioned above. This is the phenomenon that Brazilian Finance Minister Guido Mantega called the "currency wars".

The major mechanism of macroeconomic policy dialogue among G-20 countries is the Mutual Assessment Process (MAP) launched in 2009. The focus of this dialogue are "the persistently large imbalances that require policy action": "(i) public debt and fiscal deficits; and private savings and private debt (ii) and the external imbalances composed of the trade balance and net investment income flows and transfers, taking due consideration of exchange rate, fiscal, monetary, and other policies". Based on indicative guidelines, it was agreed that economies that show large imbalances in at least two areas and represent more than 5% of G-20's GDP should be subject to particular scrutiny in the associated imbalance (G-20, 2011a and 2011b). The technical support for these exercises is provided by the IMF (IMF, 2011).

The major proper IMF activity has been the strengthening of surveillance, both bilateral and multilateral. The first now includes a more in-depth consideration of financial issues, and more "candid" assessments, particularly for major economies. In turn, 25 jurisdictions with systemically important financial sectors must be subject to Financial Sector Assessments Programs (FSAP). At the multilateral character, it includes a series of new reports, including the *Consolidated Multilateral Surveillance Report,* the "spillover reports" for the "systemic 5" (U.S., U.K., Eurozone, Japan and China) and the pilot "External Sector Reports" assessing global imbalances.

The world had never developed an elaborate system of surveillance and macroeconomic policy dialogue such as this one. Whether it has is "traction" (to use a typical IMF term), particularly in relation to major economies, is of course the major question. The system that has been put in place continues to rely essentially on a mix of stronger surveillance and peer pressure. But such forces continue to be weak, as reflected in the limited practical attention to the spillovers on emerging economies generated by expansionary monetary policies in the developed countries, the incapacity to shift fiscal austerity in the Eurozone or to force China to appreciate its exchange rate at a faster rate.

In relation to exchange rates, the breakdown of the original Bretton Woods system of fixed but adjustable exchange rates in the early 1970s led what can be correctly called a "non-system", as all countries are essentially free to choose any exchange rate regime they prefer. The only constraint, according to Article IV of the IMF Agreement is that countries should "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members". This is also the center of the June 2007 decision on bilateral surveillance, which replaced the 1977 decision on surveillance of exchange rate policies. An essential problem is, however, that the IMF has failed to determine what "manipulation" means.

The system could be improved by introducing elements that enhance the capacity of exchange rate to contribute to correcting global imbalances and to provide a reasonable level of stability. The best system is probably one of reference rates among major currencies, which has been suggested by Williamson (2007), among others. This implies that major countries would follow some form of managed floating around multilaterally agreed parities or bands. One of the advantages of such a system is that it would also give some guidance to markets, which may help avoid extended periods of deviation from equilibrium. Interventions in foreign exchange markets but also other macroeconomic policies would support the movement of exchange rates towards the agreed parities or bands (i.e., reinforce depreciation if the currency is perceived to be overvalued and appreciation if it is undervalued). Intervention rules would provide an implicit definition of what "manipulating" the exchange rate means.

IV. Development Financing

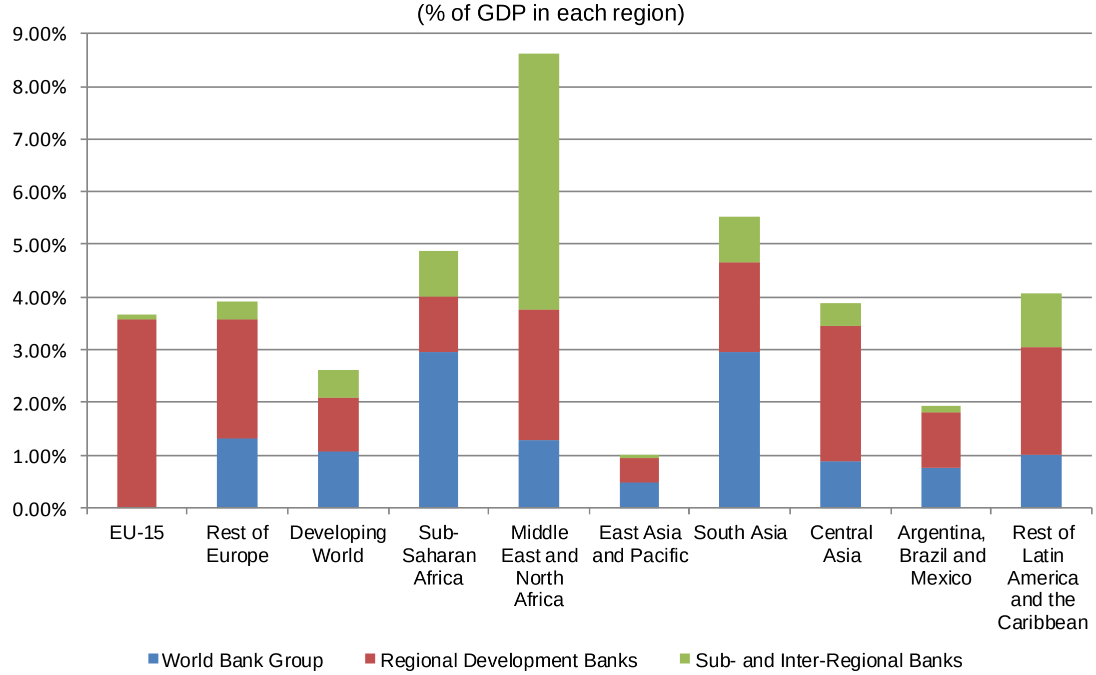
The system of multilateral development banks (MDBs) was born with IBRD but, as indicated in the introduction, was enriched with the creation of the regional development banks and a series of sub-regional banks and an interregional one (the Islamic Development Bank) since the late 1950s. Political motivations were behind the creation of many of these institutions. The Inter-American and Asian Development banks, for examples, were the result of cold war politics, while the African Development Bank was the daughter of decolonization and the later European Bank for Reconstruction and Development is the result of the West's interest in the success of market reforms in transition economies after the fall of the Berlin Wall. In turn, the origin of the Arab and Islamic institutions lies in the regional solidarity generated by the Arab-Israeli war of 1967. National development banks are also involved to some extent in international development functions, including now some from emerging economies (China being the most remarkable case). This process has not ceased, and includes now the proposal by the BRICS, announced in March 2013, to create a new bank with a major focus on infrastructure.

This network now constitutes what can be called a "dense" architecture of cooperation. As Figure 3 makes clear, this network of institutions provides quite a useful supply of services to most parts of the world, including Western Europe, through the European Investment Bank. However, the coverage of services by MDBs varies across regions, mixing in variable ways its different layers.[5] The Middle East and North Africa is the best covered region, with a large share

[5] See, in this regard, the contributions to Ocampo (2006).

of sub-regional and the Islamic Development Bank, followed by South-Asia and Sub-Saharan Africa, where the World Bank is the major player. They are followed by Latin America and the Caribbean, excluding its three largest economies, Central Asia and, interestingly, Western Europe. The three largest economies of Latin America and East Asia are the two regions where coverage of MDBs is more limited.

Figure 3
Multilateral Development Banks, Assets by Region, 2010
(% of GDP in each region)



Source: Author estimates based on information from each bank and GDP according to IMF.

With the exception of the European Investmetn Bank, which is made up entirely of industrial countries, all of which can borrow from the institution, the regional development banks include a division between developing country borrowers and nonborrowing industrial-country members. This structure was adopted only late (in 1982) by the African Development Bank, which was initially a strictly African institution, but was forced to converge toward this structure because of its financial difficulties. This capital structure allows developing countries to benefit from the excellent credit rating of the industrial-country members. It is amplified by the practice of maintaining a large ratio of subscribed to paid-in capital, which may be understood as a guarantee fund for the credit operations of these institutions.

The most elaborate system of MDBs owned by regional member is that of the Arab and Islamic world, which essentially operate as mechanisms for transferring resources from the oil-rich countries of the region to poorer regional members, as well as to other countries in the Islamic world and Africa. In other regions of the world, the best example of a sub-regional bank is the Development Bank of Latin America, the new name recently adopted by the Andean Development Corporation (CAF according to its Spanish acronym), a transformation that reflects the fact that its gradual expansion has made it a truly regional development bank, and one that is owned by developing countries (Spain and Portugal joined in recent years, but they also potential borrowers). This dynamic institution is, indeed, the best example of risk pooling in the developing world.

There are differences in the roles played by different MDBs in the various regions, but they can be categorized in four broad functions. The initial objective of these institutions was to give access to finance to countries that lacked it, at a time when the international system was still feeling the effects of the collapse of global finance in the 1930s. As the reconstruction of the global financial system took place, particularly in the 1960s, this basic function was transformed into an international redistributive function: give access to finance to less developed countries and regions that have limited or no access to private financial markets. With time, this broad function came to be understood, particularly in the case of the World Bank, as a mandate to contribute to world poverty reduction. This equity function, as it can be called, has included a concessional component (lending and grants), which has been very important in the World Bank/IDA and in the African and Asian Development Banks.

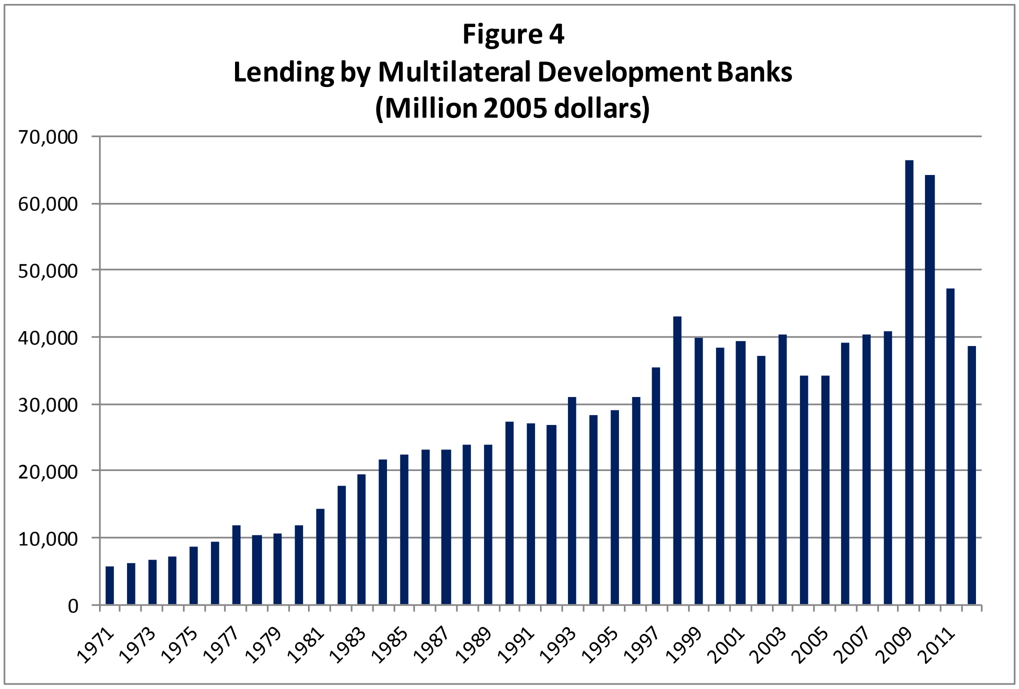
New functions were added through time. So, aside from supporting lagging regions (its equity function), EIB was given the task of contributing the infrastructure of European integration —i.e., to the provision of “regional public goods” in current terminology. This function remains marginal in other institutions but they provide other regional public goods, particularly forums for discussion and the transmission and utilization of region-specific knowledge The contribution to the production of “global public goods”, notably combating climate change, has been added in recent times, with the World Bank being the major player. New institutions have also been recently created to play this role, particularly the Green Climate Fund, in 2010, in the context of the United Nations Framework Convention on Climate Change.

With major crises, starting with the debt crisis of the 1980s in Latin America and Africa, these institutions came to play a third role: counter-cyclical financing when private financial markets dry up. However, this was only explicitly recognized as a major function of MDBs during the recent crises. It is conceptually different from provision of liquidity during crises, as it refers to the provision of official long-term finance, particularly to maintain the dynamics of public sector investment.

A fourth function is private sector development, which started with the launch, in 1956, of the IFC as part of the World Bank Group. Other institutions incorporated this into their regular financing, rather than in a separate institution, and the European Bank for Reconstruction and Development chose it as its major focus.

The differences in the portfolios of the various MDBs reflect their adaptation to the diversity of demands and financial needs of developing and transition economies. This is one the main advantages of a dense architecture. Thus while the Inter-American Development Bank has focused increasingly on social spending, sub-regional banks in Latin America and the Caribbean give greater weight to infrastructure and production sector lending. Infrastructure also plays an important role in the activities of the African and Asian Development Banks, the Arab institutions and the proposed BRICS bank. Financing intraregional trade is also a mandate of some institutions, particularly the Arab Monetary Fund. Most have private sector lending facilities, which have tended to grow over time.

As Figure 4 indicates, although this countercyclical function had already been central in the 1980s and, to a lesser extent, in the late 1990s, the MDBs played this function on the largest scale during the recent global financial crises. Lending indeed increased 52% in 2009 and remained very high in 2010. A close analysis indicates that there was differential response of different MDBs, with the World Bank leading the effort. There was, nonetheless, a bias in favor of middle-income countries and disbursements lagged behind lending commitments (Ocampo *et al.*, 2012). Among the positive features of this response, we can add the launch of a number of large regional initiatives between the World Bank and the regional development banks, and their joint program to create trade credit facilities, which were widely used by commercial banks during the worst phase of the crisis (ICC, 2009)..



Source: World Bank, *World Development Indicators* . The original series in nominal terms has been deflated by the MUV (Manufacturing Unit Value in international trade)

The response of the MDB system was partly constrained by the limitation of their capital. In April 2009, the G-20 agreed to support the recapitalization of MDBs to enable increased lending. In 2009, the capital of both the Asian and the African Development Bank was tripled. Negotiations turned out to be more difficult in the case of the Inter-American Development Bank, but capitalization was also approved in its March 2010 annual meetings. In April 2010 the World Bank received a capital increase of $86.2 billion, comprising a general capital increase of $58.4 billion and a selective capital increase of $27.8 billion; the latter was part of a broader reform aimed at increasing the share of the development countries in the capital and voice of the Bank. However, this capitalization turned out to be insufficient to maintain the dynamics of lending, and shows the major constrains faced by the unwillingness of its major shareholders (the United States) to provide funds while at the same time being reluctant to reduce its share in the capital of the bank, which gives it veto power on certain issues. For this reason, after peaking in 2009-10, multilateral lending dropped sharply in 2011-12, led again by the World Bank.

The main lesson learned is that MDBs need to permanently place their counter-cyclical function at the center of their priorities and develop the instruments to do so, allowing them to respond rapidly and significantly in times of crises. The lag of disbursements indicates that there is a need for better mechanisms for fast disbursements during crises. In turn, the limitations that insufficient capital may pose, indicates that there should be greater automaticity in replenishing the capital of these institutions and/or to allow them to leverage more their exiting capital during crises, including in the latter case through the broader use of guarantees.

MDBs should also be more active in introducing lending instruments that make developing countries less vulnerable during crises. One of them, in which several MDBs have been involved, is lending in local currencies. The MDBs could take a step further and create a diversified portfolio of local currency debt of a variety of developing countries, which could then be securitized and sold. They can also pioneer other new instruments, notably lending with payments linked to the evolution of GDP. These loans could then be grouped, securitized and sold to financial markets, helping to create a market for GDP-linked bonds, in which they could act as "market-makers".[6]

V. Governance of the system

Substantive reforms that allow the system to better fulfill the aforementioned roles must be accompanied by appropriate governance structures. In this regard, there are three interrelated issues. The first one is the design of the apex organization. Given institutional framework now in place, this could involve the transformation of the G-20 into a representative international institution. The second is the reform of "voice and participation" of developing countries in the Bretton Woods Institutions. The third is the design of a "dense", multi-layered architecture, with active participation of global, regional and sub-regional institutions.

In the first area, the major development in recent years was the decision of the G-20 to self-designate itself in Pittsburgh in September 2009 as "the premier forum for our international economic co-operation" (G-20, 2009). The creation of the G-20 at a leaders' level was, of course, a step forward compared to the G-7 in terms of representation of developing countries. This preference for "Gs" over representative international institutions has, of course, deep historical roots, as it reflects the revealed preference of major industrial countries for institutional mechanisms over which they can exercise direct influence. But this "elite multilateralism", to use the term I have proposed to characterized it (Ocampo, 2011), has also created problems, as ad-

[6] See, in this regard, proposals by Dodd and Spiegel (2005) and Ocampo and Griffith-Jones (2008).

hoc self-appointed bodies cannot replace representative institutions in a well-structured international institutional architecture.

The basic issue is the tension between inclusiveness and effectiveness –or, in Bradford and Lim's (2011) terminology, the trade-off between legitimacy as a representative body and as an effective body. In broader terms, Ocampo and Stiglitz (2011) have evaluated the G-20 as a mechanism of global economic governance on the basis of five criteria. On leadership, it has shown a positive record, notably in term of steering change in financial regulation and in putting in place a new mechanism of macroeconomic cooperation. On a second, effectiveness, after a good initial start, it deteriorated (see above and Woods, 2011). In the light of the outcomes of the global economy in 2012-13, it is clear that it has been unable to deliver on its most important commitment: "strong, sustainable and balanced global growth" (G-20, 2009, par. 13). According to three other criteria, performance is rather poor: representation, contribution to the coherence of the global system of governance, and lack of an effective secretariat that can support continuity in governance and support "evenhandedness" in the treatment of members with different power.

For all these reasons, a better option if it were a transition from the G-20 to a more representative, and thereby legitimate, mechanism of international economic cooperation. In this regard, the best recent proposal on the table is that to create a Global Economic Co-ordination Council made by the Stiglitz Commission (United Nations 2009b: ch. 4). According to this proposal, the GECC would direct, coordinate and identify areas of cooperation among all institutions that are part of the UN *system*, which includes the BWIs and would include the WTO, which would become part of the system. It would also have as special responsibilities the identification of gaps in the current system of cooperation (e.g., the aforementioned absence of a restructuring mechanism for sovereign debt) and spillovers among the areas of responsibilities of individual agencies that would need attention (e.g., environmental effects of trade policies, social effects of budgetary policies, links between conflict and economic, social or environmental issues). It would, in any case, leave to the more specialized bodies the specific decisions in their area of work. According to this proposal, the GECC would be organized on the basis of constituencies, using weighted votes, which would mix basic votes and the economic weight of countries. So, although designed in the framework of the UN system, its voting structure would be made along the lines of the BWIs, correcting of course for the problems of representation that these organizations face today. The Palais Royal Initiative has also proposed a three-level governance structure for the global economy –though, in their case, centered in the international monetary system— that would have at its top a reformed G-20 based on a constituency system (Palais Royal Initiative, 2011, p. 24).

The reforms of "voice and representation" of developing countries in the BWIs were launched in the UN Conference on Financing for Development that took place in Monterrey in 2002 (UN, 2002). They predate, therefore, the creation of the G-20 at the leaders' level, but the endorsement of the G-20 has been critical for the reforms adopted in 2010. This is particularly true of the IMF reform. They had started with modest agreements in 2006 and 2008, which were followed by a more ambitious reform adopted by the G-20 in October 2010 and two months later by the IMF Board. In turn, a reform of World Bank voting power had been adopted in the spring 2010 meetings of the BWIs, based on an ad hoc capital increase. They both involve a quota/capital increase together with greater (but still modest) weight given to the basic votes that are granted equally to all members. Both reforms are not yet fully completed at the time of writing (April 2013), as they still lack the U.S. Congressional approval, which is critical as the more than 15% voting power in both institutions gives this country an effective veto power. They are also both considered to be part of an ongoing process that will continue in the next few years. In particular, these changes only way part of the way in reducing the quota and voting power of European countries, which are over-represented in both institutions relative to their current economic weight in the world, and to correct the under-representation of some emerging economies, particularly of Asia.

The reforms of the IMF governance included a doubling of quotas, revising the allocation of quotas and voting power of developing countries, reducing by two the European representatives in the IMF Board and electing all of its members. Relative to the status quo at the time of the Singapore 2006 annual meeting, which approved the first set of reforms, developing and transition economies increased their share in quotas by 3.9 percentage points and in voting power by 5.3 points, thanks to the increase in basic votes. However, the increase was largely concentrated in a few emerging economies (China, Republic of Korea, Brazil, India, Mexico, and Turkey, in that order), which added up 7.3 and 6.7 percentage points in terms of quota and voting power, respectively. So, large part of their gain came at the expense of other emerging and developing countries. This is much less so in the case of voting power, thanks to the significant increase in the basic votes (Ocampo, 2011).

The reforms of the World Bank came in two steps (World Bank, 2010). If we concentrate on the IBRD, in 2008 there was an increase in the share of developing and transition countries in voting power of 1.46 percentage points, thanks to an increase in basic votes. During this reform, a new Executive Director from Sub-Saharan Africa was also added to the Board. During the 2010 Spring meetings a further 3.13 percentage points were added, for a total increase of 4.59 percentage points. This was the result of an ad-hoc increase in capital but also several adjustments to avoid individual developing countries from losing voting power in the reform process. As a result of these reforms, the voting power of developing and transition countries increased to 47.19% (to a lower proportion in IDA and IFC). As in the IMF, the greatest increase went to a few emerging economies, in particular China, which gained 1.65 percentage points to become the Bank's third shareholder, and five other emerging economies (the Republic of Korea, Turkey, Mexico, Brazil and India, in that order), which gained as a group 1.92 points. However, in contrast to the IMF, the rest of the developing and transition economies also gained 1.02 percentage points of voting power.

Equally interesting, there was a decision to adopt IBRD shareholding principles which are now explicitly recognized as different from those that rule IMF quotas and voting power.[7] They include economic weight (somewhat different to the formula used in the IMF), financial contributions to IDA (both historical and pledged), and a minority of the development contributions of clients to the World Bank mission, which encompass protecting the voting power of the poorest members and the contribution of developing and transition economies to IDA. The latter two are considered as "development contributions" of to the World Bank mission, and include the promise to move toward equitable voting parity in IBRD in the near future.

There are, of course, many other issues of governance that have on the table, including those proposed for the IMF by the 2009 Commission for IMF Governance Reform headed by

[7] Differences have already been created over the past two decades by recognition in the World Bank of special contributions from countries to World Bank resources, particularly to IDA.

Trevor Manuel (IMF, 2009) and by the IMF's Independent Evaluation Office (IMF-IEO, 2008), and for the World Bank Group by the Zedillo Commission (World Bank, 2009). A crucial issue, is the selection of the heads and senior management of these organizations on the basis of transparent and open processes, based on the merit of the candidates, and regardless of nationality. Although these principles were formally endorsed by the G-20, the election of the IMF Managing Director in 2011 and the World Bank President in 2012 represented only a marginal change relative to the past and ended up with the traditional allocation of the first to a Western European and the second to a U.S. citizen.

Finally, a dense, multi-layered architecture that relies more broadly on regional and sub-regional institutions offers interesting opportunities.[8] In particular, in a heterogeneous international community, the creation of *networks* of global, regional and national institutions can provide a better system of governance than arrangements based on single global organizations. This is based on old federalist principles: regional and sub-regional institutions give stronger voice and a sense of ownership to smaller countries. These institutions are, therefore, more likely to respond to their demands.

The best case in this in this regard is, as we have, seen the system of multilateral development banks (MDBs), where the World Bank coexists with several regional and sub-regional banks and an inter-regional one. A similar architecture should be adopted by the international monetary system. What this means is that the the IMF of the future should be conceived as the apex of a *network* of regional reserve funds (Ocampo, 2002). This would make it look closer in design to the European Central Bank and the Federal Reserve System than to the current IMF. A similar structure should be adopted for global financial regulation and supervision. In this regard, an alternative would be to transform the BIS in such global regulatory body, which would require transforming it into an institution with universal membership.

Regional arrangements in the monetary area include can take different forms—payments agreements, swap lines, reserve pools, common central banks—and adopt different degrees of multilateralization but exhibit today a rather empty architecture.[9] A small but very successful institution of its kind has been the Latin American Reserve Fund (FLAR, according to its

[8] See the contributions to Ocampo (2006).
[9] See, in this regard, the contributions to Volz and Caliari (2010).

Spanish acronym), made up of the Andean countries, Costa Rica and Uruguay. The Chiang Mai Initiative is the most ambitious of all, and made a significant step towards full multilateralization in December 2009. The creation of a European Financial Stability Facility and the later European Stability Mechanism are also steps in that direction, which would complement the role of the European Central Bank. The BRICS have also announced the idea of creating either a reserve fund or, more likely, a swap arrangement.

The links between the IMF and regional arrangements should be subject, in any case, to a variable geometry. In this regard, during the recent crisis, Europeans chose rescue packages in which the IMF was in fact a junior partner of the European Financial Stability Facility. In contrast, as access to Chiang Mai swap lines beyond a certain limit (20% of the agreed swap lines, now 30%) requires an IMF programme, countries that may have used the initiative during the crisis (Indonesia and the Republic of Korea) did not do so as they were unwilling to agree on any such program. In turn, the use of the Latin American Reserve Fund has traditionally been delinked from any IMF program.

VI. Conclusions

The system of global macroeconomic and financial cooperation has three basic objectives: global financial stability, macroeconomic stability and development financing, which is now increasingly mixed with financing of the provision of global and regional public goods. The best developed is the latter, which includes a network made up of the World Bank and several regional, sub-regional and inter-regional development banks. They play an essential function in development financing, the provision of international public goods, counter-cyclical financing and supporting the development of the private sector, combining in variable ways throughout the world its different layers. In monetary cooperation, there are significant gaps: there is an advance in the design of mechanism of emergency financing during balance of payments crises and an incipient mechanism of macroeconomic policy cooperation among G-20 members was created during the recent crises, but there are significant deficiencies in the design of the global reserve and exchange rate systems that have not been addressed, and a lack of a multilateral debt workout mechanism. In the financial area, advance has been made in the design of a better system of financial regulations and supervision but significant gaps remain, including in the framework for regulating cross-border capital flows.

In terms of governance structures, significant gaps are also present. The most notable is the ad-hoc character of the apex organization that the world currently has (the G-20), which faces significant problems of effectiveness but particularly of legitimacy and contribution to the coherence of the international system of cooperation. Some advances have been made in increasing the "voice and participation" of developing countries in the BWIs, but we are only in the beginning of a process that will continue to face significant obstacles. Finally, the world already has a dense, multi-layered architecture in the case of the MDBs but lacks a similar architecture in relation to both macroeconomic cooperation and financial regulation and supervision.

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