

**The Redesign of the Global Financial Architecture:
Forums, Institutions, and State Power**

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Abstract

This research examines the internationally coordinated, state-led response to the 2007-2008 economic and financial crisis. It addresses the construction of ‘alternative narratives’ which encompass a partial revision of the economic paradigm, with a particular emphasis on the role of international financial regulatory authority, its rules and institutionalization. The meta-theoretical theme at the centre of this thesis involves the manner in which severe crisis episodes provoke and also reveal the underlying tension and contestation between ‘market authority’ and ‘state authority’ in relation to the regulation of the world economy, financial system and firms, with the goal of ensuring maximization of long-term systemic stability and crisis prevention. The construction of alternative crisis-driven narratives is in part a reaction to the previous ideological hegemonic domination of laissez faire neo-liberal beliefs as applied to deregulation (i.e., of self-regulation by markets and private sector actors in the financial sector). The thesis identifies and examines a paradigm shift in response to the crisis: a move from the dominance of market authority to the reassertion of state authority over financial markets and actors. It addresses the way in which crisis narratives are constructed in response to such episodes and the policy implications of paradigm shifts when they occur.

The thesis empirically examines the elite state-level crisis response and its policy consequences, with particular emphasis on the institutional reforms most important to the construction, post-crisis, of a ‘new global financial architecture’. A principal argument within the thesis is that the severity of the financial crisis precipitated a rapid shift in the policy narrative held to by the central banking epistemic community, which constitutes a paradigm shift, and which led to a series of institutional and policy reforms addressing the application of state power and regulatory authority over global financial markets and firms.

Dedication

This thesis is dedicated to my late parents: my mother, Una Maclean; my stepfather Bernard Crick; and my father John P. Mackintosh.

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Abbreviations

| | |
|------------|---|
| BCBS | Basel Committee on Banking Supervision |
| BIS | Bank for International Settlements |
| CCPs | Central Counterparties |
| CDSs | Credit Default Swaps |
| CEO | chief executive officer |
| CFCs | chlorofluorocarbons |
| CFO | chief financial officer |
| CFTC | Commodity Futures Trading Commission |
| EU | European Union |
| EWE | Early Warning Exercises |
| FASB | Financial Accounting Standards Board |
| FDIC | Federal Deposit Insurance Corporation |
| FSAP | Financial Sector Assessment Program |
| FSB | Financial Stability Board |
| FSF | Financial Stability Forum |
| FSA | Financial Services Authority (UK) |
| GATT | General Agreement on Tariffs and Trade |
| GHOS | Group of Governors and Heads of Supervision |
| GSIFIs | global systemically important financial institutions |
| G7 | Group of Seven composed of leaders, finance ministers and central bank governors from the following countries: Canada, France, Germany, Italy, Japan, United Kingdom, and United States. |
| G20 | Group of Twenty - Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa South Korea, Turkey, United Kingdom, United States, European Union. The leadership of the World Bank and IMF also attend. Other participants are may be invited by the Presidency on a continuing or ad hoc basis. |
| G20 sherpa | The G20 sherpa is the senior finance ministry official or presidential adviser who leads a country's negotiation team prior to and during G20 summits. |
| IAIS | International Association of Insurance Supervisors |
| IASB | International Accounting Standards Board |
| IFI | International Financial Institutions |

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| IFRS | International Financial Reporting Standards |
| IMF | International Monetary Fund |
| IOSCO | International Organization of Securities Commissions |
| IMFC | International Monetary and Finance Committee |
| ISD | Integrated Surveillance Decision |
| IT | information technology |
| MAP | Mutual Assessment Program |
| NAB | New Authority to Borrow |
| OTC | over-the-counter |
| RCGs | Regional Consultative Groupings |
| ROSCs | Review of Standards and Codes |
| SDRs | Standard Drawing Rights |
| SEC | Securities and Exchange Commission |
| SIFI | Systemically Important Financial Institution |
| SIVs | structured investment vehicles |
| SPEs | special purpose entities |
| SSB | standard-setting body |
| TBTF | Too Big to Fail |
| TPN | transnational policy network |
| WTO | World Trade Organization |

Chapter 1. Introduction

1.1 Goals and content of the thesis

This research examines the internationally coordinated, state-led response to the 2007-2008 economic and financial crisis. It involves the examination of the construction of ‘alternative narratives’ which encompass a rejection of the laissez faire neo-liberal paradigm, with a particular emphasis on the role of international financial regulatory authority, its rules and institutionalisation. The meta-theoretical theme at the centre of this thesis involves the manner in which acute and severe crisis episodes such as this case provoke and also reveal the underlying tension and contestation between ‘market authority’ and ‘state authority’ in relation to the regulation of the world economy and especially the financial system and firms, with the goal of ensuring maximisation of long-term systemic stability and crisis prevention. The construction of alternative crisis-driven narratives is in part a reaction to the previous ideological hegemonic domination of the laissez faire ‘neo-liberal beliefs as applied to deregulation (i.e., of self regulation by markets and private sector actors in the financial sector). The thesis identifies and examines a paradigm shift underway in response to the crisis: A move from the dominance of market authority to the reassertion of state authority over financial markets and actors. It addresses this crisis as an instance of the greater set of historical cases of severe financial crises which transmute into economic crises. It addresses the way in which crisis narratives are constructed in response to such episodes and the policy outcomes of a paradigm shift when they occur.

The thesis empirically examines the elite state-level crisis response and its policy consequences, with particular emphasis on the institutional reforms most important to the construction of a ‘new global financial architecture.’ Calls for a new architecture have occurred in the past; there were similar demands following the 1997/98 global and East Asian financial crisis. A principal argument within the thesis is that the severity of the financial crisis in this case precipitated an important shift in the policy narrative, a paradigm shift, and a series of policies designed to collectively apply and internationally coordinate regulatory authority over global financial markets and private sector actors in a more robust manner.

The research draws upon a series of 34 high-level, qualitative interviews with many of the governmental, central bank, and supervisory principals present and active in key decision-making meetings and roles from 2008 onwards. The insights gathered from these key actors regarding the narratives adopted and the policy shift these resulted in add meaningfully to the understanding of the G20 leaders forum, the Financial Stability Board (FSB), and the reforms underway within the International Monetary Fund (IMF). This research illuminates the rapid evolution of the new architecture and its operation in a time of crisis. It identifies the dialectic at work. As the crisis abates, in part due to the crisis management collective action of state leaders and their regulatory surrogates within these new forums and institutions, tensions return and outer limits of the new policy consensus are reached, and state diplomatic actors' positions diverge once more.

1.1.1 The context of the study: Economic cycles, crises, response, and relapse

Global and national economies and markets operate in cycles of growth that, when unrestrained, can turn into booms, which are eventually punctured by busts resulting in recessions of varying severity (Galbraith, 1954; Kindlberger and Aliber, 1978; Minsky, 2008). During the boom phase, few remember economic history, believing this time is different (Rogoff and Reinhart, 2009; Schiller, 2006), but it never is, and booms always eventually turn to bust. Global economic cycles operate on a longer frequency than national cycles, because it is rare that the credit expansions and contractions of national economies align to create a synchronous collapse of the global economy as a whole. Normally, a national recession or a banking calamity in one part of the world is balanced partially by growth and prosperity elsewhere.

The rhythm within these cycles is not only economic but also conceptual and ideological. 'Constructionists' are right: ideas do matter in the political and economic calculus of policy making. Economies are underpinned by and linked to ideological narratives, a prevailing policy consensus that places limits on policy actions and options and constitutes a dominant worldview or paradigm.

In some, but by no means all, financial crises, a paradigm shift (Kuhn, 1962) can be triggered and becomes part of the cycle and process, particularly in severe economic crises. For instance, economic failures and stagflation in the United Kingdom (UK) (a

slow-motion bust) in the 1970s paved the way for the Thatcher victory in 1979 and a significant ideological and economic policy shift that impacted the UK for decades thereafter (Blyth, 2002).

On the international level, as with economic cycles, the ideological cycle is also of a longer frequency, measured in decades, not years. But when a sufficiently severe exogenous event or economic and financial crisis occurs, it can shake the prevailing worldview. More rarely still, a shock may result in a paradigm shift in ideological and regulatory concepts held by leaders and policy makers. In such cases, a rapid evolutionary burst of action and reform, a shift in the policy consensus and worldview can occur.

In 1971, one economic and financial paradigm, embedded liberalism and the system of globally managed exchange rates (Ruggie, 1982), ended with U.S. president Richard Nixon's closure of the gold window. The end of that era gradually gave birth to another, which over time came to be characterized in part by laissez-faire neo-liberalism (Gamble, 2009, pp. 71-86), or market fundamentalism (Stiglitz, 2008), and later by the Washington Consensus (Wade, 2008; Williamson, 1993, 1994). This ideological worldview involved a championing of deregulated, unfettered global markets and firms. This shift moved economies and the financial system away from a rules-based system (Elson, 2011, pp. 208-209), to competing based on flexible exchange rates and fostering the success of their national economic models within increasingly globalised markets reliant on (it was assumed) efficient markets (Wade, 2008, p. 2). The series of policy decisions and nondecisions that flowed from this deregulatory narrative took shape in the late 1970s, gathered strength in the 1980s, and thundered forward in the 1990s and early years of the 21st century.

During the decades before the 2007-2008 financial crisis, governments allowed and facilitated the erosion and diffusion of state power to other actors—a weakening of state power coupled with a retreat of the state's willingness to supervise growing global markets and firms (Strange, 1986, 1996). Markets grew. Governmental acts or refusal to act were underpinned by the ideological and economic belief in unregulated markets rather than state regulatory power (Akerlof and Schiller, 2009; Padoa-Schioppa, 2010a; Stiglitz, 2010). Firms grew and morphed from national retail banks into global behemoths with operations interconnected across the globe. The size, impact, and influence of these firms rapidly grew, as did the complexity of markets and instruments (Maclean and Nocera, 2010; Tett, 2009), the leverage seen (Turner, 2009), the risks taken, and levels of

compensation paid to their employees (FCIC, 2011; Johnson, 2010). The dominant neo-liberal laissez-faire paradigm supported these trends and resisted those that pointed to anomalies, questioned the worldview (Rajan, 2005; White, 2008), or sought to warn of dangers ahead.

As in other previous ideological and economic cycles, the existing worldview blotted out historical memory amongst leaders and technocrats. Deregulation and self-regulation (the latter now viewed as an oxymoron) was the norm. During this period, the frequency of national boom and bust cycles grew (Allen and Gale, 2007), and the number and severity of national banking crises rose (King, 2011a), but few paid attention. The Anglo-Saxon paradigm and narrative worshipped by political leaders and regulators precluded actors from seeing the ‘black swan’, or the extreme exogenous event or crisis coming (Taleb, 2010); instead, a great moderation was supposed to be underway.

In this manner, the worldview provided ideological justification for the boom of the 1990s and 2000s. It fostered the creation of markets, firms, and instruments that would in 2007 rapidly transmit price declines in houses and condos in Nevada and Florida sold to poor, credit-challenged Americans to banks in the UK and Germany, and then around the globe. As the credit crunch and economic contagion spread, the panic grew, and leaders faced the most significant economic and financial crises since the Great Depression in 1929.

Confronted by a crisis of historic proportions, old solutions were insufficient. A breakpoint occurs and ‘the possibilities for major change are particularly great and scope of possibilities and outcomes is unusually wide’ (Ikenberry, 1992, p. 318; see also Helleiner, 2009a, p. 16). But the U.S. could not fashion the solution alone or solely with its G7¹ colleagues and allies, as it had in the past. The days when two men, Paul Volcker and Robin Lea Pemberton, could do a deal on bank regulation that was pressed upon the rest of the world were long gone (Goodhart, 2011; Kapstein, 1992).

In 2008, U.S. hegemonic power was in decline, and rising powers, especially China, Brazil, and India, demanded a voice and a role, and they had the reserves to back their demands. Emerging countries had to be included. Recognising this reality and making the switch to a larger leadership grouping at the topmost tier of international economic and

¹ The Group of Seven is composed of leaders, finance ministers and central bank governors from the following countries: Canada, France, Germany, Italy, Japan, United Kingdom, and U.S..

financial diplomacy would be necessary to make any possible solutions truly global in impact, and to ensure the legitimacy of the decisions taken in response to the crisis. As a result, while the crisis response in 2007-2008 exhibits common elements with prior cycles, the constructs created as a result of the architectural impulse would be markedly different, indicative of the evolution of geopolitical power relations and balances since the last major shift in 1971.

In summary, this research recognises that the internationally coordinated collective response in 2008 is part of this history of cycles of booms and busts, crisis management, and reform and relapse. The research will posit that this especially severe crisis forced a financial regulatory paradigm shift in worldview amongst government leaders, states, and their technocratic central banking community, that there was a rapid evolution in the collective policy-making narrative, which underpinned the new and refurbished international political, regulatory, and architectural constructs. This is ‘a new phase’ (Wade, 2008, p. 3), it and entailed the rejection of key aspects of the laissez faire neo-liberal worldview and its assumptions.

In 2013 the consensual certainties of the past have been jettisoned and a paradigm shift in G20 and financial and regulatory policy is under way. But as with such major shifts in the past, the shift takes time to form. It is a fluid process. Today, this shift remains partly formed, in dispute, and is still to be defended. The research will highlight the fluctuating strength of the policy output and reform impulse. This is to be expected because this type of major shift, this Kuhnian wave in ideological, and financial regulatory approach, takes years to solidify.

1.2 Research questions

The main question of this thesis is:

- ❖ **How should the observer view and understand the construction of the new global financial regulatory architecture commenced by leaders and their proxies in response to the 2007-2008 crises?**

In answering this core research question the research examines: the shift in ideas, the emergence of the G20 and its summitry; the creation and actions of the FSB; the reform

of the IMF; and the outer limits to the process of financial regulatory construction underway.

This focus on the economic and regulatory narratives and the policy shifts seen, leads to a number of other related questions.

- ❖ **Is there a reassertion of Westphalian state power in the global economy via the G20 and FSB, and how has the power of key state actors been affected by the growth in importance of the G20 and FSB? What role are emerging market players performing?**
- ❖ **Are there parallels to be drawn from the cycles in past national financial crises and responses and the rise of the G20 and FSB?**
- ❖ **Can we gauge how effective they are as forums and in their broader policy goals—that of enhancing economic and financial stability?**
- ❖ **What challenges and limitations do these forums face as they move from crisis management to financial reform, and to confronting the return of tension between the new consensus and renewed dissension among actors?**
- ❖ **Does the phenomenon that led to the sudden emergence of the G20 and FSB—a robust reassertion of state power—complicate their further evolution post-crisis?**
- ❖ **How was the IMF affected and reformed in response to the crisis and what role does it play in the new architecture?**
- ❖ **What do the reform responses in the G20, the FSB, and the IMF signal for the future evolution of the global financial architecture?**

The research aims to contribute to the understanding of the conceptual, ideological, and policy dynamics behind states' crisis responses. This response resulted in a significant collective reassertion of state power over markets and firms through new forums (the G20

and FSB) and reformed institutions (the IMF). The effects of these new constructions on the regulation and operation of global financial markets and firms are still being felt globally today and they have yet to markedly diminish in strength.

1.3 Key analytical and theoretical frameworks

The research will employ a series of analytical frameworks and embed empirical interview results within existing literature to illuminate the crisis response cycle, the dynamics behind the creation of the G20 and the FSB, their policy output, and the reforms in the IMF. In doing so, the research aims to address existing academic gaps in the understanding of these events, their meaning, their potential impact, and the ideological and policy narratives behind them.

The research utilizes three frameworks to dissect the summitry and regulatory rebuilding being seen. First, the research utilizes the concept of paradigm shift (Kuhn, 1962), as developed and applied to economic policy (Hall, 1993). It takes Hall's formulation of first, second, and third order changes and applies them to the events and outcomes being observed. Second, the research uses Putnam's 'two-level game' framework within the crisis altered diplomatic and technical policy making space (Putnam, 1988). The evidence will suggest the crisis affected the negotiating stance and win sets of level one negotiators, while also enlarging possible win sets and impacting level two blocking power from domestic lobbies. Third, the research applies the concept of epistemic communities (Haas, 1992a), their characteristics, operation and limitations, to the technical policy making processes led by the central banking community, drawing out the importance of this small, elite transnational policy network in the construction of the new global financial architecture.

1.4 Research design

The following lays out the research design and methodological approach used to answer the research questions and to identify patterns and shifts behind the international crisis response. The research is based on a series of 34 interpretative qualitative research interviews of key principals, actors, observers, protagonists, and academics engaged in the creation of the G20, the birth of the FSB, and the recapitalization of the IMF. The research draws on Kvale and Brinkmann's conception of qualitative research interviews

as the social production of knowledge, a conversational relationship which is ‘contextual, linguistic, narrative and pragmatic’ (Kvale and Brinkmann, 2009, p. 18). In this process, the researcher is ‘Putting oneself in the place of the other’ (Crotty, 1998, p. 76).

In commencing interpretive qualitative research, the investigator is interested in how people interpret their experiences, how they construct their worlds, and what meaning they draw out of the events in question (Merriam, 2002). A series of qualitative interviews can, according to the interactionist tradition, ‘give an authentic insight into people’s experiences’ (Silverman, 2001, p. 87). The research is also in the constructivist tradition in that it is assumed that political and economic-regulatory ideas matter in the policy process, particularly in the creation of common narratives during periods of crisis, in which rapid shifts of the consensus position are more likely to occur (Blyth, 2002).

The focus of the interviews was threefold: the genesis and evolution of the G20, the creation and operation of the FSB, and the reform of the IMF. All the actors selected had direct personal experience of the crisis management from 2007-2008 onwards and of the response since then that is the focus of the research. In many instances, the interviewees were present during pivotal events being studied and were major actors in the decision-making process. Subjects were selected depending on the seniority of their role in the G20-FSB-IMF reform process. Care was taken to secure balance within the sample, including G20 and non-G20 voices from states outside the process as well as critical external and academic voices.

Ultimately, the interviews were an ‘active’ process (Holstein and Gubrium in Silverman 2004, p. 144). The data gathered as a result of qualitative interviews and research processes cannot be considered as fact; rather, the material remains observations whose subjective worth may be strengthened if they are repeated by numerous actors or reflected in the views of others also present in key meetings and summits.

Fundamentally, it is these policy narratives, their strength, their weakness, the disputes seen, and policy outcomes observed that are central to the research. Economic and regulatory narratives matter when individuals respond to a major crisis. The research looks at the extent to which a common narrative and policy consensus emerges and can be linked to the strength of the outcomes observed. The views expressed by interviewees were subjective and influenced by the community in which they reside. Nonetheless,

these subjective narratives held collectively by senior policy makers impacted the actual outcomes of the process and the future robustness of the structures created and reformed during the financial architectural redesign post-2008.

Interview subjects were drawn from 16 states—11 G20 and five non-G20 countries. Those interviewed include presidential and prime ministerial advisers; four current and former G20 finance ministers; G20 sherpas (the G20 sherpa is the senior finance ministry official or presidential adviser who leads a country's negotiation team prior to and during G20 summits); numerous senior current and former G20 finance ministry officials; current and former G20 central bank governors and deputy governors; current and former principal supervisors; members of the leadership, steering committee, plenary, standing committees, and working groups of the FSB; one-third of the Executive Board of the IMF; and academic observers. Interviewees were recruited on a voluntary basis and their anonymity has been preserved.

Interviews took place during August 2011 through June 2013 in the U.S., Canada, France, the United Kingdom, and Switzerland. The interviews were recorded, transcribed, and made anonymous. The recordings, transcripts, and interview code were stored in password-protected computers in Newcastle and Washington, D.C.. Interview subjects signed interview waver forms releasing the anonymous material for use in this and future research by the writer. In some cases, second follow-up interviews were conducted with a participant, to drill down on a subject.

In total, globally, the principals number no more than perhaps 150 individuals (comprising G20 leaders and actors, FSB members and leaders, IMF policy makers, and key outsiders). In combination with other official documentary and academic sources, careful selection and interviewing of a large fraction of this small group of actors (34 interviews in total) captured the nature of the common post-crisis financial, economic, and re-regulatory endeavour, its narratives, disputes, and outcomes.

The seniority of those interviewed for the research resulted in numerous insights into the political economy and diplomatic factors behind the evolution of the post-crisis international architectural and regulatory policy response, through the creation of the G20, the creation of the FSB, and within the more limited IMF reforms. Seniority matters,

especially when analysing an opaque, elite, leader-driven diplomatic and technocratic policy-making process with relatively few key actors and players.

1.5 The contribution of the thesis

A great deal has been written on the causes of the 2007-2008 global financial crisis, and the faults and failings of those who did not see what was right in front of them (see, for instance, Akerlof and Schiller, 2009; Admati and Hellwig, 2013; Bair, 2011; Blanchard *et al.*, 2012; Blinder, 2013; Brown, 2010; Cassidy, 2010; Darling, 2011; De la Dehasa, 2010; FCIC, 2011; Gills, 2008, 2010; Gorton, 2010, 2012; Johnson and Kwak, 2010; Maclean and Nocera, 2010; Padoa-Schioppa, 2010a, 2010b; Paulson, 2010; Pettifor, 2006; Rajan, 2005; Roubini, 2010; Schiller, 2006; Sorkin, 2010; Stiglitz, 2008, 2009; Taleb, 2010; Tett, 2009; Turner, 2012). This research will not concentrate on that well-tilled ground.

Prior to the crisis, the architecture of financial regulation had been analysed, most notably by Davies and Green (2008). This work laid out the outlines of the architecture ‘as was.’ Other authors provided commentaries on national systems of supervision and oversight (Group of Thirty, 2008). Certain individual facets of the old structure, such as the Basel Committee for Banking Supervision, (Goodhart, 2011), or the Financial Stability Forum, (Bluestein, 2012), were subjected to historic review. The work on aspects of the global architecture either functioned as primers for national regulators laying out the bare structure in brief without dissecting the diplomatic and political economy dynamics behind the operation of the various organizations, their actors, and communities, or went into great detail in particular areas from an historic perspective. Since the crisis others, such as Elson (2011), have added to this space, addressing the strains in the international architecture and the need for reform, but have not addressed the G20’s and the FSB’s central role in the financial regulatory redesign.

This thesis makes a significant and original contribution to knowledge in several related areas concerning the international, state-led cycle of crisis response, reform, redesign, and finally a revival of dissension during the period of 2008 to 2013. The architectural constructs created since 2008 are viewed as the output of political processes, and the motivations and dynamics are directly addressed.

The research focuses on the creation of the G20 and its summits, the creation and operation of the FSB, and the reform of the International Monetary Fund. These were the key forums and institutions activated by leaders and their technocrats at the peak of the crisis and they have been central since then to the emerging global diplomatic, financial, regulatory, and institutional architectural response and redesign.

First, the research offers an account of the creation and the unfolding of the G20 summits from the outset during 2008 through 2013, and the tensions, dynamics, and motivations driving key leaders and states during this multiyear process, by drawing on the recollections of actors present during the summits. Academic and other commentary on the G20 has been extensive since the first 2008 summit. Assessments of individual G20 summits and their outcomes have varied in type. They have been supportive and laudatory of the outcomes (Bradford, 2009; Dervis, 2010); critical and dismissive (Aslund, 2009; Johnson, 2010, 2010a; Stiglitz, 2010; Wolf, 2010); and many have been episodic, that is, focused on particular summits and their goals and declarations (Goldstein, 2009; Kirton 2011; Kirton and Guebert, 2009; Trichet, 2010c). Others have addressed the G20 summits, the perceived declining hegemonic power of the U.S., and the rise of emerging countries (Beeson and Bell, 2009; Kirton, 2010; Subacchi 2008, 2009, 2010).

Notwithstanding the considerable commentary that exists, a gap remains in that relatively few have sought to address the political dynamics behind the G20's creation by viewing the series of summits as an ongoing process (Eichengreen, 2008). A rhetorical question has been raised: is this the start of a Bretton Woods II? (Subaachi, and Cooper 2010; *The Economist*, 2010) This research seeks to illuminate the G20 process as a whole, drawing on narratives from key participants to add to knowledge of how the summitry operates not simply in isolation as a diplomatic exercise in cooperation, coordination and, later, discord, but instead in relation to the architectural and reform impulses in which the summit decisions play such an important role, namely via the creation of the FSB and the reform of the IMF. In doing so, the research seeks to analyse the unfolding process and the crisis response cycle, and to draw conclusions on the nature and scope of the political, ideological, and financial regulatory shift underway.

Second, the research adds to knowledge by focusing on the creation and operation of the FSB, a subject about which literature on the dynamics behind the institutional and policy impulse is lacking. This is because the Board is relatively new and operates as an extremely opaque, obscure forum—whose *modus operandi* remains closed to almost all outsiders, including academics.

Existing literature on the FSB addresses the founding Charter and its formal structure (Griffith-Jones, Helleiner and Woods, (eds.) 2010), but not its internal dynamics and leadership processes. There is commentary on individual facets of the FSB policy output, such as their Peer Review policy implementation oversight process (Porter, 2010, p. 39-42), the relationship with the IMF (Momani, 2010, p. 36-38), and surveillance and macro-prudential issues (Walter, 2010, p. 32-35; Turner, 2010, p. 43-48). Initial analysis of the FSB has suggested it is an historical reversion away from universal institutions (Pauly, 2010, p. 15), raising questions of illegitimacy and exclusivity (Bluestein, 2012; Vestergaard, 2011; Vestergaard and Wade, 2010). Others take the view that its creation addresses some of the legitimacy issues that hampered its predecessor, the Financial Stability Forum (Griffith-Jones and Helleiner and Woods, (eds) 2010, p. 28). There have also been proposals for governance reform and enlargement (Brookings Institution, 2011). Much of this initial work has been brief and speculative, and has not been based on accounts from participants inside the FSB and its leadership.

As of September 2013, the actual dynamics and functioning of the FSB and its political and institutional processes have not been the subject of close analysis and scrutiny, and none utilise the lens provided by the epistemic community framework fashioned first by Haas (1992), and since applied to many areas of international technical policy making by other transnational policy-making communities. (See the section on epistemic communities and financial reform in Chapter 2 for a definition and discussion of ‘epistemic community’). This lens is directly applicable to, and particularly useful in, understanding and dissecting the processes of the FSB.

In summary, the research seeks to add to knowledge by addressing directly and in detail the creation and policy output of this highly opaque, elite policy-making forum and process during its first years of operation, drawing heavily on first-hand accounts from many of the Board’s leading figures engaged in all aspects of the FSB’s creation and work, an area where ‘no systematic comprehensive studies’ exist (Baker, 2010, p. 19).

Finally, this research analyses the modest reforms made to the IMF at the behest of the G20 leadership and analyses the potential effect that these resource, voice, and vote reforms may bring. There is a very large, deep, and broad literature on the nature of the IMF, its institutional politics, and the drivers behind the decision-making processes.

The history and evolution of the IMF has been discussed in detail by many authors (see Babb, 2007; Bluestein, 2001; Fischer, 2005; Group of Thirty, 2009b; Helleiner, 1994; James, 1996; Kenen, 2002, 2007; Peet, 2010; Thacker, 1999).

Much research has also been done on the internal decision-making processes. Existing research on IMF lending dynamics indicates that politics and economics intrude into the lending process (Steinwand and Stone, 2008); political influence and links to key shareholders matter (Bird and Rowlands, 2001), as does a member state's relative size and Executive Board representation in the IMF (Barrow and Lee, 2005; Thacker, 1999). The conditions attached and the type of loan monitoring can be affected by a country's ideological links to the U.S. (Williamson, 1994).

Work addressing the IMF's governance and surveillance processes is also extensive. Core nations are shown to control the IMF (Frattani and Patison, 2004; Truman, 2011), exercising 'bloc holder power' (Kahler, 2006, p. 259). Surveillance is seen to bend to the demands of the more politically influential states (Fratzscher and Reynaud, 2010; Mussa, 2007). Given the above research, the goals in this area are more limited because the space for a contribution is correspondingly smaller.

This research, drawing on interviews with approximately one-third of the national shareholder leadership within the IMF, seeks to draw tentative conclusions on the impact of the G20 on the reform process within the IMF, in terms of resources and lending, governance (i.e., the emerging country voice and votes), and on surveillance policy and outcomes. The research will show that the IMF has been strengthened in terms of resources, but that its position in the global financial architecture has been downgraded, with the G20 and FSB now leading on financial reform. It will further be suggested that the reforms within the IMF have made the organization relevant again, and has drawn emerging countries back into an engagement with and commitment to the organization. But the reforms are nevertheless much less significant than those seen undertaken by the G20 and FSB, and are at most first and second-order incremental changes.

1.6 The structure of the thesis

Following on from this introduction, chapter 2 presents the analytical framework used in this research. It explains the selection of a multifaceted framework through which to view and understand the response of leaders and technocrats of the advanced and emerging countries from 2008 onwards. The chapter demonstrates that applying the concept of paradigm shift to the events from 2008 has utility and draws out the importance of a shift in the regulatory policy consensus and narrative. It underscores the particular applicability of the concept of epistemic communities to the process being analysed. The chapter also highlights the usefulness of Putnam's 'two-level game' in understanding the summitry and high-level technical negotiations during the crisis period (Putnam, 1988).

Chapter 3 focuses on the genesis of the G20 leaders' forum in the heat of the crisis and on the summitry since then. Rather than looking at the summits as discrete events in chronological order, the summitry is viewed thematically as a process. The chapter divides the summitry into three phases: (1) crisis management, (2) concrete reform, and (3) a return to dissension among states. The chapter suggests that at the diplomatic level of the G20, leaders adjusted their views but did not themselves jump to adopt a full paradigm shift in their global macro-economic approach. But leaders did rely heavily on the technocratic expert central banking epistemic community to delineate the scope of new re-regulatory structures and a related new paradigm applied to markets and firms. The chapter analyses who leads the summitry process and the role of emerging country leaders. It finds that the G20's emergence and the phases are dialectic. The state power that is applied effectively at the outset and during a rapid period of reform and consolidation ultimately results in a return to relative calm, this allows dissension and national interests to reemerge as the outer limits of a new paradigm are reached.

Chapter 4 explores the political dynamics behind the creation of the FSB, its structure and functioning. The chapter illuminates the nature and operation of this new forum that sits right at the centre of the new global financial architecture. It dissects how this elite, opaque, obscure body functions as the central coordinator backed by reformers composed primarily of hawks from the central banking epistemic community. It addresses how the Board was fashioned and is still evolving as a nascent but powerful international institution, one dominated by a central banking and supervisory community, a community

which is essential to the creation and maintenance of the financial re-regulatory paradigm shift that is observed.

Chapter 5 addresses a series of FSB policy outcomes. In the end, the durability of the new re-regulatory paradigm depends on the actual policies enacted that turn ideological goals agreed by the G20 and FSB leadership into facts on the ground. The research shows that the policy output fluctuates and is stronger in some areas and weaker in others, ranging from Hall's first, to second and third-order changes (Hall, 1993). Viewed in their entirety, however, the policy reforms suggest that the ideological shift, although lumpy in effect, is being made real on the ground. But it is still to be completed, and must be defended and maintained by its community.

Chapter 6 dissects the reform of the IMF and its position within the new architecture. The research suggests that unlike other reforms that are the focus of the thesis, IMF reforms are less significant. In 2013, the institution is once again relevant and recapitalized, with recommitment and re-engagement from emerging countries. But the organization and its leadership operate in an existing institutional framework, and they did not go through a paradigm shift. As a result, reforms are incremental and evolutionary.

Chapter 7 draws conclusions from the research and explains how they relate to the research questions.

Chapter 2. Analytical Framework

'The Western financial system is rapidly coming to resemble nothing so much as a vast casino'.
(Strange, 1986, p. 1)

'If the years before the crisis were years of over-reliance on markets and mistrust in government – or, more simply put, too much market and too little government – what we have seen in 2008 and 2009 has been a spectacular comeback of government'.
(Padoa-Schioppa, 2010b, p. 8)

'The G20 has led to a new paradigm in multilateral cooperation'.
(G20, Los Cabos Declaration, 2012)

2.1 Introduction

This research addresses the burst of architectural redesign of the global financial architecture involving the G20, the Financial Stability Board (FSB), and the International Monetary Fund (IMF) which began in the fall of 2008 and continued through the end of 2012. The research employs a number of existing analytical frameworks to explain the events under consideration, which are of a multifaceted, highly complex nature, with different types of actors involved, and policy areas addressed. The overall approach will be described in brief and then each analytical framework used in the initial research will be discussed individually with reference to its particular utility to the subject in question and existing academic work in the field.

2.2 A meta-theoretical approach

The research underscores that for several decades there has been a decline in the relative power of individual states accompanied by a simultaneous rise in the size, complexity, and power of global financial markets and the firms that operate within those markets. This decline was cemented by a laissez-faire neo-liberal ideology that legitimized deregulation and the growth of unrestrained and opaque global markets. 'Casino capitalism' grew and spread (Gamble, 2009; Pettifor, 2009; Strange, 1986). The research starting point is the work of Susan Strange on the nature of state power and the study of the political economy of international relations. Her work laid out the changing nature of state power and challenges to its effective use decades before the current period of increasingly severe multiple global economic and financial crises catalysed by an

interconnected, large, and complex system of financial markets and firms spanning the globe. It will be argued that the events of 2008 and since show that the extent to which state power had withered was overstated. In response to the crisis, G20 leaders and technocrats made a leap in their willingness to use collective state power to re-regulate global markets and firms.

The analytical and theoretical framework will draw upon the concept of paradigm shift (Kuhn, 1962) applied to economic policy making (Hall, 1993), the financial crisis, and the international response. Kuhn developed his seminal concept of sudden paradigm shifts in worldview. The shifts he described were due to the build-up of contradictory anomalies and evidence that cannot be dealt with by an existing worldview. Ultimately, the process results in the emergence and acceptance of a new alternative theory that is better suited to explain and understand scientific phenomena. The new theory overturns the previous worldview and constitutes a paradigm shift. Kuhn underscored that scientific revolutions are not about immutable objective facts, but are a struggle over the explanatory utility of different scientific worldviews, and that science takes place within a somewhat fluid universe of competing ideas and theories.

Kuhn's concept of paradigm shift resonates with what occurred in 2007 and since then with the onset of the financial crisis. Major economic and regulatory actions and reforms require state leaders and in particular technocrats to reject previous truths and to adopt of a new, more activist, more interventionist worldview—more state power and regulation and greater restrictions on markets, firms, and their power.

The 2007-2008 crisis created conditions in which the prior worldview's anomalies became starkly obvious. The policy-making community responded by reevaluating their consensus and moves to adopt a new narrative that would signal a paradigm shift—a new worldview centred on the merits of global re-regulation of financial markets and firms. Reforms are begun and new institutions are created, and policy shift commences because of this ideological and narrative shift. Such ideological changes are seen in earlier periods of significant economic policy turmoil (Blyth, 2002).

Through this crisis response and paradigm shift, leaders and technocrats rejected parts of the laissez-faire neo-liberal ideological stance and worldview of the previous decades and adopted new policy positions based on aggressive re-regulation of financial markets and

an architectural redesign of the regulatory superstructure. The G20 consensus approach significantly expands the centrality of international mechanisms for coordination and cooperation in the re-regulation of global financial markets and considerably widens the scope of regulation. Once leaders commit to a reassertion of state power to arrest global economic collapse, they are aided by a few score central bank and supervisory technocrats who rapidly design and build a new regulatory structure and formulate its associated policies from 2009 through 2012.

Drawing on documentary and interview results, the research will posit that a new paradigmatic policy consensus (McNamara, 1998) is being formed and championed by an empowered central banking and supervisory community. This community is composed of a core group of officials and actors numbering perhaps a few dozen people from advanced and emerging countries. They act in concert driven by a feeling of fellowship (Dore and Whittaker, 2001), and a broad general agreement on the required shift and reform measures. McNamara (1998) developed the concept of policy consensus to describe monetary politics and the creation of the Economic and Monetary Union within the European Union (EU). In this case, what we witness is a partial rejection of aspects of that neo-liberal worldview, a new G20-FSB policy consensus on the need for a reassertion of collective state power. It is centred on re-regulation and monitoring of global markets, a rejection of self-regulation by leading firms, and an extension of central bank responsibilities to include not only price stability but also macro-prudential goals which are designed to mitigate the worst effects of boom and bust cycles.

The subject of this research is an elite, opaque, exclusive process of economic diplomacy involving a few score leaders and policy makers meeting in private behind firmly closed doors at the G20 summits and FSB. This community sought to agree a new common narrative, without which successful policy making in the G20, the FSB, and IMF would be more difficult to secure. The research will demonstrate that when a common narrative, or policy consensus, in McNamara's (1998) parlance, does arise, albeit circumscribed by the nature of the G20 and FSB processes and fluctuating power politics, policy action of a robust form is possible. Where, in contrast, narratives are fractured or in dispute amongst members of the G20 and FSB, the policy outcome is weakened and the results are less satisfactory from a global supervisory and regulatory standpoint. The research will demonstrate that the paradigm shift that is being seen, and the creation of a new policy consensus and narrative, underpins the financial reform and redesign undertaken by the

G20 and the FSB. The policy outcomes are still underway, are fluid and not uniformly strong and robust in all dimensions or policy areas simultaneously; some policy reforms that result from the shift are stronger than others. Where the paradigm shift is more marked and the policy consensus more cohesive, the outcomes are stronger. Where the paradigm shift is less effective and policy aims in dispute, first- and second-order changes result.

The research will show that the construction of the G20-FSB-IMF reforms and the associated paradigm shift and policy consensus are a matter of debate, dispute, and negotiation. A dominant but declining hegemon (the U.S.), its supportive but competitive allies (in Europe), and rising emerging powers (China, India, Brazil, and to a much lesser extent, Russia) all negotiate within the new, reformed G20-FSB-IMF structures. This is a materially significant change in international economic and regulatory diplomacy and a recognition of evolutionary changes in relative state power, a permanent downgrading or sidelining of previous inadequate structures (such as the G7). However, U.S. and European leaders and their technocratic elites continued to dominate the policy-making process in its formative years (2008–2012), even as more room is made around the table. Emerging powers will be seen to have had an impact; they are gradually asserting their prerogatives, but their ability to drive the agenda is limited at the outset.

By reaching out to the emerging countries, the G20's leading state powers are able to craft policy outcomes in line with their agreed goals and with a global impact backed by new powers whose leadership had differing degrees of influence at the G20 summits and technocratic policy making and implementation process below that.

The research further hypothesizes that the outcomes observed in the international policy process driven by the G20 and its progeny, galvanized by a paradigm shift, was and continues to be impacted by the cohesiveness of the particular transnational policy networks and epistemic communities (Adler and Haas, 1992; Haas, 1992a) that control the policy-making process. An epistemic community is a network of professionals with particular policy competence. Such communities can be transnational and are composed of technocrats in particular fields with demonstrable expertise recognised by their community and by political leaders. The communities share common understandings, ideologies, methodologies, and approaches, which create collegiality and group cohesiveness. This lens will prove particularly useful as the research seeks to analyse the

technical-level financial reform agenda and outcomes below the G20 leaders forum led by the FSB and the standard-setting bodies (see the Figure 2.1 p. 33), and the role and operation of these epistemic communities within the G20 and FSB-led process. It will be observed that when the epistemic community is strongest, agrees on a policy consensus, and controls national-level policy levers, the results are qualitatively different. Where the epistemic community is weaker and does not control the policy outcome (perhaps because of legislative and regulatory gaps that must be bridged), the policy outcome is less satisfactory. It will be shown, in addition, that if epistemic communities clash and the policy consensus is therefore lacking or in dispute, a strong epistemic community can defend the status quo and resist paradigmatic change demanded by others.

The research will show that not only have transnational epistemic communities seen their importance buttressed as a result of the G20-led process, but they have also, in certain cases, most notably via the FSB (and its key standard-setting body, the Basel Committee on Banking Supervision), become perhaps key actor or actors in the creation of the new re-regulatory paradigm, policy consensus, and reform agenda. It will be shown that the policy consensus was driven by a relatively small number of actors who all knew each other, lived through the crisis together, and had a clear conception of the problem and desired solutions, over and above traditional national policy stances. The G20 empowered those expert communities to act for the G20 and under the aegis of the G20, drawing these overlapping, sub-state, standard-setting bodies into the state-to-state economic diplomacy process underway.

The research will also utilize one other analytical framework when dissecting the process of G20-led global architectural redesign. An assessment of the G20 summitry would be incomplete if the research did not draw upon the two-level diplomatic game which is underway and which was identified by Putnam in other negotiating circumstances (Putnam, 1988). It will become clear that each player at the G20 and FSB table has international goals and national interests to consider and domestic pressures to contend with, and that these impact the negotiations and policy-making process. The research will show that when negotiators are forced together in the heat of the crisis win sets open up. In contrast, as the crisis wanes, interests diverge and normal national domestic interests begin to reassert influence.

Finally in addressing the nature and evolution of institutional politics within the IMF, the research will draw on existing work on the political economy and functioning of the IMF as an institution. It will be seen that the established internal political dynamics evident in the IMF still operate, notwithstanding modest G20-led reforms, and they result in a very slow-moving institution that still largely reflects a neo-liberal ideology as a creditor/lending body. It will be suggested here that although the IMF has been recapitalized by the G20 process, and is much stronger as a result, there is no paradigm shift inside the IMF; it is national politics as usual in the Executive Board, with emerging creditor nations slow to change the internal dynamics of the IMF.

To summarize, the research meta-theory and analytical framework is grounded in the interpretative power and force of Strange's work on financial markets and state power (Strange, 1986, 1996, 1998). It rests on the overlapping frameworks of paradigm shift in economic policy to analyse the policy changes witnessed in the G20, FSB, and IMF (Kuhn, 1962; Hall, 1993). Both concepts describe how narratives are constructed, defended, and overthrown. The research will also take into account the changing power relationships as U.S. relative hegemonic power declines, and emerging countries' influence and power rises within the various forums and institutions. The research will furthermore utilize the concept of epistemic communities to aid in understanding the operation of the FSB-led technical reform agenda. Finally, the research will also draw upon other lenses, specifically, Putnam (1988) and the two-level game of international economic diplomacy.

2.3 Revisiting Casino Capitalism

Strange, in *Casino Capitalism* (1986) firmly grasped the potential risks to states and their populaces of unrestrained and growing global financial markets whose scale and operation even then were becoming somewhat disconnected from the real (i.e., goods-based) economy, potentially exacerbating market volatility, sudden flows of capital, and the frequency of financial crises (Allen and Gale, 2009). Since Strange identified the dangers these markets and financial actors posed, the size of global capital flows, the levels of risks, the levels of leverage, and the size of the financial flows within complex securities markets have grown exponentially. Complex securities markets are today of a scale unimaginable in the 1980s and 1990s when Strange began her work and states did not regulate these markets as they grew during those decades. Thus, daily turnover of

foreign exchange contracts were a staggering US\$6 trillion in June 2012. Notional total value of all OTC derivatives contracts outstanding in June 2012 stood at US\$638 trillion (BIS, 2013).

The numbers involved are almost inconceivable and far dwarf the output of the real global economy, leading some to question the economic and social utility of some of these new markets and socially worthless products (Turner, 2009a). As Strange described, many of these esoteric foreign exchange securities, and others that were invented since, such as Credit Default Swaps, are nothing more than bets that a stock, bond, or other instrument (which the investor often does not own) may rise or fall (Strange, 1986).

Originally, these products were seen as a form of insurance, but today they do not in general perform that function. Other complex securities, such as Collateralized Debt Obligations (CDOs), CDOs squared, CDOs cubed, and synthetic CDOs, multiplied the risk associated with products (in particular, home mortgages in the U.S.), and obscured the risks contained within them. These securities were difficult or impossible to value or price in times of crisis since there was no transparent marketplace; in fact, many of the instruments proved worthless as the crisis unfolded in 2008 and began to be referred to as toxic assets (Roubini, 2010).

Strange was right; global, highly complex securities markets do resemble casinos in which vast sums of money, unconnected but herd-like in action and interconnected through counterparty risk, are placed as bets with huge potential upsides and downsides, both individual and societal, depending on how the chips fall (Lewis, 2010; Maclean and Nocera, 2010; Tett, 2009). The growth of these unregulated, unsupervised, and interconnected financial markets and capital flows has increased the frequency and amplitude of financial and banking crises over time; indeed, the frequency of highly destructive banking and financial crises now mirrors the harrowing period before World War II (King, 2011a). The 2008-2009 financial crisis and the subsequent ongoing sovereign debt crisis in Europe are the latest manifestations of this phenomenon of severe volatility—market crises, financial collapses, and destruction of individual and societal wealth across the globe—for few states or individuals are safe from the ill effects of spillover.

Strange and state power proponents viewed the development or failure or refusal to develop effective international financial regulation and related structures as best explained as being driven by changes in state power, and the power and interests of key state actors (Helleiner, 1994; Helleiner, Pagliari, and Zimmermann, (eds.) 2009; Strange 1986, 1997, 1998). Strange maintained some states more than others have seen a weakening or diffusion of their power as national and international financial markets grew in size, complexity, and influence, and further developed this analysis of the weakening of state power in *The Retreat of the State* (Strange, 1996). Strange identified decisions and nondecisions destructive of state power and which contributed to this retreat of the state and diffusion of state power.

However, unlike the period in the history of international political economy about which Strange was writing, when the financial crisis commenced in 2007 and reached its initial crest in September 2008, state power was aggressively collectively and individually reasserted. The research identifies a series of collective actions by G20 leaders and central banks the economic and financial size of which had never been seen before and which continues to a degree today. Central banks of the G20 nations stepped in as lenders of last resort and provided massive infusions of liquidity to underpin the system. Governments seized control of the situation, outlining a series of major steps to stabilize the system and reform global financial markets. What we see is a reapplication of international and national supervisory power over markets, firms, and actors via the G20-FSB process.

State power became more diffuse and retreated in decades of blind adherence to the previous paradigm, what Padoa-Schioppa called economic ‘radicalism’ unrestrained by reasoned consideration and historical reflection (Padoa-Schioppa, 2010a, p. 4). The emergence and evolution of the G20 and of the FSB and the related financial reforms that are the focus of this research will, however, show that states ultimately collectively reassert their legal and regulatory power to set new rules and establish new frameworks for financial markets and investors when they were forced by the financial crisis to do so. The period since 2007-2008 has seen a historic collective reapplication of state power by the G20 governments. States, which had permitted their power to wither in the face of growing financial markets and multinational actors, stepped forward as a group to halt a global economic collapse of monumental proportions. They demonstrated the willingness and the ability to reassert state power over markets nationally and internationally via a series of G20 summits and the accompanying financial regulatory reform processes which

continue today. In conclusion, Strange was perhaps too pessimistic. Crises beget action, and a severe crisis can precipitate dramatic paradigmatic third-order change.

2.4 The financial crises, paradigm shifts, and reform

‘Changing paradigms is not easy. Too many have invested too much in the wrong models. Like the Ptolemaic attempts to preserve earth-centric views of the universe, there will be heroic efforts to add complexities and refinements to the standard paradigm. The resulting models will be an improvement and policies based on them may do better, but they too are likely to fail. Nothing less than a paradigm shift will do’. Stiglitz, 2010

‘The G20 has led to a new paradigm in multilateral cooperation’.

G20, Los Cabos Declaration, 2012

In analysing the success or failure of the redesign of the financial architecture by the G20, its progeny the FSB, and the recapitalization of the IMF, the research will draw upon the concept of paradigm shift developed by Thomas Kuhn in his seminal work *The Structure of Scientific Revolutions* (1962), and further developed and applied within the economic policy-making context by the work of Peter Hall (1993).

Kuhn describes the development of scientific worldviews, within which facts and discoveries move as waves resistant to change for long periods until a sudden revolution or paradigm shift takes place. A shift occurs when anomalies arise that can only be effectively described, answered, and dealt with by new hitherto controversial explanations (theories) and an accompanying worldview. Only after a paradigm shift occurs does this series of different truths take their place at the centre of the new worldview constructed of new scientific facts and a new orthodoxy. Thus: The Sun revolves around the Earth; observational anomalies develop; Copernicus makes the key discovery supported by others (such as Galileo); a paradigm shift occurs; the new orthodoxy is adopted that the Earth revolves around the Sun.

This research will utilize Kuhn’s paradigm shift concept as further developed in particular by Hall (1993) and others to dissect the G20 summitry since 2008. Hall applied the concept of paradigm shift to describe and analyse intellectual and political forces centred on economic policy making in Britain and a dramatic shift from established Keynesian norms to neo-liberal monetarist supply-side economics in the 1980s; this was the construction of a new policy paradigm. He posited three orders of change.

First-order changes are forms of normal policy making, ‘a process that adjusts policy without challenging the overall terms of a given policy paradigm’ (Hall, 1993, p. 279). These are everyday adjustments or small changes in focus and direction within an agreed narrative construction. Existing truths are not challenged and are not in dispute. Second-order changes are moderately more significant where the instrument of a policy is adjusted but not the overarching policy. Both first- and second-order changes are characterized by incrementalism (Hall, 1993). Third-order changes reflect radical changes to the overarching terms of the discourse and indicate a paradigm shift is occurring. They involve the accumulation of anomalies, experimentation, failures, and a reappraisal of existing truths. The process is likely to be contested. An intensification of debate about economic issues will occur. Issues of authority (i.e., power) are central. Third-order change, the paradigm shift described by Kuhn in the scientific world and Hall in the economic context, is a revolutionary reappraisal, an event at least an order of magnitude greater than first- and second-order changes.

Many authors have addressed the concept of paradigms and paradigm shifts within the political economy. They observe that political economy paradigms can become institutionalized until challenged by crises and growing anomalies (Weir and Skocpol, 1983; Wilson, 2000). Hall focused his analysis on national policy making and action, but paradigms and paradigm shifts can be international in scope.

Economic and other paradigms can be reflected in international forums and institutions (Ruggie, 1982, Babb, 2013). They can be championed and promulgated by small groups of transnational experts and networks (Porter, 2011; Skogstad, 2011; Slaughter, 1997), operating in epistemic communities (see Haas, 1992a; Adler and Haas, 1992). Paradigms can be observed being constructed and defended in different sectors, from accounting to vehicle safety standards (Porter, 2011), to nuclear disarmament (Mitchell *et al.*, 2007), to the banning of chlorofluorocarbons (CFCs) (Haas, 1992b).

Robust policy consensus can be institutionally grounded. The IMF, for example, the leading global macroeconomic lending institution, has since the end of the Bretton Woods system, through the adoption of what became known as the Washington Consensus, maintained and defended an intellectual, political, and institutional paradigm (Babb, 2013), which could also be described as embedded liberalism (Ruggie, 1982) but which is

more often described as neo-liberal (Gamble, 2009). This neo-liberal paradigm came under attack after the Mexican and Asian crises of the 1990s (Stiglitz, 2008, 2009, 2010), but its validity was generally maintained within the IMF by its neo-liberal economists and a small number of key creditor states, led by the U.S., that control the organization. Paradigms tend to be championed by leaders, experts, and transnational actors and are characterized by periods of stability followed by abrupt episodes of substantial change (Wilson, 2000). For a policy paradigm shift to take place, policy-making actors must be challenged by model failures and growing anomalies (Weir and Skocpol, 1983). The paradigm or era can be said to end when its basic illusions are seen as false. The financial crisis created conditions for a paradigm shift because the dominant laissez-faire neo-liberal deregulatory model of financial architecture of the last two decades was compromised (Bhide, 2010; Wade, 2008). This allowed the intellectual economic beliefs behind the prevailing paradigm to be increasingly challenged (El-Erian, 2009; Stiglitz, 2009a, 2010), based on the failings of economic ideological positions hitherto adopted as scientific truths (Reinert, 2012). This led some to suggest the Anglo-American deregulatory laissez-faire, neo-liberal, neoclassical economic paradigm has become exhausted (Palley, 2009). A strong challenge to the dominant worldview is then possible because the severe economic crisis creates a transformational opportunity, a paradigmatic moment (Assenza, Sokolickova and Martynau 2011; Fergusson *et al.*, 2009; Soros, 2008).

But not all new narratives lead to paradigm shifts. Leaders, policy makers, or experts may be too far ahead or outside of the consensus position within their community (Bhide, 2010; Fergusson *et al.*, 2009; King, 2009b; Padoa-Schioppa, 2010b; Turner, 2009a). A critical mass or consensus is needed; the anomalies and pressures must be such that sufficient numbers of actors alter their position and break with and reject the past orthodoxies in question.

Moreover, a major paradigmatic shift does not always result in the rejection of all previous truths or adoption of the most radical solutions. This will be seen to be the case in the international response to the crisis. An international regulatory paradigm shift can be identified. But many facets of neo-liberal economic belief remain in place. Radical solutions, while sometimes rationally persuasive, may lack the necessary backing in a community of actors. In fact, a paradigm shift can be limited and exclude certain ideas and agendas and be beyond the limits of a new community consensus.

A paradigm shift may be an abrupt break with the past or it can unfold over a protracted period. Thus, the neo-liberalism so clearly evident in Margaret Thatcher's Britain post-1979 did not occur in a single moment in time, even though there was, in retrospect, a paradigm shift. Instead, it was composed of a series of actions which collectively amount to the shift we now see so vividly. This research suggests that this process occurred in the financial reform space; a swift paradigm shift in some policy areas, but less dramatic change in others. Taken as a whole, however, and viewed over a longer time period, it is possible that the G20 and FSB response to the financial and economic crisis during 2008-2013 will be seen as a broader financial and regulatory paradigm shift.

2.4.1 A paradigm shift in state oversight of global financial markets

When fundamentally challenged, shaken by events, by repeated and destabilizing anomalies, and confronted with imminent economic catastrophe, the worldviews of G20 political leaders and central banking technocrats altered significantly. In 2008-2009, we see and can dissect third-order change of the type identified by Hall (1993)—change that is international in scope—a paradigm shift in the global regulatory approach to financial markets (Turner, 2010). The shift was one in which decades of laissez-faire neo-liberal orthodoxy was proved wrong (Turner, 2012), rejected, and replaced with a new worldview. 'September 2008 was to market fundamentalism what the fall of the Berlin wall was to Communism' (Stiglitz, 2008). Or, as Mohamed El-Erian, chief executive officer of PIMCO, a global investment management firm and one of the world's largest bond investors put it, the crisis broke the spell of the 'mystical Anglo-Saxon model of liberalization and deregulation' (El-Erian, 2009).

The research will show that in a relatively short period, G20 leaders and their proxies in the international technical forums chose to reassert their collective sovereignty and regulatory power over global financial markets, a power they had retained in theory but which had been progressively undermined and which was in retreat in practice from 1971 to 2008. Leaders seized back control of the regulation of global financial markets. There is visible amongst G20 leaders, and in particular amongst a subset of their technocrats, specifically the central banking and supervisory community, a paradigm shift in worldview and in their approach to the re-regulation of global financial markets and firms. The crisis drove action and reform, and the result is a reassertion of state power through re-regulation of global financial markets. This narrative shift underpins a new

technical re-regulatory policy consensus, which enables a series of reform proposals to be agreed and commenced within months, with tight timelines and deadlines attached.

The G20-led process rests on a policy consensus (McNamara, 1998). McNamara developed the concept to describe a historically unprecedented convergence of beliefs—a neo-liberal worldview (McNamara, 1998, 2006). McNamara analysed how ideas about economics shape how state actors interpret and act on their interests, outlining the shift towards neo-liberalism that helped create the new consensus around the goal of monetary union, which began to move theoretical debates towards being implemented in 1999. McNamara identified policy paradigms (including a prevailing belief in monetarism and price stability) as key to the creation of the political and economic consensus behind economic and monetary union.

McNamara's identification of the central importance of the development of an agreed policy consensus for successful multi-state diplomacy also holds true in the G20 and FSB cases. Indeed, protagonists describe the process as a 'convergence' or an 'alignment', echoing McNamara's construction (Blanchard *et al.*, 2012; Interview 32, 2012, p. 31; Smaghi, 2008). The research will show that the G20's most effective policy consensus, and as a result international coordination and rule-making activities that emanate from it, is underpinned by a new narrative which required a partial rejection of the laissez-faire neo-liberal worldview, the earlier paradigm described by McNamara.

The creation of a new policy consensus can be quite rapid—a sudden shift in stance precipitated by a crisis and a common consensus about its causes and possible solutions. Alternatively, the build-up of anomalies, crises, and the process of paradigm shift and consensus creation may be a multiyear exercise in deliberation and dispute. In other words, changing the policy consensus can be fast or slow. The creation of this common worldview and consensus viewpoint enables movement from a second-order change to a third-order change and paradigm shift is seen in the 2008-2012 financial reform process.

2.4.2 Constructing a new paradigm, worldview, and narrative

Prior to the 2008 eruption of the financial crisis, the political and central banking communities' worldview was neo-liberal. It was strongly tilted against regulatory rigour and in favour of an Anglo-Saxon (i.e., a U.S.- and UK-led) light touch, hands-off, neo-

liberal deregulatory approach. Policy makers opposed those who sought to circumscribe or limit global financial markets (such as Brooksley Born then Chair of the U.S. Commodity Futures Trading Commission), actors and firms in any meaningful manner. Laissez faire neo-liberal ideological economic truths formed the foundation of this worldview, held sway, and were believed by many key state powers, the private sector, and most regulators.

There were voices raised against the dominant paradigm. Until the crisis began, however, they did not alter the worldview. This macrolevel neo-liberal narrative defended questionable economic truths and orthodoxies, blocked historical memory of previous crises, allowed regulatory laxity, overlooked the ‘capture’ of the regulators by the regulated, permitted dangerous market and firm-level risks to build up, and resisted action to mitigate the worst effects until the crisis was all but upon us.

As the number of anomalies and economic shocks mushroomed in 2006 and 2007, and mutated they generated dangerous economic contagion, and regulators began to recognise a clear and present danger to the global economy. Faced with imminent collapse of the global economy, the old deregulatory worldview had demonstrably failed. In the heat of the crisis, the only solution for the G20 leaders was a collective reassertion of state and government power and central bank intervention, and a re-regulation of financial markets. The view of key leaders, central bankers, and supervisors shifted in how they viewed the proper use of state power to oversee financial markets and firms.

The research will show that when a strong common policy narrative is in place, underpinned by an agreed paradigm of how to view the financial system’s weaknesses, its faults and possible solutions, a policy response can be more robust. When conflicting policy narratives remain and clash within the G20, the possible consensus that emerges is weaker and less robust, with the outcome being incremental changes and policy adjustments (i.e., first- and second-order changes *à la* Hall). This process of building an agreed policy consensus for action is characterized by competing narratives jockeying for dominance.

The research will underscore that what was proposed by the G20 and acted upon in 2009 and since could not have been accomplished without a shift in worldview. Moreover, this

paradigm shift was most pronounced and most sustained amongst a small group of technocrats that constituted their own epistemic community.

2.5 Epistemic communities and financial reform

This research not only concerns summitry at the G20 level; it is also focused on the technical-level policy outcomes agreed in principle by the G20 but designed and executed by communities of supervisory technocrats and the central banking community. To address the policy-making process below that of the G20, it is useful to gaze through the analytical lens of epistemic communities developed by Haas (1992a) and Adler and Haas (1992) and debated in detail in a seminal issue of the journal, *International Organization*, in 1992.

An epistemic community is a network of professionals with recognised expertise and policy competence and knowledge in a specific field. While all members of the community need not come from the same speciality, community members share in common (1) a set of normative and principled beliefs, which underpin the interaction of the community; (2) causal beliefs based on an analysis of the shared problems they confront, possible policy actions, and desired outcomes; (3) notions of validity, of intersubjective, internally defined criteria for judging knowledge in their area of expertise; and (4) they will be engaged in a common policy enterprise addressing the identified common problems related to their area of expertise which they believe will result in improvements to the commonwealth (Haas, 1992a, p. 3).

Research has described the development and operation of national and international epistemic communities of experts and technical policy actors. These communities are identified in a great many different fields, such as accounting and vehicle safety standards (Porter, 2011), CFC elimination (Haas, 1992b), nuclear arms control (Mitchell *et al.*, 2007, see also Adler, 1992), international telecommunication regimes (Cowley, 1990), pollution control (Haas, 1989), in the creation of economic and monetary union (Verdun, 1997), and acid rain policy (Zito, 2001), for example.

The significance of the transnational context within which these communities and organizations operate, and through which groups of experts can influence and implement policy, (G30 2009b, 2010, 2012; Porter, 2011; Tsingou, 2009) has been previously commented on. These communities, which are also known as transnational policy

networks (TPNs), can have a significant effect on international and domestic policies and outcomes (Keohane and Nye, 1972), in some cases limiting or opposing the national governmental policy of individual states. This process, in which individual elements of the state and individual policy makers interact directly with their counterparts through TPN-epistemic communities creating lasting links and relationships, has been described as a new, transgovernmental order (Slaughter, 1997). Their existence has led some to conclude that, in recent decades, as power became progressively dispersed, a myriad of non-state transnational actors filled the gap, and ‘much contemporary international cooperation is not international at all; rather, it is occurring amongst discrete, specialized agencies’ (Raustiala, 2002, p. 2). According to this view, TPNs and their epistemic communities can develop their own objectives, and community stances which directly impact policy making over and above the adoption of purely national stances reflective of domestic interests.

Epistemic communities as transnational policy networks often share certain structural and common internal cultural features. These include: members may be sub-state actors and may not represent national governments; they may be informal in nature and have no international legal standing; they tend to have a more flexible internal structure and lack binding constitutive documents; they have small bureaucracies and small budgets; their decisions have ambiguous legal force and do not create rights, obligations, or binding duties on members; and decision making is normally taken by consensus (IMF, 2010a).

The above analytical framework of epistemic communities of varying strengths and cohesiveness operating within a transnational context as TPNs has considerable investigative utility when analysing the process of international financial reform, because much of the detailed policy generation and implementation process by necessity takes place below the political level of the G20 leaders’ forum, amongst groups of national specialists and experts. The G20 leaders relied on precisely these types of epistemic communities of central bank policy experts and technocrats to identify the needed reforms which they only then agreed to. Leaders lack the skill set to fashion and implement changes, and in most cases they defer to technocrats’ solutions. In certain cases, leaders also demand action when technocrats do not seek it, on compensation, for instance.

To identify and implement reforms, the G20 created a new forum of technocrats and backed others, some of which have proved more effective and some less so. The G20

backed the FSB, a new broadened, empowered, forum supported by an elite epistemic community predominantly composed of principal central bankers and supervisors. The broader community already existed (Helleiner, 1994), in the membership of the Bank for International Settlements and the Basel Committee on Banking Supervision (BCBS), but post-2008, it has been reinforced and reinvigorated by the G20 and elevated through an empowered FSB. The FSB is charged with the responsibility for policy coordination and oversight of the financial regulatory reform agenda and multiple work streams identified by the G20 in 2008-2009 (many of which are still underway today).

This complex task of reform and regulation is further delegated to a number of other transnational policy networks, including the BCBS, the International Organization of Securities Commissions (IOSCO), and the International Association of Insurance Supervisors (IAIS), international standard-setting bodies which are drawn into the new architectural structure created by the G20 (see Figure 3.1, p. 79).

This research utilizes the concept of epistemic communities as transnational policy networks to dissect aspects of the financial reform process driven by the FSB and communities of technocrats and experts. The relative success in a particular reform endeavour will be seen to relate to a particular community's recognition of anomalies, its cohesiveness and international and national policy-making strength, and its sense of common policy narrative. These combined factors influence the relative success or failure of policy reforms pursued by epistemic communities in particular cases and the degree of paradigm shift visible.

In general, it will be observed that the G20 process has empowered the FSB and other TPNs or standard-setting bodies and communities and drawn them into cooperation on the financial reform agenda in a way not previously seen. Epistemic communities led by the FSB are tasked with delivering for the G20 leaders, and they all connect to the new architecture via their own work streams and through the FSB. The communities are pressed, collectively and as individual national regulators, to deliver the agreed G20 goals by specified deadlines. This responsibility galvanizes action from community members and forces change.

In conclusion, utilizing the concept of epistemic communities will demonstrate that the FSB and other TPNs are key to the design and implementation of many of the reforms

identified and backed by the G20 that make the re-regulatory narrative paradigm shift real and meaningful.

It is useful at this point to combine the discussed analytical tools graphically, as is done in Figure 2.1 These tools are:

1. The build-up of recognised critical anomalies in the system (top X-axis);
2. The strength of the epistemic community in policy making and implementation (bottom X-axis);
3. The strength of the policy consensus seen in the policy area (right-hand Y-axis);
4. The Kuhn/Hall paradigm shift and first-, second-, and third-order changes (left-hand Y-axis).

The sloping line running diagonally through the chart represents different policy outcomes.

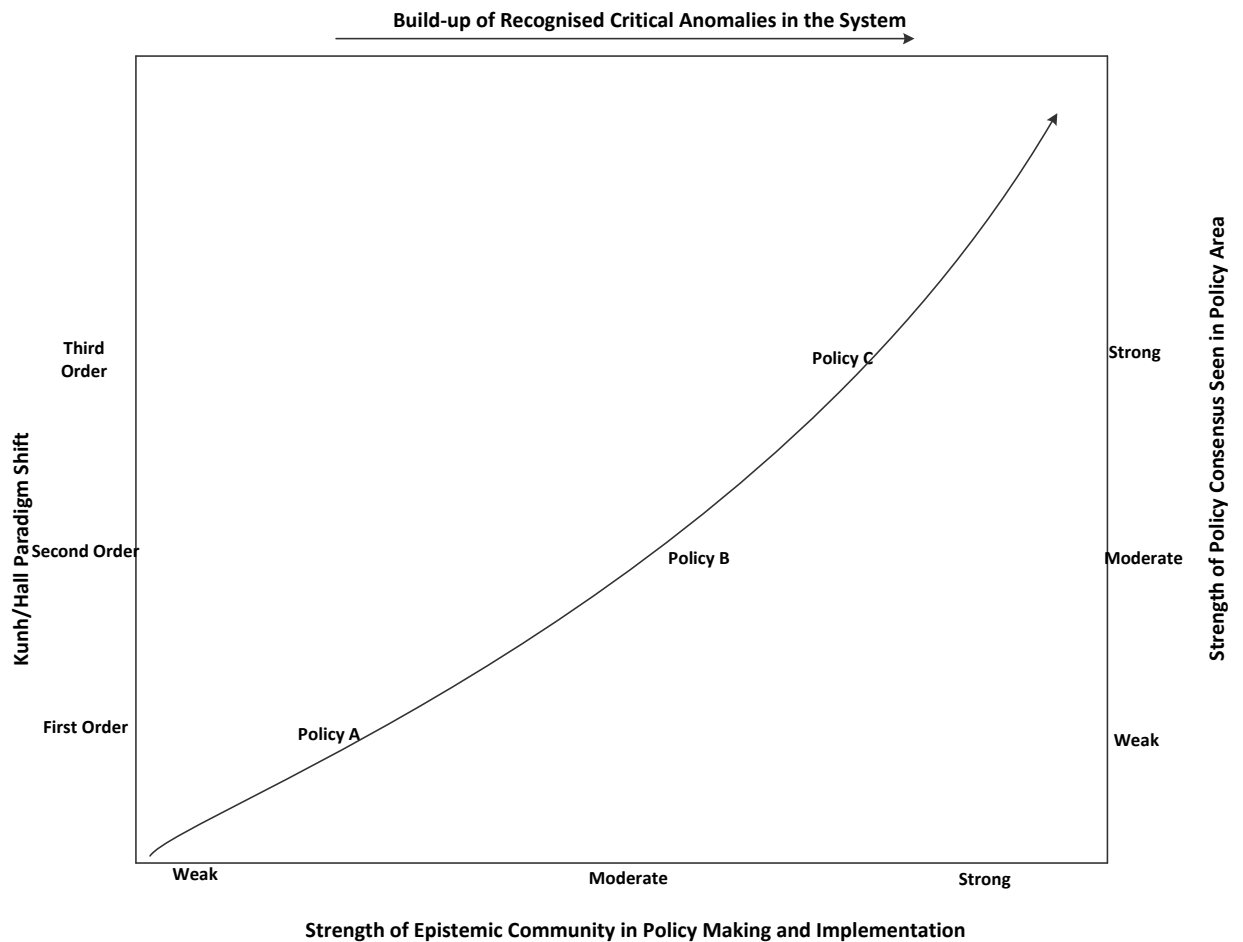


Figure 2.1 Conceptualizing Paradigm Shifts and the Role of Epistemic Communities

In Policy A: The number of collectively recognised anomalies is small. The epistemic community is weak in the policy area. The resulting policy consensus is also weak and the results are first-order changes. The combination of these factors (too few anomalies, a weak or conflicted policy community, and a weak consensus) together produces poor policy outcomes.

In Policy B: A greater number of anomalies are recognised. The epistemic community is stronger in the policy arena. The policy consensus is more robust. The resulting policy outcome can therefore be stronger and of second-order magnitude.

In Policy C: Huge anomalies are present and are recognised by a majority of the community and actors. A strong epistemic community is in control of policy and recognises the anomalies. A strong new policy consensus is agreed. The community has power and influence in the policy area. This results in a third order, paradigm shift.

What the chart underscores is that it is the combination of these different factors that results in different policy outcomes and orders of change or degrees of paradigm shift. Bearing this schema in mind will prove useful in Chapters 4 and 5 when analysing the growth and impact of the FSB and the relative strength or weakness of the policy outcomes seen.

2.6 Additional analytical lenses

In preparing to analyse the creation of the G20, the FSB, the reform of the IMF, and the construction of a new global financial architecture, the research will also draw upon, where appropriate, other potential lenses through which aspects of the process can be critiqued and dissected: (1) hegemony, hegemonic decline, and competition; (2) in the G20 context the important work done on two-level games (Putnam, 1988) as applied to the multinational summitry and economic diplomacy.

2.6.1 Hegemony, hegemonic shift, decline, and competition

In analysing the creation of the G20 leadership forum and summitry process since the first meeting in Washington, D.C., in November 2008, the concepts of hegemony, hegemonic shift, decline, and competition can be used. Hegemony is defined as ‘leadership or

dominance, especially by one state or social group over others' (Oxford, 2012). Kindleberger (1986) applied hegemony, or the lack of hegemonic power, to the years between World War I and World War II. He suggested that the economic chaos in this period was due to the fact that Britain had ceased to be the global hegemon and the U.S. was refusing to assume the role of world leader, and he concluded that the stability of the global system requires a hegemon to promulgate and enforce the rules of the system. This was subsequently defined as the hegemonic stability theory. Much subsequent work has been done by (Gilpin, 1987, 2001; Keohane and Nye, 1972, 1974; Keohane, 1984) on hegemony and stability.

Today, some view the U.S. as the undisputed global hegemon in a unipolar world and believe that the end of the Cold War left America more dominant rather than less (Ikenberry, 2002; Ikenberry, Mastanduno, and Wholforth, 2008). Those who hold this view are joined by other antideclinists (Kagan, 2012; Lieber, 2012). According to this view, the continuing unipolar power of the U.S. is said to create stability (Wholforth, 2008), and it remains the global hegemon (Nye, 1990, 2002).

Other political scientists and historians instead detect a cyclical process of hegemonic rise and decline, under which the dominant state's power (in various forms, cultural, political, economic, and military) gradually weakens and declines. A hegemon's rise and fall may correlate to available resources and economic durability, and to military expenditures. Its eventual relative decline can occur if the latter outpaces the former (Kennedy, 1989), or its decline can be due to other factors.

America's dominance and unipolar power is said to be in decline (Jacques, 2009; Layne, 1993, 2006) for numerous reasons. Aggressive use and overextension of U.S. military power (Bacevich, 2005) is seen as counterproductive. Hypocrisy in U.S. policy making and human rights actions has weakened U.S. soft power legitimacy as the hegemon (Finnemore, 2008). Domestic American political and economic malaise since the 2007-2008 crisis has also led to discussion of the possible decline in U.S. hegemonic power (Brzezinski, 2012), to which the failure of the domestic political system is said to have contributed (Mann and Ornstein, 2012).

Such failings lead to a reorientation of state power, accompanied by the rise of new regional and global powers (Layne, 1993, 2006), such as China (Jacques, 2009; Subramanian, 2011), or Brazil (Rhoter, 2010). Hegemonic competition and the rise of other powers is described as part of an inevitable process (Gilpin, 1981; Layne 1993) and

is cyclical. But just who will be the next hegemon is not always clear. In the 1980s it was Japan, but two lost decades ended that. Now China's rise is said to be inevitable.

How useful are concepts of hegemony, hegemonic shift, competition, and possible decline in understanding the creation of the G20 and the FSB and recapitalization of the IMF since 2008? The concepts certainly illuminate possible motivations behind the G20-FSB-IMF financial reform process and the possible reasons why the U.S. and its allies chose to create new bodies (the G20 and the FSB) to take forward collective policy consensus goals and the agreement to change the voice, votes, and funding of the IMF.

The G20 consensus-based summitry process will indicate the U.S. recognises it must secure agreement from the EU, Japan, and major emerging countries to achieve its global financial regulatory goals. At present, the U.S. remains a system maker and privilege taker, but it can no longer count on getting its own way (Mastanduno, 2008).

In addition to being an explicit recognition of the rise of emerging countries, by championing the G20 process, U.S. policy makers may blunt calls for even more radical redesign solutions post-crisis. It will be seen that American leaders were able to modestly strengthen their position and blunt certain European (in particular, German and French) demands for an even more extensive rewrite of multilateral state-based regulatory systems.

By including emerging countries, the U.S. could strengthen its relative position despite a secular decline in its relative power vis-à-vis different rising state actors. The U.S. may also pull those actors into a greater commitment to new rules that are global in reach, yet stop short in most cases of binding rules with direct effect (in the legal sense).

Below the level of the G20, in the FSB-led technical process, the research will suggest that the U.S., despite being an economically weakened hegemon, and the Europeans, as key allies, together retained a technocratic edge and considerable control over the expert-led policy-making process in the early years from 2009 through 2012. There is a co-opting of the emerging powers into a process which they did not control or design; it is a U.S.-European construct, led from 2009 through 2012 by almost exclusively western 'hawks'. The U.S. and the EU do appear to surrender policy-making levers to the rising powers in the early stages of reform; at that point, policy making remained largely controlled by a small group of G20 leaders and technocrats from North America and (especially) Europe, supported by emerging countries, amongst which the proposed

solutions—more state regulation of markets not less—has considerable obvious ideological resonance.

The evidence will show diplomatic moves by a slowly declining U.S. hegemon and its European allies to implement the new rules before they handed over more control of the G20 presidency and agenda to emerging countries at the end of 2011. The U.S., whose soft power and ideological appeal has been damaged by the crisis, agreed to a series of imperfect consensus-based multilateral G20-FSB-IMF policy solutions that leant away from an Anglo-Saxon laissez faire neo-liberal approach towards more robust re-regulation of global financial markets, rather than risk a head-on bilateral competition with rising hegemonic powers, in particular China, but also Brazil and India. The current hegemon and its allies benefited. They brought emerging country powers within the reformed international structure of cooperation and coordination, and they agreed to an enhancement of their roles within the IMF. In doing so, emerging country leaders and technocrats are pressed to play by a Western rulebook, albeit one that had some chapters paradigmatically rewritten and others subject to considerable reinterpretation post-crisis.

It is too soon to determine whether the continued championing of multilateral policy narratives and solutions by the U.S. will begin to weaken if there is a shift towards bipolarity (U.S. balancing China), multipolarity (U.S.-China-Brazil-Europe), or more intense direct hegemonic clash (U.S. versus China), which some suggest might herald greater tensions or—less likely—war (Wholforth, 2008). But it is possible that in these scenarios, multilateralism and internationally coordinated cooperative consensus-based solutions formed within the new and reformed structures could be more important, not less, to the U.S. as a declining hegemonic power intent on cementing the rules now, while its leverage remains relatively effective.

Alternatively, it could be that as the crisis wanes, (in phase three of the G20 evolution), the very success of the G20-led process in phases one and two (crisis response and reform) may have laid the foundation for a return to national policy narratives, international state competition, disputes, and discord between a declining power, the U.S., and rising powers, particularly China, and to a lesser extent Brazil, but not yet India.

It may also be the case that we are viewing developments in too short a time frame. Hegemonic conflict and change occurs over decades as one power weakens and new powers rise. Given this, what we observe during 2008-2013, namely the evolution of a

more assertive emerging market voice, currently circumscribed by the declining powers, could be part of a process which still has a long period to run and is far from complete.

2.6.2 The two-level game

An assessment of G20 summitry would be incomplete if the two-level financial and economic diplomatic game which is underway was not considered (Putnam, 1988; Putnam and Bayne, 1984). Putnam used game theory to design a model in which international negotiations between states comprise simultaneous negotiations at the international level, between governments (level-one negotiations), and at the intranational level, or domestic internal negotiations between actors (level-two negotiations). In the domestic negotiations, the government weighs demands by actors and constructs coalitions. At the international level, the government seeks to address demands without committing to anything that could prove unacceptable to major domestic interests. Agreements in summitry are composed of what Putnam calls ‘win sets’, which occur when the positions of the actors at both the international and national levels overlap and permit agreement. There is clear applicability of the two-level game analytical framework to the G20 process.

In the case of the crisis and reform phases of G20 summitry, this research will show an increase in the international overlap of level-one policy goals and objectives at a time when national positions (macroeconomic and especially technocratic and regulatory) were forced to converge because of the severity of the crisis and the need for collective action or, alternatively, are muted. During a crisis period, there is a temporary weakening of the influence of national actors and level-two players, i.e., financial firms and banks that would otherwise negatively impact the overlap of policy positions. At critical junctures G20 leaders and central bankers did not consult with business interests or engage in the normal lengthy back and forth level-two talks that could have shrunk the win-sets and undermined possible agreement.

Figure 2.2 shows the two-level game in non-crisis periods and in a period of economic crisis. In non-crisis periods, level-one negotiation positions of A and B may have limited overlap. Each actor’s position is distinct and may be in conflict. For example, in non-crisis periods, U.S. negotiators rarely see overlap with the level-one goals of their Chinese counterparts. In normal times, domestic interests on both sides also drive them apart,

creating little if any win sets. For example, domestic U.S. demands for market access by major U.S. financial firms to Chinese markets falls on deaf ears in Beijing because this conflicts with the position of China's state-owned banks to restrict new entrants into the domestic market. Result: No level-one or level-two win-set space and no progress.

In a period of severe economic crisis, the diplomatic negotiating calculus changes considerably. The goals of level-one negotiators in country A and country B converge or overlap. Win sets open up as domestic interests either temporarily diminish in importance or can be overridden by level-one goals. Result: A consensus and policy actions can be agreed and acted upon.

In the areas where most progress on re-regulation was seen—capital regulations and Basel III—we see a correlation identified by Putnam: ‘the greater the autonomy of central decision makers from their level two constituents the larger the win set’ (Putnam, 1988, p. 449). G20 leaders are negotiating and agreeing to deals, fashioned by central bank and supervisory technocrats, who are independent and face no electoral pressure. These officials in a crisis are able to take positions opposed by their own level-two constituents (i.e., the banks).

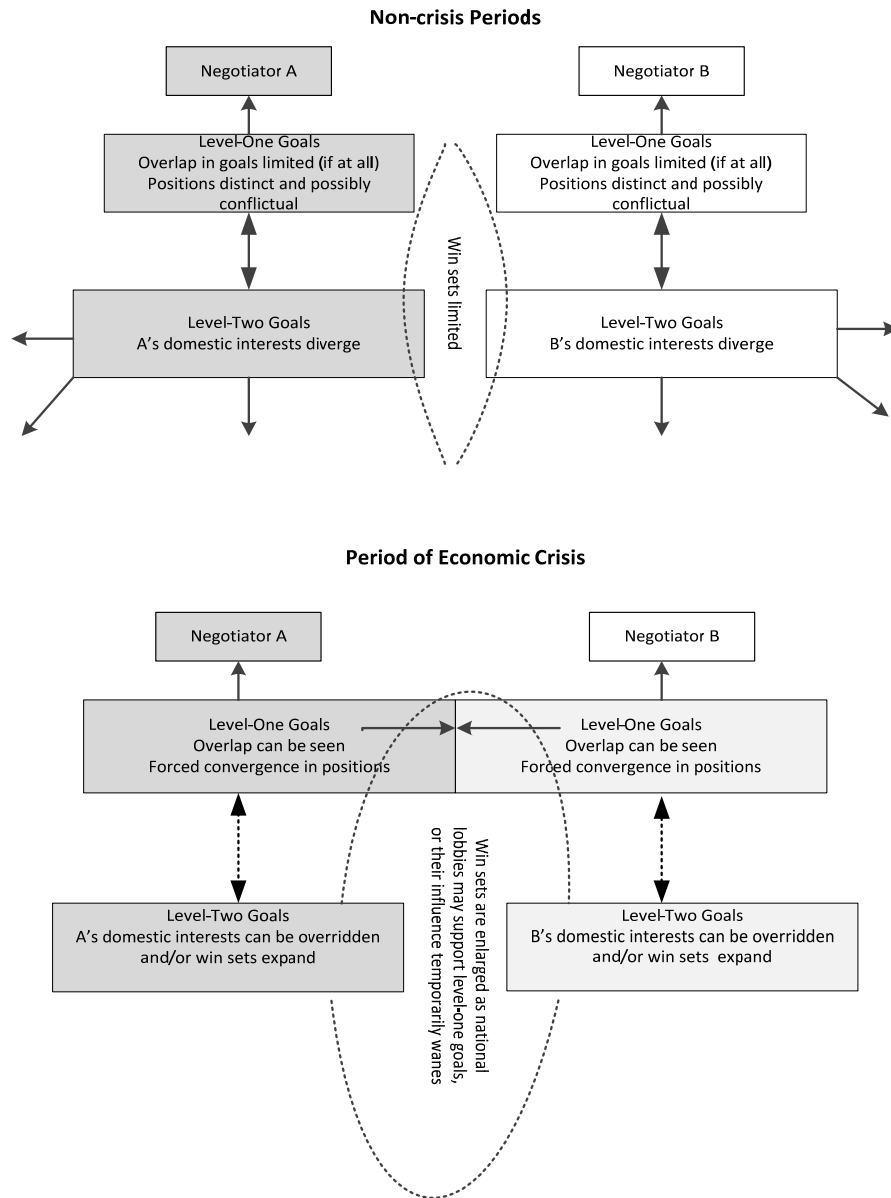


Figure 2.2 Two-level Games in a Non-crisis Period and during a Period of Economic Crisis

In other more contentious reform areas, we observe Putnam’s two-level game also operating. Where the G20 technical negotiators go back and seek legislative solutions to a problem agreed to at the macro-G20 level, and therefore engage in parliamentary and national negotiations with domestic interests, the complexity and difficulty of securing final ratification, and agreement amongst national actors, and thus implementation, increases.

In line with Putnam's approach, it is also possible to view the preference of G20 policy makers in contentious areas to opt for principles rather than rules-based solutions as a drive to widen the win sets and the extent to which we see overlap of level-one and level-two negotiations; G20 work on compensation would be an example of this. In yet other areas, level-one G20 negotiators may be seen to be limited by level-two concerns and the small size or total lack of a win set.

2.6.3 IMF reform

To effectively address the recapitalization of the IMF (Chapter 6) and its important although not lead role in the crisis response and financial reform process commenced in Washington in 2008, the research will draw on the considerable literature on the history of the IMF, its institutional politics, lending, and surveillance (see, for instance, Bluestein, 2001; Chen, 2010; Chwieroth, 2010; Dixit, 2000; Eichengreen, 2007, 2008; Fratanni and Patisson, 2004; Griffiths, 2010; G30 2009b; Lombardi and Woods, 2007; Mussa, 2007; Peet, 2010).

This research will show that the IMF emerges from the crisis and reform periods, and from phase three materially strengthened. It undergoes a process of gradual evolution, with the relative power and authority of emerging countries increasing within the institution. Creditors make the rules, and as emerging countries become leading creditors within the IMF, their voices will be seen to become more distinct and influential. However, the U.S. retains considerable dominance at present.

The research will suggest that the IMF, its staff, and leadership did not experience a paradigm shift of the type seen amongst the G20 leaders and central banking and supervisory community, in particular. While the IMF is now driven by the G20 leadership and follows the agenda set by the G20, the institution itself did not undergo fundamental ideological and operational change. The operation of the IMF, while enhanced, does not undergo a third-order change in worldview or approach as a lender and macroeconomic surveillance organization. Post-crisis it was simply tasked with more conditional lending and more surveillance, but with very minor adjustments in approach.

In contrast to the rapid pace in the G20 and FSB, the IMF's existing internal narrative, essentially a neo-liberal view, is retained, with some French refinements to its anti-

Keynesian bent and hostility to capital controls, in particular. The analysis will show that the IMF post-crisis is larger, better financed, and relevant once more, but it remains a fundamentally conservative lending institution with the associated creditor mindset. Looking ahead, it is too soon to ascertain whether the rising emerging country representation within the IMF will make a qualitative difference in the organization's worldview in the years ahead.

2.7 Conclusion

The meta-theory and analytical framework just described will be used in this research to add to the knowledge by illuminating the nature of an internationally coordinated crisis response led by key states faced with the particularly severe and rare economic and financial crisis of 2007-2008. Table 2.1 presents the three principal frameworks, their dimensions, and their applicability to the subject areas being studied.

| Framework | Dimensions | Application |
|---|--|---|
| Paradigm Shift (Kuhn/Hall) | Narratives and Worldview First, Second, Third Order policy changes [After a third order shift occurs the dimensions and scope of the shift can fluctuate from weak to strong] | G20 summitry FSB creation FSB policy outcomes IMF reforms |
| Two-Level Game (Putnam) | International National/Domestic [Crisis impacts game & size of win sets available to negotiators by increasing overlap of level-one & two goals or by affecting level-two actors' input] | G20 summitry FSB creation FSB policy outcomes IMF reforms |
| Epistemic Community (Haas and Adler) | International National/Domestic [The stronger the community consensus, the more they control the policy agenda and implementation, the stronger the potential policy outcome] | G20 summitry FSB creation FSB policy outcomes |

Table 2.1 Principal Frameworks, Dimensions, and Applicability to the Subject Areas Studied

The meta-theory used in the research is of necessity multifaceted; it must be in order to capture and aid in the understanding of the ideological paradigm shift and diplomatic and state-power-based struggles and two-level games at the G20 summits. The epistemic

community lens will be useful in dissecting the role of the key technical community at the heart of the policy shifts underway. The events being analysed are part of a crisis and response cycle, which itself impacts the outcome of the two-level game, and the role played by the epistemic community. The selected analytical frameworks and conceptual lenses permit the effective illumination of the cycle of crisis management, reform, and a return to dissension among states that is observed.

Chapter 3. The G20, Global Summitry, and Financial Reform

'The formation of the G20 group of world leaders is likely to be the most lasting institutional consequence of the global financial meltdown of 2008'.
(The Economist, 2009)

'The G20 has evolved into the closest thing to a board of directors for the world economy'.
(Davis and Poletta, 2010)

'No longer the CEO of Free World Inc., the United States is now the largest minority shareholder in New World Order LLC'.
(Jones, 2011).

3.1 Introduction

This chapter analyses the rapid emergence of the Group of Twenty (G20) forum and leadership summits as the principal political and diplomatic vehicle behind the response to the financial crisis and the reform of the global financial regulatory architecture. It seeks to answer why and how an informal, ad hoc, relatively exclusive forum, with no staff and no treaty or legal basis underpinning it successfully seized the initiative and became the epicentre of the global economic policy-making process, a position the G20 retains today. The summitry process will be dissected to identify the political economy drivers within G20 summitry, and the diplomatic capital and leadership provided by the G20 states that permitted the forum to temporarily overcome narrowly defined national interests that would in Non-crisis circumstances make major regulatory reforms difficult or impossible to achieve.

The research finds that the new forum's leaders moved to a partial rejection of the prevailing laissez-faire neo-liberal or market fundamentalist (Stiglitz, 2008) worldview, which championed unrestrained and unregulated financial markets operating with as few barriers as possible. Leaders begin to lean away from this Anglo-American or 'Anglosphere' ideological stance (Gamble, 2009). In its place we will see an embrace of the re-regulation of global financial markets, firms, and instruments, with key input from the Western central banking epistemic community (see Chapters 4 and 5). The scope and magnitude of this re-regulatory paradigm shift and the policy response will become clear during this chapter and the analysis of the Financial Stability Board (FSB) and its output.

The research indicates that the G20's actions amount to a paradigm shift (Kuhn, 1962) in the approach of the leaders, and especially of the technocratic central banking

community, towards regulation and oversight of global financial markets and firms. This paradigm shift in the policy consensus is not instantaneous. It does not have an equal effect across all points in time and all policy areas. It can be ‘lumpy, jerky, and uneven in important respects’ (Biesterker, in Payne, 2005, p. 75). As with other paradigm shifts—scientific (Kuhn, 1962), atmospheric (Haas, 1992b), nuclear (Mitchell *et al.*, 2007), economic (Hall, 1992; Blyth, 2002), economic development (Gore, 2000)—the shift occurs over a longer period of time and can be spasmodic and fluctuating in different policy areas.

This shift has various elements. Anomalies build up and can be institutionalized until challenged by crises (Weir and Skocpol, 1983; Wilson, 2000). The current worldview cannot explain the failures and loses utility. A new worldview and policy consensus (Blyth, 2002; MacNamara, 1998) takes shape and begins to be championed by more actors. A tipping point occurs—for the purposes of this research, the peak of the economic crises occurs in September 2008—and over a period of time, months and years, the new worldview is clarified, solidified, and made actual on the ground, step by step.

This chapter argues that, taken in its totality, the creation of the G20 and the structural redesign and policy actions the leaders agreed in a series of summits (and which are carried out and led by technocrats) suggest that: ‘The G20 has led to a new paradigm in multilateral cooperation’ (G20, 2012). This most severe financial and economic crisis precipitated a greater shift in worldview than previous more minor crises (in the 1990s, for instance). This fraught and fluid environment allowed the rejection of previous regulatory truths. A new consensus (political and technical) took shape within which the G20 acted, summits took place, and policy goals were formulated. As Blyth and other constructivists note, ideas matter and they help shape the effectiveness of the G20 process and policy making that commenced in 2008 and which continues today. The scope and breadth of reforms that commenced in 2008 support the view that a shift is underway, and that it amounts to a possible third-order change in the international regulatory architecture (Hall, 1993), even as some individual policy changes viewed in isolation from one another are first or second order in nature.

The creation of the G20 in the midst of global economic crises is a significant and lasting alteration in the practice of international economic diplomacy. In the first five years of its existence, the G20 has emerged as a ‘board of directors’ for the world economy (*Wall Street Journal*, 2009). In the corporate world an effective board, must establish the

culture, set the strategy, agree to the firm's risk appetite, and then direct the firm's senior management to get on with the job (G30, 2012). This is essentially what the G20 sought to do. The new forum would begin a cultural shift, grasp the crisis, set the agenda, identify key priorities, and clamp down on risks. The 'culture' in this context is a new consensus worldview of the necessity for state oversight and regulation of global financial markets and the financial actors and firms within it.

G20 summitry and the developing policy consensus and regulatory agenda that the meetings produced, especially in the earlier gatherings, are evidence of an unambiguous reassertion of collective state power and a signal that the retreat of the state (Strange, 1986, 1996), so long underway, has stopped and reversed direction. States, acting together, buttressed the world's economy and global financial markets with public funds, providing bailouts and guarantees that amounted to 27 percent of the developed world's GDP (Trichet, 2010a). G20 leaders, in return for the public's largesse, would take back control over markets and institute much more aggressive supervision and re-regulation as the *quid pro quo*. This dramatic reassertion of state power over global financial markets is led by the leaders of the established powers, principally from Europe and North America, aided by emerging powers in the forum. All understood the depth of the economic chasm before them in September 2008, and the real risks they still faced in 2009, and the G20 summit outcomes reflect this.

Utilizing Putnam's two-level game (1988) applied to the financial crisis (see Figure 2.2., p. 40) events in 2008 force level-one negotiators together. There is an increase in the degree of level-one policy agreement and overlap amongst state actors. Meanwhile normal level-two processes that act against accord, i.e., divergent national interests, are temporarily overridden by the severity of the events and by the pressure for action based on the common leader-backed and technocrat-driven policy viewpoint. Recent events underscore again that financial and economic crises force national negotiators together and create such win sets. Thus, the latest wave in the crisis, this time a sovereign debt crisis in Europe, forces the G20 leadership to strike a US\$461 billion firewall deal in an attempt to arrest the Eurozone crisis in the spring of 2012, even though public policy tensions are much more apparent by that juncture.

G20 summitry results strengthen the position of the U.S., which is operating as a gradually declining hegemonic power (Layne, 1993, 2006). By taking the initiative to set up the new structure and rules, the U.S. shores up its position and those of its key allies.

The U.S. draws the emerging powers further into the new architecture and into its reformed forums and institutions, which are designed largely by technocrats from Europe and North America based on their norms and, albeit altered, rules. In this manner, the summits lock the rising powers into the reformed architecture. The summits may therefore help postpone, or alternatively institutionalize, an otherwise more potentially disruptive direct clash between the declining power—the U.S.—and the central rising power—China—as well as others—such as Brazil and India (Jacques, 2009; Rhoter, 2010; Subramanian, 2011). Having emerging-country leaderships reinvested in the altered structure's success, politically and financially, may have the effect of extending rather than diluting U.S. influence as the declining power.

Finally, to further illuminate the birth of the G20, the research uses a thematic approach to divide the chapter's narrative and analysis, because the summits are better viewed as part of a process rather than as discreet events on a calendar. The three phases are (1) crisis management; (2) concrete reform; and (3) a reemergence of tension between the new consensus and dissension among G20 states. The thematic approach aids the reader in understanding the fluid process underway. It will be seen that the response starts with frantic crisis management efforts. Actors then move onto an analysis of what went wrong and how to fix things, i.e. the construction of a common narrative or a policy consensus (McNamara, 1998) and the reforms that logically follow from this new worldview (Blyth, 2002). As the crisis abates and matters return to relative policy normalcy, national political disputes, differences, and potential dysfunction reappear, only to be temporarily arrested by the need to react to the crisis in the Eurozone. In this particular case, both the partial success of the summits and the widespread relative economic weakness still seen during 2010–2013 also create new tensions in the G20.

This chapter does not address in detail the principal regulatory reforms given political backing by the G20 summits and coordinated by the FSB and the IMF. A detailed assessment of both and their respective roles in the architectural redesign will be discussed in Chapters 3 and 4 (FSB structure and outcomes) and Chapter 5 (IMF).

3.1.1 Background

In the years prior to the financial crisis, leaders and their governments allowed and facilitated a progressive erosion and diffusion of state power to other actors, through a series of deliberate decisions and nondecisions (Bachrach and Baratz, 1963; Strange, 1986, 1996). Governmental acts or refusal to act were underpinned by ideological and

economic beliefs, a paradigm that championed unregulated markets ahead of state prerogatives (Akerlof and Schiller, 2009; Padoa-Schioppa 2010a; Stiglitz, 2010). There was a weakening of state power and a gradual retreat of the state's desire and authority to regulate a rapidly growing global financial system and bank and non-bank actors as a corollary to this deregulatory neo-liberal paradigm (Strange, 1986, 1996).

As state power retreated, there was a concomitant increase in the size, impact, and influence of the liberalized financial sector, and within that of systemically important interconnected financial firms and banks, and the levels and magnitude of the compensation of their traders and investment bankers spiked upwards (FCIC, 2011; Johnson, 2010). Unregulated or underregulated, the shadow banking sector grew simultaneously with a series of unregulated new complex markets, firms, and products that increased leverage and magnified risk (Helleiner, 2010; Lewis, 2009; MacLean and Nocera, 2010; Tett, 2009). This financial engineering brought the illusion of wealth but did not support genuinely sustainable growth (Maclean and Nocera, 2010).

These extremely complex global markets, firms, and the leveraged products of financial engineering they constructed proved highly destructive to the commonwealth when confidence in the markets disappeared and investors panicked. During this period of excess credit, liquidity, and the worship of the deregulatory gods, the magnitude and frequency of boom and bust cycles grew (Allen and Gale, 2007) and the number and severity of banking crises rose to a level last seen in the pre-World War I era (King, 2011a).

A deregulatory, laissez-faire, neo-liberal Anglo-Saxon paradigm and narrative championing economic markets over regulatory vigour underlay these developments (El-Erian, 2009). This was parroted by leaders, such as Bill Clinton, George W. Bush, and Gordon Brown, and major regulators such as the U.S. Federal Reserve and the UK Financial Services Authority. Markets were said to be self-correcting and would always return to stable equilibrium unaided. Excessive risk, speculation, manias, and dangerous booms and busts were a thing of the past, or so many policy makers believed, blind to economic history (Kindleberger and Aliber, 1978; Minsky, 2008). A 'great moderation' was said to have begun (Bean, 2009). In theory, financial risk was spread. In reality, no one could gauge the risk or who held it. Few regulators lost any sleep over or thought to question this worldview or to consider the dangers they might engender. Those who did

express concern, such as Raghuram Rajan, former IMF chief economist, or the officials at the Bank for International Settlements (BIS), were not heeded (Rajan, 2005; BIS, 2008).

This deregulatory paradigm and largely Western and Anglo-American narrative provided intellectual justification for the progressive erosion of conservative prudential supervision of major financial institutions and actors in major markets, including the U.S. and the UK, in particular, as regulators became ‘captured’ by those firms they regulated, i.e., the major financial market actors. Neoclassical economic beliefs, in market equilibrium, in rational actors, in the efficiency of liberalized markets, were championed and behavioural economics languished, notwithstanding the latter’s greater explanatory power regarding booms and busts (Akerlof, 1970; Akerlof and Schiller, 2009; Stiglitz, 2008, 2010). The historical memory of the behavioural drivers of individuals and investors, of the commonalities in past boom and bust cycles, was forgotten. Just as in past booms, ‘this time’ was thought to be ‘different’. It was not (Galbraith, 1954; Kindleberger and Aliber, 1978; Minsky, 2008; Rogoff and Reinhart, 2009). Ultimately, the latest, largest, most interconnected, highly leveraged, opaque credit and U.S.-real-estate-driven boom, fuelled by a great many market and regulatory failings, turned to bust. The mania turned to panic and near global economic collapse (FCIC, 2011).

In 2007-2008, the global economy faced the worst economic crisis in 80 years. The autumn of 2008 saw the bankruptcy of Lehman Brothers, the U.S. government takeover of American International Group (AIG), the forced merger of Merrill Lynch with Bank of America, and action to secure the remaining two American investment banks, Goldman Sachs Group Inc. and Morgan Stanley (Federal Reserve Bank of St. Louis, 2008). Scores of other large banks and financial firms closed their doors (FDIC, 2013). Elsewhere across the globe other giants of finance were already wards of the state, such as the RBS and HBOS.

By September 2008, the global financial system was under huge stress and the economic crisis in the U.S. had accelerated. Credit remained tight or almost nonexistent. International trade flows had collapsed (OECD, 2009). Markets and investors were in a panic. Certain types of asset classes or ‘socially worthless’ instruments (Turner, 2009a; Cassidy, 2010), composed of poorly underwritten subprime mortgages sold in the U.S. and securitized, had collapsed in value or could not be sold at any price. The overnight repo market had frozen (Gorton, 2010, 2012). The U.S. plunged into its most severe contraction in 80 years. Families saw a loss of a greater proportion of their net worth than

occurred in the Great Depression, and jobs disappeared at the rate of 800,000 per month (Goolsbee, 2011). Many other nations, such as the U.K., China, France, and Spain, also faced economic contractions that would develop into full-blown recessions.

Policy makers confronted ‘the limits of unrestricted globalization [and] ... the intrinsic tension between global financial markets and sovereign states’ (Subacchi, 2010a, p. 258). Leaders faced ‘not only with the collapse of a financial system, but also with the collapse of a worldview’ (Assenza, Sokolickova and Martynau, 2011; Fergusson *et al.*, 2010). Laissez-faire neo-liberalism confronted a legitimacy crisis (Chorev and Babb, 2009; Helleiner, 2010), and the spell of the ‘mystical Anglo-Saxon model of liberalization and deregulation’ was broken (El Erian, in *The Economist*, 2009). As a result of the crisis, a change in the paradigm of regulatory and economic governance began (Constancio, 2010).

Leaders, galvanized, seized upon an elevated G20 forum to be the coordinator and decision-making centre for international economic diplomacy and their crisis response. Through it, leaders would fashion a new policy paradigm, alter the regulatory architecture, and reassert national state power over, and supervision and regulation of, financial markets and firms.

3.1.2 A thematic approach

To shed light on the recent history of the G20 summits as the principal leadership forum on international economic diplomacy, the analysis will be broken into three thematic phases which encapsulate and reflect the forum’s emergence, evolution, and maturation since the first emergency meeting in November 2008. Rather than discuss the summits as a series of individual chronological events, this thematic analysis helps illuminate the G20’s evolution, which is similar to the crisis and reform cycle observed during national financial crises. The thematic approach used in this chapter divides the G20 summitry into three phases through which to view it: (1) crisis management; (2) concrete reforms and redesign; and (3) the reemergence of dissension among G20 states and leaders, and the rise of emerging country leaders within the process.

1. Crisis management: Phase one is marked by a focus on emergency global crisis management efforts, with national leaders seizing upon the G20 forum and elevating its status from a finance ministers’ forum to provide a hastily arranged venue for leaders to debate and address a still unfolding financial crisis. Phase one

is limited to the first summit in Washington, D.C., in November 2008. During this global crisis management phase, much of the corrective and economic stimulus activity is nation-state-focused; it is bilateral and ad hoc. Broad-based international solutions are only partly formed or in the initial design stages.

Many of the officials present during this period use similar imagery. They talk of recognising the chasm ahead, of standing on the cliff's edge, or having no alternative (Interview 5, 2011; Interviews 13, 17, and 31, 2012). Government leaders faced a real and present danger. They knew they had to be seen to act and to deliver a modicum of calm, to begin to take charge as the 'board of directors' of the global economy in Washington, and they arguably succeeded in doing so.

Importantly, this natural crisis management reaction was coupled to an immediate recognition that the response should be a process, (Interview 5, 2011; Interviews 18 and 20, 2012)—i.e., the start of reform, not the end. This first phase would have objectives and deliverables of a breadth and complexity not seen in previous summit-based crisis management by weaker forums, such as the G7.

2. Concrete reform: Phase two is the period of maximum G20-directed reformist zeal, underpinned by a clear policy consensus and policy narrative, and the political capital of the G20's leadership. It marks a reassertion of state power by the core and emerging-country G20 leaders over financial markets and firms. It unfolds principally during the leadership of the UK and the U.S. in summits that occurred in London and Pittsburgh, Pennsylvania, in 2009. With the immediate financial crisis morphing into a real economic threat, and with global economic output slumping, a series of major stimulus moves are announced. These joint and several fiscal stimulus and financial rescue measures show states working in tandem via the G20 forum at this juncture. Crucially, phase two also sees the identification and enumeration of a great many key institutional and regulatory reforms by the G20 leaders, prompted by the assertive central banking technocratic epistemic community, which would be central to the post-crisis financial architecture.

In this phase, the G20 begins the architectural redesign and reform with vigour. Leaders agree the outlines of and direct international and national regulatory actors and agencies to begin to negotiate the details of the financial reform agenda. The G20 is confirmed as leading the international economic policy-

making process. The FSB is created. The reform, major recapitalization, and a rebalancing of voice and voting power between the North and South and the East and West within the IMF is commenced.

In phase two, the urgency for action is clear, and G20 leaders seize the regulatory reform initiative. It is widely recognised that this period of the G20's evolution constitutes the apogee of the forum's effectiveness. Big solutions were needed. British Prime Minister Gordon Brown, U.S. President Barak Obama, and others, closely advised by key central banking and regulatory figures, set forth an ambitious agenda. During this phase, a broad G20 policy consensus on action can be identified even as differences are seen (over stimulus and exit strategies, for instance). Overall, the G20 in this phase adopts a wide-ranging agenda and ambitious work programme goals. The narrative and its policy products result in state power beginning to be reasserted over markets across many policy areas.

3. A reemergence of dissension among G20 states and leaders, and the rise of emerging country leadership: Phase three sees a return to dissension among G20 actors, interrupted by the need to construct a response to the Eurozone crisis in 2011-2012. The period 2010-2013 is a time of increasing dissension and divergence within the G20 over new policy goals, assumptions, and reassertion of national and regional interests. As the immediacy of the crisis begins to wane, and the redesign and reform process continues at the technical level, attempts to further extend the policy narrative and paradigm to new areas (such as global imbalances) proves impossible.

In phase three, the G20's focus turns to deeply intractable perennial global macroeconomic issues that resurface as blocks to global accord coordination and further action. Uppermost amongst these are matters centred on global imbalances (i.e., between deficit and surplus countries), the future of the international monetary system, and the role of the dollar as a reserve currency. Competing paradigms of national political economy in these areas are reasserted by major G20 actors, as these sensitive topics rest on competing nation-state narratives related directly to the management of national economies, fiscal policies, and trade policies. As a result, securing a G20 consensus on an expanded agenda becomes much more difficult. The very state power that is reasserted to considerable effect in phases one and two becomes an impediment to possible

agreement as increasing disagreement is seen and the challenge of finding solutions to recurrent global macroeconomic problems looms large. This dissension among G20 states is also in part explained by national governments' perceptions and the two-level game; i.e. the growing impact of domestic politics and national interests as level-two blocking factors that stop the creation of additional win sets that might extend policy solutions beyond the financial regulatory and to the economic.

Phase three begins with the Toronto Summit (2010) and continues through the Seoul (2010), Cannes (2011), and Los Cabos (2012) Summits. It would be wrong to suggest that phase three sees no regulatory progress; to the contrary. Commitments made in phases one and two continue to be addressed and developed at the technical FSB level. But the macroeconomic policy consensus starts to fray at the G20 level as it is stretched too far.

A cycle or dialectic can be identified. Disputes sharpen and the policy consensus weakens compared with phases one and two. As in previous national financial crises, the window of opportunity for action is relatively short. Once a modicum of economic and financial stability returns, in part due to actions taken in phases one and two, more narrowly defined national state interests and the demands of domestic lobbies confront political leaders, all of whom face re-election pressures and the nature of political cycles, and appealing to national audiences and interests occurs. In addition an understandable desire for economic growth presses many G20 leaders to seek to export their way to that goal by devaluing their currencies, but with too many states taking that route, currency tensions escalate.

This dialectic and the dissension in phase three are temporarily interrupted by the severity of a new episode of the financial crisis, namely the sovereign debt crisis in the Eurozone and on its periphery. Faced by market pressure and panic in 2012, the G20 leaders are once again forced towards a policy consensus and action, via a massive commitment of bilateral funds channelled through the IMF. Crisis once again focuses minds, forces compromise, and galvanizes leaders. The G20, again, shows that as a forum it operates at its best in crises.

Finally, in phase three we can also identify the changing role of the emerging-country members of the G20, as they begin to take a more assertive role in the negotiations and also take over the Presidency of the G20.

At the end of each thematic section presenting the political dynamics and results of G20 summitry, an analytical commentary will place events within the broader analytical framework.

3.2 Structure and membership of the G20

Membership: Membership of the G20 is comprised of the following countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and the U.S.. The European Union (EU) is represented by the rotating European Council presidency and the European Central Bank. Other institutional participants are the Managing Director of the IMF, the President of the World Bank, and the chairs of the International Monetary and Financial Committee and Development Committee (World Bank).

A small number of other countries' leaders have a seat at the table, either because of their institutional position or simply because of the influence of the individuals and governments in question. Thus, the head of the European Council attends. The Prime Minister of Spain attends as a 'permanent guest'.

The G20 membership is not set in stone; it has increased slightly from 2009, and in 2013 has a fluctuating membership and is actually the 'G20 plus five', The membership now includes Ethiopia and Benin (representing the African Union), since the Seoul Summit; Cambodia (representing the Association of Southeast Asian Nations [ASEAN]); and Chile (representing a broad constituency of others 'left outside' the forum).

Summit Presidency: The country that chairs a summit acts as President of the G20. It sets the agenda and writes the draft declaration, action plans, and communiqués. The country in the chair has significant influence on the outcome because, according to participants, other members tend, within limits, to defer to the chairing state's leadership (see Interview 5, 2011; Interviews 12 and 18, 2012). After the first summit, the declaration agreed at each summit contains consistent themes, i.e., follow-on work from previously agreed policy actions, some omissions, and additions made by each chairing country as that leader and his or her ministers strive to create a successful summit that addresses matters of particular concern to the chair, both domestic and international (Interviews 16 and 18, 2012).

Decision making: At a summit and at the ministerial pre-meetings during the year, all decisions are taken on the basis of consensus. This is a strength and a weakness. In times of crisis, events push level-one negotiators together and decisions are brisk, win spaces open up amongst the leadership, and the creation of a policy consensus is easier. This occurred in 2008 and 2009. Once a crisis passes, especially in phase three, a consensus is harder to secure. The quality of the declaratory and decision-making output of the G20 can also decline in non-crisis periods, because the compromises required to switch the last ‘no’ to a grudging ‘yes’ dilute the results.

The European voice: European leaders retain a loud voice in the G20. Eight of the 26 principals around the table are European leaders. It would be an oversimplification to suggest that this means, in a consensus-based forum, that Europeans dominate. But the evidence suggests that the Europeans, especially when in accord with the U.S. and Canada, do largely determine the content of declarations. In total, as many as 42 nations with a direct or indirect presence are included as a result of EU representation (Payne, 2010).

Therefore, there remains a North America-EU de-facto co-dominance within the G20. European leaders have leverage over and above their numerical advantage because of their economic and financial importance. Moreover, EU leaders can and do pursue their individual pre-summit goals bilaterally, and they also adopt joint EU positions prior to summits, increasing their collective impact in this manner, as well. In general, European leaders are very well versed in international interstate diplomacy—they practise it constantly in the EU—and this may give them an advantage in the G20 forum.

The emerging-country voice: Key emerging countries — Brazil, China, India, Mexico, and Russia—are included in the G20. Others are included for geopolitical as well as economic reasons, such as Indonesia (the world’s largest Muslim nation), Saudi Arabia (for oil revenues and sovereign wealth fund cash), South Africa (as the dominant sub-Saharan economy), South Korea, and Turkey (a regional giant in Central Asia). The G20 inclusion of major emerging powers of global and regional significance is a lasting innovation and one which cannot be reversed; once a state is admitted, it cannot easily be ejected.

Anomalies arise. There are only three African states. There is only one Arabian or Persian Gulf state. Turkey is elevated without explanation. Argentina is included (Peru has as

good or better claim to a seat at the table than Argentina). Other candidate countries have merit but are outside the process, for now.

Other participants: G20 leaders' meetings include finance ministers, deputy finance ministers, central bank governors, and 'Sherpas', who act as the drafters, coordinators, and protectors of each country's respective positions.

Legal personality, resources, and frequency of summits: The G20 is an informal grouping, not an institution. It has no legal personality, resources, or institutional solidity besides that conferred on it by the seriousness with which the leaders treat its gatherings and policy outcomes (Interview 3, 2011). It is not a treaty-based organization. The G20 has no founding document, there are no specified government signatories, it has no formal power, creates no obligations, and has no resources of its own. It is simply a forum for periodic meetings staffed by national officials of the country chairing the next summit, assisted by the IMF and World Bank. The 2011 Cannes Summit affirmed this approach; during this summit, leaders rejected calls to create a separate secretariat distinct from the national leadership of the summits.

The G20's effectiveness year-to-year rests, in part, on the power of the Presidency and the chairing country and its leadership. The more powerful (i.e., politically and economically dominant) countries can achieve more than the smaller, less influential countries (such as Canada or even South Korea). The G20's effectiveness also depends on the ability of the host country leadership to harness the collective will of the leaders present and to foster a policy consensus regarding the particular issues the G20 seeks to address at any one point in time. This, in turn, is impacted by what phase the G20 is in at the time. Consensus is always easier to create during a crisis; it is difficult to create and sustain when the crisis abates. As a result, dissension amongst participants can be seen.

G20 summitry is controlled by the national actors themselves (in reality, certain powerful governments), and they therefore maintain the buy-in of leading states. This structure also results in the effectiveness of summits varying somewhat due to a country's ability to staff the summit process, the political weight of the country in question, and the urgency of the global economic matters set before the leaders. For some states, such as Mexico and South Korea, hosting is a large task—one that, according to finance ministry and central bank officials, stretches institutional capacity and resources (Interviews 16 and 18, 2012).

G20 leaders at Cannes in December 2011 cemented the summit process into a Troika of leadership to include the immediate past country chair, the current country chair, and the next summit chairman, similar to the long-standing EU Council process prior to the appointment of a permanent Council President. In doing so, leaders aim to improve continuity and allow smooth institutional handovers from one summit to the next. This approach shows the continued European influence in the G20 form and construction.

Preparatory meetings: The first G20 summit and subsequent ones are buttressed by ongoing multilateral and bilateral exchanges and multilevel ministerial discussions that assist in preparing the agenda, declarations, and action plans. To help prepare these summits and press the agenda forward, G20 finance ministers, G20 sherpas, and central bank governors continue to meet several times a year, including on the fringes of the spring and annual meetings of the World Bank and the IMF. Progress on declaration drafting is monitored by the finance ministries, and the work feeds into the leadership summits. Working Groups are established to formalize this process and monitor deliverables. By the time of a leaders' summit, according to a U.S. G20 sherpa, the content of the declaration or communiqué should be 'pretty much pre-cooked' (O'Toole, 2009), with most policy differences ideally greatly minimised.

3.3 Phase one: crisis management - the G20 emerges

In tackling the global financial and economic crisis, leaders and states began to make a paradigm shift. The first G20 summit marked the return of the state or the swinging of the pendulum (Gills, 2008) away from laissez-faire neo-liberalism. Leaders signalled the start of an evolution of their policy worldview on the desirability of comprehensive global and national supervision and regulation of financial markets and major financial firms. Individual national governments, unable to deliver a return to economic stability alone, decided to act collectively and globally in order to regain control and restore a degree of market confidence and economic stability. Leaders sketched the outline of a new approach toward application of state power to regulate markets and firms more comprehensively and in a much more coordinated fashion than previously witnessed.

States did so via a hastily convened G20 leadership forum (in Washington, D.C.) in November 2008. The summit brought together, for the first time in decades, leaders representing 85 percent of global gross domestic product (GDP), from developed and emerging economies, to identify a way out of the crisis. Few commentators at the time expected much from the forum, believing it to be a weak enlarged G7 clone.

At the G20 summit in November 2008 governments began to reassert a significant degree of state power and authority over financial markets. They signalled the intention to commence a redesign of the global regulatory architecture. States, in moving to re-regulate finance with the backing of the G20, demonstrated that the erosion of state power, informal and formal, had been overstated. The crisis and the G20 response to it in November 2008 underscore that, ‘the state is irreplaceable as a risk manager of last resort and as a regulator of irretrievable imperfect markets’ (Constancio, 2010, p. 3).

A new paradigm and policy consensus began to take shape. G20 governments moved to regain control over underregulated and deregulated financial markets. A rebalancing of formal hard state power exercised individually and collectively over financial markets and firms commenced. But the severity of the crisis in phase one meant that much of the focus had to be on a series of immediate steps to be taken to stimulate the economy, essentially neo-Keynesian policy actions, in a drive to halt the slide and rebuild confidence. More detailed reform plans would follow later.

3.3.1 An emergency summit takes shape

The move to address the crisis through an emergency summit in 2008 was not carefully thought out. In a crisis, decisions need to be made quickly. Many leaders urged action, proposing different configurations. French President Nicolas Sarkozy, German Chancellor Angela Merkel, and British Prime Minister Gordon Brown all called for some type of emergency summit (Rieffel, 2008). Sarkozy floated the idea of an emergency summit of heads of state using a ‘G8 plus five’ structure (Interview 5, 2011), and Merkel leaned towards the old G7-G8 format (Interview 4, 2011).

According to one former official, U.S. President George W. Bush and his Treasury Secretary, Hank Paulson, worried that a summit meeting could degenerate into a platform of grandstanding (Interview 12, 2012). Bush suspected that the participants would attack the existing global economic and financial system, which he did not see as broken (Interview, 5 2012). Bush and Paulson struggled over the issue of who would attend and what the goals would be, and decided to avoid that problem by elevating the G20 finance ministers’ forum into a leaders’ summit, because they knew the forum and believed a conversion was the simplest route (Interview 5, 2011).

This was a pragmatic solution (Interview 18, 2012). Finance ministry officials in the forum could rapidly act as Sherpas for the new G20, smoothing planning and

coordination. In addition, there would be fewer complaints from emerging countries that their inclusion was an afterthought, as might happen with the Sarkozy proposal. Bush was joined by Brown, who agreed that using the G20 format would involve the least complexity and avoid the need to create an entirely new body and the diplomatic difficulties that would ensue. In the end, Merkel also came on board and backed the Brown-Bush jump to the G20 (Interview 4, 2011). The hastily convened summit would bring round the table almost all the major global economic powers including the leadership of key emerging economies (Brown, 2010; CSIS, 2009, p. 21; see also Interview 5, 2011; Interviews 8 and 12, 2012). The G20's creation sent the message that the prior institutionalized format (G7 or G8, in particular) was inadequate to the task (Cooper, 2010). It was a recognition that the U.S. as a weakened hegemonic power and its allies can no longer drive the process alone (Beeson and Bell, 2009).

Emerging country leaders supported the calling of a G20 leaders' summit. They were eager to become full members of a new forum, rather than ad hoc additions to an existing smaller grouping. The rhetoric was sweeping. Brazilian Finance Minister Guido Mantegna stated that they were, 'creating a new international economic order ... a new international economic architecture that has the G20 at the top of the pyramid, providing guidance and support to international financial institutions' (IMF, 2009a, p. 2). With hindsight, Minister Mantega would be proved largely correct.

The G20 proposal to include emerging economy leaders from Brazil, China, India, and Russia, as well as other influential players such as Saudi Arabia, South Africa, and Turkey, was an explicit recognition of the severity and global nature of the crisis, and of the need to bring the leaders of both creditor and surplus states to the table as equals (Interview 13, 2012). This time, however, the creditors were emerging economy players and the debtors were in the G7, a role reversal from prior financial and banking crises that historically erupted more frequently in emerging economies (Rogoff and Reinhart, 2009, p. 160). Expressed most simply, it was a recognition of the reality that 'we ought to have new institutions that reflect the world we live in' (Traub, 2009, p.4).

Boosting the role of key emerging economies had been a long-standing U.S. Treasury goal, and the crisis afforded an opportunity to hasten that change (Interview 12, 2012). To the watching world of nervous voters and panicking investors, a summit of the G20 could also signal it was 'no longer business as usual' (*Financial Times*, 2008) and might help

rebuild economic, market, and investor confidence. But the change would still leave the core members calling the policy shots.

3.3.2 The Washington Summit delivers more than expected

A ‘Summit on Financial Markets and the World Economy’ took place in Washington, D.C., on 14-15 November 2008 (White House, 2008). President Bush had relatively limited goals for the meeting. He saw it, as did his Canadian counterpart, Prime Minister Stephen Harper, as the start of a process (Interview 5, 2011; see also Kirton and Guebert, 2009, p. 7).

U.S. policy makers were correct in suspecting the summit would be used to mount an assault on free market orthodoxies. Brown and Sarkozy took direct aim and began sketching their own outlines of the future. Brown styled the meeting a ‘Bretton Woods II’ conference, an opportunity to reform global financial institutions (Kirkup and Waterfield, 2008; Giles and Parker, 2008). Sarkozy, joined by Merkel, called for a ‘new constitution’ for world financial markets and for the construction of a new regulatory architecture (Kennedy and McKee, 2008) and wanted financial regulation to be centre stage (Benoit, 2008). Europe’s leadership hoped for a major breakthrough at the summit, while the White House was less ambitious, with Bush operating as a lame-duck president, albeit one who was willing to act.

Outside observers were not optimistic. The late Peter Kenen, Senior Fellow in International Economics at the Council on Foreign Relations and Professor of Economics and International Finance at Princeton University, observed that the original Bretton Woods meeting in 1944 was preceded by careful planning over a number of years involving economists and officials, not government leaders (Rieffel, 2008). The Bretton Woods conference was underpinned by a concentration of state power, an expert consensus, and wartime conditions, all of which helped secure the desired outcome (Helleiner, 2010). Lacking these underpinnings, there was a risk the Washington summit would result in broad policy statements and calls for reform but no action; simply a G20 version of a G7 post-summit communiqué; nice language but no real action. In the end, the cynics were too pessimistic, and the crisis pushed the G20 leaders and their technocrats together and forward into a multiyear refashioning of the structure of financial regulation. They would extend the power of the state, expressed collectively via the G20, and recast the structure of new and existing forums, institutions, and regulatory bodies in a significant and long-lasting manner.

The arguments before the first summit showed the tension between those (predominantly Europeans) whose narrative understanding of the crisis recognised a series of major market failures. They demanded a strong reassertion of state power, commitments to stimulus, a shift towards a re-regulation of markets, and an abandonment of laissez-faire, neo-liberal self-regulatory tropes. The host president was reluctant to agree. Ultimately, the pressure forced the two groups together, but, as will be seen, on balance the re-regulators won and the redesign began.

The crisis forces Putnam's level-one negotiators together, but it did so by creating win sets more favourable to those calling for state supervisory and regulatory action. During this crisis stage, there was no real evidence of level-two impacts on the hasty deliberations. Interest groups were not part of the process. Market events were moving too quickly. It was left to the leaders and officials to fashion an agreement. This would also prove to be largely the case in phase two.

3.3.3 Broad political direction now, detailed plans later

The first G20 leaders' summit and the crisis management phase saw the securing of a series of agreements and commitments that were preparatory in nature, but nonetheless more concrete than expected. According to one participant, leaders and their Sherpas were galvanized by a 'sense of crisis and responsibility' (Interview 5, 2011, p. 8). Another former official characterized it as a 'fire-fighting summit' (Interview 24, 2012, p. 3). All leaders understood they could not return home to an unfolding economic crisis with nothing to show for it. To have done so would have risked worsening market panic and accelerating the collapse of investor confidence (Kirton, 2009, p. 15; Interview 20, 2012).

During the negotiations, Sherpas rejected a last-minute effort by the French to substitute their own five-point text, and held onto the more detailed, more specific, less incendiary U.S. language (Interview 12, 2012). The U.S. sought to blunt criticism of the market economy model, and this was backed by an Indian intervention in favour of more balanced language. Overall, U.S. negotiators were successful in retaining control of the drafting process, and the outcome was 'far more measured than the rhetorical build-up' (Interview 5, 2011, p. 10).

The declaration was nonetheless a relatively robust reassertion of state prerogatives and of the essential nature of nation-state fiscal and regulatory intervention in times of economic crisis. It appeared to be an assertion of an emerging new re-regulatory paradigm, a common narrative, which was at odds with market fundamentalist, the old norms of self-regulation and deregulation. The Washington summit started a paradigm shift and a financial reform and architectural redesign process that still shapes global markets five years later.

There is little doubt the leaders understood the broad parameters of what needed to be done in Washington: first, send a message that world governments were acting collectively via a collective and bilateral stimulus to halt the slide into another great recession (Stevens, 2008); and second, signal that an era of re-regulation would begin, via a series of specific actions and reforms (Interview 5, 2011).

By focusing on specific goals, this first G20 summit avoided the pitfalls of past summits, which descended into acrimonious ideological disputes (Reynolds, 2009) or meaningless platitudes. Specifying timelines and tasking other institutions with deliverables was also a key development. Deadlines concentrate minds and provide impetus for process-based progress towards known goals.

In the communiqué, leaders stressed the goal of restoring economic stability via joint and several stimulus actions, and of planning for post-crisis reforms, the details of which would be determined later. They underscored their belief in ‘market principles, open trade and investment regimes’ (G20, 2008a; p. 1), a fillip to the U.S., and then turned to the need for economic stimulus and a re-regulation of markets. Addressing the macroeconomy, summit leaders agreed to ‘take whatever further actions are necessary’ to stabilize the financial system, supporting that recovery with monetary and fiscal measures to provide markets with liquidity (G20, 2008a; p. 2). More economic stimulus, tax and interest rates cuts (Elliot, 2008), together with central bank liquidity would be provided by each country where needed. The leaders of Britain and Canada moved to increase the existing stimulus, for instance, as did others, following on from passage of the US\$700 billion U.S. Troubled Asset Relief Programme (TARP) program a few weeks earlier (Federal Reserve Bank of St. Louis, 2008), and China’s announcement of a US\$586 billion stimulus package just before the summit (Lander, 2008). President Obama, for his part, would act once in office with a further stimulus of US\$887 billion in February 2009 (ARRA, 2009).

As part of the move to boost economic stability and stimulus, leaders committed to provide more resources to the IMF, after strong pressure from then-IMF Managing Director Dominique Strauss-Kahn. The World Bank and other multilateral development banks (MDBs) would also see a resource boost.

Turning to financial reform and regulation, the leaders agreed on five broad parameters and 47 specific steps, which current and former central banking sources present during the debate and drafting say drew upon earlier analyses by the Financial Stability Forum (FSF) (FSF, 2008; G20, 2008b; see also Interviews 9 and 11, 2011; Interview 12, 2012). But the declaration was tougher, the language stronger, and it specified goals and deadlines that were absent from the earlier, weaker, FSF discussion paper. The crisis acted as a galvanizing external force, and the G20 reacted by empowering the technical and central banking community, which seized the initiative and enhanced their own position and they set the policy agenda.

The outlines of the reforms (and the new narrative they represented) agreed in Washington and championed by the U.S. and its European allies were a significant innovation, but were also a fundamentally Western project. As one participant observed, ‘what you got was you got all the emerging markets to sign up to our whole financial regulatory agenda. Pretty damn good deal’ (Interview 12, 2012, p. 11). In Washington, the leaders agreed to:

- ❖ Strengthen transparency and accountability: This meant principally work on strengthening of accounting standards, with an ultimately overly optimistic goal of global accounting standards.
- ❖ Enhance sound regulation: The FSF and IMF would begin work on macro-prudential standards, prudential oversight, surveillance of national financial systems, and risk management.
- ❖ Promote integrity in financial markets: Regulators were urged to coordinate more closely on threats to market stability.
- ❖ Reinforce international cooperation: This was to be achieved via the use of strengthened cross-border crisis management.
- ❖ Reform international financial institutions: The FSF was to be expanded. The IMF was to increase surveillance and review lessons learned from the crisis. Leaders also committed to a reform of the IMF ‘to more adequately affect the changing economic weights in the world economy’ (G20, 2008a, p. 5).

Working Groups including ministry officials would be assisted by experts and international and national agencies in drawing up particular recommendations in these key areas by the next summit in April 2009, in London. Leaders signalled that their technocratic epistemic central banking community (which had crafted large parts of the declaration itself) would also take over much of the formulation of the detailed work streams to be considered by the political leaders at the next summit. Just as Hall describes, we see a deferral to recognised expert epistemic communities (Hall, 1992). By passing key preparatory work down to national technical agencies and bodies, the leaders increased the likelihood of progress. Leaders recognised they could not make these detailed judgments; instead, others would do so with their strong backing.

Two decisions embedded within the Washington Declaration under the rubric of ‘reforming the international financial institutions’ were highly significant for the future shape of the global architecture: (1) the decision to enlarge the FSF to include emerging countries; and (2) the commitment to reform the IMF, to boost emerging market representation and IMF resources.

Both these reforms underscored that the old system run only by the few to the exclusion of the many was at an end and that, henceforth, the process of international financial regulatory redesign would involve input from more states and governments. Emerging economy leaders would now sit around the table. Their representation and voice in the FSF and IMF would be enhanced, gradually rebalancing power in the IMF.

Behind the proposed enlargement, the state actors pivotal to reform were U.S. and European leaders, essentially the old core players acting within the G20, who sought to ensure that regulatory reform and oversight would be outside the control of the IMF (Interview 12, 2012). The IMF had urged the G20 to entrust it with regulatory remit and early warning, as well as with its usual balance of payment responsibilities, but this was rejected at the outset. Instead, the G20 decided the leadership of the reform process would reside in a system of ‘networked governance’ (Helleiner, 2010; see also Chapters 4 and 5) led by the G20 and overseen by an enlarged FSF. Both bodies would be dominated by European and North American voices. The end result refashioned and reinforced the western powers’ influence within the new architecture which they themselves would be largely responsible for building. In this manner, the universal treaty-based IMF was strengthened monetarily and in its governance, but was simultaneously downgraded structurally within the new architecture with the agreement of the leading and emerging

powers, suggesting that the renewed legitimacy of a reformed IMF only goes so far (Chorev and Babb, 2009).

As the G20 process developed from November 2008 onwards, it would become clear that an enlarged FSF would coordinate, manage, and play a central role in the regulatory reform process. This process would include but would not be controlled by the IMF. Mario Draghi, then-Chairman of the FSF, had seized the initiative to the benefit of core states and their central banking and supervisory community, in particular (Interview 9, 2011). In fact, a relatively small number of national regulators would go on to retain great influence within the enlarged FSF-led process of financial reform during its first years of work from 2008 to 2012 (Interviews 9 and 11, 2011).

In conclusion, the Washington declaration, by its broad nature and considerable detailed specificity—47 deliverables and timelines—and by its delegation of authority and tasks, eclipsed G7 documents of the past. It is striking because of its depth of content. By international standards, the G20 had started off with a hyperactive plan for supervisory and regulatory action that would be detailed and enumerated still further in subsequent summits (Cooper, 2010, p. 745).

The crisis fighting exercise in phase one worked if measured by polls, market, and leadership reactions. National leaders benefited domestically from their time on the world stage. Externally, the summit played well. President Bush got a modest uptick of 2 percent in his approval rating (Rasmussen, 2008). Prime Minister Brown saw his approval rating jump 10 percentage points after the summit, from 31 to 42 percent (UKPollingReport, 2008), but the boost would be a fleeting one. Each leader stressed slightly different versions of what was achieved. Reviewing the discussions, Bush Administration officials underscored the pro-stimulus and pro-growth message and saw in it an ‘affirmation of free market principles’ (G20, 2008b) and a defence of the status quo. Prime Minister Brown lauded the ‘route map to the global economic recovery and the stimulus’ (Elliot, 2008), also choosing to stress stimulus rather than regulation as the main takeaway. In contrast, German and French leaders underscored the perceived victory against markets and the commitments to ensure that ‘all markets, products and participants are regulated or subject to oversight’ (G20, 2008a).

The Sarkozy and Merkel position mirrors most closely the tone before, and detailed content of the declaration and the regulatory reform agenda actually agreed (Benoit, 2008; Kennedy and McKee, 2008). Whole sectors of global financial markets hitherto

unregulated would face regulation or oversight. ‘Self-regulation’ was criticized, and closer supervision of financial markets and actors would take place in many sectors and national financial markets. But the narrative shift would still be limited. It did not encompass a rejection of neo-liberal economics, only of laissez faire neo-liberal approaches to markets and regulation.

Overall, the summit’s conclusions and the breadth of the regulatory reform project made clear that the G20 leadership believed the process was not a cosmetic exercise or simply first-order changes. Indeed, the process London started would result in a substantial re-regulation of key global financial markets and firms, backed by political capital pooled by the G20. The summit results were a concrete manifestation of a reassertion of collective state authority indicative of the changing policy consensus and paradigm regarding the desirability of internationally coordinated re-regulation of financial actors and markets. The reforms would be directed by an elite network or community that would drive policy convergence and harmonization (Holzinger and Knill, 2005).

In phase one, the G20 achieved more than many expected. *The Economist* opined that the summit had, ‘permanently changed the machinery of international economic cooperation’, adding ‘rich countries will no longer set the agenda on their own’ (*The Economist*, 2008). Some, such as former IMF Chief Economist Simon Johnson, disagreed, saying this was ‘plain vanilla stuff they could have agreed upon without holding a meeting,’ i.e., it was objectively unnecessary and national in substance—but not actually very radical (Lander, 2008). Viewed with hindsight, the critics were unduly pessimistic.

3.3.4 Why Washington mattered

During phase one, crisis management and the birth of the G20 as a leaders’ forum, the fire-fighting and other decisions taken in Washington were to prove crucial in a number of concrete respects. There was a ‘convergence of political, national priorities, followed by collective action’ (Interview 21, 2012, p. 8). The new forum became ‘the premier forum for global economic governance’ (Cooper, 2010, p. 741). It acted to arrest the crisis and help restore a degree of calm. Through the summitry process started in Washington, ‘collective leadership and institutions emerged in unforeseen ways as governments intervened in a myriad of rescue efforts’ (Subacchi and Cooper, 2010, p. 607). Leaders debated the policy narrative through which to view the failures and solutions to the crisis.

The end result outlined a paradigmatic shift in approach to the re-regulation of global financial markets, firms, and instruments. Leaders from France, Germany, China, and even Britain, demanded a reappraisal of laissez-faire neo-liberal norms and approaches to financial market regulation (Lander, 2008; MacGregor, 2010; Interview 13, 2012). Europeans and others who sought a reapplication of the power of the state in large part won the argument, despite protestations from the U.S., and they began fashioning elements of a new policy paradigm. The G20 defended globalization and sought to restore calm, led by leaders from the old core (Beeson and Bell, 2009) while including emerging country leaders. But the G20 leaders went further and made an ideological shift from which followed a series of major reforms over the following months and years.

After this qualified victory in phase one for the re-regulatory forces and their evolving new policy consensus, the debate and the G20 financial reform agenda would focus on the extent, speed, and depth of global re-regulation and financial markets reform, not whether such action should be taken at all. This policy consensus, this commitment to re-regulation, was signposted in the detailed plan presented in Washington, where the heat of the crisis helped create space for the new consensus. National leaders and their technocrats were literally living through the nightmare of 2008 together. They were the people bailing out the system and providing liquidity. As a result, the need for lasting regulatory reforms, the solidifying concrete basis for a new policy paradigm, based around agreement on less leverage, more capital, more oversight of markets and firms, and vigilance on systemic risks appeared clear to almost all the key leaders and their trusted technocrats.

G20 leaders understood that their countries faced terrible interlinked crises, and the solutions they reached for went beyond the expected and further than in previous financial crisis response episodes from the 1990s. This time, they formulated plans for a more ambitious reform of the global financial architecture. The severity of the crisis was a crucible for action. It forced clarity upon leaders and removed extraneous influences. In Putnam's terms, the crisis created level-one win sets while level-two concerns were muted (Putnam, 1988). When everyone is in danger, voices of narrow-minded national self-interest carry less weight or converge and overlap. Phase one of the evolution of the G20 and the reform process it started would ultimately result in meaningful substantive changes in financial markets and the supervision of those markets. As Kirton and Guebert observed, the leaders fashioned 'an ongoing summit-guided, multilevel process ...

promising to produce a permanent G20 summit institution at the centre of global financial economic governance' (2009, p. 4).

In addition, the creation of the G20 signalled an explicit recognition by North American and European leaders that the number of seats around the table would increase permanently, with key emerging-country states becoming part of the process. Those states supported the new re-regulatory consensus and paradigm. In return for a seat at the table, emerging countries committed their political and actual capital via bilateral stimulus and commitments to IMF reform and recapitalization in Washington. In phase one, however, emerging countries would not lead the G20 crisis management response.

The G20 was led by U.S. and European actors who sketched out the outline of a stimulus and reform agenda. The agenda would be pursued by a strengthened FSF and a reinvigorated IMF, with the former going on to dominate the international coordination and implementation of post-crisis global financial reform and redesign.

The G20 in phase one made what would prove to be a pivotal decision: they turned to their central banking and supervisory regulators, a group that this research shows constitutes a distinct expert epistemic community (see Chapters 4 and 5), to design the mechanisms and the detailed reform agenda. The key recommendation in phase one was the enlargement of the FSF, which Mario Draghi - an Italian central banker, economist and Chair of the FSF, who went onto succeed Jean-Claude Trichet as the President of the European Central Bank –championed and the G20 leaders then endorsed, according to those present. Much of the G20 summits' future detailed policy prescriptions and agenda would go on to be based on work done by the self-same Financial Stability Forum (soon to become the FSB) also chaired by Draghi (Interviews 9 and 10, 2011; Interview 12, 2012; see also Bluestein, 2012).

Through this gambit, a central banking community which was deeply culpable in the run-up to the crisis and in the mishandling of the global economy pre-crisis, succeeded in grasping the opportunity to determine the plan of the new regulatory structure and presented it to the leaders. From that point onward, a small coterie of principally North American and European central bankers would go on to dominate the policy-making process to an extent which remains striking even today. So Washington mattered a great deal. Decisions taken then signalled how the reform process in later phases would be led and would proceed.

3.4 Phase two: concrete reform

In phase two of the evolution of the G20, the extreme severity of the immediate financial crisis morphed into a new economic challenge as the global economic outlook deteriorated and many industrialized economies entered severe recessions (IMF, 2009). What had been seen as a U.S. subprime problem rapidly became everybody's economic problem (Interviews 14 and 17, 2012). G20 leaders moved to commit to further major economic stimulus even as disagreements over the scope, form, and duration of stimulus began to emerge. G20 leaders turned their focus to the causes of the crisis and fleshed out ambitious institutional and financial reform proposals. The G20 Action Plans unveiled in this period would build upon the broad parameters sketched out in Washington as actors begin to build a new regulatory structure.

Much was achieved in phase two because, as with many past national financial crises, the period immediately following a crisis permits a process of critical self-examination, a search for a narrative through which to understand the causes and lessons to be learnt, matched by a desire amongst the policy-making elite to repair identified gaps in the regulatory system and redesign the structures that they believe had failed.

Kuhn describes this process of paradigm shift. Existing truths fail to explain new or current phenomena properly or account for anomalies. Triggered by events and discoveries, actors seek new narratives and different explanations and solutions to increasingly commonly recognised anomalies. Just such a process of critical self-reappraisal occurred through discussions and debates and are reflected in official sector reports such as the *Turner Review* (Turner, 2009b) and *Run on the Rock* (House of Commons Treasury Select Committee, 2008) reports in the UK undertaken by key policy makers. It was also seen in various individual national reform financial proposals. Mervyn King called for the consideration of 'utility banking' (King, 2010). Paul Volcker called for limits on banking practices and heavily influenced the Obama Administration's response (G30, 2009b) and in doing so changed the scope of banking activities in the U.S.. Philipp Hildebrand, then Governor of the Swiss National Bank, increased capital on Swiss banks and reasserted the bank's supervisory policy-making prerogative over banks that had threatened the Swiss economy (Hildebrand, 2010). In the above cases, and in many others, supervisors and central bankers went through a collective process of identifying failures and causes and prepared to seize back the levers of control from the market actors. Note that it is not the G20 leaders themselves who engaged in this process

as much as it is the technical central banking community, who act as their expert advisers. Leaders did not have time for such navel gazing. What they sought was considered advice from trusted advisors. The central banking community in phase two provided that.

Phase two allowed a critical space for self-examination and reform due to a temporary weakening of the normal influence of domestic interests, Putnam's potentially pernicious level-two interests and their power over the policy and governmental decision-making processes. This outcome is because at this point, as the economic crisis unfolded, many major commercial banks were silent or were temporarily wards of the state (like AIG and Citigroup, for instance). The widely felt effects of the crisis meant that domestic institutional and private sector opposition was temporarily silenced, allowing governments, transnational policy networks, and regulators more room to manoeuvre and more policy options. The developing policy consensus also helped supply the level-one win sets Putnam speaks of (Putnam, 1988). It is for this reason that President Obama's chief of staff observed that 'you never want a serious crisis to go to waste' (Emanuel, 2008). What the FSF could not do pre-crisis the FSB could do post-crisis because of a new urgency and clarity of mission and purpose from the leadership of the G20 and the central banks. There was also a change in the power relationship between public versus private actors in favour of the state.

This second phase of concrete reform and the work of the G20 encompasses both outcomes from the April 2009 summit chaired by Prime Minister Gordon Brown in London and the subsequent September 2009 summit chaired by President Barack Obama in Pittsburgh, with the former being the apogee of reform zeal and the latter being concerned more with moving agreed reform measures forward to the extent possible while papering over policy differences as leaders began to diverge gradually over their economic plans and exit strategies from the great recession.

3.4.1 Clear deliverables in London: but first some big numbers

At the London summit in April 2009, Prime Minister Brown and the G20 leaders had one overall aim: to restore a degree of calm and confidence to markets and to underscore their commitment to support growth and restore economic stability. To succeed in that goal, big numbers were needed, and just how large was an area of some controversy prior to

the meeting. Domestically, Prime Minister Brown also wanted to demonstrate his stature on the world stage and burnish his political popularity with a major success in London.

In the run-up to the meeting, there was disagreement over what exactly constituted stimulus (Bradford, 2009). Each player wanted to trumpet their economic stimulus in the most effective manner; U.S., U.K. and Chinese ministers suggested only discretionary measures should count (tax cuts, investment and expenditure increases) (Darling, 2011). European officials disagreed and stressed automatic stabilizers should also be factored in, namely their much more generous unemployment and social welfare provisions which acted to cushion the public from the destitution seen during the Great Depression of the 1930s. At its most basic, this was an optics issue. This was a false debate (Bradford and Linn, 2010).

Combined discretionary and automatic stabilizers amounted to 2.6 percent of global GDP, more than the IMF said was necessary at that time, which helped defuse the issue. Ultimately, this compromise approach was agreed and G20 leaders announced that collective fiscal and economic commitments, discretionary and automatic, amounted to US\$5 trillion in 2009, the ‘the largest fiscal and monetary stimulus and the most comprehensive support programme for the financial sector in modern times’ (G20, 2009a, p. 2), a huge amount but a figure still dwarfed by the expansionary and war-related expenditure during World War II.

G20 leaders also struck a deal to boost resources of the international financial institutions (IFIs). The final number announced was impressive: US\$1.1 trillion in new resources for the IFIs. G20 leaders also struck a deal to boost resources of the international financial institutions (IFIs). The final number announced was impressive: US\$1.1 trillion in new resources for the IFIs. This included a new Special Drawing Right (SDR) (SDRs are how IMF contributions are calculated and held) allocation of US\$250 billion, US\$500 billion under the New Arrangements to Borrow, US\$100 billion of additional lending by the multilateral development banks, \$250 billion of support for trade finance, and IMF gold sales for concessional lending (G20, 2009b, 2009c).

Such huge numbers were agreed after both the UK and U.S. leadership pressed for maximum ‘shock and awe’ from the summit participants. U.S. Treasury Secretary Tim Geithner, for example, rejected out of hand an NAB allocation proposed by his own

officials of US\$250 billion. Instead he insisted, against their pleading, that the NAB be doubled to US\$500 billion. He was acutely aware that leaders needed the maximum impact from the announcement, and the bigger the number the greater the impact on market sentiment (Interview 12, 2012). Tim Geithner, Larry Summers (Chairman of President Obama's National Economic Council), and Gordon Brown understood that during a crisis, to restore calm, the size of the action must exceed that which is expected or assumed. Doing so can change the market dynamic and reaction from panic to calm or to positive in tone. It does not matter if all the funds are used in the end—only that the amount is massive and its use clearly articulated at the outset. It is, in contrast, notable that Europeans failed to learn this lesson during the Eurozone sovereign debt crisis, and instead in 2010–2011 repeatedly announced proposals that were seen as too small, too late, or too incoherent for the desired market impact.

The G20 leaders followed the stimulus pledges with a series of detailed, highly specific financial reform proposals for the financial system post-crisis. Principal amongst these were agreements on the following.

The Creation of the Financial Stability Board (FSB): G20 leaders agreed to create the FSB, to replace the FSF. It would include all G20 countries, FSF countries, Spain, the Netherlands, and the European Commission. The FSB would be the principal coordinating body for the raft of regulatory work specified in a two-part expanded Action Plan agreed in London. The FSB staff would double its staff from seven (as the FSF) to 15. It would grow rapidly into the principal forum for international economic diplomacy and financial coordination, backed by a broad G20 mandate for action. It would have a complex institutional structure and modus operandi much closer to that of a formal international institution than to its ad hoc predecessor, the FSF (see Chapter 4).

Financial Reform: A series of highly specific deliverables were identified in the Action Plan that was unveiled in April 2009 in London and which continues to provide the focus for reform from that point forwards to the Pittsburgh summit and beyond. Almost all the G20 workload would be overseen and where necessary actually carried out, by the members of the FSB. The G20 tasked the FSB with coordination roles that included assessing vulnerabilities affecting the financial system; acting as principal coordinator of an information exchange forum; undertaking strategic reviews of the policy development

work of the international Standard Setting Bodies to ensure they delivered on G20 goals (G20, 2009b).

The above makes clear that in London the new FSB was placed at the very centre of the regulatory reform. The scores of tasks it was given responsibility for coordinating would not be easy, and they would be quite contentious. Much of the work stream coordinated by the FSB would be dealt with by technical bodies and international agencies, such as the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), and the International Organization of Securities Commissions (IOSCO), but all would be overseen by the FSB. These aggressive regulatory goals were backed by a series of precise timelines, targets, and institutional responsibilities. The G20 leadership had taken the 47 steps agreed in Washington in 2008 and made them yet more concrete, more specific, and actionable by particular international and national agencies led by the FSB.

Reform of the IMF: G30 leaders recommitted themselves to implementing the package of IMF quota and voice (i.e., governance and representation) reforms agreed in April 2008, followed by a major review of quotas by January 2011. Leaders signalled that a reapportionment of voting and representation in the IMF would occur so that it more closely reflected the importance of emerging market powers. In a further nod to the new geopolitical reality, leaders agreed 'that the heads and senior leadership of the international financial institutions should be appointed through an open, transparent, and merit-based selection process' (G20, 2009a, p. 9). So they would continue reforms at the IMF, but this would be subsidiary to their financial reform goals, and the IMF would be following G20 directions.

The initial reaction of participants and observers to London reforms as a whole was highly supportive. Prime Minister Brown lauded the 'largest fiscal expansion ever seen' (Weisman and Macdonald, 2009) which when coupled with a reshaping of capitalism meant 'the old Washington consensus is over' (BBC News, 2009a). President Obama saw London as 'a turning point for global economic recovery' calling the collective action 'unprecedented' (BBC News, 2009b). President Sarkozy applauded regulatory reform. Chancellor Merkel called it a 'historic compromise' (BBC, 2009c). Clearly key actors saw the summit outcome in dramatic and significant terms; the degree of policy consensus and the large total committed collective state resources and the specific

quantified reform measures had an impact. Markets rose immediately after the end of the summit. London's FTSE 100 index closed up 4.3 percent, Germany's DAX index gained 6.1 percent, and France's CAC 40 rose 5.4 percent on the 'G20 factor' (BBC News, 2009d). For *The Economist*, the summit 'marked a turning point in investor and business confidence' (2009). One commentator forecast, 'In coming years, the London G-20 Summit will be seen as the most successful summit in history' (Linn and Bradford, 2010). If London was about aggressive action, big numbers, and bold construction of the future architecture, Pittsburgh was about maintaining those gains and incremental but important steps.

3.4.2 The Pittsburgh Summit - an affirmation of the G20 role

President Obama at the Pittsburgh Summit continued to support stimulus expenditure and press for and support the technical work underway. Leaders signed a 'Framework for Strong, Sustainable and Balanced Growth', and much of the document reads like a progress report on technical work underway on new Basel capital and liquidity standards, FSB compensation standards, OTC derivative clearing, accounting standards, and cross-border resolution (G20, 2009d).

Pittsburgh's most notable institutional achievement, coming as the crisis appeared to moderate, was the decision to make the G20 the permanent forum for their international economic diplomacy and cooperation—a key message of the forum's consolidation and dominance (Cooper, 2010). This was perhaps the most 'profound development in global governance since the creation of the World Trade Organization' (Patrick, 2009). Obama was indicating that G20 summits had permanently eclipsed the G7 and G8. This change made concrete what Subbachi, had already noted, namely the centrality of the more inclusive G20 process and the shift away from weaker forums (Subacchi, 2009). There would be no backsliding or the exclusion of major emerging powers via the old, less legitimate groupings. Even though leaders outside the G20 still viewed its work with a jaundiced eye, since the forum was exclusive and self-appointed (Interview 6, 2011), the wider membership further solidified the G20's leadership position atop the global architecture.

The summit's toughest and most controversial debates took place over global economic imbalances and pitted deficit-financed contracting economies (such as the U.S.) against

creditors with surpluses (such as China and Germany). This conflict was a variant of the perennial debtor/creditor-importer/exporter clash (such as the petrodollar disputes in the 1970s and the U.S.-Japan conflict in the 1990s), and it would arise repeatedly, especially during phase three of the G20's evolution and its return to dissension among members. President Obama pressed surplus nations to increase domestic demand to boost global demand as U.S. consumers retrenched (Reuters, 2009; G20, 2009d, 2009e). Matters were further complicated because of differences over exit strategies and stimulus. Chancellor Merkel disagreed with President Obama, who continued major fiscal and monetary stimulus, as did the Chinese on an even larger scale.

As in later summits, the divide over imbalances proved practically impossible to bridge. It was not part of the new policy consensus. As Dominique Strauss-Kahn, then-IMF Managing Director, said, there simply was no general agreement over 'what the long-term growth model will be' (Guha, 2009). Major powers in the G20 could not agree over whom to blame for the imbalances. Creditor nations criticised profligate debtors and their consumers. Debtors complained of currency manipulation and excess savings. In the end, Obama struck a modest compromise: G20 leaders agreed to the creation of an IMF-monitored mutual assessment program (MAP), which would monitor national economic, fiscal, and monetary policies, which might contribute to imbalances, and report to the G20. Unfortunately, reporting and monitoring are the refuge of the weak and show the lack of agreement, yet again, over imbalances and what to do about them. The IMF was given no new enforcement powers. The IMF could only name and shame. The developing dispute over imbalances, papered over in Pittsburgh, would be mild compared to that which would erupt forcefully in phase three.

One other issue roiled the summit: European leaders, led by France and Germany, wanted action on bankers' bonuses and compensation levels. Indeed, President Sarkozy threatened to walk out if no deal on bonuses was secured (Guebert and Shaw, 2009). He did not do so, but Sarkozy's threat did force the G20 to direct reluctant technocrats in the FSB to take up the issue, after the U.S. team led by Treasury Secretary Geithner refused to address compensation at the summit (Interview 12, 2012). Chapter 4 will address the policy results in this area.

3.4.3 The apogee of reformist zeal

By the end of phase two and of 2009, many of the main parts of the new regulatory structure were in place (such as the FSB) or were being built (a reformed IMF) and ‘a rapidly developed, internationally coordinated reform agenda’ took shape (Helleiner, 2010, p.632). The G20 processes could not deliver on all aspects of reform in 12 months, and many reform agenda items remained to be addressed. But during phase two, the main agenda items were set and tasks were distributed within the new superstructure overseen by the FSB. New coordination processes were implemented by the end of 2009 that did not exist less than 18 months earlier and which could potentially deliver results, albeit ones limited by the degree of policy consensus. The agenda set in this period would form the bulk of the regulatory reform workload. With the benefit of hindsight, phase two is viewed as the apogee of reformist zeal, the near crest of the wave of the new financial and regulatory paradigm shift, amongst national political leaders and their regulatory surrogates. This impression is backed many of those interviewed for this research, including those critical of the G20 output.

In this phase, there emerged a new policy consensus which recognised the need for a state-power-driven, widespread re-regulatory agenda. The G20 backed this shift closely advised by the central banking community. This policy narrative and consensus on action was strongest amongst the community of officials, regulators, and technocrats who designed the details of the new coordination structure (i.e., the FSB) and advised on the broad work programme demanded by the G20. Those officials would lead the FSB, staff the new forum, and chair the work streams emanating from phase two.

At the G20 level, decisions were largely driven by a relatively small group from North America and Europe, but the inclusion of the emerging market countries whose leaderships were supportive should not be discounted, because the new policy consensus shifted towards many of their statist/state corporatist viewpoints and preference for greater regulation and stronger regulatory systems.

3.4.4 The emerging countries’ voice

The loud North American and European voices in phases one and two in the debates over the creation of the new structures partially obscured a significant change in the global architecture of economic diplomacy that would become even more visible in phase three:

the permanent inclusion and enhanced role of major emerging powers within the G20, FSB, and IMF. This inclusion is no trivial matter. Prior to 2008, none of these emerging state powers had regularly been included in discussions over global stimulus or the regulation of the global financial system and markets. Now that they are at the table, they can no longer be ignored. Others may be added in the future, but none can realistically be uninvited. In fact, much like any successful exclusive club, the G20 must now resist the siren calls of those still outside clamouring to be admitted. In the first phase after the G20 was created, there was little evidence of emerging market leaders having an impact, except at the margins, and initially the emerging powers' voices were somewhat muted. But this is not surprising. Emerging economy voices were drowned out by the existing powers who were leading and chairing the process, whose errors and omissions had led to the crisis and within whose markets the most needed to be done to re-regulate and restore a new balance between the state and markets.

As new members of a club, emerging country leaders entered the room with varying degrees of familiarity with summitry, and some were at a disadvantage because of a lack of knowledge, technical capacity, or political room to manoeuvre to engage effectively (Interview 16, 2012). A former finance ministry participant recalls a Chinese representative at an early summit reading a position paper at the outset of the proceedings, and then reading exactly the same paper hours later at the conclusion of negotiations (Interview 4, 2011).

But the relative silence from the new actors in phases one and two is also due to another key factor. The paradigm shift underway by 2009 moved the debate towards the stance already occupied by a number of those leaders. China's leaders, for example, were supportive of greater financial regulation and control of firms (they directly control all their major domestic banks). China also already had tougher capital and prudential standards than were being demanded by the G20 and FSB and which would be fashioned by the BCBS starting in 2009. Other emerging country leaders, including Brazil, India, and Russia, were also critical of the U.S. failures prior to the crisis and were supportive of a move away from the previous Anglo-American approach and towards the re-regulation of financial markets. In other words, a lack of audible stridency by emerging countries in phases one and two should not be read as a lack of support for the paradigm shift that commenced in 2008. Indeed, in phase three those voices are now louder and sometimes discordant as emerging countries begin to take a greater public role in the G20.

Overall, the new structures and the agenda commenced in phase two constituted a shift in the agreed consensus approach to the oversight and regulation of financial markets, and also in the role of emerging markets in the diplomatic process. Phase two signalled that the new normal would henceforth always include emerging as well as existing powers in all major forums and institutions.

At the end of 2009, the G20-led process had achieved a great deal in a short time. Based on this shift in worldview, they had agreed on an ambitious new regulatory structure and state-power-driven re-regulatory reform agenda. But certain political economy issues still remained beyond the boundaries of this new policy consensus and paradigm. Thus, strains started to be seen over imbalances. But this is no surprise. Such issues could not be solved in such short order, if ever, as phase three would demonstrate. Instead, the boundaries of what may prove to be a semi-durable policy consensus and narrative are limited to financial regulatory issues and state and central bank oversight and re-regulation of financial markets and firms. That is not to belittle the achievement. The G20 and its surrogates backed by this new consensus designed, in 2009, a structure and agenda that cannot be considered as a 'G7-plus'. In its entire history, the G7 never produced this type of burst of post-crisis regulatory activism of such a robust design.

To conclude, the G20-FSB-IMF reforms started in 2009 collectively amounted to the beginning of a shift in worldview and policy consensus, and a major rebalancing of the state versus markets and regulator versus regulated, backed not only by the core members but also by emerging states. As will be seen, the process would not diminish or end in phase three.

Chart 3.1 graphically displays the new triangular global financial architecture as built by the G20 in phases one and two. It shows which forums and institutions are at the core of the structure, and which have grown in size and impact as regards supervision and regulation of financial markets.

3.5 The new global financial architecture - the G20 at the centre

At the top of the structure is the G20 (dark blue oval), a leadership and governmental forum providing political leadership, capital, and collective state power reasserted to deliver financial regulatory reform in a way not seen prior to the crisis. The G20 is the key political forum in the new design. To a considerable extent, the new architecture's

regulatory structure. For instance, the U.S. Treasury participates in the G20 leaders and finance ministers meetings, while the SEC is a member of the FSB through IOSCO.

BCBS = Basel Committee on Banking Supervision; BIS = Bank for International Settlements; FSB = Financial Stability Board; G-SIFI = Global Systemically Important Financial Institution; IAIS = International Association of Insurance Supervisors; IASB = International Accounting Standards Board; IMF = International Monetary Fund; IOSCO = International Organization of Securities Commissions; SEC = Securities and Exchange Commission; SSB = standard-setting body.

3.5.1 *The key FSB role*

The new structure includes the empowered FSB (large green circle) playing the central coordinating role. The FSB is directed by the G20 and tasked by the G20 to oversee all major aspects of the financial reform process started in November 2008 and continuing through 2009 and beyond. It includes principals from all G20 members, central banks, and finance ministries, and also the leaders of standards-setting bodies. The FSB is a small forum, fighting above its weight because it reports directly to the G20 summits (not through finance ministries). Its strength lies in this tight linkage, coupled with the commitment of key FSB leaders to oversee the financial reform process. The board has the key coordinating role at the centre of the structure. It is led by powerful central banking regulatory ‘hawks’—i.e., those most supportive of re-regulation. Practically all leadership roles, the main working groups, and standing committees during its formative period in 2008-2009, through the end of 2012, were occupied by leaders more critical of the past regulatory paradigm, such as Mark Carney (Chairman of the FSB), Adair Turner (former principal supervisor in the United Kingdom) and Jaime Caruana (General Manager of the BIS) (See Figure 4.1, p. 127). All were ‘hawks’ and supportive of the change in worldview and shift they themselves directed and commenced. The Board’s leadership roster was not an accident and it had implications for the robustness of key policies the community adopted.

The Board lacks a formal treaty basis, powers, and responsibilities. But the power of the actors that lead it and their straight communication channel to the G20 leadership more than compensates for this formal weakness. It will be shown that the Board’s creators

rapidly give it an internal structure more akin to an institution, rather than a mere talking shop (see Chapter 4 - Chart 4.1, p. 120).

Note, moreover, that the BIS plays an important parental and supporting role regarding the FSB, which it hosts and which it (post the Los Cabos Summit) finances. This underscores the power of the central banking community in the new structure. It dominates the leadership of the FSB. The BIS—and by extension the community as a whole—provides the forum’s financing. The BIS is backing the Board in a direct, tangible, and ongoing manner, potentially ensuring its continued future relevance and strength.

3.5.2 Enhanced and coordinated Standard-Setting Bodies

The new architecture shows significant changes below the level of the FSB, which coordinates the reform agenda and the related work of international standard-setting bodies (SSBs). SSB memberships are drawn from state regulatory agencies. Today, they in large part carry out work delegated to them by the G20. Not only does the FSB monitor deliverables, but it also provides the forum within which the leadership of these bodies interact and collaborate. The FSB determines whether the SSBs are following the G20 summits’ mandate. The FSB is delivering a degree of coordination that was not previously evident. This is shown via the almost solid lines of communications between the FSB and SSBs, which remain independent, but which have been elevated and incorporated into the state-based system of technical cooperation and policy making.

The FSB is central to rapid progress in the deepening of the coordination amongst actors and amongst SSBs. The FSB technical-level talks rely on and play to the strengths of the core members and the talks are heavily influenced by European and North American principals as leaders of the process, because it takes ‘impressive expertise and stamina’ to staff and operate multiple work streams (Cooper, 2010, p. 744). Larger emerging economies, such as China, can handle the demands, but others, such as South Africa, may be straining their capacity to contribute to the complex debates underway. This capacity, if lacking at present, will grow as G20 members engage on a regular basis in these debates and discussions and become more familiar with them.

To conclude, the SSB transnational policy networks until 2009 often worked alone, at odds with, the work of one another. There was no coordinating body of the strength and robustness of the FSB in which all participated (a Joint Forum did exist but it was weak and ineffective). Today, the FSB draws the SSBs and their memberships inside the state-led reform drive. SSB leaderships insist they are independent from the FSB. This may be so in formal terms, but in practice their agendas are being dictated by the G20, and the SSBs report to and are coordinating their work through the FSB. This is a level of coordination not previously seen amongst SSBs and marks a clear shift. In forcing this structural reform, the G20 created direction and coordination amongst an obscure alphabet soup of organizations where little previously existed. This was a little-noted achievement by the G20 and FSB leaderships as they sought to build a more cohesive, comprehensive, harmonised global regulatory structure.

3.5.3 IMF, bigger, better but below the G20

The IMF, which would previously have been placed in the centre in such a structure, is instead lower down. It is in part directed by the G20. As regards resources and staff, the recapitalized IMF is certainly stronger today and much more representative than it was pre-crisis, thanks to G20 government commitments. It has vastly more staff and monetary resources than the FSB. Its agenda and reforms, however, are shaped by the G20. The IMF is reinforced by the G20 but also in a real sense led by the G20 members, albeit wearing different hats and working in a different institutional context (see Chapter 6).

Note that the Global Head of Supervision (GHOS) meetings feed into the FSB process. The grouping is more exclusive than the FSB and only includes central bank governors and principal supervisors. It provided another small forum within which the key leadership community could debate new policies during the crisis and response period.

Finally, observe that neither the G8 nor the G7 is central to the new global financial architecture. The loose groupings remain in existence and do function and meet, but they are less important than in the past, and have been eclipsed by the G20 (Subacchi, 2009). It is reasonable to assume that the G20 and FSB cannot swiftly be downgraded or pushed aside from their currently now dominant position. Neither the G8 nor G7 are where the economic and diplomatic power rests at the end of 2013.

The new global financial architecture represented in Figure 3.1 constitutes at least a second-order change in international coordination and economic diplomacy. The G20 in 2008-2009 laid the foundations and began to construct the new policy consensus and narrative during the crisis management and reform phases, including these institutional alterations and changes. But the G20 leadership could not identify the technical agenda and objectives (they would not know a macro-prudential hammer from a micro-prudential screw driver) or achieve them alone. So they relied heavily on the FSB, whose expert membership is dominated by hawkish North American and European central bankers and supervisors operating as a distinct community. It is this group that leads the push to make the evolving policy consensus real via an aggressive agenda of actual policy reforms that they design or would task others with devising. The crisis and reform phases created a window of opportunity, enlarged win spaces, and permitted leaders and their technical surrogates to go much further than would be possible in normal Non-crisis circumstances. G20 leaders turned to their experts for the framework and solutions. Emboldened technocrats proposed a reform agenda that the G20 agreed which the central bankers could not previously have dreamed of securing.

3.6 Phase three: a reemergence of dissension within the G20

A crisis can galvanize reform, but the window of opportunity for action is limited. Phase three encompasses the debates at the Toronto (June 2010), Seoul (November 2010), Cannes (November 2011), and Los Cabos (June 2012) Summits. Phase three in the G20's evolution is characterized by a reemergence of dissension as the outer limits of the policy consensus is tested. G20 members, as the crisis begins to lessen in severity, bicker and argue over macroeconomic and fiscal policies, between stimulus and austerity. This is not surprising. Leaders are united going into a common crisis, but they are much less cohesive as each national economy exits at different speeds and may require different applications of the brake or accelerator. Attempts are made to extend the policy consensus to perennial global macroeconomic matters, such as currency disputes and managing global imbalances. But this effort results in visible disputes and no breakthroughs, as national narratives and political and economic goals clash rather than converge. This return to dissension is most evident at the Toronto and Seoul Summits.

External pressures interrupted this growing discordance among leaders and focused minds once more on the unfolding Eurozone crisis dominating the Cannes and Los Cabos Summits. The French and Mexican G20 Presidencies are forced to grapple with the

Eurozone troubles above all else as the crisis becomes increasingly acute with Ireland, Portugal, and then Greece facing possible national insolvency and default, and needing exceptional measures by the European Central Bank and emergency IMF funds, predominantly from EU member states, to survive. Through 2011 and 2012, G20 summits took place against a backdrop of increasingly frantic activity aimed at shoring up the Eurozone and the stability of the euro. This was a new and different wave of the financial crisis, this time centred on the EU. The Eurozone crisis recreates dynamics seen earlier in phase one of the G20's existence. That is to say, the crisis dominates the policy debate and forces negotiators together, providing win sets, temporarily muting the effect of domestic interests enough to fashion a deal and a US\$461 billion IMF firewall for the Eurozone. The deal alone does not arrest the crisis in 2012, but it demonstrates that the G20's maximum utility is in crisis circumstances: A forum that places all the principals around one table can help get a deal done *in extremis*.

Phase three is a time of increasing dissension and disagreement at the summits. This period also demonstrates the flipside limitation of summitry. Summits generally do not deliver much when normality returns. At that point, negotiators diverge over goals, and domestic interests reassert themselves, and thus win sets shrink.

National economic and fiscal policies were not, at the start, and are not today, part of the shift in regulatory worldview championed by the G20 and fashioned by the FSB. Hence, there is no consensus in that area. The policy shift and reforms agreed by the G20 in phases one and two are centred on how states and central banks regulate global financial markets and firms, not on concepts of national political economy and domestic fiscal policies. The paradigm shift in worldview does not stretch so far as to encompass the latter.

However, the tensions and discord we see in the G20 during phase three is not reflected to the same degree amongst technocrats in the FSB, who continue their work, less affected by political disputes above them; their policy consensus remains largely intact. The paradigm shift in worldview and regulatory approach signalled in 2008 and made actual in 2009 continues to be constructed and strengthened by the FSB and SSBs in 2010 and beyond, as the agreement on Basel III in Seoul makes clear.

Phase three in the G20 summitry also includes an important but gradual increase in the profile of and leadership responsibilities for emerging market countries. Over time, this

will have implications for the summitry process. It marks a new period of summitry and draws these actors further into a commitment to the reformed architecture.

3.6.1 Divergence and disputes as the consensus begins to fray

During the period encompassing the Toronto (2010) and Seoul (2010) Summits, attempts to extend the consensus narrative amongst G20 leaders to still more areas fails, and the consensus fractures to a greater degree as domestic policy differences increasingly reemerge to block progress. The very state power and interests expressed and framed collectively and applied during crisis management and the concrete reform phases begins to force leaders apart instead of towards the same goals. The remaining issues on the table facing the leaders in this period were especially difficult, long-standing, complex, and divisive, and not amenable to addition to the common regulatory narrative crafted in 2008-2009. As the G20 turned to matters such as global imbalances and the reform of the international monetary system, splits occurred between the actors, and a semblance of accord on high-level aims was no longer evident. With such complex and difficult subjects under discussion, it would have been naive to expect otherwise.

Divergent views on the causes of these imbalances, excess Chinese savings versus excess U.S. consumption; the dollar's role, safe haven, or unfair benefits of seignorage; and the fault lines in the global financial system, East versus West or developed versus emerging, which began at Toronto and became more severe in Seoul, meant that the nature of the summit debates changed from consensus building to finger pointing, and domestically fuelled G20 disputes over policy options and solutions. These arguments are almost identical to those that played out during an earlier era of tension—that between the U.S. and Japan in the 1980s (Gilpin, 1987). Tensions in the G20 reflect similar paradigm maintenance and conflict (Wade, 1996, 2008), which have been seen over aspects of the international political economy narrative in the past. But a growing discord and disagreement over perennial insoluble global macroeconomic issues did not mean the technical regulatory reform agenda was jettisoned in this phase of G20 evolution.

Work on agency-level financial regulatory reforms remained underway in phase three, closely coordinated and overseen by the FSB conducted by other SSBs and national agencies. However, the reforms already on the table in this period faced more sustained criticism, with efforts by opponents of reform to chip away at the new regulatory standards and their application in each jurisdiction. Bankers, suffering from exceedingly short memories, commenced a counterattack, seeking to weaken or rewrite the new

regulatory rules, country by country. As previously discussed, these lobbies were dormant during the crisis management phase and were only slowly reawakened during the earlier period of concrete reform. By 2010, the financial community rebounded on the back of below-zero real interest rates supplied by the central banking community of the world, and turned towards undermining regulatory action. In the U.S., efforts by lobbyists to stop or scale back the Dodd-Frank Act were underway. Thus, in 2010, over US\$468 million was spent trying to influence the legislative outcome (Centre for Responsive Politics, 2010).

During this period, leading voices in finance began to object publicly to the re-regulation. One UK banker, Bob Diamond (since resigned), declared: ‘The period of remorse needs to be over’ (Moore, 2011). A U.S. bank CEO (since fired) called for a renegotiation of Basel III rules (Jenkins, 2010; Pandit, 2010).

In phase three, transnational communities and actors began to find their goals and work programme impacted by diverging national policy stances and national positions. The sense of urgency began to dissolve and domestic interests once again pressed their respective cases, and the prior relative comity on goals, and the implementation of agreed international norms came under greater strain, was harder to sustain and, above all, to deliver upon.

3.6.2 *Toronto - stimulus or austerity?*

In Toronto, G20 leaders disagreed over progress on financial regulation and on the amount of economic stimulus that was still needed. As a result, the message that emerged from the Toronto Summit was muddled (Interviews 17 and 18, 2012). Toronto’s narrative contradicted the pro-regulation, pro-stimulus message that had come from Pittsburgh only a few months earlier. Certain G20 leaders, including those from Canada and Australia, neither of which had suffered a financial crisis due to the conservative prudential supervision of their banking and housing sectors, had begun to view the ongoing U.S.-European regulatory drive within the G20 with some hostility, (Interview 19, 2012). Canadian Prime Minister Harper warned against ‘excessive, arbitrary or punitive regulation’ of the financial sector (Guebert, 2010). French President Sarkozy warned against ‘giving in to unilateralism, to every man for himself, [which] would also be an economic, political and moral error’ (Chokshi, 2010). Harper and Sarkozy’s alarm over the direction of financial regulation was sparked by President Obama’s move to back the

so-called Volcker Rule, which sought to ban proprietary trading by commercial banks—a move aggressively opposed by the financial sector (G30, 2009b).

Splits emerged between surplus and deficit countries, creditors, and debtors. By 2010, the South Korean and German economies were experiencing accelerating economic growth; Germany faced the prospect of bailing out the Eurozone. Both states' leaders disagreed with talk of sustained stimulus and urged those countries with high current account deficits to rebalance their economies and commence austerity moves. In addition, the UK leadership changed in May 2010, and the country was suddenly a stalwart supporter of austerity as opposed to stimulus. Participants in Toronto recall what a difference this made to the balance of the debate between Keynesians and those calling for austerity. The U.S. was more isolated, still backed on the need for stimulus by France, but opposed by German Chancellor Merkel and a victorious Prime Minister David Cameron, who revelled in championing austerity and lecturing G20 participants (Interviews 12 and 22, 2012). Meanwhile, China was managing the inflationary effects of their massive 2009 domestic stimulus. Needing to cool its economy, it remained deaf to complaints from the U.S. on currency levels, imbalances, and surpluses. As a result of all these factors, at the Toronto Summit, national domestic regulatory and economic preoccupations and concerns created splits among states over the issues still on the negotiating table and shrank the level-one and level-two win sets.

The Canadians tried to balance disparate and conflicting goals, and the declaration stressed the need to 'sustain the recovery, create jobs and to achieve stronger, more sustainable and more balanced growth', while also communicating 'growth friendly' fiscal consolidation with numerical goals for deficits (G20, 2010a, p. 2). Overall the declaration was evidence of the growing divergence between debtor and surplus states. It called on the former to boost national savings rates to address their deficits and the latter to reduce their reliance on external demand while opening markets. The Toronto Declaration was an exercise in the triumph of hope over actionable policy prescription. Given the disagreements over exit strategies, austerity, and rebalancing growth, any progress in Toronto was destined to be incremental.

In conclusion, the Toronto Summit moved the financial reform agenda gradually forward, but the other results were underwhelming. The summit highlighted national differences, not commonalities. Coordinating exit strategies—deciding on when stimulus should halt and austerity should start—is a disjointed and by its nature a state-by-state matter. The

difficult perennial nature of the remaining issues at hand, in particular the issue of imbalances and currency values, meant it was too much to expect continued breakthroughs. As one participant observed, not every summit can announce major achievements (Interview 17, 2012). Finally, a diminished sense of crisis and ‘summit fatigue’ was by now setting in (Dong-Hwi, 2010). If Toronto sent mixed messages on stimulus versus austerity and imbalances, the Seoul Summit saw much louder disputes as the ‘G2’, i.e., China and the U.S., clashed head-on over imbalances.

3.6.3 Seoul and imbalances – the G20 has no solution

The Government of South Korea, the first emerging-country Presidency of the G20 process, strove to succeed where the Canadians had failed. But the public G20 debate and private disputes in Seoul were particularly strident. The South Korean Presidency had to referee a dispute between the declining hegemon (the U.S.) and the rising power (China), made more complex because of electoral matters on the one hand and internal disputes within the leadership on the other.

A single issue above others dominated the pre-summit and summit debates in Seoul: a dispute between key G20 members, and in particular the U.S. and China, over the causes of and cures for global imbalances and currency mismatches. This clash created an impasse. U.S. Treasury Secretary Geithner took aim at China, alleging the renminbi was undervalued to boost exports and limit U.S. imports. He criticized the piling up of excessive reserves, the Chinese trade surplus, and the resulting imbalances in the global economy. It was midterm elections in the U.S. and Geithner’s position reflected a need to get tough with China. Geithner urged G20 leaders to adopt targets for maximum permitted surpluses and deficits and pressed China to allow its currency to appreciate more rapidly. His proposals echoed previous international economic disputes. They echoed Keynes’s plan of the 1940s to manage the global financial system (Skidelsky, 2010). Historical comparisons continued to resonate when the two states’ ministers clashed.

The Seoul Summit was not the first time a deficit-burdened U.S. administration sought an accord aimed at managing imbalances, but this time it was China, not Japan, that was the alleged culprit. In the 1980s, the Reagan Administration proposed currency targets, with a similar goal. On that occasion, the U.S. and Japan ultimately signed the Plaza Accord, which managed a devaluation of the dollar. But the deal failed to alter significantly the

U.S. trade deficit with Japan, which still persists today (Gilpin, 1987, p. 163). Geithner's attack on China was reflective of short-term political considerations, but it also echoed historic phenomena which remain unresolved.

The imbalances dispute in Seoul was complicated by other dynamics. The South Koreans sought a way out, but it proved to be a dead end. They approached China's central bank with a specific numerical target of a current account surplus maximum of 4 percent, which the central bank had earlier supported, and to which they agreed as a compromise (Interviews 17 and 18, 2012). However, the Chinese leadership rejected the 4 percent cap in the draft communiqué at the summit itself (Interviews 12 and 17, 2012). As a diplomatic and practical matter, because the People's Bank of China proposal was *ex post facto* championed by Geithner, for domestic political reasons, the Chinese political leadership reacted negatively and strongly. They could not be seen to give in to external American pressure and demands. Thus, the 'currency war' that broke out at the Seoul summit reflected different national economic narratives, and behind the failure to solve it was also an internal struggle within the Chinese leadership, which the Chinese central bank lost. Finally, the dispute was made worse by political grandstanding by Geithner, who mishandled the diplomacy.

The Chinese leaders at the G20 summit rejected Geithner's demands, countering that excess consumption and lax U.S. monetary policy (and dollar devaluation) was at fault. According to this narrative, the imbalances were not caused by China's currency management, its cheap labour, and assembled goods (Yang, Chen, Monarch, 2010). It was, instead, America's profligacy and the desire of its government and population to live beyond its means that was to blame. Behind this was the reality that Beijing leaders focus on the need to keep a growing population employed while restraining inflation (PBOC, 2009). An appreciating renmenbi does not help the former, and quantitative easing in the U.S. was fuelling the latter. In addition, quantitative easing was driving down the value of the dollar and increasing other exporters' pain as well, causing an alleged rapid appreciation of Brazil's real, for example.

Thus, China's leaders had allies in its rejection of the U.S. imbalances narrative. Opposition to a cap on mercantilist growth strategies also came from other major export-oriented, surplus country leaderships, including Germany and Brazil. They accused the U.S. of its own currency manipulation and of embarking on a managed devaluation of the

dollar, and they rejected calls for numerical targets for surplus and deficits. To make matters yet more rancorous, British Prime Minister Cameron chastised the U.S., opining that ‘I am not one, and Germany is not one, who says growth and fiscal consolidation are contradictory’ (Chen, Stolberg, and Sanger, 2010).

The South Korean Presidency found it impossible to negotiate a real compromise between fundamentally opposing positions. Geithner’s gambit had failed (Chen, Stolberg, Sanger, 2010). This meant that no substantive progress in this area was possible. In the G20 context, a lack of a common narrative means no progress. It therefore led to a weak declaration. The Seoul Declaration committed G20 leaders to simply monitoring matters, via an FSB-IMF Mutual Assessment Process (G20, 2010b). In this manner, leaders kicked the imbalances can down the road.

3.6.4. Summit disunity: but real progress in the regulatory sphere

Notwithstanding the rancour over exit strategies, imbalances, currency values, and global macroeconomic disputes that mushroomed in the period encompassing the Toronto and Seoul Summits, regulatory reform measures continued. Of particular note were breakthroughs on bank regulation, capital, and IMF reforms.

Financial reform: In Seoul in 2010, G20 leaders agreed the Basel III accord, which had been supported by work done in Toronto and which was negotiated by the FSB and BCBS in a very rapid 12 months (Interview 20, 2012). As Chapter 4 will demonstrate, this single multifaceted deal, coordinated and driven by the FSB expert technocratic epistemic community, constitutes evidence of a third order (Hall, 1993) paradigm shift in the regulation and supervision of global financial markets and of systemically important banks. G20 leaders at Seoul signed off on a deal fashioned by a small epistemic community led by hawks who agreed a cohesive new macro-prudential policy paradigm and narrative. G20 political leaders backed a deal over which they had had essentially no input and were presented with a fully formed agreement in Seoul. Sources indicate that leaders and their finance ministers did not at that time fully comprehend the scope and impact of the deal (Interviews 13 and 17, 2012). This conclusion is supported by the subsequent demand for a ministerial role in the FSB leadership structure from 2011 onwards. G20 finance ministries felt the deal was a regulatory overreach and did not want a reoccurrence (Interview 13, 2012).

IMF reform: In 2010, leaders agreed to double quotas from 238.4 billion to 476.8 billion SDRs, equivalent to US\$750 billion. The G20 was significantly recapitalizing the IMF as agreed at earlier summits. Leaders also agreed to voting reforms, and to an eventual shift of over 6 percent of quota shares from overrepresented to underrepresented member countries, in particular moving the quotas to dynamic emerging economies and developing countries. The reforms and adjustments would result in China's quota and its voting power in the Executive Board doubling to over 6 percent, approximately 40 percent of the U.S. quota level (of 16.5 percent, in line with China's economic position globally). This would make China the third-largest member country in the IMF. In addition, three other major emerging economies—Brazil, India, and Russia—would also be pushed into the top 10 shareholders in the IMF (IMF, 2011a).

The reforms were backed by the U.S. and emerging countries, and were reluctantly supported by the Europeans. In agreeing the reforms, Europe's leadership went only so far and no further. They supported quota increases and greater resources for the IMF, with part coming from existing leading member states and the rest from emerging market countries. In taking this stance, they avoided the full burden of recapitalization of the IMF. The U.S. got what it wanted, a rebalancing away from Europe and a recommitment of emerging states to the institution. They drew the rising powers into an organization that they dominate but which was in need of rejuvenation and renewed relevancy. The cash injections and reforms could eventually result in slow evolutionary change, but would contain disputes within the existing institutional system. They also strengthened the organization.

The principal powers reformed and recapitalized the IMF. They rejected using the IMF, however, as a vehicle for global financial reform, hence its demoted position in the new architectural structure (Figure 3.1, p. 79). G20 leaders rejected a leadership role for what they saw as a bureaucratic, slow, universal organization, which some emerging countries still viewed as lacking in legitimacy, despite the recommitment. Leaders already had their preferred vehicle, the FSB, which would remain largely under their national technocrats' control.

Thus, even as disputes on outstanding irresolvable macroeconomic and fiscal matters were publicly aired and became much more marked, regulatory and reform processes

agreed in phases one and two continued successfully. This outcome underscores that the paradigm shift we observe, in worldview, policy reforms, and prescriptions is predominantly a supervisory and regulatory community-led shift. Effective policy response is limited to those areas over which these individuals collectively recognised critical anomalies, the strength of the epistemic community charged with policy design and implementation, and the degree to which a strong policy consensus exists as to action (see Figure 2.1, p. 33). This broad theme and hypotheses will be developed further in Chapters 3 and 4.

3.6.5 A degree of progress but a lot of discord

In conclusion, the Seoul Summit saw strident, nationally sparked arguments and disputes over the functioning of the international monetary (non) system coupled to real progress (led by the FSB epistemic community) towards the existing agreed regulatory reform goals.

On global macroeconomic matters, consensus was a thing of the past. It had become every country for itself. Malloch-Brown, identified the emergence 'of a new pecking order' in which the U.S. plays a more diminished role as China rises (Malloch-Brown, 2010). That rise, he added, would not be easy, and the G20 risks, 'being reduced to the sum of its feuding parts as structural trade imbalances, currency wars and very different views of each other's relative economic prospects drive stakes into the enterprise'. Larry Summers, then-Chairman of the U.S. National Economic Council, took a slightly different view, noting that 'the world is more divided today than it was in London because nations not facing the prospect of a depression have that luxury' (Sanger, 2010). It was clear that the 'fellowship of the lifeboat' was gone, replaced by conflict (Vestergaard and Wade, 2010). Not everyone was giving up on the G20. Kemal Dervis argued that the IMF-led monitoring of imbalances was major notwithstanding the lack of hard targets, maintaining that the process could yet succeed and that we should give it a chance to work (Dervis, 2010).

If a mark of policy effectiveness is the sound of screams of anger from its targets, then this phase of G20 work was impactful, notwithstanding public macroeconomic disputes. Loud whining could be heard across the globe as bank CEOs realized tangible common equity capital levels would increase to at least 7 percent or to more than 10 percent if a

firm was a risk-taking, globally systemically important financial institution. Banks confronted the immediate need to raise capital. CEOs warned of the negative impact on growth. But this was disputed by the BIS, which estimated the costs at as little as 0.6 percent of GDP, a small price for fewer panics and crashes (*The Economist*, 2010). The position that Basel III was a good deal was underscored by the hawks who crafted the accord. Mark Carney, Governor of the Bank of Canada, countered that the accord could save the G20 US\$12.9 trillion, '30 percent of GDP in present-value terms' (AFP, 2010). He was joined by BCBS Chairman Stefan Ingves and by Jaime Caruana, General Manager of the BIS, who made clear there would be no backsliding on Basel III.

Where one stood on the success of the G20 at the end of 2010 was impacted by where one sat, which nation one represented, whether a state was in or out of the club, whether one was a U.S. or Chinese negotiator, and whether one was a banking regulator working feverishly behind the scenes at the FSB or the CEO of a regulated firm. Voices were raised and collegiality around the negotiating table was lacking, but reforms still continued at the technical level.

In Toronto and Seoul, the G20 reached the outer limits of the new policy consensus paradigm. This was balanced by continued technical success in actual regulatory policy making. National governments disagreed over exit speeds and over stimulus versus austerity. Leaders, especially but not only the U.S. and China, playing to domestic interests and electoral and economic demands, clashed loudly over insoluble global macroeconomic differences and goals.

These thorny issues are not new and they were not amenable to compromise and solution, because the G20 states' national narratives of causes and solutions clash and diverge. Numerous actors and policy makers recognise the international monetary system was and is dysfunctional (*The Economist*, 2010). As Padoa-Schioppa noted, 'Those eager to envisage the post-crisis era in constructive terms need to promote the reconstruction of a fully fledged international monetary order' (Padoa-Schioppa, 2010b, p. 8). But periodic reform proposals have led nowhere (Palais Royale Initiative, 2011). The failure to design a new Bretton Woods is because the policy consensus and narrative does not extend to such highly contentious politically and economically sensitive issues. Neither level-one nor level-two win sets exist and the U.S. has neither the wish nor the power to force the new architecture into this space. This is not the end of World War II and Bretton Woods

II; power is much more diffuse now (Cohen, 2008a) and the hegemon weaker, even if still *primus inter pares*.

Instead, the policy consensus remained confined to financial regulatory reform matters, where it was possible to discern the many fingerprints of the Western central banking community on the G20 declarations and agenda as it was progressively crafted and implemented in this period by those same individuals and their agencies. So while public discord is the overriding acoustic note heard at both Toronto and Seoul, behind the scenes the regulators continued their work, agreeing deals that could strengthen the system and potentially also change the nature of the institutional politics in the IMF in favour of the rising emerging powers in the future. This public divergence on global macroeconomic issues would be interrupted by the crisis in the Eurozone in 2011 and 2012.

3.6.6 Cannes and Los Cabos: Dealing with the Eurozone crisis

In 2011 and 2012, divergences amongst G20 leaders would continue to be seen, but events in the Eurozone force the actors to confront this latest manifestation of the financial crisis. President Sarkozy would see his planned G20 agenda sidelined by the crisis, and would almost make a breakthrough on the Eurozone. The Mexican G20 Presidency, confronted by an even greater sense of urgency, would get a deal done in Los Cabos and once again prove the utility of the G20 as a global crisis management forum.

Originally, President Sarkozy had started 2011 with a broad and highly ambitious agenda focussed on numerous structural global macroeconomic issues (Interview 17, 2012). Sarkozy had hoped to take action on issues that included commodity markets, capital flows, the perennial problem of global imbalances, and weaknesses in the international monetary system. The French agenda was broad and sweeping—too broad, according to critics (Interview 5, 2011) who maintained he reached too far looking for grand schemes on the global economy (Beattie, 2011). The French G20 Presidency showed the difficulty of seeking to make major breakthroughs in areas where G20 states have divergent interests (Dadush and Suominen, 2011). The harsh reality of the Eurozone crisis intervened.

Sarkozy reached well beyond the edges of the new policy paradigm into areas that were highly controversial, but the weakness of this agenda was not tested as external events

derailed the ambitious plans, from the arrest of his main socialist rival Dominique Strauss-Kahn, to the (far more important) crisis over Greece and a possible sovereign default. As a result, the French G20 Presidency focused primarily on the crisis in the Eurozone and Greece, not on other matters. This was to be expected since the G20 works best as a forum for rapid political action *in extremis*, and the crisis in Greece galvanized the leaders present.

3.6.7 Greece dominates everything

The French G20 Presidency and summit focused squarely on the crisis in Greece and the steps necessary to arrest the threat of a disorderly default in the Eurozone and possible contagion. But at this stage, the U.S. and Europeans were unwilling to do a deal offered by emerging-country leaders.

Faced with the Greek and Eurozone crises, emerging countries went to Cannes offering to further increase SDR commitments at the IMF as a backstop; Brazil, China, and Russia supported the call for more quota resources (Interviews 20 and 21, 2012). But other leaders balked. U.S. officials argued there was no need for more IMF resources—that the EU had the funds and could solve its own problems (Interviews 14, 20 and 21, 2012; see also Blackden, 2012). This was correct. It was an internal political and fiscal matter—whether Germany would pay—to save the Eurozone; but it was more complex than that. The U.S. resisted a further change in SDR quotas and votes that would have come with yet more emerging market cash, and U.S. officials knew they could not get further financing from Congress (Interview 21, 2012). Europeans also did not wish to deal with more changes in the balance of power at the IMF, which would logically also diminish their votes and voice (Interviews 21 and 22, 2012). The end result was that money was on the table from emerging countries but no deal on further finances for the IMF was reached at Cannes. A full deal would have to wait.

The G20 Cannes Declaration reflects the forced change of focus caused by the Eurozone crisis and a failure to advance on other fronts. On global macro issues there was no major breakthrough on the monitoring of imbalances, but there was some modest progress on the metrics of the monitoring process (G20, 2011). Language on commodities, capital flows, and the international monetary system is included, but is weak and unspecific, as were other statements on a burgeoning list of issues from climate change to the marine

environment to social cohesion to the dead global trade round. Sarkozy reached for much at the outset and ended up with a declarative anodyne outcome which failed to live up to the start of his G20 Presidency. Despite a general lack of movement on global macro matters at the Cannes summit, with French leadership, the G20 did make progress on five architectural matters of future import.

First, leaders determined there would be no G20 secretariat. The G20 would continue to be informal and driven by the chairing country and national Sherpas. Finance ministers saw this as a positive, because it retained the direct commitment by national leaders and ministers who would staff and act as negotiators on summit texts, deals, and outcomes (Interviews 12 and 17, 2012). National officials view the rejection formalization as preserving the forum's flexibility and safeguarding its usefulness to political leaders while preserving state control over the process.

Second, leaders agreed there would be a Troika of immediate past, current, and future G20 Presidents to enhance coordination and smooth transition from one country to another. This is a new and fitful construct currently, in that the current President and future Presidency both tend to resist sharing information about their drafting and plans (Interview 17, 2012). This may gradually improve and should help with continuity and assist those states less able to host the talks and the meetings that are needed around each summit. Once again, European fingerprints can be seen; this is exactly the same format as historically operated within the European Council.

Third, leaders agreed to 'the establishment of the FSB on an enduring organizational footing' (G20, 2011). Even as G20 leaders rejected greater formalisation and institutionalisation of their own ad hoc forum, they agreed on strengthening the technical coordinating body central to cement success on financial reform. This was a clear indication of the G20 leaders' support of the Board. It also reflected the continuing impact of the central banking community and the FSB Secretary General, who had pressed for a stronger legal foundation, against the complaints of some (Interview 15, 2012).

Fourth, Cannes included a barely noticed but potentially significant structural breakthrough on the monitoring of established FSB compensation practices and principles. Leaders agreed the creation of a Bilateral Complaints Handling Process (FSB,

2012a). This is a formal dispute settlements procedure similar to (yet less robust than) that used in the World Trade Organization (WTO). The implication of this small but important move will be dealt with in Chapter 4. It is yet more evidence of stealthy institution building by the central banking expert community, even as public disputes appeared to dominate Cannes.

Fifth, Cannes marked the G20 leadership handover to non-core states. In Cannes, leaders agreed that, going forward, future summits would be led by Mexico in 2012, Russia in 2013, Australia in 2014, and Turkey in 2015. After 2015, leadership of the G20 will be chosen from rotating regional groups, starting with the Asian grouping comprising China, Indonesia, Japan, and Korea (Cannes, 2011). Thus, Cannes signalled non core largely emerging countries would begin to take the lead in the G20. European and North American states would step back, providing an opportunity for emerging market leadership and recognition of changing state power dynamics. But it may also result in possible gradual partial disengagement of the core from G20 commitments once economic stability is established. However, this possibility would not arise imminently.

In conclusion, Cannes was a failure if evaluated on Sarkozy's ambitious goals, few of which he achieved. The summit also failed to secure a deal on the Eurozone, although it came close to doing so. However, leaders took a series of institutional decisions that solidified state control over G20 summitry, and simultaneously strengthened the institutional foundation of the FSB, and its dispute settlement procedures, and laid out the future role of emerging markets. In the end, the Cannes outcome was mixed to positive.

3.6.8 *Finally, a firewall*

Mexico took over the leadership of the G20 in 2012 but confronted the same fundamental problem as the French: the need to halt the market panic and restore some calm in markets so as to allow time for the solution of the troubles in the Eurozone. Ultimately, as a junior partner, the Mexican G20 Presidency could do little but try and referee disputes among the principal G20 powers as they grappled with the Eurozone panic.

Obama Administration officials by 2012 were increasingly angered by the continuing failure of EU states and the ECB to halt the panic. Obama's election prospects rested, in part, on the economic outlook in America, and a recession in Europe could prove

economically and, thus, electorally, costly. Europeans reacted angrily to the lecturing from Washington. European Commission President Jose Manuel Barroso lashed out, complaining that the crisis was originated in the U.S. and contaminated Europe's financial sector, adding we are 'not coming here to receive lessons from nobody' (BBC, 2012). The criticism stung because it hit the mark. European leaders were consistently behind the curve in dealing with the market panic and repeatedly failed to send a clear message of action and resolution.

In hurried negotiations that built upon an outline deal formulated earlier at the April 2012 spring meeting of the IMF, the U.S. stressed that Europe must deal with its own crisis; they had the resources and they should act first (Interviews 14, 19 and 21, 2012; see also Blackden, 2012). At that point in 2012, the administration had no room domestically and could not provide more IMF funding; U.S. negotiators had no negotiating space. U.S. leaders wanted a deal but they could not act because of opposition from level-two actors (i.e., Congress). Emerging market leaders were again willing to fund a firewall, but Europeans opposed additional finance from emerging countries if the cost was quota and voice reductions in the IMF (Interviews 20 and 21, 2012). The U.S. also opposed any further shrinkage of their voting power. Emerging countries, however, could not be excessively generous without changes in quotas and votes to assuage their own voters, who had no interest in bailing out the rich and foolish of the West (Interview 21, 2012).

Ultimately, a deal was forced by the urgency of events in Los Cabos. The threat of a default in Greece cascading into Spain and Italy focused minds. Forced together by crisis events, G20 leaders agreed a massive US\$461 billion package of additional bilateral funds. This was a success for both the G20 and IMF. Cash came from Europe (US\$200 billion-plus) as exceptional bilateral financing and from emerging and other economies, especially Japan. It had the Europeans self-finance their bailout with the fig leaf of a potential IMF program for ailing economies without any further reforms of IMF governance, thus dodging immediate fights over governance. On balance, in Los Cabos, the crisis made the G20 agree a workable deal with a large additional resource boost.

Once again, this was not the only area of progress. Just as in Cannes, central bank technicians were busy in the FSB, building their structures, and sending them to the G20 for their imprimatur. Two areas are worth a brief comment.

First, the FSB Charter was further clarified and the internal structure enhanced and detailed. Second, the FSB was put on a solid financial footing with five years of financing agreed by the BIS, avoiding the need to return to the G20 states every time they required resources. These incremental but important first-order changes underscored how influential the FSB's central banking backers remained as the leaders, agenda setters, and now direct financiers of the key coordinating forum and community within the global financial architecture.

3.6.9 *Emerging country voices*

Phase three was a period of increasing discord interrupted by the need to address the Eurozone crisis. It is also notable because of the rising volume of the emerging country leaders' voices and their greater influence and willingness to act and negotiate hard, for example, on the IMF deal that was almost struck in Cannes. China's leaders repeatedly clashed head-on with their U.S. counterparts over imbalances and related global macro issues, national political economy goals, and drivers. Other emerging countries raised their voices in 2011 and 2012. Differences became more marked and public, but the disagreements are taking place inside the G20 structures. They are contained within a relatively new existing process not taking place outside or entirely bilaterally, where the chances of a rapid and damaging escalation of claim and counterclaim can be much higher.

Not only are emerging country voices easier to discern in phase three, but they are beginning to take a formal leadership role in the presidency of the G20. The leaders of South Korea and Mexico both acquitted themselves well. The former refereed an imbalances shouting match between the G2 and still continued financial reform with the landmark signing of Basel III under its leadership, and the latter got a deal on the Eurozone firewall. These are not minor successes. Thus, two emerging country powers delivered major breakthroughs even during a time of increasing public diplomatic tension.

The impact of individual emerging countries varies. This ranges from increasingly effective interventions from the Chinese (Darling, 2010; see also Interview 8, 2011) to what is seen as sporadic but sometimes effective engagement from India (Interview 12, 2012), and general silence and 'disengagement' from Russia (Interview 18, 2012). The latter is notable given that Russia is President of the G20 in 2013, despite having very

little input prior to this leadership role. Such differences in influence and impact are to be expected. The emerging country leaders are not cohesive (or indeed a real group at all). The leaders come to the table with divergent views, cultural and political economy approaches, and varying degrees of interest in the economic and financial matters placed before them. Unlike the discernible EU voice, there is no one emerging economy view. Instead, what can be observed are competing national perspectives voiced with different degrees of forcefulness and effectiveness.

Finally, irrespective of issues around individual leader's capabilities and those of their officials and governments, given the nature of consensus decision making, an unwillingness to change position or a refusal to agree in the G20 remains a powerful tool. It is one used by emerging countries such as China to stall G20 policy developments when they see fit to do so.

In conclusion, phase three demonstrates the paradigm shift's limitations: re-regulation, yes; global macroeconomic breakthroughs on currency levels and international monetary system management, no. The period sees increased national posturing and defence of national economic policies and positions against G20 encroachment. It is also marked by emerging countries growing into the process and increasingly asserting their influence and taking leadership roles within the structure, a positive change with implications for the future. Phase three shows the limitations of summitry as national differences reappear. But it also demonstrates the forum's continued utility in crisis situations where negotiators' win sets open up, allowing for additional breakthroughs.

Behind the bluster and G20 posturing over divergent national economic policies and interests, the re-regulation of financial markets continued. Dissension at the G20 level did not translate into paralysis at the technical level. At that level, the leadership from the core continues to build out structures born in 2009. The FSB's status was formalized. Its financing for the next five years is set. The internal structure is delineated in greater detail. This is institution building up close and carefully done. At the very birth of the FSB, 'If it had had any power it would not have been created' (Interview 28, 2012, p.25). But since 2009 and through phase three and the end of 2012, the central banking leadership in charge of the FSB has more than made up for that weakness with step-by-step adjustments designed to create a lasting institution at the centre of redesign by stealth.

On the policy front, phase three of the G20 evolution has also been marked by considerable steps towards self-imposed goals—on Basel III, on compensation, on derivatives, and in other areas. The policy objectives sketched out in 2008-2009 continued to be actively worked on from 2010 to 2013. This reform wave is still underway and yet to peak and subside. The narrative shift commenced in 2008-2009 is still being translated into policy output. This is being done by largely the same principals and experts from the core as was the case at the outset. As stated in the Introduction to this thesis, policies are not uniformly strong in all directions. Indeed, the further away from direct control of the central banking community, the weaker they sometimes appear. But there is no doubt that at the close of 2012, the policy actors are still engaged to a degree that prior to the crisis would not have been imagined. Today, they are working on policy formulation and also on paradigm maintenance and defence. But that also is normal, because after a paradigm shift, a community must still defend that which it has implemented.

3.7 Conclusion: watching a paradigm shift take place

The creation and evolution of the G20 since 2008 is marked by a narrative and paradigmatic shift in worldview in regulatory policy objectives, and more gradually, actual outcomes. Leaders fought over and began to construct a new worldview in 2008-2009 which rejected certain laissez-faire neo-liberal truths and self-regulatory tropes. The new paradigm views self-regulation as an oxymoron. Going forward, financial markets would be re-regulated and supervised more aggressively. A new era of international regulatory activism was ushered into existence. The power of the G20 member states, long in retreat, was brought to bear to re-regulate global finance to an extent, scope, and depth not seen since the 1970s and the end of the Bretton Woods system.

The new worldview could not take shape in an instant. It took time to create and make more solid and lasting through the building of new forums and through the reform of institutions and their resources. Making the shift real and lasting also required significant policy changes and reforms. To achieve this and to carry out detailed reforms, the G20 backed, relied on, and empowered a particular epistemic community—the same central bankers who had failed to see the crisis coming in the first place. But the central bankers' culpability was not necessarily an impediment to action, because the community collectively grasped a new worldview.

G20-sanctioned reforms were designed, enumerated, and led by this chastened but re-empowered central banking community. They had gone through the crisis with the G20 leaders and had a particularly acute common perception of the failures of global financial markets and the dangers posed by too much market and not enough state power applied to the regulation of those markets. The community, in particular, had a clear sense of the nature of the regulatory paradigm shift in worldview they believed was necessary to deliver financial stability going forward. They began to build the new architecture headed by the FSB and commenced re-regulation swiftly in 2008-2009. There was a burst of construction followed by a process of gradual policy work and additions that appear designed to strengthen the new forums and structures to make the new paradigm progressively more robust. The process of making the worldview actual on the ground is yet to be completed in 2013. This is potentially a sign of the durability and nature of the shift that began in 2008 and which continues today.

The creation of the FSB was the G20's technical-level financial reform masterstroke. The FSB is clearly at the centre in the new global architecture. Its senior national state-level technical leadership and its own staff leadership have leveraged its position into the central coordinator reporting directly to the G20 leadership. Today, the FSB is the most effective transnational policy network; it sits right at the centre of all G20 regulatory action and coordinates and reports on all major work streams, including those it does not undertake and which are tasked to others. Because of behind-the-scenes construction steps (sanctioned by the G20) from 2008 through 2013, institution building by stealth, today the FSB is increasingly solid, permanent, and robust. The longer it occupies this space, the stronger it may become institutionally. But it remains driven by its principally Western members and by the G20 leadership. A dearth in leadership or disputes at the G20 level could dilute its influence, but this seems unlikely to happen soon.

3.7.1 *Perspective matters*

Critics (such as Johnson, or Stiglitz) maintain that what the G20 did in phases one, two, and three does not amount to the outline of a meaningful paradigm shift, that the changes do not go far enough, that the same actors are in charge, and that the adjustments are not radical enough. This ultimately depends of the perspective and the time frame through which events are viewed. Looked at from a greater distance, there does appear to be a real shift in the policy consensus, and in the underlying re-regulatory narrative, a partial

rejection of the laissez faire neo-liberal worldview amongst leaders and the elite level technocratic community. The structures and actual policy outcomes that flow from the new narrative during the evolution of the G20 reflect this shift. These architectural and policy changes commenced in phases one and two, are being tested in phase three. The changes are not yet complete; they remain partially formed and are being disputed by opponents. Taken as a totality, however, the change in worldview and the reforms commenced are indicative of a paradigm shift in approach to international economic diplomacy and re-regulation that is visible and actual in ongoing processes and summitry. As a result, 'whether the task is developing ideas, reaching consensus on their desirability, or moving from ideas to implementation, the G20 which has working groups active in all these areas is where the action is' (Eichengreen, 2009).

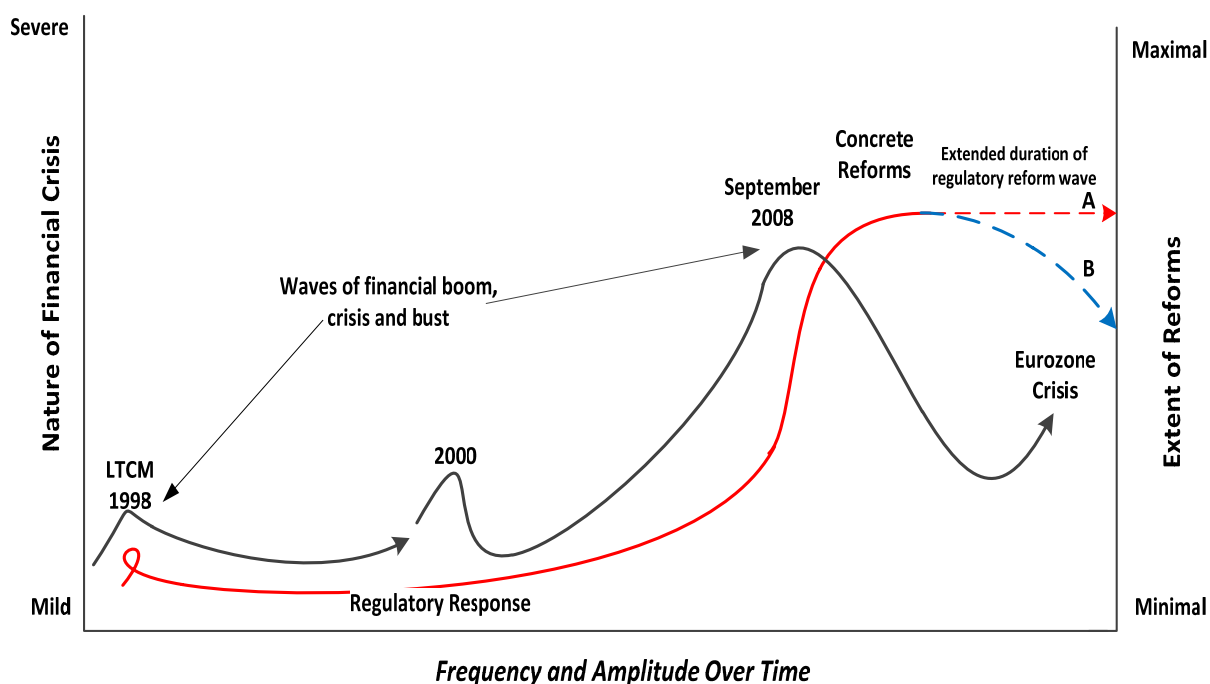
The outline of a new financial regulatory worldview and associated new and rebuilt structures (G20-FSB-IMF) are becoming visible. If the scope of the shift is still somewhat indistinct to critics, this is because they are viewing events from the wrong perspective and over too short a time frame.

Previous international and national shifts are instructive. International and national economic paradigm shifts take a long time to become fully apparent. Just as the 'Bretton Woods system did not emerge from a single moment but rather from a much more extended historical process' (Subacchi and Cooper 2010, p. 607), so a similar pattern is observed in this case. National paradigm shifts are similar in their pace of evolution.

The Thatcherite revolution 'did not spring upon the world fully formed and fully armed' (Payne, 2005. p. 74); it took years to be ideologically conceptualized (by thinkers such as Milton Freidman, Sir Keith Joseph and others) it was then gradually realised via policy shifts. The winter of discontent, 1978-1979, in the UK created crisis conditions that set the stage for the election of Mrs. Thatcher. She was swept to power and began contentious reforms. But the extent, scale, and long-term impact of her changes in Britain were not immediately apparent. Mrs. Thatcher tackled some policy areas (the trade unions) and not others (the National Health Service). But a new consensus did take shape. Looked at in totality over a longer period, it is now widely recognised that there was a Thatcherite revolution, a neo-liberal paradigm shift in certain economic ideas and policies sparked in 1979 (Blyth, 2002; Gamble, 1998; Hall, 1993).

A partial answer to critics of the G20-led process is, therefore, to suggest they look at the process and reforms underway with a different, longer, and broader, perspective. When one does so the paradigm shift can be seen to first emerge as a change in the ideological stance of G20 leaders and to a greater extent policy making technocrats vis-à-vis the merit of regulation of global markets and firms and application of collective state power to that task. That narrative consensus is then applied to the difficult task of policy making.

Drawing on Kuhn’s work, it is useful to view the crisis and the G20-led paradigm shift as waves (see Figure 3.2). The crisis peaks first in 2008. Policy makers rush to react in Washington, London, and Pittsburgh, creating their own wave of reformist shift in worldview and policy actions through 2009, 2010, and beyond, the full outlines of which are not yet visible. The peak of the economic disaster is now past. The amplitude of the reform wave is greater still and may not be fully appreciated at this point in time, for that is the nature of a large wave that has yet to crest. The lone surfer cannot fully determine the size of the wave when they are riding it.



Note: LTCM = Long-term Capital Management collapse.

Figure 3.2 The Regulatory Reform Wave

In case A in the figure, the paradigm worldview and policy shift continues beyond 2013, and the G20 and its regulatory surrogates maintain vigilance and continue constructing the new architecture, not as frenetically as in phases one and two, but still in a diligent manner in phase three. The central banking technocrats leading the FSB, which direct much of the policy implementation of financial reform, continue the work started in 2009 and act to maintain and defend the paradigm. This is, in fact, what the evidence discussed in this chapter suggests is happening throughout phase three and through 2013.

Certainly in phase three there is evident public discord at the G20 summitry level. But paradigm maintenance continues nonetheless. In phase three, leaders are determined to maintain the G20's flexibility as an informal state-led forum controlled by themselves and their finance ministries (i.e., not to institutionalise the forum or extend its membership too far). At the same time, however, G20 leaders also back a further series of measures that strengthen the institutional structure of the FSB and processes below them. Thus, leaders retain flexibility for the political forum while they are engaged in institution building, which continues led by the epistemic central banking community backed by the G20.

In case B, the policy paradigm and policy outcomes it produces lessen in strength beyond 2013, and the reform wave weakens in response to various factors, including G20 discord, national-political-economy-driven clashes, slow global growth and, potentially poor implementation of agreed standards. Outcome B cannot be dismissed at this stage. However, the indicators are that the paradigm shift and policy reform wave and redesign begun in 2009 is continuing today if measured by regulatory impact and other indicators, within certain boundaries.

It is important to recognise the limits of the new paradigm. All such shifts take place within particular science or policy universes and are subject to constraints based on the strength of the discoveries and the consensus narrative that compelled their adoption in the first place, and supports their maintenance once a shift has occurred. It should not be expected, and the evidence does not show, a G20 paradigm shift that is constantly growing in size and volume; this is not an economic big bang and ever accelerating policy universe.

What is seen are clear limits to the expansion of the G20 and FSB-led paradigm shift. The shift is a rejection of laissez-faire neo-liberal truths and the adoption of a state-power-backed aggressive, re-regulatory approach and programme, not a complete abandonment of current

free market structures and economic norms. According to Padoa-Schioppa, ‘If the years before the crisis were years of overreliance on markets and mistrust in government – or, more simply put, too much market and too little government – what we have seen in 2008 and 2009 has been a spectacular comeback of government’ (Padoa-Schioppa, 2010a, p. 8). That comeback, that reassertion of collective state oversight and control, is real, but the shift has limits.

It does not extend to include perennial global macroeconomic issues such as imbalances or national economic or currency policies. As this chapter has shown, there is no G20 policy consensus visible there, only discord. And, as has been shown, a paradigm shift does not occur if there is a lack of consensus on anomalies, failures, and solutions. Instead, what occurs are disputes and the maintenance of the status quo. Such clashes are not necessarily a weakness of the G20-triggered shift itself, but are instead the outer limits of it. Beyond that boundary, elements of ‘paradigm wars’ and paradigm conflict still exist.

What is notable in the case of the G20’s creation, process, and evolution is not how limited its policy effect may become, but how fast it has proceeded and how many areas it is impacting. Bankers themselves (admittedly self-interestedly) complain of the huge effect of the multiple national and international regulatory processes started by the G20. But they are correct that this is a significant multifaceted and possibly durable re-regulation process; central bankers deliberately designed it to restrict risk taking and decrease the danger of another crisis; it is meant to make banking and risk taking more costly and less appealing, and it is not meant to be temporary.

It is to be expected that the impact of actual policy changes begun by the G20 and FSB fluctuate and currently lack consistency area to area and country to country across the globe in mid-2013. Policy making is a messy process, after all. Viewed in isolation, individual policies promulgated as a result of the G20-led and FSB-championed shift may look more or less strong. But viewed in totality and within the wider cultural context, the fundamental hypotheses that what we see is underway is a G20 directed, central bank-designed, and still being constructed series of concrete policies underpinned by the narrative and policy consensus paradigm shift among regulators and central bankers. In 2013 the new consensus is being translated into first, second and third order changes in coordinated international financial regulatory policies (Hall 1993). Once again, perspective matters, and the observer

may be too close to events that continue to unfold to fully appreciate the nature of the change in worldview started by the G20 and the FSB leadership in 2008–2009.

3.7.2 What type of paradigm you get depends on who leads

This chapter has demonstrated that the creation of the G20 forum brought together old leadership from North America and Europe plus the leaders of the major emerging economies in a manner not previously seen and to an extent that will have a significant impact in the future. This change was not and is not temporary window dressing and it cannot be rescinded. Today, the leadership forum of global international economic diplomacy is now permanently larger. However, especially during phases one and two of the forum's evolution, the burst of activity and the reform agenda was driven by North American and European leaders. The crisis was their fault, and weaknesses in their supervision, their regulation, and their markets needed to be addressed. Emerging market leaders agreed with this assessment and did not oppose G20 reforms and action plans which would predominantly impact regulation of markets at the core. They permitted the core in the G20, advised by their central banks, to devise the redesign and reform agenda in 2008 and 2009.

Crucially, principal officials from those states directing the detailed re-regulatory programme tended to be hawks—i.e., supportive of state power reassertion and aggressive re-regulation of global finance. It will become clear in Chapter 5 that the detailed financial reform agenda, within the FSB and within the SSBs during phases one and two, and arguably even in phase three, also reflect these actors' goals and not those of a smaller grouping (from France, Germany, and Japan) seeking weaker responses.

U.S. and European powers moved away from a reliance on the G7-G8 groupings in favour of a still exclusive but much more inclusive collectivist (Germain, 2001) process over which they continued to retain a pivotal degree of influence and control. They expanded the collectivism of the wider forum but also simultaneously used the G20 as an instrument of 'hegemonic incorporation' of emerging countries within a new architecture still largely designed by and led by members of the G7 'as was' (Beeson and Bell, 2009, p. 67)

This dominance by those at the core has led some to suggest the G20's emergence and its leadership entrenched 'the institutional leadership of the advanced imperial powers of old' (Kirton, 2010, p. 13), or in other words, the G7 (Porter, 2000; Soederberg, 2002). Perhaps in

phases one and two it could be concluded that this was the case. The shift, reform agenda, and its policy prescriptions turned out to be a Western package addressing Western failings and designed by Western leaders and their more hawkish technocrats. But the emerging countries' roles and approach to the G20 process was itself evolving, and not much should be read into their relative silence at the start of the process, when they were brand new members of this still exclusive club. They were still around the table for the first time, every time, with their voices finally being heard to a notably greater degree than in the past, and were in support of the direction of the paradigm shift. The G20 does not signify a wholesale change in power relationships. But change it is, and over time, the effect will become more and more apparent.

3.7.3 Emerging countries growing into their roles

In 2008 and 2009, key emerging economy players were getting much of what they wanted. In the first instance, that was a seat at the G20 table and an enhanced voice within the FSB and IMF. Having secured this, emerging market leaders would engage gradually, to different degrees, and on different topics, depending on their familiarity with the subjects at hand and their relative economic power and assertiveness. Importantly, the G20's policy direction was sympathetic to some of the emerging state leaders' economic goals and ideological stances. China, for example, was supportive of greater financial regulation and control, higher capital standards, and macro-prudential oversight; it was already implementing such policies internally, and its policy makers had made it clear they saw the financial crisis as having illuminated the flaws in the U.S. system. They underscored the need for increased regulation and a move away from the Anglo-Saxon model (MacGregor, 2012). Sitting in the Forbidden City in Beijing, it would be reasonable for officials to see the policy shift as being a positive one worthy of support. Thus, a lack of opposition to this redesign and re-regulatory agenda in phases one and two by China and others is not necessarily surprising. This relative silence also changed markedly in phase three.

Emerging-country voices are not only critical but also increasingly additive and strategic in phase three. This is very obviously the case in the talks over a Eurozone firewall in 2011 and 2012. Emerging-country leaders came to the table with solid offers, cash, and reasonable *quid-pro-quo* demands. That they ultimately were rejected by the core states guarding their positions inside the IMF is less important. More significant is that the emerging countries actively engaged to an extent not seen in phases one and two. In doing this, they were

negotiating within the new G20 process advocating their own political and power goals. They took positions that showed an increased commitment to the G20 process and, not incidentally, to the IMF itself, an institution that a mere five years earlier they had practically abandoned because of what they saw as its almost total lack of legitimacy. This is clear evidence of the G20 process fostering change and the emerging countries buying into the process and engaging in a way they would not have done in the absence of the G20 structures and summitry.

In summary, after the Washington summit, and as a result of each subsequent interaction, it appears that emerging countries and their leaders are becoming more used to the process, supportive of the framework, and assertive within the structure. Certainly, the G20 is still exclusive, but the table is larger and many more key players are present. This club, founded as a leaders' state-to-state diplomatic construct, will not satisfy critics (Aslund, 2009). But it is broader and more representative than previous forums (Bradford, 2009a; Subacchi, 2009), and it is more legitimate as a result (Subacchi, 2010b). It can therefore be seen as a relative improvement.

3.7.4 Inclusion postpones a head-on clash

Instead of a head-on clash between the rising powers and a slowly declining global hegemon outside of existing structures, as could have occurred without the latter's inclusion in the new superstructure, disputes are now internalized and modified by the processes that are in place. Most of those processes and reforms have been constructed largely by western leaders and their officials, albeit backed by the emerging powers and paradigmatically redesigned. Now what exists is a U.S.-backed empowerment of the leadership of emerging countries in the structures, and in return the U.S. may prolong its own centrality in the process within institutions that it helped construct and now maintains.

As emerging countries take over the leadership of the G20, they will take a larger and larger role, indicative of this permanent but gradual adjustment in power relationships within the new architecture. North American and European voices may still dominate for the short to medium term, but the balance of power is changing within the flexible G20-led architecture.

3.7.5 The G20 as a flexible leadership response to the crisis

The G20's success after its hasty creation and during its formative and early reformist period has depended not only on the pressure of events and the urgency of action, but also on the nature of the forum itself. Part of the forum's success is due to the flexibility provided by the G20 meeting format. In crisis, placing all leaders in one room is effective and can produce results. It did in London when Gordon Brown locked the door until a deal was done (Darling, 2010). Creating a forum where leaders can confront major issues head-on, even when they are in dispute, is invaluable because leaders, face-to-face, can strike a deal when Sherpas cannot. Even when a deal cannot be done, small, incremental steps are still often taken. Other more formal settings, such as the International Monetary and Financial Committee, do not replicate the tension, the degree of urgency, or this action-oriented format (Interview 21, 2012).

The evidence analysed from the summits shows that the G20 forum, because it is ad hoc, still relatively small, and has only the major old big and new big players at the table, does indeed produce relatively rapid decision making in times of crisis. The Washington Summit lasted less than 24 hours and the London Summit only marginally longer, and a general accord amongst key actors and consensus was reached swiftly. The G20 as a relatively small, nimble, non-rules-based forum was able to make a rapid economic impact and force regulatory progress in 2008-2009 and in 2010 (in Seoul on Basel III), despite very public spats and 'currency wars'. In the G20, there is a necessary trade-off between legitimacy, representation, and effectiveness (Patrick, 2009). What is seen in the G20 is an updated concentration of state power designed to more closely reflect 21st century geopolitical realities. However, critics are not easily assuaged by small adjustments in relative power in a still exclusive forum that was admittedly nimble in the face of the crisis.

3.7.6 Legitimacy still matters

What is obviously necessary in a crisis and accepted even by those excluded in an emergency, when a great many risk almost all if nothing is done, appears much less appealing when the wave of the crisis dissipates and the chosen forum continues to exclude the many and the small (Vestergaard, 2011; Vestergaard and Wade, 2010). Complaints that the G20, the architecture, and the process it has constructed are illegitimate continue to be heard. Critics warn that it 'represents an extraordinary regression in international governance to

Prince Metternich's concert of great powers in Vienna after the Napoleonic Wars in 1814–15' (Aslund, 2009). Aslund and other champions of universal institutions reject the 'small and flexible' defence. They retort that the G20 represents a retreat to the power politics of the past. It still excludes 150 of 192 countries and is not universal (Payne, 2010). It is condemned as a shift towards a 'plurilateralism of the big', with the smaller states still frozen out of the informal summitry processes (Vestergaard, 2011, p. 7).

The G20 is, it is said, usurping the sovereignty of those excluded from the process. Just such a concern pushed UN Secretary General Ban Ki Moon to counter with his own, much less successful, forums (Cooper, 2010). Excluded national leaders, such as former Danish Prime Minister Lars Rasmussen, concur and have voiced concern about a sustained move away from universal institutions in favour of a G20 exclusive state-power-based, informal forum (Rasmussen, 2011), even as they recognise the forum's effectiveness in 2008–2009 and its improvement over the G7-G8 approach (Vestergaard and Wade, 2010).

The critics are right. The rise of the G20 and FSB process is a reassertion of state power and more informal political structures and processes in place of universalism. Their complaints about the process of selection and the forum's lack of regional representation and balance are also reasonable. This route was chosen in part because key actors did not want to use the IMF because of its own perceived failings and weaknesses. In addition, the resort to an elevation of the G20 was a sudden move, unplanned and forced by events in 2008.

The wave of policy making and institution rebuilding and reform that result from the crisis, and the decisions that are made in such times, are never perfect and seldom please even most of those consulted, let alone all of those left outside the room. That was the case in Washington, and it remains the case today. The G20 was hastily formed from a previous body and so exhibits, as most similar constructs would, its own, new, legitimacy gap. To be sure, small steps are being taken to increase communication amongst a wider grouping (it is now really the G20 plus five).

However, by increasing the membership, its breadth of agenda could undermine the G20's identified strengths. It works now because of its flexible and small nature, and expansion, if excessive, would be foolish and counterproductive. Such steps could diminish its effectiveness or just drive the decision makers to select other mechanisms to pursue common policy goals. But the G20 is not going to become a permanent free-standing resourced universal international body. Decisions taken at the Cannes Summit make it clear it will not

evolve into a body with the features of a global universal institution, like the IMF or WTO. Membership creep may still occur, via the technical bodies, in particular, but universality is off the table. Given that fact, those outside will need to find others ways of impacting an evolving process rather than simply demanding admittance.

The G20-FSB-IMF reforms are a response to a particular, especially severe, global financial and economic crisis. The forums continue to evolve and the process and cycle have elements of dialectic contained within them.

3.7.7 Dissension and the dialectic of crises response and reaction

The recent history of the creation and early growth of the G20 follows a similar trajectory as responses to past national financial crises. There is a crisis response phase in 2008; a concrete reform phase in 2009; and a tension between the new consensus and dissension among states' leaders from 2010 to 2013. Today, the evidence suggests that, at the G20 level, but not yet at the technical level, public disputes have become increasingly vocal and strident. As a degree of economic normalcy returns, in part thanks to actions in stages one and two, the benefits of collective action seem less compelling to G20 leaders. This, too, should be expected. The limits of the paradigm have been reached.

The issues left on the table are those that are not part of the agreed crisis-formed policy consensus. They are grounded in competing national paradigms of growth and economic policy. Still, the negotiators grapple with the issues, almost always unsuccessfully, particularly as regards imbalances. Historical antecedents can be seen, with similar disputes occurring repeatedly over time—especially over currency, trade, and surplus matters. With no consensus on causes, solutions, and actions in these areas, no progress is possible. Now, with the crisis behind them, G20 leaders grapple with difficult, potentially insoluble, global political economy issues. The very state power that was centripetal in the crisis and reform phases now is centrifugal in phase three because their macroeconomic and currency goals cannot be reconciled.

Thus, we have the dialectic: crisis management, reform and results, leading to a consequent return to nations pursuing their own national interests and the consequent increase in public disunity due to this greater economic stability. So the cycle continues. A period of some years of relative calm may occur. A gradual amnesia will occur amongst the regulators and (certainly) amongst the regulated banks as to the lessons of this most recent crisis. Troubles

will build once again. An unanticipated crisis will occur, and the cycle of crisis management, concrete reform, redesign, and eventual dissension amongst actors will commence again.

Putnam's model (Putnam, 1988) applied to the crisis and to the G20 and its evolution follows a similar fluctuating rhythm. In phase one, national negotiators are forced together by the severity of global economic events. Level-one goals overlap. Level-two blocking interests of each side are muted or overlap. Win sets are enlarged and accessible. Thus, there is the basis for a policy consensus and swift action post-crisis. In phase two, there is construction of the policy consensus and continued overlap of level-one goals. At this time, regulators collectively move swiftly without reference to their level-two goals and constituents. Win spaces are still clearly seen and seized by the central banking community to make the new consensus concrete via specific policy changes backed by level-one actors. In phase three, as economic normalcy returns, in part because of the effective and aggressive collective steps taken in phases one and two, reforms already agreed continue at a technical level, but disputes driven by level two domestic issues and lobbies reemerge. National actors begin to reassert their own distinct goals, blocking further consensus or further adding to the still new re-regulatory paradigm. Policy consensus and overlap disappears (for new macroeconomic and nontechnical issues). It is back to business and bickering as usual.

The changes wrought as a result of the 2007-2008 crisis are real. The severity of the crisis forced the beginning of a paradigm shift worldview among technocrats and in certain regulatory areas and a series of interrelated reforms that continue today. But the economy goes through boom and bust cycles, and the response by policy makers operates in cycles, as well.

Eventually, as in previous lesser economic crises, when the crisis dissipates, the urgency evaporates and state commitment to the process will tend to weaken. It is unlikely, therefore, that a further extension of the policy consensus is possible post-crisis. To the contrary, completing national narratives, national interests, and national objectives are again becoming the norm, and the G20 is becoming hamstrung. In addition, when external pressures are removed, or a summit's leadership proves ineffectual, summitry is less effective. Since it is a non-rules-based, ad hoc, consensus-driven forum, the G20 is most effective in a crisis. It will tend to lose focus and drive in normal, less economically fraught periods, and disputes at summits will increase. This is the nature of the forum and of episodic global summitry that responds to external crises and events.

The G20 is, however, a permanent addition to the top of the architecture of international economic and financial diplomacy. State-to-state, power-based diplomacy is back and is here to stay. Critics of the process therefore need to seek other ways to impact policy making indirectly, (through the IMF, for instance), rather than just demanding admittance, or they should look to the policy process below the G20 summit declarations—that is to say, inside the FSB. It is this new institution which has taken the consensus in the G20 and made the paradigm shift real and potentially long lasting. It is this body, a direct creation of the G20 in 2009 and their central banking community, which acts as the central contractor of financial reform and whose decisions and policy pronouncements change the financial rules and reality for banks and investors across the globe, developed and developing, North and South, East and West.

The following two chapters analyse the FSB and its policy output. It is this forum and its community which is the most important actor and institutional product of the G20-led response to the 2008 financial crisis. It is at the heart of the G20's crisis response and reform drive. The success and resilience of the elite driven focused re-regulatory paradigm shift depends on the actions and output of the FSB-coordinated process begun in 2009 and which is still underway. Such shifts are indeed ideological shifts. To become real and lasting, however, they require that actual third-order policy changes be constructed, defended and, when necessary, further added to. It is for this reason that the role of the FSB is pivotal in any attempt to judge the long-term impact of the creation of the G20 and its policy agenda since 2008.

Chapter 4. The Financial Stability Board: Its Creation and Structure

'Institutional change only makes sense by reference to the ideas that inform agents' responses to moments of uncertainty and crisis'.

(Blyth, 2002)

'The FSB is the fourth pillar in the system of global governance'.

(Geithner, in Helleiner, 2010)

4.1 Introduction

The G20's enlargement of the Financial Stability Forum (FSF) to include emerging countries, and its decision to refashion it into an empowered Financial Stability Board (FSB), is the most significant reform of the global financial architecture undertaken by the G20. This chapter will outline the central role that an elite, expert, tight-knit epistemic community (Haas, 1992a; Helleiner, 1994), primarily composed of central bank principals from a few Western states, played at the Board's creation and in delineating its structure and the scope of its activities going forward. Not only are members of the FSB the recipients of the G20's political capital, but they also play a highly influential role in fashioning the reform mandate that the G20 agreed in 2008-2009 and subsequently.

This community of officials, it will be shown, is essential to the creation and maintenance of a paradigm shift focused on state regulation of financial markets firms, and to the diffusion of policy (Levi-Faur, 2005; Lazer, 2005) observed in 2008 and 2009. That shift continues to be gradually strengthened by this community even during phase three of the G20's existence. A transnational policy community that largely failed to anticipate the financial crisis in advance (Perlman, 2012; Vanoli, 2010) succeeded in seizing control over the reform and redesign via the FSB and to comes out of the process reinvigorated and more powerful than before the crisis.

From its birth in 2009, the leadership of the FSB rapidly developed the Board's structure of a permanent institution, even though the forum started with no formal power and today still lacks some of the aspects normally expected of an international organization. This new and complex multilevel structure did not exist before the crisis. Yet, in 2013, the FSB is the dominant coordinating forum, underpinned by the financial regulatory transnational policy network and epistemic community. It is led by principal central bankers, supervisors, and (post the 2011 Cannes Summit) finance ministry officials. In the short to medium term, the organizational impact of the FSB is considerable in terms of increasing the intensity and

efficacy of international cooperation and the coordination of the policy output of the actors and standards-setting bodies involved.

The findings presented here indicate the FSB's creation increased by at least an order of magnitude the level and intensity of the international technical state-level agency-to-agency coordination and cooperation amongst central banking and supervisory communities. This enhanced and increased cooperative endeavour is required because the reforms identified and agreed by leaders at G20 summits are very detailed and broad based (as crafted by the FSB actors themselves). The G20 move to create the FSB and the processes it oversees is, therefore, a potential third-order change (Hall, 1993) and constitutes part of the concrete realization of the paradigm shift begun by the G20 in 2008. U.S. Treasury Secretary Timothy Geithner called the FSB 'in effect, the fourth pillar in the system of global governance' (in Helleiner, 2010, p. 6). The financial regulatory reforms agreed by the G20 and are overseen and directed by the FSB. The forum's members and its processes are at the heart of the transformation of a paradigm shift in the consensus technical re-regulatory narrative into policy shifts visible gradually in outcomes, which are still underway in phase three.

By 2013, the Board had four years of dedicated resources, but was awaiting a distinct legal identity and had no underlying enforcement power or capabilities, raising continuing questions about the strength of the underlying structures. Today, the forum is being built by stealth, brick by brick. In phase three, the process is facing opposition from within the membership (Interview 15, 2012), and ambivalence among some G20 officials and former officials over the desirability of creating a still stronger forum separate from national agency leadership. Ultimately, the forum's success remains linked in part to efficacy and strength of the G20. Even after the Cannes and Los Cabos Summits, which further built its structure, the Board remains an institutional infant, albeit a precocious one carefully nurtured by its central banking parents.

In analysing the FSB structure and functioning and who exerts the greatest power, who leads the organization, and who influences and controls its deliberations and policy making, the evidence will suggest the FSB is stronger, more dynamic than its predecessor, more inclusive, and activist. But the information gathered in the interviews also indicates that the Board was created by, and is still largely directed by, predominantly hawkish officials from a small group of key advanced economies who from 2009 to 2012 led the organization, chaired many

of the committees and working groups, and determined key work streams (Interviews 7, 8, 9, and 10, 2011; Interviews 15, 22, 24, 25, and 34, 2012).

Although it is a more inclusive Board, in 2013 a relatively small number of European and North American central banking and supervisory technocrats still wield significant power even as the leadership roles change. In essence, key actors responsible for major markets in leading G20 states continue to dominate the reform deliberations and will likely do so going forward. Emerging economy voices are being heard, for instance, at the outset in support of the new re-regulatory paradigm (Interview 7, 2011). These actors participate, and their engagement is quantitatively and qualitatively greater than in the previous exclusionary structure. On occasion, their input can tip the balance in favour of a particular policy solution. But especially in the key formative years, the Board's organs and policy levers remained in the hands of a few from the core. This leads to some consternation over governance issues, such as, who leads and who chairs what (Interview, 15, 2012). In 2013, emerging economy members have an enhanced role but are not yet central actors.

The Board is a relatively new institution and it has been the focus of some academic analysis. This includes work by Lombardi on structure and governance (Brookings Institution, 2011a, 2011b). Its creation and governance have also been addressed by Helleiner (Helleiner, 2009a, 2010; see also Griffith-Jones, Helleiner, and Woods, N. (eds), 2010; Bluestein, 2012). Not everyone is enamoured of the new forum. Critics view the Board as a historical backsliding away from universal institutions and 'not a good development' (Pauly, 2010, p. 16). Can it perform all the tasks it is assigned? Critics suggest it will not be up to the surveillance and monitoring tasks it has been set (Momani, 2010), that much remains to be done on amplifying its peer review functions (Porter, 2010), and that its macro-prudential policies also remain to be tested (Turner, 2010). However, notwithstanding this scholarship, the Board remains relatively obscure, opaque, and little understood.

The Brookings Institution notes that 'there is extremely limited knowledge as to how the FSB operates and is governed' (Brookings Institution, 2011a, p. 3). This view is supported by Baker, who observes: 'No systemic comprehensive studies' have been conducted and, moreover, that 'most of us have only an anecdotal appreciation of what goes on behind closed doors' (Baker, 2010, p. 19). The Brookings Institution and Baker lament of a lack of understanding about the Board and how it operates are legitimate and justified. The FSB's precise role and *modus operandi* are quite obscure to outsiders. The forum is far less

transparent or open to civil society than the International Monetary Fund (IMF) or World Bank, for instance. This is despite its position at the very centre of the post-crisis redesign of the global financial regulatory architecture. In 2013, in comparison to the existing international financial institutions (such as the IMF), it has been subject to relatively little academic analysis, principally because of its novelty and its closed mode of operation. *Ex post*, the forum's output can be read on the web, but this gives the researcher practically no contextual depth as to the reasons behind particular outcomes, the policy narratives driving them, or the actors' possible motivations.

In this chapter, on the FSB's creation and structure, and in chapter 5, which addresses the Board's mandate, key FSB responsibilities, and tentative policy results, the aim is to enlarge the understanding of the new forum. This is done by analysing its creation and its role in the redesign and financial regulatory reforms started in 2008. The analysis employs conceptual lenses which highlight the paradigm shift witnessed and the extent to which this is underpinned by a new policy consensus among an elite community of senior policy makers within a distinct expert community.

The chapter will draw out the new policy consensus and paradigm shift adopted by the western powers' central banking community supported by emerging country regulators. It will show the conceptual shift, toward a support of re-regulation. As in the past a policy failure and crisis drives action (McNamara, 1998). The crisis response was centred on the creation of the G20 and then the FSB forum in 2009, as well as reform of the IMF. A burst of rapid institutional and policy development was then followed by additional, more incremental steps to strengthen the new Board. This rhythm in the construction, strengthening, and paradigm maintenance of the FSB in part matches, but extends and deepens, the shift seen at the political level of the G20 summits. This is because the FSB community is more cohesive and has a particular and unique influence over and role in the G20 policy reform process as a whole. The two processes are interlinked, and the FSB and its output are important to the creation of the G20-signalled paradigm shift, and to its maintenance.

This chapter's analysis of the drivers behind the creation, structure, and functioning of the FSB draws extensively on interviews with numerous principal actors who participated in its creation, and who have experience operating within the FSB, its steering group, and its plenary and working groups. Using this type of source material, the analysis hopes to add meaningfully to knowledge of the FSB by drawing on scores of personal narratives of the

policy process and events surrounding the creation. Utilizing quantitative interviews enables the observer to get a sense of how these key actors interpret and construct their worldview, how they viewed the events as they unfolded (Merriam, 2002), and the institutional and policy choices they supported or rejected. Clearly, the interview material informing this type of analysis is subjective and is not composed of hard facts. However, confirmation from various sources may increase an observation's solidity.

The political shift which began in 2008 with the creation of the G20 was accompanied, strengthened, and influenced by a new policy consensus and narrative held to strongly by a central banking epistemic community that proposed, led, and today still largely directs the FSB. The strength of that community is important to the success of the redesign. Since the technical expert narrative and policy consensus are key to the process and outcomes, it follows their individual and collective narratives matter to the process and outcomes (Kvale and Brinkmann, 2009) of the events being dissected and analysed.

4.2 The creation of the Financial Stability Board

G20 summitry shows that for the decision makers, 'it often takes a crisis or shock to overcome the institutional inertia and habit and spur them to seek help from an epistemic community' (Haas, 1992a, p. 14). Blyth adds: 'institutional change only makes sense by reference to the ideas that inform agents' responses to moments of uncertainty and crisis' (Blyth, 2002, p. 251). In the case of the creation of the FSB, a small community joined by common experience and beliefs rapidly evolves during the crisis and acts internationally in support of a re-regulatory collective state-power-based paradigm shift. In 2008, the central banking and regulatory community rushes to support the G20 and to provide the outline of a consensus view about the crises' causes and effects, and its failures and solutions. This developing consensus reduces uncertainty and facilitates the paradigm shift in worldview and policy prescriptions (Blyth, 2002). The group advises and directly impacts the shape of the G20-backed reforms, policy process, and options going forward. This grouping of principal central bankers and supervisors should, in fact, be viewed as a distinct epistemic community (Haas, 1992a).

Importantly this new consensus only extends to regulatory matters over which the FSB had purview. It does not extend to macroeconomic matters, to matters of national economic

prerogative, to imbalances, or to a broader questioning of the market based neo-liberal economic model operating in most states of the G20.

4.2.1 *Central bankers as an epistemic community forming a new consensus*

The central bankers and supervisors who came together to create the FSB in 2009 appeared to operate as an epistemic community; prior to the latest crisis, the grouping was perhaps a gradually coalescing nascent epistemic community (Kapstein, 1992; Helleiner, 1994). Post-crisis, they were a community with a largely common experience of crisis management, and a common conception of the anomalies that led to the rising crisis, its causes, and a clear sense of possible solutions and notions of validity, all of which are prerequisites for a paradigm shift to occur and for a new policy consensus to begin to take hold.

This small community facilitated policy convergence, bound by knowledge and expertise and experience of common policy problems and solutions (Bennett, 1991; Kingdon, 2011). Once policy options became clear, they assisted in efficient top-down information diffusion (Levi-Faur, 2005), via ties that connected otherwise unconnected communities across geography, culture, and political and economic factors (Lazer, 2005). The community—comprised of a small number of top central bankers and supervisors whose lives were consumed with crisis management during 2007-2008—prepared the ground for international policy harmonisation (Holzinger and Knill, 2005). As early as late 2008 and the spring of 2009, the outline of a new policy narrative was taking shape.

The G20 set the process of reform going, with an investment of collective political capital. There was an ‘alignment of leaders and technocrats’ and, on the actual policy prescriptions, ‘technical professionals were allowed to figure it out’ (Interview 22, 2012, p. 12). The central banking and supervisory community was tasked with identifying the proximate causes of the crisis and possible policy solutions. It is not necessary to revisit them all in detail, but causes of the crisis include global imbalances driving a credit boom in deficit countries (Smaghi, 2008); unintended consequences of the great moderation (Gudmundsson, 2008); excess leverage in banks (Draghi, 2008; King, 2010; Turner, 2009b); poor risk management and excessive risk taking (King, 2009a); opacity in complex interconnected global securities markets, which acted as a risk and panic transmission mechanism for the crisis (Buchanan, 2013; Gudmundsson, 2008; Weber, 2008); and a failure of supervision and oversight of markets and firms (G30, 2009a). Having a common crisis-driven conception of the nature of

the failures, it was then possible for the community to coalesce relatively quickly around a new paradigm or approach in response to the crisis and its anomalies.

Table 4.1 modifies Kapstein’s 1992 view of the common beliefs of the central banking community (Kapstein, 1992, p. 282), and updates it with the post-crisis position. It underscores that the central banking community has shared causal beliefs, principled beliefs, and, a shared project: the internationally coordinated macro-prudential supervision of the system as a whole—overseen by the FSB.

| Table: 4.1 Shared Beliefs and Common Policy Project of the Central Banking Epistemic Community Postcrisis | |
|--|---|
| Shared causal beliefs | The economic and financial crisis threatened a collapse of the world economy and the global financial system. It was driven by excess risk, leverage, opacity in complex interconnected markets and firms, and a failure of supervision and oversight of firms and destructive unregulated markets. |
| Shared principled beliefs | The international trade and payments system is a common good. Central banks should ensure financial stability and the safety and soundness of the system. They should act as providers of liquidity and lenders of last resort. Markets and firms are incapable of providing system stability. |
| Shared policy project | Internationally coordinated re-regulation of global markets and firms utilizing macro-prudential tools and mechanisms and increased capital to ensure long-term financial stability. Regulation and supervision will focus on the stability of the system as a whole and on large interconnected individual firms. |

Table 4.1 Shared Beliefs and Common Policy Project of the Central Banking Epistemic Community Post-crisis

The community thus responded by offering a new consensus which is based on a rejection of laissez-faire neo-liberalism’s worshipping of deregulated financial markets. In its place, the community moved to champion a series of macro-prudential solutions that address what they view as gaps and failures in the previous architecture. We can identify among central bankers a broad-based call for a meaningful reassertion of collective state power and for the systemic re-regulation of global markets and systemically important firms, in the sense that the calls become insistent and consistent from many sources. Actors within the community demand a ‘rethink of financial regulation’, with an emphasis on systemic risks and regulations across all

markets (Noyer, 2008, p. 1; see also Caruana, 2009; Darling 2011). The prior approach is seen as having been too narrow (Noyer, 2009). The response would therefore include greater macro-prudential oversight of markets and firms and enhanced capital and liquidity standards (Draghi, 2008; Turner 2009a), and would address procyclical tendencies (Caruana, 2009; Xiaochuan, 2009) and run across the economic business cycle, i.e., apply during boom and bust periods (White, 2008).

The FSB move towards financial market reform and stronger global regulation during this crisis period is explicitly characterized as a new ‘consensus’ by various sources (Blanchard *et al.*, 2012; Constancio, 2010; Smaghi, 2008, p. 3). What is being constructed is a policy ‘consensus amongst the elite that operates, in first instance, above the fray of domestic politics’ (Bennett, 1991, p. 225). Members of the community stress that consensus solutions, as specified at the Washington Summit and which would be laid out in still further detail at the London and Pittsburgh Summits, would require ‘greater international coordination, requiring concerted efforts by international organizations’ (Watanagase, 2008, p.3), and a strengthening of the international architecture (Noyer, 2009); hence, the need for a new structure or forum to match the ambitious policy goals.

These central banker and supervisory responses show many elements that are indicators of an epistemic community. The group exhibits a shared set of causal and principled beliefs and notions of validity. From 2008 onwards, the community rapidly developed a common policy consensus and enterprise which includes a series of policy responses to the crisis and internationally coordinated reforms. As with other such epistemic communities, the actors knew each other very well and tended to trust one another (Adler, 1992). They operated as a ‘network of professionals with recognized expertise and competence’ (Haas, 1992a, p. 3). They are deferred to for technical expertise by political leaders, and they, also unlike some other communities of experts, have the independent regulatory authority to make policy changes in many key areas they identified for reform.

This is what was occurring through the output of the G20 summits and during the financial reform process. As with other epistemic communities, the ability of the central banking community to seize the policy-making initiative is buttressed by the deference shown to the group as knowledge elites to whom the leaders defer, especially in stages one and two of their response. The regulatory issues are very complex and technical in nature, and this forced G20 leaders to turn to the community for advice, as has happened in other cases (Haas, 1992b),

sometimes on the basis of incomplete knowledge, which some government officials report they later regret (Interviews 13 and 17, 2012). This expert community thus influences the debate, provides the technical knowledge, identifies cooperative options and, in this case at the very outset, pushes for the creation of an institutional structure that could build collective vested interests into the international reform process (Adler, 1992)—the FSB itself.

Crucially, it is the combination of relative clarity on external anomalies and causes, coupled to a strong epistemic community and the coalescence around a common policy consensus, which increased the probability of a paradigm shift in worldview and linked policy outcomes (see Figure 2.1, p.33).

Because this combination is present in this crisis, the re-regulatory shift begins, and this community proves to be the most influential transnational policy network below the G20 level, one key to the creation of a Board that the community would then go on to dominate during the first four years of the policy-making process.

The G20 leaders solicited the community's views and advice, adopted much of it, and then delegated responsibility to those actors to monitor progress and carry it out (Haas, 1992a). In conclusion, a relatively small group of central bankers and supervisors acting as an epistemic community turns out to be crucial to the output of the G20 summitry and related policy processes.

4.2.1 Seizing the crisis and reasserting collective state and central bank control

At its most basic, the FSB is created by senior officials from the core as a structural reaction to the financial crisis spurred by a belief that policy actions must be taken to address the failings of the global financial market system. These actors, and their political leaders, had been working feverishly together for months by the summer of 2008 in an attempt to grapple with the rising crisis as it developed and intensified (Federal Reserve Bank of St. Louis, 2008). They participated in joint meetings, scores of calls, agreed massive currency swap deals, slashed interest rates, and took a series of extraordinary national monetary policy actions designed to address the crisis (Darling, 2011; Paulson, 2010; Sorkin, 2010). Together with finance ministers, central bankers were the defenders of stability and providers of a rapid policy response. Moreover, the crisis, as is often the case, exerted a clarifying effect, and brought the key actors closer together, simplifying issues, changing perspectives and

policy stances, and opening up win sets and speeding decision making and action in 2008-2009 and since.

Two officials in particular, Tim Geithner and Mario Draghi, appear to be instrumental in the FSB's creation, according to sources. As the crisis grew in 2007-2008, they consulted with an ad hoc grouping of senior central bankers and supervisors, for discussions at the margins of other official IMF and G7 gatherings to consider the options. The central banking community leadership dominated these informal discussions (Geithner at that time was a central banker and subsequently became U.S. Treasury Secretary).

The meetings included a 'who's who' list of the world of central banking: The two leaders—Mario Draghi (as FSF Chair) and Tim Geithner—were joined by Mark Carney, Governor of the Bank of Canada; Jaime Caruana, General Manager of the Bank for International Settlements (BIS); Philipp Hildebrand, Governor of Swiss National Bank; Mervyn King, Governor of the Bank of England; Jean-Claude Trichet, President of the European Central Bank; Adair Turner, Chair of the U.K. Financial Services Authority; Axel Weber, President of the Deutsches Bundesbank; and a few others. The group was almost all central bank governors, and many of them now tended to lean in favour of greater international regulatory discipline, higher capital, less leverage, more liquidity, and other solutions that, taken together, signalled a possible re-regulatory paradigm shift. It is from these deliberations that the Board concept emerged (Interview 15, 2011).

The actors saw the crisis as an opportunity for institutional re-creation and international and national re-regulatory action, a reassertion of their power and authority over markets and firms (Interview 9, 2011). Aside from the evident real economic costs of the crises, failure to seize control of the reform agenda could have led to an alternative structure, with the IMF taking a larger role in regulatory matters, as occurred in response to the Mexican and Asian crises of the 1990s. Instead, by championing a more exclusive Board led by the same small group of national central bankers and supervisors, the community's members kept the regulatory policy-making response still within their control, as the functional exclusion of finance ministries from the leadership decision-making process from 2009 to 2011 underscores. This technocratic elite community would be pivotal at the outset and throughout the policy responses during 2009-2012.

During 2008 and until creation of the Financial Stability Board by the action of the G20 leaders in London in the spring of 2009, the central banking community, and predominantly this small, largely Western, subsegment of it, discussed options. It was clear to many of these actors that ‘there needed to be an international group whose remit was to take a top-down view of the entire financial system’ (Interview 15, 2012, p. 2). Their solution: A renamed, enlarged, empowered FSF to mirror the leadership forum above it. Thus, the epistemic community met informally, digested options, and formed a consensus on how to proceed, institutionally and in terms of policy choices. In doing so, they ‘seek out the forum most favourable to their interests’ (Raustiala and Victor; 2004, p. 280). This forum was a reformed, enlarged, and renamed FSF. The FSF itself had been created in 1997 by a former grouping, the G22, in reaction to a previous, less severe financial crisis cycle (Cartapanis and Herland, 2002) of crisis, response, reform, and relapse.

In the autumn of 2008, the central banking community projected these recommendations upward as expert advice to G20 leaders desperate for effective policy actions which could resonate with their expressed political commitment and real need to reassert collective and national state control over markets. The FSB structure that the G20 agreed, advised by the central banking community, would prove to be instrumental in the reform process.

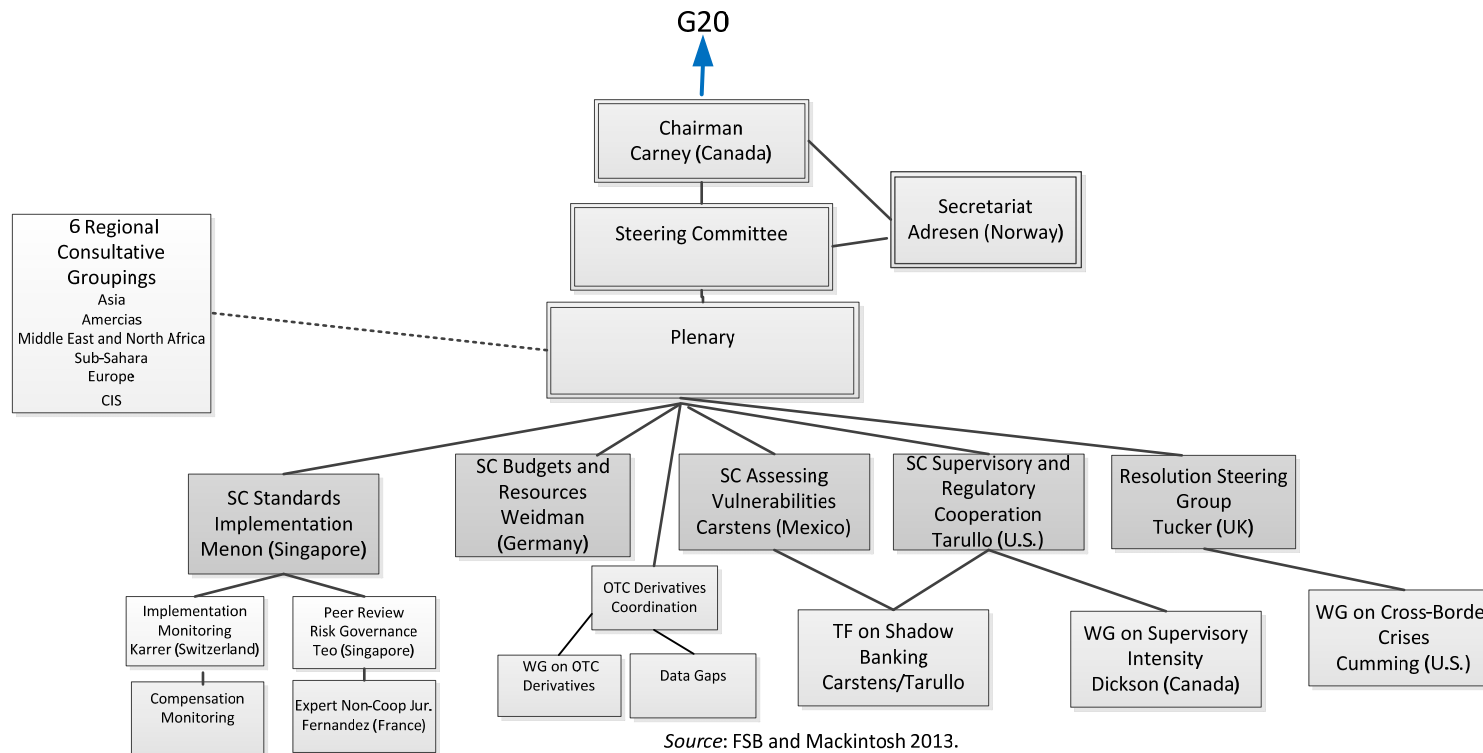
The decision was made to change the name to the FSB, since this was seen as being stronger than a forum, because, ‘a forum sounds like you are discussing things, a board sounds like you are deciding things’ (Interview 9, 2011, p. 4). Making the name change also provided an institutional and psychological boost to the reform impetus. It avoided having the same body (the FSF) charged with handling the reform agenda. In remaking the forum, the central bankers could divert attention from their own culpability in the run-up to the crisis, since the focus would be on the new structure and process and not on the prior failures.

Thus, a community from the core states duplicated and slightly expanded the G20 diplomatic structure via the creation of the overarching FSB to stand between the G20 leaders, deputies, and Sherpas (political operatives) and the standard-setting body (SSB) members (second-rank technicians and officials). The former had clear political constraints and lacked the technical know-how, but the latter lacked the authority to take robust action. Inserting in the middle a leadership body composed only of central banking and supervisory principals could provide both direction and authority to national agencies and technocrats, many of whom work for the central banks anyway.

The same European and North American principal central bankers and supervisors who conceived of the Board would go on to serve and lead this new forum. They would charge themselves with overseeing a broader, deeper work stream (Interview 15, 2012). With a new name and enlarged membership to reflect the composition of the G20 leaders' forum, the Chairman of the FSB, Mario Draghi, who also chaired the predecessor FSF, could swiftly press regulatory changes and reforms. Numerous sources note that many of the solutions the FSB would propose had been previously identified by the FSF in 2008 (Interviews 9 and 11, 2011; Interview 12, 2012; see also Smaghi, 2008). Post-crisis, the reforms could be pursued with greater international and institutional vigour and more success, with more explicit political backing provided by the G20 summit process. Draghi, an accomplished political operator, would design a forum that would have many of the characteristics of an institution. Over the next four years, it would be further strengthened and solidified in its structures and role and become the central new actor in the coordination of international financial and regulatory diplomacy.

4.3 The institutional structure of the FSB

Architecturally, the FSB would be a process-driven organization, and it required 'an institutional structure commensurate with its expanded tasks' (Draghi, 2009, p. 2). Its supporters expected it to become a 'fully-fledged international body' (Noyer, 2009, p. 4). Indeed, its structure at first glance projects solidity and includes five levels of organization (Chair, Steering Committee, Plenary, Standing Committees and Working Groups). The Board has a larger membership than the FSF, and this necessitates a more than doubling of the staff resources and a considerable increase in time commitment and resources from scores of agencies and many principal-level officials, backed by a G20 commitment to its common goals. The following sections outline the structure of the FSB, and address its strengths and limitations.



Note: The FSB process reports directly to the G20 summits; it does not report via finance ministries. FSB leadership roles changed in 2013 and now include additional emerging market leaders. During the forum's formative period, 2009-2012, it was led exclusively by North American and European central bankers and supervisors.

OTC = over-the-counter; SC = Steering Committee; TF = Task Force; WG = Working Group.

Figure 4.1 Structure of the Financial Stability Board

Membership: FSB membership includes 36 states, institutions, and agencies, as follows: Argentina, Australia, Brazil, Canada, China, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Mexico, the Netherlands, the Republic of Korea, Russia, Saudi Arabia, Singapore, South Africa, Spain, Switzerland, Turkey, the United Kingdom, and the U.S., the IMF, the World Bank, the Bank of International Settlements, the European Commission, the European Central Bank, the Organization for Economic Co-operation and Development, the Committee on the Global Financial System, the Committee on Payment Settlement Systems, the International Organization of Security Commissions, the International Association of Insurance Supervisors, the International Accounting Standards Board, and the Basel Committee on Banking Supervision.

The FSB is larger than the G20 leadership grouping. It has been designed to include key financial markets, states, and standard setters that play a role in global financial regulation and supervision. Hong Kong, Singapore, and Switzerland, are included because they each have major regional or global financial centers. Within these jurisdictions there are also key interconnected actors (i.e., they are host to systemically important financial firms and institutions).

Chair: The FSB Chair is appointed by the plenary for a three-year renewable term. The individual chairs the Plenary and the Steering Committee and oversees the Secretariat. There is no formal process of election; instead, there is only an informal ‘sounding out’ of key constituencies (Brookings Institution, 2011a). This process allows the most influential states to retain control of this post without public disagreements, since the name that is proposed will already be the consensus choice of the key states and their central banks by that time. In practice, the Chair has wide discretion in the running of the organization, its plenary, and its meetings.

The Chair is important to the effectiveness of the organization. A strong, diplomatic, consensus-building leader can effect change. A lesser leader might result in a loss of institutional momentum and prestige. The first Chairman was Mario Draghi, Governor of the Banca d’Italia. Draghi moulded the FSF into the FSB and led the organization in its formative period until 2011 and ensured its central role in the post-crisis global architecture. The FSB is viewed by participants as Draghi’s creation (Interviews 7 and 10, 2011; Interview 15, 2012). Certainly the Board’s success is a measure of Draghi’s diplomatic skill of institutional transformation, turning a sub-par FSF into a turbocharged FSB, demonstrating his ability to

seize the crisis and press for an architectural solution and a series of concrete reforms to the benefit of his personal and community institutional standpoint during 2008-2011.

Mark Carney, now Governor of the Bank of England, replaced Mario Draghi in 2011. Carney is widely viewed as one of the most influential central bankers of his generation and is well known as a consensus builder and an intellectual force. It is notable that Carney played a significant role in the reform process (on the Basel III Accord, for instance) and is viewed as a hawk; he is not thought likely to back away from positions agreed by the Board and his community (Interview 15, 2012), and he has said as much in his clashes with bank CEOs.

Steering Committee: The steering committee is appointed by the plenary, but members are in practice recommended, that is to say, selected, by the Chair (Interview 7, 2011). This is where the real power lies and where the Chair focuses his or her attention. The Steering Committee meets at least four times a year. The size of the Steering Committee has grown, and in June 2013 it had 39 members (FSB, 2013).

Chairman Draghi created the Steering Committee at the outset because he wanted a smaller, more select grouping to effectively direct and coordinate the work stream (Interview 15, 2012). The Steering Committee's formal duties are to promote coordination among FSB bodies, review progress in policy development, and carry out the work of the FSB. The Steering Committee was created as the key decision-making body in the structure. As the committee's leadership role became clear, more and more FSB members began to demand admittance; like any popular club, those outside want in.

From 2009 until the Cannes Summit in 2011, the Steering Committee had no ministry of finance representatives. At Draghi's insistence, it was technocrats only. From the first burst of institutional creation until well into phase three of the G20-led process, the leadership of the forum was completely in the hands of the central banking epistemic community, and dominated by European and North American hawks, i.e., those most supportive of the re-regulatory macro-prudential shift in worldview. This, it is suggested by supporters, protected the forum's depoliticized technocratic expert nature, strengthening the early regulatory response. But the makeup of the Steering Committee caused complaints from leaders and finance ministries (Interviews 13 and 18, 2012) whose found themselves with regulatory deals (like Basel III) over which they had almost no input, a factor that supporters of the FSB agree caused consternation (Interview 7, 2011).

As a result of demands for inclusion the Steering Committee in 2013 has as many members as the original FSB had in 2009. It has gradually expanded since its creation in response to repeated successful attempts from those outside looking in to join the decision making body. The Steering Committee retains the central role and is the organ through which the FSB is run on a day-to-day basis. It now includes finance ministry officials from the leading G20 states, which changes its nature away from a technocratic club to one that must now also consider national political factors, insofar as they might now block Steering Committee decision making. These types of considerations were not uppermost during the first years of FSB operation, when only central bankers and supervisors were at the leadership table.

Plenary: The plenary is the final decision-making body of the FSB and operates by consensus, although each person has one vote. The FSB Charter does not state how consensus is achieved. The Charter only states that all seats have equal rights. The plenary approves the work programme of the FSB, adopts FSB reports and recommendations, appoints the Chairperson, and decides on FSB membership matters. The plenary takes place twice a year. The number of seats a country has in the plenary depends on the size of its national economy and financial market. Large powers and emerging economies have three seats, the middling powers two seats, and the rest a single seat at the table (FSB, 2009, p. 4). In the case of the large states, each state actor is permitted to send a representative from its finance ministry, its central bank, and its regulatory agency responsible for financial stability. This ensures that the U.S. maintains a large voice and also that Europeans have what some view as disproportionate representation (Interview 9, 2011).

Interviews indicate that, in practice, the plenary tends to confirm decisions taken by the Chairman and Steering Committee. It is characterized by participants as a rubber stamp of the Steering Committee and decisions already agreed by FSB committee chairs—that is to say, decisions taken by the core group driving the Board (Interviews 7 and 10, 2011). Participants are well aware of their respective economic and political weight within the forum and generally defer accordingly to Steering Committee views, especially if they reflect the views of a plurality of key state central bankers and supervisors (Interview 9, 2011).

Standing Committees: The FSB has established five standing committees that assist in carrying out its regulatory roles. The Chair recommends and the plenary appoints the committee chairs, and the chairs then determine who sits on each committee. The makeup of

the membership of the standing committees is not publicly disclosed. The committees and their responsibilities are as follows:

1. Standing Committee on Assessment of Vulnerabilities: Coordinates work on financial stability, systemic risks, and early warning exercises.
2. Standing Committee for Supervisory and Regulatory Cooperation: Responsible for coordinating G20-directed policy development across all SSBs. It monitors and advises on best practice in meeting FSB regulatory standards. The committee oversees two working groups on Supervisory Intensity and Shadow Banking.
3. Standing Committee for Standards Implementation: Responsible for conducting member country peer reviews and for monitoring state compliance with FSB prudential regulatory and supervisory standards. The committee oversees working groups on Implementation Monitoring; Peer Review; Non-cooperative Jurisdictions; and the Compensation Monitoring Group. The latter is little known, but is potentially a major institutional innovation to result from the Cannes Summit (see p. 179, Chapter 5).
4. Standing Committee on Budget and Resources: Determines the resource needs of the secretariat, weighing mandates, work programmes, and developing issues. This committee did not exist prior to Charter additions at the Los Cabos Summit.
5. Resolution Steering Group: Addresses the issues related to too big to fail, and oversees the working group on cross-border crisis management.

Additional ad hoc Working Groups: Ad hoc working groups can be established by the FSB plenary. As of July 2013, there were the following additional ad hoc working groups: Over-the-Counter (OTC) Derivatives Coordination Working Group, OTC Derivatives Working Group, Data Gaps Working Group, and Credit Ratings Agencies Working Group (FSB, 2013, unpublished data).

Standard-Setting Bodies (SSBs): The leadership of key SSBs are included in the Board. This is an important innovation because it brings under FSB auspices independent sub-state-level transnational policy networks that until 2009 tended to operate largely in isolation from one another, without proper coordination or communication, each guarding its prerogatives. Previously, there was an institution known as the Joint Forum, but it performed inadequately,

and had little political capital and little or no ability to actively oversee the work of the SSBs or press for collective action. To put it bluntly, these obscure technical bodies hitherto had not been coordinated across sectors by state actors.

With the creation of the FSB, that changes. The FSB charter requires it to monitor the G20 work delegated to the SSBs, drawing these sub-state bodies into structured coordination and collaboration driven by the G20 agenda as identified by the FSB leadership. SSBs are independent international sub-state forums, but in practice, much of their workload, deliverables, and their enhanced relevance are now affected by the G20 tasks they are asked to perform. In 2013, the SSBs are, because of the FSB, under much greater pressure to deliver and effectively collaborate, according to participants (Interviews 15 and 22, 2012; Interview 34, 2013).

Regional Consultative Groupings (RCGs): In response to complaints by non-member countries that the forum is too exclusive and exclusionary of the majority of states, the Board at the Cannes Summit in 2011 created six regional consultative groupings. Each consists of 12 non-FSB countries (reminiscent of the constituency approach within the IMF Executive Board). They are co-chaired by one current FSB member and one non-member of the FSB. The latter ‘may’ be invited to attend FSB plenary meetings. The groupings set their own agendas, but in general they mirror topics being considered within the FSB (Thorne, 2012).

The RCGs have no formal role in FSB decision making, and it is too soon to gauge their impact on the Board. But this is yet more membership creep, and at the very least, it could make matters more complicated as more actors demand to be heard (Interview 15, 2012). Indeed, once created, such bodies tend to ask for input. If they prove ineffectual, they cannot be easily dismantled. From a more positive standpoint, the groupings indicate the Board leadership is listening to external complaints about its legitimacy and exclusivity, regardless of the new groupings’ actual utility.

The International Financial Institutions (IFIs) and the FSB: The relationship between the FSB and the IFIs is evolving. A wide degree of engagement and overlap in leadership and responsibilities can be seen. Many of the principals who drive the G20 and FSB are key ministers or central bankers who provide leadership to and control interactions with the IMF, for example. Although the IMF is a distinct body, its decisions are, at the most senior level,

being made by many of the same individuals and countries wearing different institutional hats. The G20-FSB-IMF nexus will be discussed further in chapter V.

Institutional and legal basis for the FSB: The FSB is an institution without a strong legal foundation, a compromise necessary to get G20 leaders to agree to its creation in 2009. Thus:

- The FSB Charter is a political statement of intent, not a legally binding document. Article 16 of the Charter, states the Charter 'is not intended to create any legal rights or obligations' (FSB, 2009. p. 7).
- The FSB is being provided with legal standing as a Swiss registered nongovernmental organization in response to demands for legal certainty from the FSB secretariat at the G20 summit in Cannes in 2011.
- The FSB has no capacity to enter into agreements. It has no privileges or immunities, unlike formal treaty-based institutions such as the IMF or the World Bank.

In 2013, we see a complex organizational superstructure, but it rests on a still weak legal foundation compared to the IMF or the World Bank, but this is the norm for non-treaty financial regulatory organizations, compared to those other SSBs, the FSB is institutionally strong, not weak.

Secretariat and Resources: The secretariat of the FSB is headed by a Secretary General, Svein Andresen. The FSB in June 2012 got a five-year financing agreement with the BIS (Los Cabos; 2012). The central banking community is putting its resources behind the Board, avoiding the necessity to go hat in hand to national governments at a time when they would hardly be likely to well fund a body they do not control. At present, the Board has over 30 staff (up from 7 in 2009), many of whom are temporarily seconded by national central banks and regulatory agencies. Participants suggest Secretary General Svein Andresen has done an effective job with very little, and has played the role of coordinator and facilitator to near maximum institutional effect (Interviews 7 and 10, 2011). Critics who counter this view complain that staff are engaged in empire building and manipulation of the agenda to suit their goal, namely the strengthening of the Board and its mandate (Interview 15, 2012).

4.4 Dissecting the FSB's structure and operation

The following sections dissect and analyse the Board's structure, its leadership, its legitimacy, transparency in its operation, and its strengths and potential weaknesses.

4.4.1 An institutional structure that implies permanence

The detailed and complex institutional structure delineated above is not usually associated with flimsy, ephemeral, temporary institutions. To the contrary, it provides signals of solidity and structural permanence, with the strong leadership, four tiers of committee structures, a direct reporting line up to the G20 leadership summits, and a supervisory and oversight line through to the SSBs below. This points to the conclusion that the Western leadership of the central bank epistemic community wanted something with permanence and institutional weight but took a roundabout way to achieve that goal. In 2009, Draghi created the complex structure and control system he wanted and needed to coordinate reform, including a larger organization with a strong role for the chair, a chair role in selecting the steering group membership, and also in selecting the chairs of both committees and working groups from within a small community group. He would get the legal foundation and resource issues dealt with later.

The G20 deferred the structural matters to him, and he and his team took full advantage of his room to manoeuvre. Subsequent G20 summits in 2011 and 2012 would build incrementally on the initial structure. They began to strengthen it and fill in the gaps in the foundations, both legal and resource, which remained, advised as always by the supportive central bank community. In 2013, the forum appears to be becoming solid and changing into an institution, as Noyer implied would take place (Noyer, 2009).

4.4.2 Lack of formal state obligations not insurmountable

Viewing the lack of legal foundations and the absence of a treaty base for the FSB, this appears at first glance to be problematic, because it suggests the base of the new structure is weak and lacking in the solidity to match the multiple upper tiers and superstructure. But this may be less of a problem than it at first appears. As has been observed, the policy makers' imperative was to set the structure up and get the process running and actors committed in 2009. Legal matters could come later.

Other institutions have been born in this ‘lumpy’ fashion. The World Trade Organization did not start as a strong organization with a judicial arm capable of binding all member states to its rulings. It was weak for decades, becoming particularly strong only after it superseded the General Agreement on Tariffs and Trade (GATT) (Jackson, 2008). It is a question of perspective. Institutional birth and creation takes time. Not all bodies emerge fully via a single binding treaty (as occurred at the Bretton Woods Conference). Notwithstanding this evolutionary path, in July 2013, four years after its creation, the FSB does not suffer from a lack of policy-making capability due to legal concerns.

While this not a problem in 2013, these formal legal weaknesses may prove troublesome going forward, because when the crisis finally abates, as it will, in part due to the work of the G20 and FSB, the pressure for collective action and demands for tough implementation may fade. Level-one win sets will shrink, and even among the members of this cohesive epistemic community, national level-two domestic differences will become more marked and divisive. At that point, post-crisis, having the FSB almost totally reliant on outside national drivers for its mandate and the strength of its policy output could be problematic. The forum could lose focus and strength. But this is not happening yet. In 2013 the Board is still being built. Central bankers are now engaged in paradigm maintenance. Many policies and standards being promulgated are not yet complete but are still being backed by most of those inside the community in leadership positions.

That could change in the years ahead; if paradigm wars erupt over new standards, the Board will be tested. Given its consensus nature, it may not be able to act and may not be effective at monitoring the policies already in place should internal strains and differences become acute. How the FSB will evolve in the coming years is uncertain, but if the first four years are any guide, it will not rapidly lose momentum. Instead, it may, if the paradigm shift is successfully defended by the community, become progressively stronger, with foundations to match the superstructure in place in 2013.

4.4.3 Dominance by European and North American members of the community

The FSB is driven by its chair and committee leaderships operating in the Steering Committee. It is of considerable importance that up until the end of 2012, almost all the key roles (Chair, Standing Committee Chairs, Working Group Chairs, etc.) were held by senior

central banking and supervisory principal figures from Europe and North America. From its creation, almost all the main decision-making roles were held by those who were hawkish and supportive of the construction and maintenance of the new re-regulatory paradigm. In 2013, that changed, and more emerging candidates were promoted, but this occurred only after many of the major policy areas had been decided and (in large part) acted upon.

The FSB leadership in the first four years was drawn from Canada, Italy, Norway, Spain, the UK, and the U.S.. Central bankers and supervisors less supportive of reform (from France, Germany, and Japan, for instance) were excluded from leadership positions in this period. This may be selection bias. Draghi and Carney were pushing difficult reforms resisted by the doves. Neither would put those who did not solidly support the process in charge of the FSB committees overseeing the implementation of those same reforms.

The leadership grouping has considerable discretion to craft the details of the Board's agenda, agreed with the G20, and to determine what is and what is not discussed in committee, to fashion draft texts, and to manage the process of debate and negotiation that results in final reports and texts, which are sent directly to the G20 leadership summits.

The leadership roles are not just titular. One participant observed about the FSB process, 'the senior people do the work and that is what is remarkable about it' (Interview 10, 2011, p. 9). Decision making is also more effective; as another participant notes, 'you have all the principals at the table and so buy-in is much more readily available' (Interview 24, 2012, p. 7). The Board is not driven by anodyne staff position papers generated out of national agencies and committees. The end product of key policies often bears the personal imprint of the principals themselves. This process contrasts sharply with the methods in larger institutions like the IMF. Inside the Board, the chairs of the committees individually drive the process and help shape the policy outcomes.

Does geographic bias matter? Participants stressed that the early dominance by European and North American leaders was due to their institutional and personal intellectual heft, not regional or geographic balance. This rings true. All were and are well-known heavyweights within the small epistemic community. But the leadership imbalance, although justifiable on an expert-to-expert level, is obscured, and the FSB structure and membership of committees are not as a matter of general practice made publicly available. This lack of transparency may be to spare the blushes of the G20 states that do not have key roles and committee

assignments (Wright, 2011). But it could quite easily be the reverse. The early European and Anglo-North American nature of the Board's leadership could have required a lack of transparency 'precisely because the composition is inappropriate' (Interview 11, 2011, p. 24). Certainly the Board leadership's skewed early makeup would have been embarrassing if exposed to the glare of publicity and possible calls for change, regardless of the actual talents of those performing their assigned leadership roles.

4.4.4 Decision making within the Board

Each member of the FSB has a vote, but in practice there is no voting and decisions are taken by consensus, with an implicit understanding of who carries the most weight economically and in terms of the importance of their financial markets. In this manner, the U.S. and Europeans maintain a disproportionate representation and influence on decision making, in addition to their already dominant leadership roles in the forum. Practically all substantive decision making takes place within the Steering Committee, in the standing committees, and in working groups between the meetings of the full plenary (Helleiner; 2010, p. 8; Interviews 7 and 10, 2011; Interview 15, 2012). This is not surprising: A consensus on particular standards should ideally emerge before proceeding to the plenary meeting for formal decisions. Only when matters are especially difficult or important would detailed policy formulation issues be left to be decided in plenary, since doing so signals a failure of the work of the other organs of the Board.

Developing customary practices within the Board provides room for manoeuvre for the FSB chair and his or her senior colleagues, and the absence of a clear definition of how consensus must be reached provides flexibility and facilitates the decision-making process as they seek to secure agreement (IMF, 2010b). For example, when a standing committee chair finds consensus elusive in committee discussions, he or she can decide to fashion a new draft based on further consultations and review. In practice, this means that a chair is at liberty to construct a consensus drawing on various bilateral approaches and building on the positions of key G20 representatives before returning to the committee as a whole (Interview 15, 2012).

As a practical matter, informal subgroups of the key member states operate in the FSB (Interview 34, 2013). This decision-making reality ensures key state representatives retain influence over deliberative outcomes, and this is reinforced when smaller informal subgroupings appear to be deliberating amongst themselves to reach deals. This may be a

negative. In terms of legitimacy, such sidestepping of full committee or Board discussions short circuits the formal structures and systems of deliberation and further concentrates influence. But it is also the case that no consensus is possible without agreement among the representatives from most powerful G20 states. If this requires some additional diplomacy on the sidelines that is the price participants appear willing to accept. These types of negotiating tactics and mechanisms, that is, ad hoc informal bilaterals, are used in the much larger consensus-based World Trade Organization. They are also seen in the informal soundings used within the Executive Board of the IMF. It is therefore not surprising that similar practices are evolving within the FSB as ways to advance decision making in the Board.

4.4.5 The evolving Steering Committee membership

Responses from interviews indicate that the Steering Committee is the key power centre within the FSB (Interviews 7 and 10, 2011; Interview 15, 2012). Its membership was first determined by Chairman Draghi, and until late 2011 it was composed exclusively of key central bank governors and supervisors, the majority of whom came from Europe and North America. In fact, the Board was, at the outset, such a central bank creature that its meetings took place (and still generally do) to coincide with BIS meetings, further evidence of the dominance of a subgroup within the central banking epistemic community on the Board's functioning.

As previously noted, from 2009 until the Cannes Summit in 2011, there were no finance ministry members on the Steering Committee, and thus no explicitly national political voices, a factor that technical expert participants report was central to its early effectiveness (Interview 10, 2011; Interview 15, 2012) as the engine of reform. This technocratic central bank dominance of the Board was in 2011 weakened after the Cannes Summit, with the addition of finance ministry officials from France, the UK, the U.S., and a few other states (Interview 7, 2011; Interviews 13 and 15, 2012).

Finance ministry officials demanded a larger role after G20 leaders signed the Basel III deal in 2010 over which some of them felt they had too little (almost no) input. They belatedly realized the accord's impact on their national banks, and were not amused. A realization of the importance of the new accord caused *ex-post-facto* consternation and led to successful demands for a change in Steering Committee membership (Interview 10, 2011; Interviews 13 and 17, 2012). Ministers felt they left too much to the technocrats and pressed for a larger

role (Interview 13, 2012). A Steering Committee that had been composed purely of technocrats and that was insulated from national political voices was thus forced to change.

Draghi's defence of his technocrat-only Steering Committee may have been affected by the dual role and diplomatic game he played in 2011 as Chair of the Board and then prospective candidate for Presidency of the European Central Bank. That is to say, his need for German and French political support for the latter may have impacted his willingness to admit finance ministry officials to the former (Interview 15, 2011). Even if this was the case, and Draghi would never admit it, demands for inclusion from the ministries was such that it is unlikely Draghi could have resisted. Had he refused, the influence of the FSB would have faced a challenge and a possible downgrading by G20 political leaders.

Looking ahead, finance ministry inclusion within the membership of the Steering Committee is bound to change the tone and form of discussion, from technocratic towards more national political matters and calculations. Finance Ministry officials, even very senior ones, have ultimately considerably less room to deviate from agreed positions than independent central bank governors and principal supervisors, who answer to no one above them. Finance ministers exhibit political and ideological differences and are also subject to electoral pressures. Ministerial motivations and positioning is likely, therefore, to be different (Interview 15, 2012). Moreover, in some G20 states (such as the U.S.), ministries are explicitly prohibited from determining regulatory decisions.

By securing a seat on the Steering Committee, finance ministry leaders have a new avenue through which to influence regulations within their own borders. This potential political influence is viewed with concern by some on the Board (Interview 10, 2011). Others are less worried. They feel that given how important national legislative action is to continued implementation of FSB financial reforms, inclusion of political actors is not wholly negative, because governments and legislatures must be supportive of the FSB policy goals and willing to legislate to assure proper national implementation of G20-FSB reforms (Interviews 13 and 15, 2012).

The gradual enlargement of the Steering Committee is a structural and institutional factor to watch. It may change the nature of decision making, and not necessarily for the better. Of course, it is in the nature of institutional development that there are pressures to grow. Those outside want inside. Once inside, FSB members realise the decision-making centre is within

another body, so they demand to sit on the Steering Committee. In 2013, the Steering Committee includes 39 members from the full membership of the Board (FSB, 2013). This is understandable from an individual perspective, but the desire for inclusion in and expansion of the Steering Committee could have negative operational effects. As one participant noted, ‘You have too big a group. In order to be effective, you have to have a smaller group. You create the smaller group. It’s effective. All the people in the bigger group want to be in the smaller group; now that you’ve moved them into the smaller group, it cannot be effective anymore’ (Interview 15, 2012, p. 8).

As the Steering Committee’s size increases, this may make it more cumbersome operationally. It eventually could push the Chair to take decision making into other informal groupings outside the Steering Committee. If so, this could create a new gap between the leadership decision makers and the rest of the Board. So the Steering Committee’s role risks being adversely impacted by its own success as it expands to accommodate more and more individuals. The reliance on informal subgroups with the membership and organs of the Board to thrash out deals is indicative of the effect of expansion in the key decision-making organs and committees of the board; as the size of the formal committees and organs increase leaders adopt coping strategies that operate outside or parallel to the formal processes. It is probable such informal practices may be used more and more if the size of the Steering Committee is seen as unwieldy.

4.4.6 Legitimacy and the FSB

The initial and continued dominance of the Board by North American and European leaders of the central banking epistemic community who were instrumental in its creation raises concerns of legitimacy. In particular, it shows the G20-led decisions directed via the FSB continues to be a policy process with control by the old core over the new architecture, despite the enlargement of the size of the negotiating table. Compared to the FSF structure, however, the FSB is an improvement in legitimacy and authority.

Legitimacy is certainly necessary for the forum to wield authority among and beyond its membership, which is essential if the FSB is to be an effective central component of the new global architecture. The previous FSF’s membership was far too small to command broad legitimacy, respect, and authority from non-member states, and the system was divided into rule makers and rule takers (Helleiner, Pagliari, Zimmermann, 2009).

Although the FSB remains a relatively exclusive forum, its membership represents 85 percent of global GDP, and the Board includes practically all the major financial market regulators. Rules agreed by the FSB, if applied consistently, now have the practical effect of being global standards. FSB-endorsed standards fashioned by expanded SSBs, under the FSB rubric, also have greater weight because the forum ties all member states and their agency heads into the standard-setting process, and by extension places pressure on all officials involved to adhere to standards they jointly endorse.

The makeup of the leadership of the FSB organs certainly still shows the dominance of the advanced core economies in the FSB despite the inclusion of emerging economy representatives. But this in part reflects the recognition by emerging economy members that those actors have more at stake, that their firms and markets are more developed and interconnected, and that these states should of necessity play a larger role in the Board in repairing the system. The makeup also means that the crisis management and reform phases within the FSB are driven by the Western powers, whose markets and failures caused the crisis, with emerging countries playing a supportive but not especially visible leadership role within the new formal structure.

Critics are right to demand a larger role for emerging states' officials. Otherwise, the FSB will focus on Western rules applied across the globe, without consideration of other models, levels of development, and so forth. Because emerging country leaders are taking a larger role in leadership of the G20 summits, this should also begin to translate into a correspondingly larger role within the FSB. At the least, in 2013, a larger number of senior officials are gradually, on an individual case-by-case basis, being given greater responsibility in the leadership structure and in the design of the rules and regulations of a global economy in which they will play a larger and larger role. Daniel Tarullo, an FSB member, argues that 'a desirable concrete first step is to give emerging economy representatives leadership roles in some of the FSB areas of responsibility' (Bretton Woods Committee, 2010). Tarullo got what he wanted: In 2013, the leadership of the FSB began to shift and includes more emerging market representatives.

Despite their weaknesses in the leadership roster, emerging country representatives are becoming more engaged and assertive, and this trend will likely continue. As that takes place, the Board leadership team could alter its leadership makeup to a degree (Interview 10, 2011).

While leadership makeup matters, it is not the only measure of meaningful change within the FSB.

Since 2009, senior officials from old core and new emerging states have been interacting repeatedly within the forum, in its organs, and through the SSBs (which have been enlarged to mirror the FSB). This broadening and deepening of linkages of the membership is of value in and of itself. One regular participant in the FSB securities-related SSBs states: 'I know many more people in many more markets than I knew just a year ago. I have ... more productive relationships with my peers' (Bussey, 2011). This is a considerable benefit. Buy-in from national principals and their agencies is secured by their being part of the process. These individuals both debate new standards and ultimately must agree to the codes, principles, or binding rules, and proceed with national implementation and monitoring. This coordination process is multifaceted and additive as agencies and SSBs interact between countries and across sectors in a way not seen previously.

Dialogue and the building of networks in non-crisis periods take time to establish. During a crisis, without preexisting networks, officials do not know whom to call, and if they do call, whether they can trust the officials not to disclose sensitive information, on imminent banking failures, for instance. In this important tangible sense, the enlarged FSB and its coordination processes materially deepen and strengthen networks and linkages within the core and between the advanced and emerging economies.

Until the Washington 2008 G20 summit, individual leaders, ministers, agency heads, and senior officials from developed and emerging market economies engaged in international regulatory debate via other forums. But this engagement was sporadic and unsatisfactory. For instance, at the outset of the financial crisis in 2007, as Northern Rock faltered in the UK and non-banks and investment banks in the U.S. shook, communication between core and emerging economy partners (such as China) was suboptimal, to say the least, with essentially no dialogue taking place. The emerging market leaders were on the outside looking in. Such isolation of key officials cannot happen now, because emerging economy central bankers, regulators, and actors are firmly part of the G20 and FSB processes.

4.4.7 Does size matter?

This review of the creation and evolution of the FSB shows progressive membership expansion. But the extent to which this is a real answer to the legitimacy issue remains in doubt. One way to address the current legitimacy gap faced by FSB could be to further enlarge it. Paul Martin, creator of the finance ministry G20 process in the 1990s, suggests opening membership to all 187 members of the IMF and World Bank (Helleiner, 2009a). But this step could negate key reasons for opting for the FSB over the universal IMF: its nimbleness, flexibility, and small size. Indeed, global governance and collective decision making in general often ‘faces a trade-off between efficiency and legitimacy’ (Trichet 2010a, p. 5). If one accepts this, the Board is a considerable improvement and should not be pressed to expand much more. But recent changes indicate that is what we are witnessing. Voices clamouring outside to get in have been partially successful, with the FSB’s agreement on six RCGs. This may go some way to address the complaints of outsiders. It is a small step towards opening a wider constituency. But it could just be window dressing: No one is suggesting the RCGs will have a direct say on FSB agenda items and policy decisions; if this remains the case, then it does not effectively address complaints of illegitimacy.

On balance, it is probable that the 2009 FSB creation and membership enlargement will never assuage those that remain on the outside looking in. States excluded from the process still view with some distrust demands that they apply G20-FSB standards (Interviews 1 and 6, 2011), and as a result, opposition to the process can ‘become politicized quite quickly’ (Helleiner, 2009a, p. 7). However, demands for yet more seats at the table also need to be weighed against a reflection on how the Board functions. If being relatively small and flexible are important goals, then gradual expansion may undermine the key reasons the FSB was selected for the role in the first place: a desire to avoid the bureaucracy of the IMF and the problems universal organizations can present to effective financial policy making. Difficult choices regarding legitimacy will remain, and they are made worse when looked at in tandem with issues of transparency.

4.4.8 Transparency: A real weakness in the new structure

Compared to the IMF and World Bank, the FSB is a black box. The FSB is not a transparent body. There is no requirement for transparency within its charter and practically no role for civil society actors or outsiders. The membership of all the various organs is not made public

as a general rule; who sits on the working groups is not disclosed. The functioning of the Board's plenary, Steering Committee, standing committees, and other bodies is opaque to outsiders. The decision-making processes and resultant policy outcomes are private until they are announced as a *fait accompli*, notwithstanding occasional leaks. Facing this reality, external critics have called for governance and transparency changes, including an open selection process for the Chair of the FSB (Brookings Institution, 2011b).

As of 2013, only one small alteration addressing transparency concerns has taken place. In Los Cabos in 2012, the FSB Charter was changed to include the requirement for a 'structured process for public consultation on policy proposals' (FSB, Art. 3(2), 2012). For the first time, the FSB was required to interact in advance of the policy decisions with interest groups and civil society. This small step forward was designed to address the Board's opacity. But as of July 2013, this has not reportedly led to changes in actual practice. It may be too soon to see changes, however, because a formalized process is not fully in place.

At present, participants within the structure tend to support continued opacity because they believe it is required to get results; keeping the organization relatively small with deliberation and disputes private permits better decision-making outcomes. This may be the case. Certainly, the major G20 states do not wish to have all their disputes aired or see them subject to review by outsiders. It is simpler that way, and less complicated, but legitimacy suffers if policy is made in back rooms (Alston, 1997).

Looking ahead, the continued relative lack of transparency in a body engaged in establishing standards and best practices across national and global financial markets could negatively impact the Board's broader legitimacy with national legislatures and civil society. To suspicious outsiders, this lack of transparency and accountability, this type of elite closed network, can have the smell of 'a vast technocratic conspiracy' (Slaughter, 2001, p. 347).

Opacity may suit the G20 leaders during a crisis, but it may be harder to promulgate effective regulatory standards if the process remains obscure. Policy making may be easier in small private groups but the output can be harder to defend from external critics. It is difficult to build coalitions in support of global standards when the process of arriving at those standards is highly exclusive and not properly understood. An exclusive process controlled by the few, even one, ostensibly engaged in furthering the general public good—supporting systemic financial and economic stability—may be weakened by its own limited nature.

New international forums as they evolve and mature need to secure support from the general populace, and to do this they need to be reasonably transparent and open to public understanding, scrutiny, analysis, critique, and cross-examination. After the initial reformist burst of its creation during the crisis, now four years later, the Board needs to articulate its role and its mission to the wider public, market participants and voters. As the FSB secures a stronger legal institutional foundation with dedicated resources, its leadership needs to become more open and more comprehensible to external observers regarding its membership, procedures, processes, and outcomes.

The FSB publishes its charter and its final policy output. That is about the extent of current transparency, and it is insufficient. It also needs to publish its full membership (including all committees and working groups), and establish general principles and standard approaches to public consultation and interactions with civil society. This much should be demanded by outsiders, whether from the financial sector or civil society, more generally.

It is probable that the FSB's creation by the central banking community is a handicap in this area. This is a community of members and supporters that are used to operating in private and prefer general obscurity, despite their individual and collective power over markets. Central banks tightly limit their transparency and rarely reveal their thinking prior to policy decisions. In this case, the community norm leans hard against openness. But by being a largely closed elite forum and system of decision making, the Board may damage the legitimacy of the process and its output in the medium to long-term. If policy makers do not properly articulate the reasons behind policies, even if they are perhaps rightly thought necessary for future financial stability by those charged with taking action, they will be vulnerable to attack from national and international lobbies that may have little interest in stability and more interest in private profit over public good.

Issues of legitimacy and transparency will continue to arise and remain to be addressed in a manner that partially satisfies critics. The Board leadership is addressing complaints over legitimacy via gradual membership creep. But this expansionary impulse must balance a desire for greater inclusiveness with the need to retain the effectiveness which comes with a smaller size and more flexible mode of operation. On transparency, very small steps are being taken to tackle the forum's relative obscurity, an obscurity which could undermine necessary support from the other stakeholders and actors as well as the public.

4.5 Conclusion

The creation of the FSB is perhaps the singular institutional triumph of the G20-led process. From out of the crisis, a new coordinating body was born, an institution in outline and form which has been strengthened progressively from 2009 through 2013. The process was not solely the masterstroke of the G20 leaders who backed the move. Mario Draghi also played an early instrumental role. Those interviewed for this research are clear about Draghi's centrality to the birth of the FSB. He quickly understood the need to enlarge the FSF (which he chaired). Supported by his own epistemic community of like-minded central bank governors and principal supervisors, he seized the opportunity that the crisis offered to pursue his own (and the community's) reform agenda and to defend their centrality in the reappraisal that began in 2008.

Draghi and his community made a clear power play to defend their position in the reform response. The same bankers who had not seen the dangers of the 'great moderation', those from the core of the advanced economies, grasped control. This cohesive epistemic community was deferred to by G20 leaders as experts and constructed a coordinating mechanism that reflected their goals and their biases. In taking charge, this 'consolidated the position of central banks as leaders of the regulatory agenda as well as the monetary agenda' (Interview 9, 2011, p. 9).

Through the creation of the Financial Stability Board, Draghi pushed aside the IMF and took control of the re-regulatory policy agenda, ensuring this universal institution would be downgraded in the regulatory architectural redesign, to the consternation of those outside the new club. Today, much more power is in the hands of this community and the central banks as a group than previously, a triumph for Draghi and his collaborators who constructed a Board designed to their specifications, that would operate for its first years, from 2009 to 2013, largely beyond effective external scrutiny, led by its Chair who knew what he was aiming for and who could rely on his allies.

The research findings presented here demonstrates the new forum was structured in a way to ensure maximum speed and control by the Chair; Draghi then selected the leaders himself and determined (from 2009 through the end of 2011) who would serve on the Steering Committee. It is no accident that the leading roles were and remain held by those of Draghi's

colleagues (and now Mark Carney's) who are highly supportive of the move to re-regulate, of the macro-prudential policies required facilitate that, and of this paradigm shift that the community adopted as their common project.

The following chapter will demonstrate that, having created the Board to maximise the community's own objectives, Draghi, Carney, Trichet and other leading technocrats rapidly addressed the common agenda and specific goals that they themselves had designed and secured backing for from the G20 in 2008 and 2009. These policies would differ in strength, area to area, but they would collectively add to the solidity and regulatory reality of the paradigm shift in the policy consensus commenced in 2008-2009 and led by the Board and its pivotal community.

The FSB as a coordinating forum is a considerable structural and institutional improvement over its predecessor. Its creation forms part of the concrete re-regulatory paradigm shift seen after the crisis. The Board's increased size and greater structural complexity indicates a rapid crisis-driven jump from a small talking shop into a nascent international institution at the centre of the new architecture of international financial diplomacy.

The crisis response resulted in a technocratic consensus, a new re-regulatory narrative and paradigm shift, and a concomitant burst of institutional creation and policy making followed by more gradual steps. Since its creation in 2009 the structure has been built upon with progressive incremental changes addressing functions, standing and resources. Its creation as the central coordinating body for global financial regulatory reform amounts to a third order change (Hall, 1993). In 2013 the FSB is maturing fast backed by hawks from the western-dominated central banking epistemic community whose members debated its creation, advised the G20 on its structure, and then went on to lead the board from 2009 until the end of 2012.

Chapter 5. The Financial Stability Board and Key Policy Outcomes

'The general contractor of the reform process'.
(Interview 22, 2012, p. 8)

5.1 Introduction

This chapter addresses Financial Stability Board (FSB) policy outcomes. The FSB's success is driven by a particular, stronger, consensual paradigm and narrative and policy consensus agreed after rapid policy convergence (Bennett, 1991) by key state actors, and within a relatively small group of North American and European central banking technocrats leading the reform process who form part of a cohesive epistemic community (Haas, 1992a) and who act as the vanguard of the reform movement (Interview 24, 2012). This elite expert epistemic community championed the creation of the FSB, and this same relatively small group of principals took control of the leadership of the forum from 2009 through the end of 2012, before broadening the leadership roster to more emerging country officials in 2013. During phases one, two, and three of the evolution of the G20, this community moved to implement a complex, multi-tiered, internationally coordinated financial reform agenda that they fashioned or alternatively tasked to other standard-setting bodies (SSBs). These policy outcomes form the concrete realization of the paradigm shift in the policy consensus that the technical community embarked upon in reaction to the financial and economic crisis of 2007-2008.

Policy making and implementation is where the FSB regulatory heft is measured, where G20 political capital matters, and where the existence or not of a common narrative amongst the community of technical actors can have direct impact on the actual policy outcomes. Where reforms are led and emerge out of this elite expert community they are markedly stronger, strengthened by the common policy consensus and convergence within the FSB, backed by the G20, and by the regulatory power of the former in key processes of implementation and oversight. The central banking community's control is behind the FSB's most successful reforms, which show a rejection of the previous laissez-faire neo-liberal financial deregulatory paradigm and the adoption of a new worldview in which financial markets and firms would be internationally and nationally re-regulated, principally by national agencies overseen by the leadership within the small FSB community.

This chapter will demonstrate that in two specific policy areas there has been a third-order (Hall, 1993) change, a paradigm shift in approach by the central banking community. These

areas are (1) the coordinating function of the FSB itself as an institution in the making; and (2) the adoption and implementation of a macro-prudential approach (via the Basel III Accord) to the supervision and oversight of the financial system as a whole and of major banks and systemically important financial institutions, in particular.

In other policy areas, the output will be seen to be more mixed and less substantial because the policy process is impacted by a number of factors. The policy process can be negatively affected by disagreement within the G20 and the FSB membership over the narrative in a policy space, i.e., the lack of a cohesive policy consensus, the inherent complexity of the policy area and a lack of existing control mechanisms over national legislative and regulatory levers, or failure of the FSB to press existing SSBs to depart from historically obstructionist stances in which policy norms clash rather than converge (Interview 10, 2011). The research will suggest that the further the FSB leadership is from actual policy design and regulatory responsibility, the more limited its ability to counteract domestic-policy-driven centrifugal forces propelling the G20-FSB consensus apart, adversely impacting level-one and level-two win sets, particularly in phase three, when tensions and discord and greater divergence amongst state actors, is seen.

On balance, the policy output of the Board will be seen to be effective in a number of reform areas. But the Board's impact is still circumscribed because it is a state-based, consensus-driven beast, reliant on the willingness of participants to agree to a consensual policy narrative, to identify desired policy actions and outcomes, and (importantly) to deliver on implementation and monitoring. Viewed individually, the height and breadth of a particular discreet policy reform act or wave fluctuates from substantial, to moderate, to very minimal. Viewed as a single international project, the FSB epistemic community increased the amplitude of international and national regulation of financial markets and firms. Taken as a whole, the Board's policy actions are indicative of the paradigm shift signalled by the G20 in 2008-2009.

5.1.1 A policy reform matrix

In order to make a spatial judgment of the reforms and to visualise the directional movement in the policy landscape, the chapter includes a heuristic policy reform matrix (Figure 5.1) to capture the major policy actions of the FSB. The matrix contains four quadrants, and each policy reform is located within this topography. Reform measures are categorised as moving

from ‘very weak’ to ‘extremely strong’ on the X axis, and ‘strongly nationally based’ to ‘strongly globally harmonised’ on the Y axis.

The matrix will be used to illustrate the policy movement from 2009 to 2013 of various components of the G20-mandated and FSB-coordinated reform agenda. It is a graphic representation based on judgments as to the directional shift of policy actions seen. As each area is analysed in the chapter, its movement on the matrix will be identified and the degree of shift being seen will be highlighted. Finally at the chapter’s conclusion all policies being discussed will be placed together providing as sense of the total overall directional movement of the policies under consideration.

Policies will be colour coded on the chart as follows:

- ❖ Green - Third order paradigm shifts
- ❖ Orange - Second order shifts
- ❖ Blue - Advisory only
- ❖ Red - No shift or deterioration

The chapter is structured as follows. First, it briefly lays out the FSB’s mandate. Second, the nature of the FSB approach to financial reform is addressed. Third, the chapter reviews and assesses the overall coordination, cooperation, and monitoring role performed by the FSB nexus of international policy coordination. Fourth, the chapter analyses areas of relative success and contrasts those with weaker outcomes where less progress has been evident. Finally, the chapter includes a brief assessment of the early warning and other mechanisms designed to monitor the FSB policy output and improve supervisors’ ability to identify future boom and bust cycles.

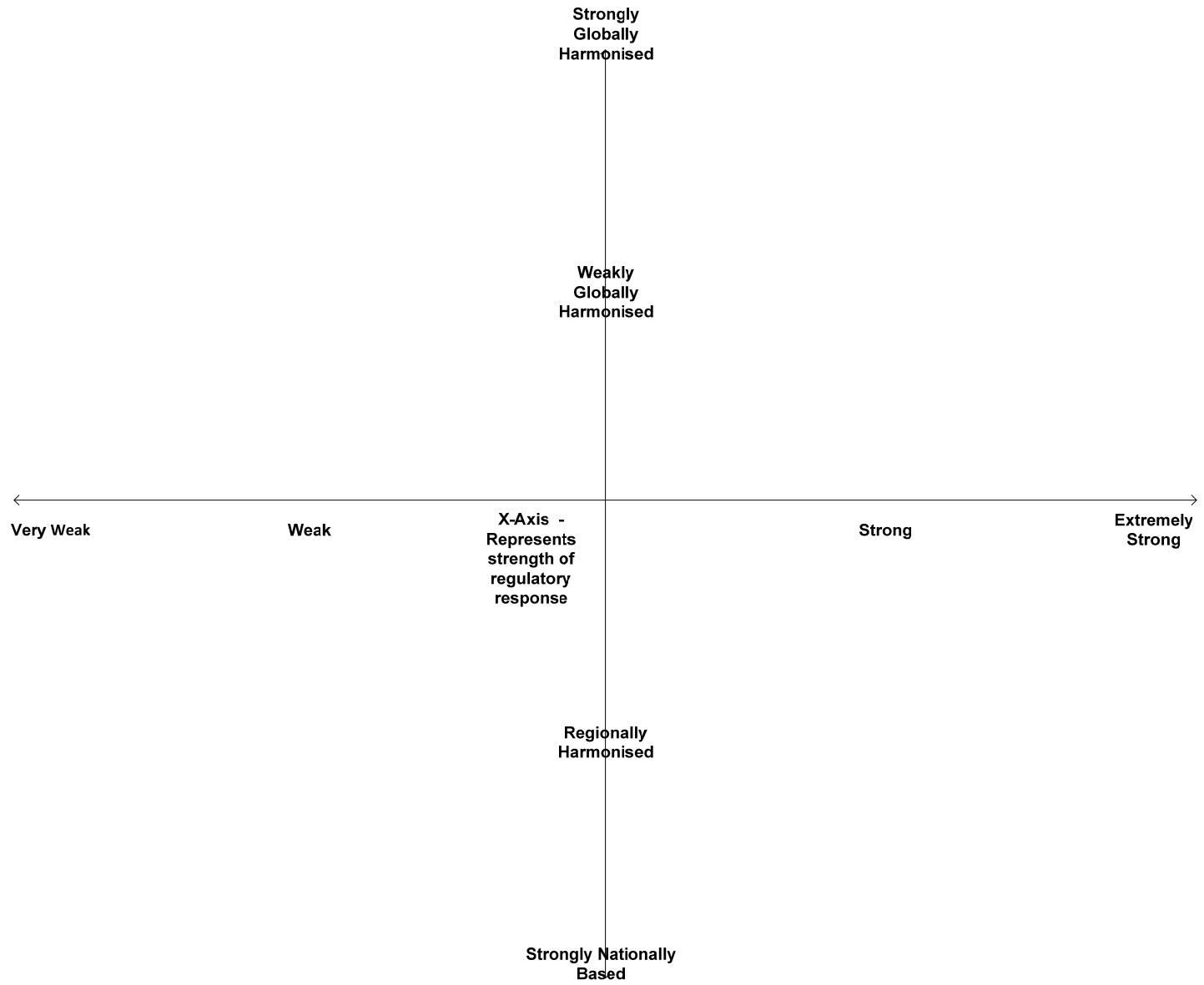


Figure 5.1 Policy Reform Matrix

5.1.2 Defining success

Since this chapter judges the efficacy and success of the FSB policy-making process, it is necessary to define success.

Success is the accomplishment of an aim or purpose. Here, success is defined as the extent to which G20-FSB-directed policies result in stronger globally agreed harmonised results that may increase financial stability and resilience and mitigate future systemic risks to the global economy. In this research, the success or failure of Board policies must be judged on a subjective basis and measured against agreed timelines, the current state of implementation in key countries, and the possible future effectiveness of the reforms as proposed and enacted.

This key issue of compliance will be developed further in the chapter. Ultimately, a determination of success or failure is analytical. It is a judgment based on the actions of key players, their motivations, announced positions, and observed outcomes, and how this affects global regulatory harmonisation and promotes financial stability.

5.2. The FSB mandate

The FSB's mandate contains a series of broad objectives, which fall into three categories.

1. Coordination and information exchange: The FSB is charged with overseeing the collaborative work of national financial authorities and international SSBs with the goal of aiding in the development, promotion, and implementation of effective regulatory, supervisory, and other financial sector policies and best practices. This coordination and cooperation role is a central part of the Board's mission as facilitator of the policy process (FSB, 2012: Art 2(1) b, d, and e; Art 2(2).).
2. Macro-prudential policy tools and mechanisms: A large part of what the FSB is tasked with relates to the monitoring and design of policy to enhance financial stability and resilience and mitigate future systemic risks to the global economy arising from markets and firms (FSB, 2012; Art 2(1) a and b).
3. Early warning, mutual assessment programs, and peer review mechanisms designed to identify, anticipate, and address future systemic risks: The FSB is required to 'assess vulnerabilities affecting the global financial system' and to recommend regulatory, supervisory, and related actions needed to address systemic risks (FSB, 2012; Art 2(1)

a). The Board is also required to support contingency planning for cross-border crisis management and resolution, particularly with respect to systemically important firms (FSB, 2012; Art. 2(1) c, f, g, and h).

Mandate changes: The Charter allows the FSB to make additional recommendations to its members on policy issues and leaves open the possibility of a more expanded mandate. Thus, Article 2(i) empowers the FSB to ‘undertake any other tasks agreed by its members in the course of its activities and within the framework of the Charter’ (FSB, 2012, Art. 2j). This is open-ended and somewhat weak in formulation. It does not, for example, empower the FSB secretariat to determine new tasks and areas of focus; consensus amongst all members will be required to create further areas of responsibility.

5.2.1 Compliance

The FSB Charter is strikingly silent on the enforcement of agreed common standards. It instead must ‘promote members’ jurisdictions’ implementation of agreed commitments, standards and policy recommendations through monitoring, peer review and disclosure’ (FSB, 2012; Art. 2.(i)). However, in practice, the charter’s apparent weakness does not completely bleed through into a weak and worthless approach by those actually charged with overseeing the monitoring and compliance process. To the contrary, one of the more influential FSB Standing Committees handles policy implementation and monitoring (Interview 22, 2012; see also Bluestein, 2012).

The form of the compliance mechanism used in each case is impacted by the strength of the community leading and controlling the process and the degree of agreement on the policy goal; it is not solely determined by the weakness of the Charter itself. There are instances where compliance and monitoring is relatively robust, and also examples where monitoring is less impressive and derivative of past practice. Looking just at the FSB Charter gives an incomplete picture of compliance and monitoring; some FSB-led practices appear to send a different, more subtly substantive message.

5.3 The FSB approach to international financial regulation

The Board, as the G20’s financial reform coordinator and facilitator, collectively strives to secure the goals agreed by the G20 leadership. To understand the policies proposed, agreed, and implemented, it is useful to briefly consider the nature of the regulatory approaches used since their form, content, and structure can impact effectiveness (Raustiala, 2005; Victor,

1997). At one end of the legal spectrum are binding legal treaties between sovereign states that result in specific obligations for each state signatory party. Examples of this type of agreement include the Montreal Protocol, the Kyoto Agreement, and the World Trade Organization agreement. In such cases, states bind one another via legally enforceable treaties, with the state leaders signing and committing their governments to specific obligations they contain. These documents are recognised as international law. The agreements are viewed as contracts (Raustiala, 2005) between state parties.

Non-state parties (such as the FSB or SSBs) cannot commit their governments to contractual agreements; they have no standing to do so. None of the policy output produced by the FSB on behalf of the G20 has the direct force of international law. The FSB operates by securing agreements based on pledges from participants. The pledges are not binding as treaties. Pledges are the default mechanism of international agreements across the globe, from regulatory agreements to human rights accords (Brilmayer, 2006).

Pledges are ‘most common in areas of technocratic cooperation’ (Raustiala 2005, p. 600). The substance addressed by agreements composed of pledges can vary from deep to shallow. But, overall, agreements composed of pledges tend to have greater depth and complexity than binding treaties that are limited and declaratory in nature (Brilmayer, 2006; Raustiala, 2005; Victor, 1997). When faced with uncertainty, state negotiators create more win sets and greater depth (i.e., content) by committing to non-binding pledges. Not all pledges are deep in content or successful in their goals. The Copenhagen Accord on climate change is an example of weakness and is a pledge-based agreement (Rogelj *et al.*, 2010).

The pledge-based approach seen in the FSB process shows sub-state actors lacking the formal creating agreements, grappling with complex policy issues backed by a fluctuating policy consensus while understanding the need for broad-based internationally coordinated nationally implemented accords. Not all FSB pledge-based agreements are similarly successful.

The FSB community, where they control the levers of policy making and implementation, and when this is underpinned by a particularly strong internal policy consensus and narrative, can secure qualitatively more robust, stronger agreements with greater impact internationally and nationally. Such agreements are not directly legally binding. But they can usefully be described as ‘rules’ to which all participating states and sub-state actors commit. Such rules-

based accords can have a major impact on international markets and actors. They are the product of the FSB acting as the key transgovernmental network of experts and other SSB networks acting on the FSB's behalf. These rules constitute the output of this latest 'next generation of international institutions' and transnational bodies (Slaughter, 1997, p. 196).

Within the FSB context, a more robust rules-based approach is the exception, not the norm, and requires a strong consensual narrative and community viewpoint. Where the policy consensus is less robust, when the FSB does not control implementation, or where national level-two processes and legislative negotiations impact negotiations, the output may instead utilise principles (sometimes also called best practices, standards, or attributes).

A principles-based approach is one in which the policy makers identify high-level principles or best practices and refrain from prescriptive rules. Despite the apparent weakness, this approach can be the best alternative option policy makers have in certain cases. Principles-based approaches allow reforms to be identified, agreed, and pursued within divergent national legal and cultural settings (Griffith-Jones, Helleiner, and Woods, N. (eds.), 2010, 2010; Raustiala, 2005). This approach avoids trying to determine detailed rules *ex ante*, permitting further negotiation and trial and error in implementation (Raustiala and Victor, 2004). National agencies and banks can determine how to achieve the goals set. These accords must rest on trust if they are to be effective (Black, 2008), and on a perception by state signatories that some reputational damage may occur if they fail to comply (Downs and Jones, 2002).

In analyzing the FSB policy output, the research identifies tension between a rules versus a principles approach in many areas of FSB work. The particular regulatory form chosen depends on the extent to which the common anomalies are recognised. It depends on the strength of the epistemic communities involved. It also depends on the degree to which a community or clashing communities defend or shift the policy consensus, assuming there is a consensus. These different approaches to agreements and accords are reflected in the positioning of the policies on the matrix. Where rules are enhanced, clear, and being applied in most G20 countries, the policy at issue will be seen to move diagonally and upwards left to right across the matrix, i.e., becoming stronger and more globally harmonised and consistent. Where policy areas are left with nonbinding principles, patchy application, and weak monitoring, the policy will move a smaller distance (if at all) within the matrix.

5.4 Coordination and information exchange

The FSB is tasked with coordinating and improving the information exchange and dialogue among SSBs, member finance ministry officials, central bankers, supervisors, and IMF officials, on the issue areas identified by the G20. The FSB plays the key role in facilitating, monitoring, and reporting on all work streams resulting from the G20 process. The FSB leadership does not in all cases produce the regulatory recommendations themselves. Other SSB representatives also produce deliverables under the aegis of the FSB, its standing committees, and working groups. The FSB leadership then monitors progress, reports on outcomes upwards to the G20, agrees next steps, and provides a venue for discussion of the continuing work streams.

The FSB has a multitier upward reporting and monitoring superstructure. This is new and significant because it puts pressure on SSBs and national regulators to act to complete the G20 tasks assigned to them and to monitor adherence to agreed standards and report this to the Board's leadership and G20 summits. In return, SSBs get an elevated status, as scores of senior regulators drawn in participate in the policy process internationally. The SSBs and their national officials play a bigger role in the policy process and are more closely connected to decision-making processes than previously, and this is gradually binding together disparate actors, pressing for uniformity and accountability in application of agreed standards, best practices, principles, or rules by members. This is an exercise in considerably enhanced peer pressure, via policy dialogue and reporting systems (FSB, 2010c, 2010d), rather than compliance mechanisms.

5.4.1 Stronger lines of communication and control

Participants see the level of upward reporting through the FSB structure as an innovation and stronger than the previous processes with multiple layers (Interview 7, 2011). In the structure, policy development can, for example, proceed as follows.

Output from an SSB (responding to the G20-FSB direction) is passed to FSB Standing Committees or Working Groups (policy review and monitoring). This then goes to the Steering Committee (providing direction), and onwards to the FSB Plenary. This process is overseen and managed by the FSB Chair. Periodic reports are finally sent up to the G20 leaders summits, which can supply political pressure, when needed. Thus, there is policy

development, monitoring, and reporting pressure on SSBs and national agencies from multiple FSB actors, and monitoring and pressure from the G20 and FSB leadership through the structure and policy process.

In contrast, the prior structure was truncated, weaker, and less effective. Each SSB operated independently. They were linked to other SSBs via the Joint Forum, but this was a body with a weak mandate and no power or authority. SSBs did not feel pressure in this structure, and they did not report via a direct chain to a body composed of principals and on to a broader grouping of national political leaders at summits. Pre-crisis, SSBs had fewer clearly coordinated policy goals and timelines, and were under relatively little political or institutional pressure to deliver.

This contrast indicates the new structure is qualitatively stronger and can exert more coordinating pressure, and direction on the collective FSB-SSB output. This view is supported by principals engaged in the new structure who see the FSB direction and coordinating process as a significant innovation and an increase in intensity of the dialogue. A senior U.S. participant observed the forum has been, ‘invaluable in coordinating and urging SSBs to move forward with their work’ (Bretton Woods Committee, 2010). An EU Commissioner and participant applauds the G20-FSB process for facilitating a ‘constant dialogue at the technical level’ (Barnier, 2011). Former European Central Bank President Trichet stressed that the process ensures, ‘an unprecedented degree of international cooperation in regulatory matters’ (Trichet, 2010a, p. 5). Another observer finds that the FSB leadership corralled together diverse constituencies and delivered a sense of shared purpose (Interview 28, 2012).

Through the FSB, the G20 gets closer to achieving an enhanced, institutionalised, regularised system of international coordination and cooperation on financial regulation amongst a much larger grouping of regulators than hitherto existed, building on existing networks, structures, and SSB processes; the structure and operation of the forum and the coordination mechanisms essential to the reform project.

In 2013, the FSB is acting as the general contractor of financial reform (Interview 22, 2012) for the G20. It is fostering closer state-to-state international cooperation and coordination than existed in the past. It dominates the SSBs it oversees, interlinks, and directs these forums and includes them within the state-driven re-regulatory process. The intensity of the dialogue,

the number of actors involved, and the multifaceted nature of the discussions are quantitatively greater and qualitatively better. The breadth and depth of the work streams handled by the Board's organs from 2009 onwards have been considerable. Led by Mario Draghi, (and since 2012 Mark Carney), the Board grasped the opportunity to closely coordinate the G20 financial reform agenda in 2009, and it has yet to let go.

Providing a regular venue for these discussions is not a minor matter and helps improve post-crisis information coordination and exchange among officials. The process and the constant engagement reinforce the transgovernmental policy networks and linkages between G20-FSB states and amongst senior SSB national agency officials. This has tangible and intangible benefits. Although the SSBs remain independent, their current workload, and enhanced relevance are the result of their being brought within this FSB chain of communication and collaboration below the G20. In 2013, SSBs are under pressure and, according to participants, they have been 'raising their games' (Interview 22, 2012, p. 15) and are being forced to more effectively collaborate (Interviews 15 and 22, 2012).

As the forum at the centre of the re-regulatory reform drive, the Board is today highly influential as a venue, not as much as an institution; it is not yet quite that strong. But as the locus for interstate regulatory diplomacy, one within which North American and European central bankers and supervisors dominate, it is performing the coordinating role more effectively than previous mechanisms and forums.

Placement in the policy reform matrix: This facet of the FSB's role is a process, not a policy, but due to its importance it appears in the matrix as an outcome. 'FSB Policy Coordination' moves from 'very weak' and 'regionally harmonised' (under the smaller exclusionary, ineffective FSF structure) to 'weak-to-strong' and to above 'weakly globally harmonised.' So the coordination function moves diagonally upwards from the bottom left quadrant towards the middle of the top left quadrant, a significant improvement over previous coordinating mechanisms. On balance, this movement may actually understate the nature of the forum's coordination role. Without the high-level coordinating role which the FSB provides, the reform process as a whole would be handicapped and harder to achieve. It constitutes a third order change.



Figure 5.2 Movement of FSB Policy Coordination on the Policy Matrix

5.5 A significant macro-prudential policy shift

In London, in April 2009, the G20 leaders called on the FSB, the Basel Committee on Banking Supervision (BCBS), and other SSBs to ‘reshape our regulatory systems so that our authorities are able to identify and take account of macro-prudential risks.’ (G20, 2009a, p. 4) At the Pittsburgh Summit later that year, the leaders added that macro-prudential policy must ‘help prevent credit and asset price cycles from becoming forces of destabilization’ and that, moreover, there must be ‘an adequate balance between macro-prudential and micro-prudential regulation to control risks, and to develop the tools necessary to monitor and assess the build-up of macro-prudential risks in the financial system.’ (G20, 2009d)

Prior to the financial crisis of 2007-2008, the term ‘macro-prudential’ was largely absent from central banking literature in Europe and North America. Since then, the concept has become a buzzword, signalling a new policy approach to financial stability and global markets. Macro-prudential policy ‘Seeks to develop, oversee, and deliver appropriate policy response to the financial system as a whole rather than focusing on individual institutions or certain economic measures in isolation. Macro-prudential policy aims to enhance the resilience of the financial system and to dampen systemic risks that spread through the financial system.’ (G30, 2010, p. 13)

This concept represents a paradigm shift in the Western central banking supervisory approach, from one predominantly focused on the stability of *individual* institutions (so-called microprudential oversight) towards a focus on the stability of the financial system *as a whole*. Until the crisis in 2007-2008, there was ideological resistance amongst central banks and supervisors from advanced western economies to view the financial system as increasingly interconnected and vulnerable to asset booms and busts, and to contagion effects that could amplify individual firm-level decisions into damaging systemic events. A wilful blindness existed despite strong historical evidence that banking crises had become progressively more frequent and severe (Allen and Gale, 2007; King, 2011a), the result of the deregulatory mindset and worldview that coalesced after the collapse of the Bretton Woods system in 1971 (Helleiner, 2010). If and when actual busts occurred, then and only then might actions be taken at the margins to halt a resulting recession.

Alan Greenspan, a disciple of Ayn Rand, author of *Atlas Shrugged*, a controversial economic libertarian work of fiction (see Gold, 2010), and past Chairman of the U.S. Federal Reserve System, infamously repeatedly refused to intervene during the upswing of the credit boom

cycles. Unlike other U.S. Federal Reserve Chairmen of the past, such as William Mcchesney Martin or Paul A. Volcker, Greenspan refused to ‘take the punchbowl away just as the party gets going’ (Manikew, 2007). Instead Greenspan, and his replacement, Ben Bernanke, opted to clean up after the party was over and everyone awoke suffering from terrible global hangovers.

Post-crisis, central bankers relatively swiftly adopted a new, largely uncontested, worldview and narrative centred on backing a macro-prudential approach, which views asymmetric supervisory and monetary policy as exacerbating booms and busts, and as excessively procyclical. Post-crisis, a plurality in the community subscribed to the belief that central banks should have a new job—i.e., restraining inflation *and* helping ensure financial stability by smoothing out destructive extremes of asset price booms and busts (Cooper, 2008; Prasad, 2011). Participants such as Blanchard, Smaghi, and Constancio recall this as an important shift in the consensus (Blanchard *et al.*, 2012; Constancio, 2010).

Building on this narrative consensus, the FSB and the BCBS sought to design and agree macro-prudential tools which would be applied consistently throughout the economic cycle (such as higher capital, liquidity, and leverage standards), and variable tools that could be triggered during the cycle as asset bubbles begin to develop (such as countercyclical buffers), a demand made by one of the most ardent critics of the pre-crisis excesses (Rajan, 2010, pp. 161-162). In recognizing and constructing policies meant to deal with booms, busts, major market failures, and potential future systemic risks and excesses, the central banking community was *ipso facto* rejecting the prior laissez-faire neo-liberal deregulatory worldview. The policy is the reverse of a hands-off deregulatory norm: It is a multifaceted re-regulatory stance and series of policy solutions.

The recognition of the importance of systemic macro-prudential oversight may have been new in London and Washington, but it was old news in Asia. Asian states had been using these tools since the crisis in the 1990s (Borio, 2006; Kawai, 2011; Shirakawa, 2012). But in the West, macro-prudential policy remained, at this stage, ‘a theory yet to be proven in practice’ (Bretton Woods Committee, 2010). The Basel III Accord is the product of this shift in the West. It is arguably the most important financial regulatory reform in the post-crisis period produced by the G20-FSB process and is of a third order in magnitude. The accord is the strongest policy expression of the new re-regulatory paradigm, one in which financial markets and systemically important firms (especially large banks) are constrained by tougher rules and limits on risk taking.

5.5.1 *Basel III - the high point of the regulatory reform wave*

The central banking and supervisory community, led by the FSB, came out of the crisis with a consensus that higher capital of a more liquid and tangible form was essential. The crisis showed previously permitted functional capital levels were woefully inadequate (at approximately 1 percent) and totally insufficient given the maturity transformational nature of banking. A new Basel accord was needed. It would prove to be the most important piece of financial regulatory reform post-crisis. Commenced at the behest of the G20 leadership in April 2009, negotiations were completed and a deal agreed by the Seoul Summit in November 2010. In contrast, Basel II took 15 years to complete and was never implemented by all signatory states (the U.S. never fully implemented it).

The crisis response was driven by the FSB leadership. The key community leaders also met and debated the new standards within the Group of Governors and Heads of Supervision (GHOS) (Bair, 2012; Interview 7, 2011; Interview 24, 2012). The central bank and supervisor principals in the FSB galvanised the BCBS, which was composed of the FSB leaders' deputies, who were under clear direction and pressure from their own institution's principals, most of whom were in relative accord on the necessity of this paradigm shift on capital and supervision, but argued over the magnitude of the shift.

5.5.2 *Capital: How much is enough?*

Because there was little internal debate within the central banking FSB and BCBS membership over the need for increased capital minimums, due to the common agreed policy narrative which saw a lack of capital as a root cause of the crisis, the reform debate in 2009-2010 centred instead on metrics, on the level and type of capital required, and the length of the phase-in period, not on whether higher capital was required. The Basel III Accord resulted from intensive FSB-BCBS negotiations and pitted those arguing for a tough approach (higher capital, tougher definitions, and a short phase-in) against those in favour of a weaker response (lower base capital levels and a long phase-in). The battle is one of hawks versus doves (Interviews 5 and 7, 2011).

Negotiations and discussions took place in the FSB, in the GHOS, in BCBS formal processes, and in informal discussions at the margins of Bank for International Settlements (BIS) meetings in 2009 and 2010 (Interview 7, 2011). Just as the conceptualization of the FSB occurred in informal and formal meetings, so too, agreement on the Basel accord was facilitated by a series of informal gatherings supporting the formal process.

On one side of the debate were the hawks, including central bankers from Switzerland, the UK, Spain, the U.S., and emerging markets. Philipp Hildebrand, then Chairman of the Swiss National Bank, pushed for high base capital levels (Interview 7, 2011). UK regulators, including Adair Turner, Paul Tucker, and Mervyn King, were also unambiguous in their support of higher capital standards. Spanish central bankers, who already applied relatively strict prudential oversight and banking regulations domestically on big banks, also pressed for a strong accord, joined by Jaime Caruana, General Manager of the BIS. Canada's Mark Carney was also supportive of tough core standards (Interview 19, 2012).

Within the U.S., the view was more complicated. Leaders in the U.S. Treasury, the Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC) all strongly supported higher capital standards (Bair, 2011, pp. 257-64; Geithner, 2011; Tarullo, 2011b, pp. 2-3). But the principal bank regulator, the Office of the Comptroller of the Currency, which was led by a Republican (Walsh, 2011), sided with banks and resisted higher standards. Congress, meanwhile, switched from pro-reform under the Democrats to hostile to regulation under the Republicans in 2010.

On the other side of the debate were the doves, arguing for a weaker accord, including German, French, and Japanese central bankers and supervisors (Bair, 2012, p. 260). Each country had its own reasons. German supervisors worried that too strict a Basel III deal on capital could adversely impact their Landesbanks and other German financial institutions that could need major capital infusions to comply with a new accord. French regulators, meanwhile, viewed the financial crisis as an America disease transmitted nefariously to Europe, and feared the impact on their large universal banks. They therefore argued in favour of lower capital minimums. Both countries' banks were in a weak capital condition post-crisis and were heavily exposed to the Eurozone sovereign debt crisis that erupted in 2011. Japan, although its banks weathered the storm well, sided with the doves.

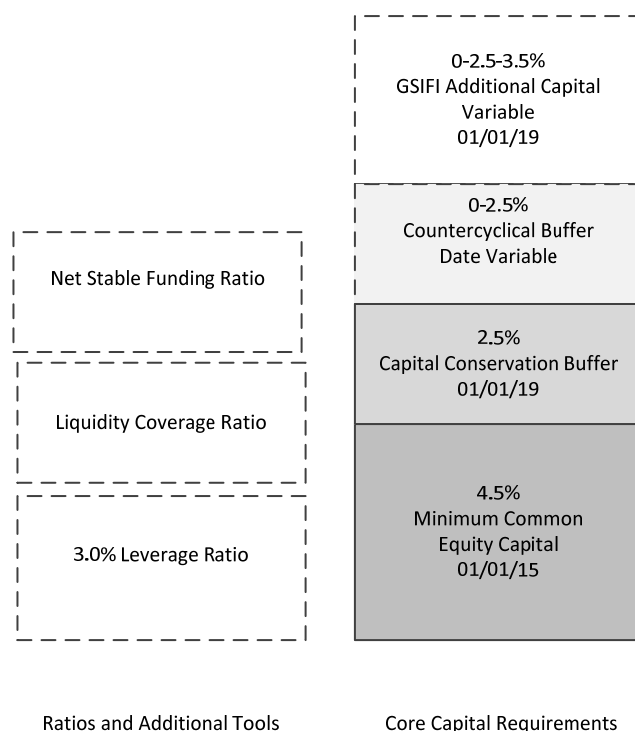
Importantly, emerging market voices were strongly in favour of higher capital. European and North American hawks were backed by tough stances from Singapore, Hong Kong, China, and India (Interview 7, 2011; Bair, 2012, p. 263). Emerging-country FSB members were in agreement with the general aims of the Basel III Accord. In fact, Asian states had been implementing similar policies for years (G30, 2010); China and key Asia G20 emerging countries viewed the new accord as a move towards, not away from, their own policy proscriptions (and national regulatory approaches) of tighter state control over the financial sector. They were content to go along with standards lower than their own domestic position.

In this manner, the new Western paradigm and consensus moved towards the emerging countries' position on capital and liquidity.

The end result was a multifaceted accord with a significant increase in minimum (risk-weighted) capital levels coupled to a long phase-in period. It was a compromise which gave something to both sides. Influential and persuasive roles were played by Mario Draghi as Chair of the FSB, and Jean-Claude Trichet, President of the European Central Bank, who helped bridge the gap between the hawks and the doves, pushing the latter towards a deal (Interview 15, 2012). The agreement finally unveiled was, according to Geithner, 'critical to making the financial system more stable and more resilient' (Geithner, 2011, p. 4). Trichet called it 'a cornerstone of the new regulatory system' (Trichet, 2010b, p. 3). Caruana lauded its 'fundamental strengthening – in some cases, a radical overhaul – of global capital standards ... [which] deliver on the core of the global financial reform agenda' (Caruana, 2010, p. 6). The Basel III components are as follows and are summarized in Chart 5.2:

- ❖ A qualitatively strengthened definition of risk-based capital and an increase in the minimum level of core equity capital from 2 percent to 4.5 percent.
- ❖ A conservation buffer, to absorb losses in periods of stress, of 2.5 percent of risk-based capital, for a total minimum of 7 percent.
- ❖ The adoption of a countercyclical buffer of zero to 2.5 percent, to be increased when an economy is booming and drawn down when an economy contracts (based on the Spanish model).
- ❖ A capital surcharge (of zero to 2.5 percent) levied against the world's largest banks (so-called global systemically important financial institutions [GSIFIs]), depending on size, risk, interconnectedness, and other factors which raise these institution's riskiness to the system as a whole. The capital used would be common equity capital (BIS, 2011), a victory for those seeking real equity rather than other less liquid forms of contingent capital.
- ❖ A leverage ratio of 3 percent to capture risk behaviour and to monitor and limit it. Constraining leverage is key. As Turner observes: 'There is simply no good theoretical argument or empirical evidence that we need to run banking systems with anything like as highly leverage as over recent decades' (Turner, 2011 p. 6). A leverage ratio seeks to address this.
- ❖ A liquidity coverage ratio, to address the need for highly liquid assets in times of credit shortage.

- ❖ A net stable funding ratio to provide further strength to the institutions when they face stress.



Source: BIS

Note: GSIFI = global systemically important financial institutions.

Figure 5.3 Basel III Components

The Basel III Accord resulted in increases in capital over the previous regime—up to a 7 percent base (a 4.5 percent common equity and a 2.5 percent capital conservation buffer) from a 1 percent functional level pre-crisis (Carney, 2011; Caruana, 2010). It was hoped that this sevenfold increase in base capital would strengthen firms and reduce risk taking, and thus also reduce the severity of boom and bust cycles in the future.

The accord included further capital requirements such as the countercyclical buffer, to be built up during periods of excess credit growth associated with increases in system-wide risk and drawn down in periods of stress. It includes a ‘GSIFI surcharge’, which was very contentious (Interview 7, 2011), requiring the largest firms to hold more core equity capital, up to 2.5 percent extra normally, with an additional 1.0 percent for firms that grow excessively large despite supervisory warnings. International banks fought hard against the

GSIFI surcharge, but failed to halt the drive for higher capital for the largest firms. Total risk-based and common equity capital will amount to more than 10.5 percent by January 1, 2019.

Taken together, the provisions are a declaration by regulators that the very largest financial interconnected and complex institutions pose inherently more systemic risk to the global economy (Drehmann and Tarashev, 2011; Haldane, 2010a; Haldane and May, 2011). This view amongst politicians and regulators has solidified since 2010 (Bair, Brown and Huntsman, 2012; Federal Reserve Bank of Dallas, 2012; Haldane, 2012b).

Other mechanisms to provide further stability and resilience against firm-level risk-taking behaviour include a leverage ratio, a liquidity coverage ratio, and a net stable funding ratio. These tools are designed to complement the effect of higher capital. Limits on leverage will add a brake on risk taking. Liquidity and funding ratios are designed to ensure that when a credit crunch occurs, banks have resources available to continue to operate and fund themselves (they did not possess sufficient liquid assets in 2007-2008). When and if these firms take excessive risk, the new tools and mechanisms should aid in raising supervisory red flags in advance of systemic problems.

5.5.3 A paradigm shift takes shape

The Basel III Accord's provisions are concrete evidence of the qualitative (type of capital) and quantitative (an order of magnitude of capital) shift in the re-regulatory paradigm led by the hawks in the FSB leadership. The deal is not, according to backers of the accord, tinkering at the margins. It is imposition of collective and national supervisory authority over global banks by a central banking epistemic community led by principals in the FSB. The accord marks the reassertion of state power over regulation of global financial markets and firms. It shows a rejection by FSB technocrats of the extremes of laissez faire neo-liberalism. For regulators, it signals the end of the deregulatory and self-regulatory era that started in the 1980s and gathered pace in the 1990s. For the G20, but especially for the FSB and BCBS, the accord is the apogee of the reformist wave and paradigm shift. It is a focussed regulatory shift. It does not extend to macroeconomic matters and does not imply a wholesale rejection of neo-liberal economics.

The accord, and its implementation were possible because the central banking community showed a common understanding of the failings and anomalies in the previous worldview. As the pivotal expert epistemic community, they agreed a new common macro-prudential policy consensus. Based on this shift, the Basel accord was agreed. The combination of recognised

anomalies, a strong epistemic community, and a shift in the policy consensus permits this third-order policy shift (Hall, 1993), as per Figure 2.1, Chapter, 2, p. 33. The expert-fashioned accord was deferred to by the G20 leadership, which signed off on the accord over which they had essentially no input, angering some of their finance ministries (Interview 10, 2011; Interview 17, 2012).

The negotiation required elite policy convergence (Bennett, 1991), followed by coordinated top-down policy diffusion (Levi-Faur, 2005) via the FSB mechanisms to implement its provisions. The policy making was led by the officials from Europe and North America supported by leading emerging countries' representatives. The accord and its implementation mechanisms are potentially stronger and more robust because the policy actors are independent regulators. During phases one and two of the G20's evolution as they designed the policy, level-one win sets existed between national negotiators (on capital, leverage, and liquidity); these were exploited in 2009-2010 without reference to level-two domestic lobbies; the firms are excluded from the process by the FSB negotiators acting as the leading distinct transnational network and expert technical community in the process.

5.5.4 Pledges with international reach

The central bank epistemic community, through the Basel III Accord, committed to an agreement whose form and structure is a relatively robust pledge-based agreement, one that was then backed by the G20 leaders at Seoul. It is not a treaty or contract resulting in binding state-to-state obligations. It is a pledge-based agreement and its depth, breadth, and complexity are clearly visible. Nonetheless, the accord has some of the effects of a binding text, albeit one ultimately enforced state by state. Critics of 'soft law' suggest that because this type of agreement does not result in legally enforceable contracts, their effect on states is less valuable (Raustiala, 2005, p. 581). This is not entirely convincing. Sub-state actors would not engage in the detailed complex negotiations if they did not result in what the actors and their community view as important multilateral obligations which will be nationally enforced state by state. Hence, the heated arguments over implementation, and the raised voices when one or another state is alleged to be failing in its obligations.

Markets and investors clearly believed the signals the Basel III Accord pledges sent. They did not wait for legal certainty and full implementation before reacting to the accord. Banks that are failing to reach the accord's capital standards even years in advance of formal deadlines are being hit hard negatively by investors. Gradually, a hard law effect, via national domestic rules and regulations, will occur in many states, but there is naturally a delay between when

an international accord and its pledges are inked and when these turn into hard law enforced by each state's regulators. In summary, Basel III showed the negotiators trying to construct the strongest agreement possible given their limitations as sub-state actors, drawing on their community worldview and narrative, their strength as the dominant transnational expert network and epistemic community in global finance, and their roles as independent national regulators.

5.5.5 Taxation not prohibition

Basel III opted for taxation instead of prohibition (Haldane, 2010c). The accord is highly complex, and this raised concerns over implementation, gaming, and arbitrage opportunities (Haldane, 2012b). The accord's provisions operate as taxes on banks' future behaviour. But taxes can only achieve their goal if the rules are clear and they are applied with vigour. As Haldane states, 'keep it simple. Complex control of a complex system is a recipe for confusion at best and catastrophe at worst' (Haldane, 2010a, p. 13). The complexity of the markets, of the multinational banks and their businesses, and of the country-to-country application of the Basel III standards, may allow firms to work around them to minimise the impact of these new rules or engage in regulatory arbitrage.

Basel III's designers decided against prohibition of systemically risky behaviours, an approach which would set out clearer lines of what can and cannot be done by major banks and financial firms. Because of the problem of arbitrage (i.e., tax avoidance) discussed above, clear prohibitions can work better. The U.S. Glass-Steagall Act, drafted after the Great Crash of 1929, set the rules which contributed to decades during which there were many fewer systemic banking crises in the U.S. because major commercial banks were prohibited from the investment banking and securities businesses, and capital mobility was also restricted (Haldane, 2010b; Perino, 2010). Properly designed, applied, and supervised prohibitions are relatively easy to enforce; well understood by both sides; and less prone to avoidance, arbitrage, or manipulation by the regulated.

Although Basel III is a major innovation and large in scope and impact, by opting for taxation and against prohibition, negotiators risk players gaming the system and engaging in arbitrage in the future. According to critics, the level of taxation was too low and based on risk-adjusted capital (Admati and Hellwig, 2013), a factor which may have pressed many policy makers to reach for Basel-plus national regimes.

The decision to select taxation and not prohibition shows the outer edge of the paradigm shift and the limitations of the policy consensus within which the FSB community and its leaders operate. The FSB community did not consider more radical and simpler structural reform solutions offered by heretics from within their own ranks. Alternative narratives and solutions were never really considered, showing what is kept off the agenda, i.e., nondecisions (Bachrach and Baratz, 1963; Strange, 1986), are important because options are thus limited and solutions circumscribed, influencing outcomes to what is socially possible and acceptable (Lukes, 1974).

More ambitious structural reforms were not seriously considered or allowed onto the G20-FSB agenda. Thus, a narrow banking structure was out of the question (Kay, 2009; Kotlikoff, 2010). A utility banking structure was never seriously entertained (King, 2009b). A Tobin tax, i.e. a tax on every financial transaction (Clark, 2011; Turner, 2009a), which could reduce risk in complex trades and markets, was rejected because the U.S. would never agree to such a tax (a tax of this type was passed into law by the Eurozone states acting as group in 2012). Other even more radical solutions, such as a switch from process- to performance-based regulation, was also off the table (Blanchard *et al.*, 2012).

Notwithstanding the above, Basel III is still a paradigm shift in macro-prudential supervision of major banks. Viewed in the G20 political context, a policy shift is of necessity limited by the strength of policy consensus and of the community behind it. The policy outcome cannot exceed the new consensus. Once the accord is in place and the long phase-in is agreed, the central banking community then changes gear from paradigm construction to paradigm implementation, defence, and maintenance.

5.5.6 *The cost of Basel III*

In the third phase of the G20 process, and following on from the deal on Basel III, reemerging domestic lobbies began to attack the policies being enacted to implement the paradigm shift, seeking to weaken Basel III's application. Domestic interests, especially the banks, did not impact the level-one talks in 2008 and had only marginal influence in 2009 and through 2010. But these lobbies took up arms against the Basel III implementation process and raised questions about the impact of the accord. A push against the deal and efforts to weaken its provisions and impact on the ground began. Critics warned banks faced a huge capital shortfall (Masters and Baer, 2010). Many banks needed to raise more capital to meet the Basel III standards.

BIS data estimated that the average common equity capital ratio of internationally active banks was 7.1 percent compared with the Basel III minimum requirement of 4.5 percent. Nonetheless, for all banks to reach the 4.5 percent minimum, BIS estimated an additional €38.8 billion was required. To reach the full 7 percent target, i.e., including the capital conservation buffer, they estimated that a further €485.6 billion was needed (BIS, 2012) at a time when the total profits after tax and prior to distributions of all globally active banks monitored by the BIS was only €356.6 billion during 2010-2011.

Responding to the capital demands of Basel III, Bank CEOs from Goldman Sachs, Standard Chartered, Citigroup, Barclays, and others, bemoaned the alleged ill effects of Basel III on the rate of global growth (Guerrera and Pimlott, 2010; Guerrera and Tett, 2011). JPMorgan CEO Jamie Dimon, the most powerful banker in the world post-crisis, alleged the new accord could actually slow the recovery (Sorkin, 2011) and that the standards could stifle a weak economic rebound. The general claim was that the standards were too high—that the capital requirements were too onerous, too restrictive, and too costly for the global economy. But such complaints are self-interested; the lower the capital standards are, the higher the permitted leverage, the greater the risk, and the larger the compensation packages of CEOs themselves. Bankers' claims of global economic damage must, therefore, be viewed with some scepticism.

Just how costly Basel III will be in the long-term from a macroeconomic perspective relies on Miles' Law: Where you stand depends on where you sit (Miles, 1978). Central bankers and regulators do not see the standards as onerous. According to the BIS, each percentage point increase in the capital ratio causes a median 0.03 percent decline in GDP, relative to the baseline (BIS, 2010). This is a very small price to pay for increased economic stability. Turner agrees, underscoring that 'the adverse costs of even very rare banking crises are so great as to outweigh any marginal growth penalty resulting from higher equity ratios' (Turner, 2011, p. 6). Admati *et al.* back the central bankers, maintaining that increasing bank equity is not expensive, and suggesting that much is 'fallacious, irrelevant, or very weak' because the risk premium paid (i.e., the cost of capital) must go down, not up, if banks have more equity (Admati *et al.*, 2011, p. 1; see also Haldane, 2010a), with more equity capital, as much as 25 percent non-risk-adjusted capital, being ideal (Admati and Hellwig, 2013).

Key policymakers predicted large economic gains from the Basel III deal. Carney estimated that the new standards would be worth savings of US\$10 trillion in global output due to the avoidance of future financial crises (AFP, 2010), i.e., the future potential costs avoided by

higher capital requirements are massive. So while banks CEOs bewailed the supposed burdens upon their bloated institutions, central bankers and regulators viewed Basel III as a major and relatively cost-free improvement. In fact, the central bankers' actions since then suggest that some in the central banking community felt they should have gone even further.

5.5.7 Basel-plus - national add-ons are seen

Since 2010, the actions of the more hawkish central bankers suggest that the deal struck in Seoul could have perhaps been even tougher. Many have moved towards 'Basel-plus' arrangements, which add to, rather than subtract from, the standards agreed by the G20-FSB-BCBS. These actors viewed the accord as the minimum, believing actual capital levels should be still higher. Miles *et al* thus argued that a 19 percent capital requirement would be optimal (Miles, Yang, and Marcheggiano, 2011; see also Mallaby, 2011). Bank of England Governor Mervyn King warned that 'even the new levels of capital are insufficient to prevent another crisis' (King, 2010, p.12), suggesting only very much higher levels of capital, levels which would be seen by the industry as wildly excessive most of the time, would prevent the next crisis (Guerrera and Pimlott, 2010). Adair Turner agreed and observes, 'in an ideal world, equity ratios would be set much higher' (Turner, 2011, p. 16). U.S. regulators also agreed, urging full speed ahead, and the higher the better (Bair, 2011; Sorkin, 2011).

The global compromise contained in the Basel III Accord left many hawkish central bankers and supervisors reaching for more, not less, capital. The Vickers Commission Report for the Bank of England recommended a higher capital requirement for the largest British banks of 10 percent minimum (Vickers, 2011). The Swiss National Bank applied capital requirements of 19 percent (Swiss National Bank, 2010). Chinese authorities set varying capital levels as high as 11.5 percent (*China Daily*, 2011a). The U.S. Federal Reserve also acted, demanding application of Basel III by the end of 2013 by U.S. banks and adding Basel-plus leverage requirements (Crittenden, 2013).

These national 'Basel-plus' rules show instead of a race for the bottom, the policy convergence is an upward swing in standards in jurisdictions overseeing most of the largest banks in the world, demanding higher capital, liquidity, and other measures, in line with what Drezner has suggested (Drezner, 2001). The above add-ons do not negate the FSB process. Rather, the Basel III standards are the minimum, not the maximum. States retain the ability to apply 'gold-plated' standards. Clearly central banking hardliners think the benefit of higher

standards worth the potential business lost through arbitrage. A Basel-plus renationalization on top of the global harmonization of capital standards is seen. This is a mixed outcome for champions of a single regulatory approach globally. But it also shows the extent to which there has been a strong regulatory policy shift towards still higher capital since the accord was signed in Seoul.

5.5.8 Intended and unintended consequences

Markets are demanding banks apply the Basel capital requirements immediately. Stronger players are trumpeting their return to levels of capital at or above the Basel III standards. Less healthy firms, in Germany and France, instead complain loudly of the burden of applying multiple layers of new capital minimums too quickly, and are engaged in a rush to sell assets to raise capital, i.e., they are shrinking lending. This has alarmed political leaders especially in France who fear further unintended economic consequences (Interview 13, 2012) from the rapid forced deleveraging underway. It is perhaps correct that weaker banks should recapitalise, rebuild or, if necessary, shrink or go out of business (Miles, 2009; Miles, Yang, Marcheggiano, 2011). Thus, the effect of the Basel III Accord is being felt in advance of full implementation by 2019. Implementation still matters, however, and vigilance on consistency of the Basel minimums will be important because of the relative complexity of the regulatory taxation system adopted.

5.5.9 Consistent implementation and monitoring is key

Given the decision by Basel III's designers in favour of taxation and against prohibition, the full potential of Basel III can be achieved only if G20 and FSB member countries and regions work within the global process and fully implement the minimum standards (Walter, 2011). Consistent implementation of the new minimums is essential if the global harmonisation of the new standards is to be a success. Firms should be unable to avoid the regulations that should ideally be nondiscretionary and clearly enforced (Rajan, 2010). The medium-to-long-term efficacy of Basel III, and by extension the strength of this main facet of the paradigm shift, depends on monitoring implementation and on national enforcement of the new regulations so as to minimise regulatory arbitrage opportunities.

Leaders inside the FSB understand the importance of monitoring and reporting of implementation, and as a result the process they have put in place is new and stronger than previously. Historically, BCBS did not make judgments on national compliance with past accords. There could be harping and *soto voce* complaints but no compliance action or up-

front naming and shaming of fellow regulators. The pre-crisis process was informal, less institutionalized, and tended to rely on discussions in which supervisors avoided placing direct blame for failures on their counterparts elsewhere. Not anymore. Now, post-crisis, the FSB and the BCBS below it are engaged in a potentially meaningful reporting and compliance process, making judgments on national regulatory actions, pro or con. This is a significant change, according to observers and participants (Interview 34, 2013).

To achieve this, the FSB and BCBS have constructed a three-tier reporting process: level one, timeliness of adoption; level two, regulatory consistency observed; and level three, ensuring consistency of outcomes. The process of oversight is being paid for by the BIS (Interview 34, 2012). The reporting, country-by-country, is sent directly via the FSB to the G20 summits on a semiannual basis. This process is qualitatively different from past practice and is more meaningful. Pressure to apply the consistent standards is seen. Thus, the FSB October 2012 compliance report took direct aim at failures in consistency in implementation in the EU, the U.S., and Japan (BIS, 2012), pressing for changes on all sides. These judgments are public. This arguably places greater pressure on the miscreants to improve their implementation and compliance. It also empowers the regulators themselves against domestic opponents, because the former can use complaints from the FSB to strengthen their position against the latter.

This form of detailed monitoring—of naming and shaming of those states that do not, in the Committee’s judgment, measure up—is ‘unprecedented’ (Interview 27, 2011, p. 13). It has never been done before by the BCBS. This underscores the commitment of the central banking community to make the accord work and is echoed by the uncompromising language on implementation used by the principals, such as Stefan Ingves, Chair of the BCBS, and Mark Carney, Chair of the FSB.

This is policy paradigm implementation and maintenance in action. The leaders of the FSB and BCBS who agreed the accord fashioned a new compliance and monitoring process that is better than the previous nonjudgmental, weaker reporting regime. The FSB leaders know implementation matters. A refusal to judge others’ failures is no longer an option. Clearer judgments in the G20 reporting process ensures not only the naming and shaming of laggards, but also moves towards the gradual establishment of norms and customs of adherence and, ultimately, potentially stronger compliance with the rules over time, which through repeated reporting may become widely understood and better applied.

In this process, the FSB community leaders moved to a defence of the agreed policy paradigm shift contained in the Basel III Accord via stronger compliance and monitoring

mechanisms. This more rigorous reporting and compliance structure is also evidence of the strength of the FSB-BCBS expert epistemic community, its policy consensus, and its ability to bind and press its own membership in a way not seen in other policy areas. The community is holding itself to norms it agreed and via mechanisms it controls. Failures will be regularly reported upwards to the G20 summits.

Placement in the reform matrix: The Basel III Accord is the most significant policy reform initiated by the G20 and FSB designed to re-regulate the international financial system and the banking sector. It was driven by the leading epistemic transnational expert community, which itself directs the FSB reform process. This community created pledges and constructed monitoring and compliance processes. Once fully implemented, the accord may result in the FSB overseeing nationally enforced binding standards. Compared to previous accords, the new accord is more robust and could be potentially more effective in enhancing financial stability and mitigating systemic risk.

Given the relative strength of the Basel III Accord, with seven to over 10 times the previous core capital levels, its wider base in terms of coverage; and its multiple other facets, tools, and new compliance processes; the accord is pictured on the matrix as moving from ‘very weak’ to ‘strong’ and above ‘weakly globally harmonised’, from left to right and upwards across the policy matrix landscape. The policy shift is the most dramatic of any areas tackled by the G20 advised by the central banking community, and constitutes a third-order change and paradigm shift in technical financial regulatory policy.

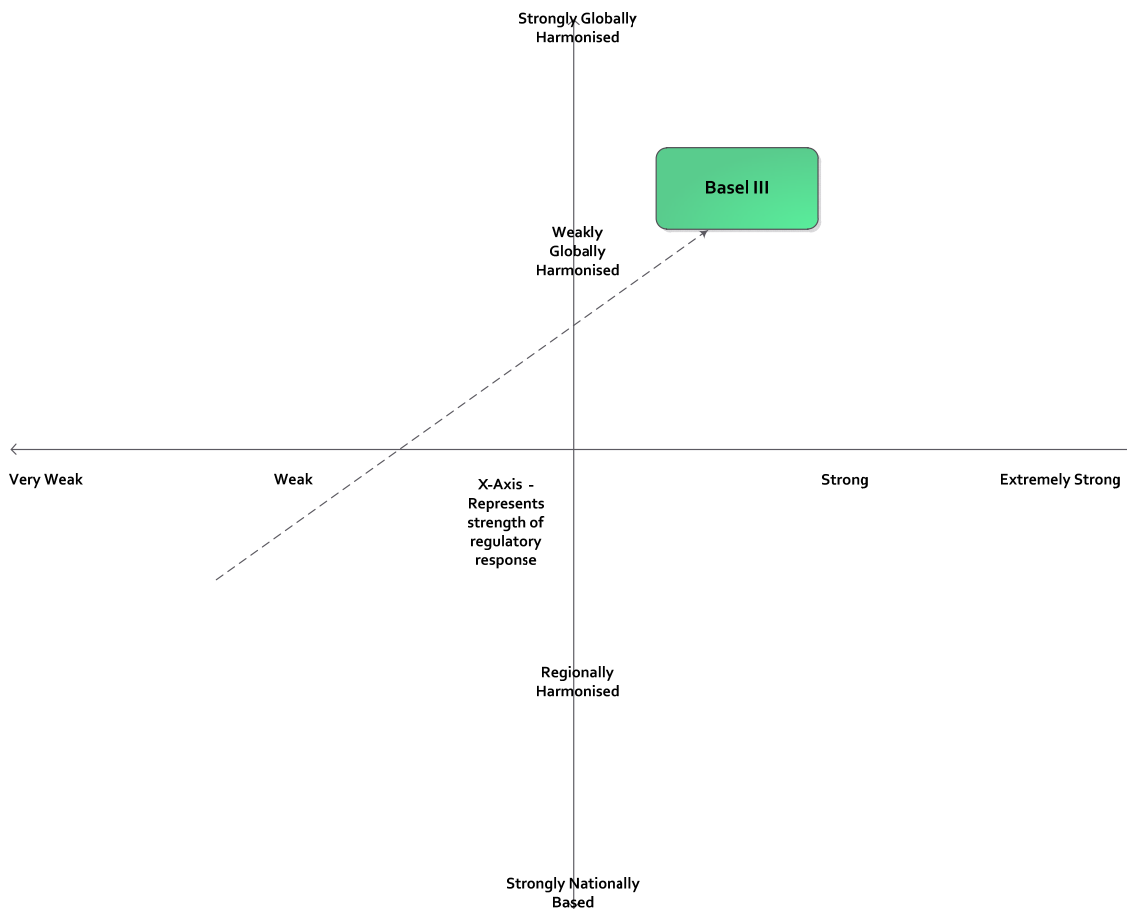


Figure 5.4 Movement of Basel III on Policy Reform Matrix

5.6 Clearing of OTC derivatives

The lack of regulation of the over-the-counter (OTC) derivatives market acted as a major transmission mechanism and a contributor to the 2007-2008 crisis (FCIC, 2011). As the G20 in Pittsburgh observed: ‘the crisis demonstrated the potential for contagion arising from the interconnectedness of OTC derivatives market participants and the limited transparency of counterparty relationships’ (G20, 2009d). This massive unregulated market added layers of leverage, obscured risk, and transmitted contagion when the credit crunch began, and investors either demanded payment of Credit Default Swaps. The securities contributed to a system where large financial institutions were not only too big to fail, but too interconnected to fail (Gensler, 2010, 2011). The derivatives market was unregulated then, and today it remains a huge potential transmission mechanism for booms and busts, worth US\$638 trillion in notional value in June 2012 (BIS, 2013).

Post-crisis, the G20, central bankers and regulators signalled a resolve to deal with OTC derivatives. In Pittsburgh, the G20 leaders agreed: ‘All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties ... non-centrally cleared contracts should be subject to higher capital requirements’ (G20, 2010d). All G20 states agreed to adopt OTC derivatives regulation by the end of 2012, a potential strong second-order change. The G20 and FSB agreed to regulate a vast part of the global financial marketplace that until this juncture had no oversight or regulation at all. This would not prove to be easy; those who called for regulation in the past, such as Brooksley Born, had failed (PBS, 2009).

Fashioning a globally consistent regulatory structure for derivatives, as demanded by the G20 and as urged by the FSB epistemic community, would be complex, and the outcome would also demonstrate a dynamic touched upon at the start of this chapter: The greater the policy-making distance between the FSB as coordinator and the actual national policy makers in a market, the greater the chance of disputes, the greater the likelihood of a suboptimal narrative, and the weaker the regulatory hold the FSB would have over the final policy outcome. As a result of these differing dynamics, although the policy being implemented is a real and marked improvement, the reforms have been undermined by domestic interests. FSB success in this case is only partial, and the reforms are of a second-order magnitude.

5.6.1 *Consistency and a minimum of exemptions*

In order to be a success, the derivatives reforms should capture a majority of derivatives contracts within OTC Central Counterparties (CCPs) and exchanges if it is to significantly enhance potential market stability. To succeed, the FSB needs the U.S., the U.K., the EU, and Japan to agree comparable regulatory standards and parameters (since these are the most important markets). In addition, to secure their goal, the FSB-supported OTC derivatives regulation needs to ensure practically all derivative contracts are standardised, trade via transparent Central Counter Parties (CCPs) and require similar margin collateral for riskier nonstandard trades (so-called skin in the game). If successful, standardization of most derivatives contracts and use of exchanges for contracts could impact the gaming of the system and help ensure stability. In general, the larger the number of exemptions from the proposed rules, the greater the opacity of the market, the less liquid it may be, the more inefficient it could be, the more prone to shocks and crises it will continue to be in times of stress, and the less it can be considered a success.

As of September 2013, the original completion deadline of end-2012 had not been met by all FSB jurisdictions, but a great deal is in place in major markets. Market infrastructure is in place in most markets, and the implementation of global clearing CCP mechanisms is underway. In the European Union, regulations on derivatives and CCP trade repositories are in place. Japan, too, passed the main OTC legislation and regulations, in 2012. In the U.S., the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) adopted a number of the necessary final rules (FSB, 2012a). Hong Kong is not far behind. The U.S. and the EU have agreed their approaches and to recognize each other's standards as equivalent (Trindle and Fairless, 2013). To be clear: FSB states missed their self-imposed deadlines, but the process is a long way towards completion and states have built entirely new regulatory structures relatively swiftly in the face of concerted resistance from banks and brokers.

The goal of the reform: 'All standardized over-the-counter derivatives should benefit from central clearing' (Gensler, 2010). Forcing most if not all derivatives through CCPs is still being resisted with some success by banking and broker dealers. Achieving a functioning commonality of approach and a minimum of exemptions requires resistance by regulators against pushback from bankers, dealers, and end users, all of whom have sought to weaken the stringency of the FSB-supported OTC CCP reforms.

Banking industry proxies maintain most derivatives should remain custom products and be excluded from the new transparency, oversight, and CCP requirements on the basis that the securities are complex, bespoke, and not amenable to standardisation. This logic is flawed and is akin to suggesting that because cars are complex, each customer should be sold a custom-built vehicle, with no measure of standardization, price discovery, or safety and reliability (i.e., risk) data being available to the consumer. This is rent seeking behaviour by the banks. It is in the banks' interest to maintain an opaque marketplace where information asymmetry between seller and buyer is the norm, as per Akerlof's *Lemon Law* (Akerlof, 1970). The 2013 EU case against banks for OTC market fixing in this space is evidence that banks know this and sought to block reform (Chee, 2013).

Because of the pressure by the banks on the regulators, a number of types of derivatives have been excluded from the G20 OTC derivatives regulation. The exclusions include derivatives bought by industrial end users, and foreign exchange swaps and forwards transactions (Gensler, 2010). The former exclusion is directed at companies that buy or sell derivatives to hedge commodities used in the normal course of their businesses, such as multinational manufacturing firms or airlines. The latter exclusion, applying to foreign exchange derivatives and forwards, excludes US\$4 trillion in transactions every day from stricter regulatory oversight by supervisors (BIS, 2012). The U.S. Treasury defends its decision, maintaining it is driven by the 'distinctive characteristics of these instruments' (U.S. Treasury, 2011). Not so, according to the critics; instead, the decision simply 'invites more trouble' in the years ahead (*New York Times*, 2011).

The FSB-led OTC derivatives policy shows the limits of the FSB-led control over a policy outside their area of regulatory responsibility. The central banking epistemic community understands this to be a major problem area and one where action is needed, but they passed the responsibility down to the SSBs (in this case, the International Organization of Securities Commissions [IOSCO]). This SSB is younger, larger (in terms of membership), weaker, and less cohesive than the FSB-BCBS nexus (Interview 34, 2013). The IOSCO does not, therefore, exhibit the same strength as an epistemic community, nor are its members (securities regulators) as strong institutionally and domestically. The IOSCO is being forced into action by the G20, it is not leading the action. The OTC policy response also requires major new legislative and national regulatory action, both of which are opportunities for level-two domestic interests to intervene and impact the policy process. These dynamics

result in a more mixed, less robust outcome monitored by the FSB and implementation is not being dealt with in the same detailed manner as the BCBS-overseen process for Basel III.

The monitoring and compliance process in the OTC derivatives space consists of semiannual reporting of the status of implementation by G20 states through the FSB standing committee process (FSB, 2012b). But the reporting stops short of qualitative judgments on actual implementation. The procedure does not evaluate the nature of regulations implemented by G20 states. It merely determines whether states have self-reported and enacted regulations as per FSB commitments. This reporting may still have a reputational effect of pressing members of the community to comply (Downs and Jones, 2002). Monitoring also adds pressure to adhere to the deadlines and timelines. But the FSB OTC process does not determine the actual strength and consistency of the national laws and rules, resulting in a weaker process.

To conclude, these markets were hitherto completely unregulated. In 2013, laws and regulations are in place in all the major markets, which should result in a great deal more transparency, internationally coordinated OTC regulation, and capital margins for the widespread use of custom products, in this key part of the shadow banking sector. Prior to the crisis, these steps were not feasible because resistance from vested banking and broker interests was simply too great. The current status of a partial implementation of OTC derivatives reforms is a significant development—a high second-order change (Hall, 1993) even if the final outcome appears unsatisfying and remains less than a complete success.

Placement in the policy reform matrix: The FSB OTC derivatives policy shift in the matrix is considerable but still limited. It moves the left-hand 'very weak' up towards 'weakly globally harmonised' on the right. This is a high second-order (perhaps borderline third-order) change because this is a new policy approach, not just an adjustment of an existing policy, and is therefore not strictly incremental change. However, exemptions are being seen. Because of these exemptions the danger remains that significant obscured systemic risk can still exist within these markets and the massive global casino they represent. Regulators and participants still confront a continued lack of market transparency. Perhaps in the short term, risks will not precipitate crises because the market for these complex securities has yet to rebound. But if the markets recover and if they remain opaque and illiquid, then the risks inherent in them will resurface.

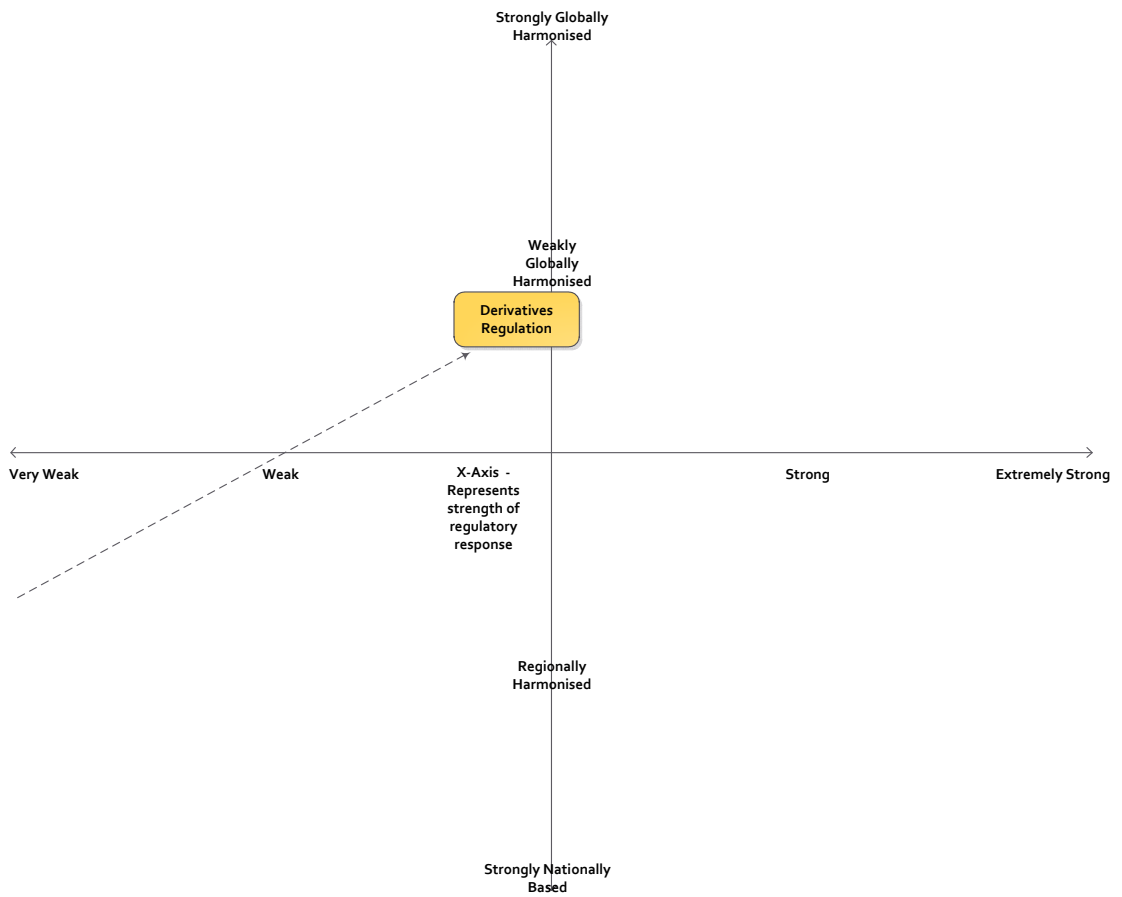


Figure 5.5 Movement of Derivatives Policy on the Policy Reform Matrix

5.7 Compensation, bankers' pay, and bonuses

The G20 charged the FSB and BCBS with addressing compensation after contentious debate at the Pittsburgh summit between the French and Germans, who wanted hard and fast rules, and the UK and especially U.S. leaders, who opposed action. The FSB turned to the issue at a time when some national governments and agencies had already commenced unilateral action (FSB, 2010a). The FSB, BCBS, and central banking community was responding to an apparent but contested linkage between many years of rapid increases in financial sector pay (FCIC, 2011; Johnson and Kwak, 2011), increased leverage, perverse incentives, excessive risk taking, outsized profits, and naive investors unaware of the dangerous actions of firms' management. Given the split (Europe versus America) over the subject, the FSB sought to deal with the issue via a principles-based approach (Bolton, Marhal, and Shapiro, 2010).

Compensation is the clearest example of the internal FSB tension between a rules-based approach and a principles-based approach used by members. The latter is selected when FSB leaders differ markedly on approach, as is the case with compensation. When matters are too complex for rules, principles are the remaining option. But the approach also tends to indicate a lack of strong FSB agreement on the policy narrative on causes and solutions as is the case in this policy area. In France and Germany, bankers' high compensation and bonuses were believed to have been a causal factor in the crisis; in that case, hard rules can be used to limit such excesses. In the U.S., officials, more ideologically sympathetic to bankers, did not agree compensation played a major factor in the crisis, maintaining it is not the job of regulators to decide compensation systems and levels in a market economy. Given this split the FSB defaulted to a principles approach.

The FSB, decided to monitor the application of the *Principles for Sound Compensation Practices* (FSF, 2009). The principles are either banal or high-level depending on one's view and are a first step (Ferrarini and Ungureanu, 2010). They include agreement on a need for a board-level remuneration committee as an integral part of an organization's governance structure; a possible limit on variable compensation as a percentage of total net revenues; that pay should be aligned with risk; when a firm's performance declines, so should bonus compensation; a recommended deferral (at least three years) of 40 to 60 percent of bonus, with a substantial proportion awarded in shares or share-linked instruments; the inclusion of a claw back provision where unvested payments can be taken back from the employee if the performance of the of the firm declines; and a ban on employees hedging their own

compensation or taking out insurance to sidestep the compensation changes. The principles are largely uncontroversial and it is left to national supervisors to decide whether to enshrine them in national regulatory or legislative language.

To date, jurisdictions have implemented the principles using a mix of light supervisory oversight (the U.S.) and enforceable regulation and law (the EU). The precise type of supervisory or regulatory approach depends on the equilibrium between the various domestic interests in play and the country (or region's) cultural preference. The light supervisory approach has led to complaints of gaming the system. Some firms' personnel, such as employees at Goldman Sachs Inc., are accused on actively avoiding FSB compensation principles, demonstrating the weakness of a supervision and principles-only approach (Dash, 2011).

EU states took a regulatory route made more robust via enforceable EU law on compensation and bonuses. The EU codified a number of the principles as minimum requirements within European law, and in 2013 the EU (backed by strong German support) placed an absolute cap on bonus levels. Individual G20 states have also issued national implementing regulations or incorporated the principles and standards into existing law, with supervisory guidance illustrating how the rules should be met (FSB, 2010a).

5.7.1 Monitoring and enforcement: A real and meaningful shift?

In this policy area, exceptionally and paradoxically, despite the tension between the U.S. and the EU, monitoring and enforcement has advanced further than any other from a structural and institutional standpoint. First, the policy area has periodic monitoring and thematic peer reviews and reporting as per other policy areas, through the FSB standing committees and up to the G20 (FSB, 2012c). This has required G20 states to survey actual compensation practice of systemic banks and report the comparative data through the FSB thematic review. But this is far from all.

5.7.2 A new dispute settlement procedure

The clash between those who wanted further thematic reviews and those who sought to close the sensitive subject down proved institutionally productive. A compromise result secured by the FSB leadership saw the creation of the first formal dispute settlement procedure within the G20-FSB architecture.

Under the 2012 Bilateral Complaint Handling Process FSB (FSB, 2012a), members can use a mechanism for judgments on compliance if they believe they are at regulatory disadvantage due to inconsistent implementation of the compensation principles.

The complaint process has a judicial ring to it. A supervisor lodges a complaint on behalf of a firm, details the complaint, specifies the target firm that undertakes such practices, the home jurisdiction, lays out the nature and magnitude of the disadvantages, and the individuals (i.e., senior executives and their compensation packages) concerned. All these steps (and many others) delineate a procedure that is legalistic in its construction and approach. A Compensation Monitoring Contact Group, composed of national experts with regulatory responsibility for compensation, meets under the oversight of the Standards and Implementation Standing Committee, and determines the outcome (i.e., makes a judgment) on a complaint and whether there has been inconsistent implementation of the compensation principles and standards. If there has been inconsistent implementation that will be brought to the attention of the firm's supervisor. If failures are seen, they will be 'Verified and addressed as needed via bilateral exchanges among national supervisory authorities' (FSB, 2012a, p. 15).

The dispute process has not yet been triggered (Interview 34, 2013), but over time it could generate decisions on inconsistent implementation of agreed FSB compensation principles and standards. The FSB indicates that it expects that such firm-specific cases will provide more clarity on the application of the standards across jurisdictions. This is a potentially significant FSB institutional process. It is the first dispute settlement mechanism in the new architecture, and it has some similarity to the World Trade Organization dispute settlement process, which is judicial (Jackson, 2004, 2008). Those in the leadership inside the FSB recognise this mechanism to be a potential innovation (Interview 24, 2012). Yet, because it is so new, the change has received little external notice or analysis. It is clearly an area for potential future study and analysis as complaints and judgments are made.

What this innovative new dispute settlement approach demonstrates is FSB leadership reaching to create institutional strength from an internal central banking dispute. A clash over the application of compensation principles results in the creation of a quasi-judicial complaint process. Yet again, FSB policy action, this time paradigm maintenance, benefits from the strength of the epistemic community leading change, even here, where there is a dispute.

Placement on the policy reform matrix: The observer will see the FSB policy action on compensation as moving left to right across the matrix from ‘very weak’ towards ‘weak’ and to ‘weakly globally harmonised’. Over time, this policy may move it further still into the ‘strong’ category, as per the arrow indicating future movement. At present, this policy melds principles with a new untested dispute procedure and is a second-order change. In 2013 it is untried. But it is a potentially significant dispute settlement procedure. On the other hand, there are divergent national approaches, from supervisory in the U.S. to regulatory in the EU, and this could weaken the overall global effect, especially if no cases are lodged using the dispute settlement procedure.

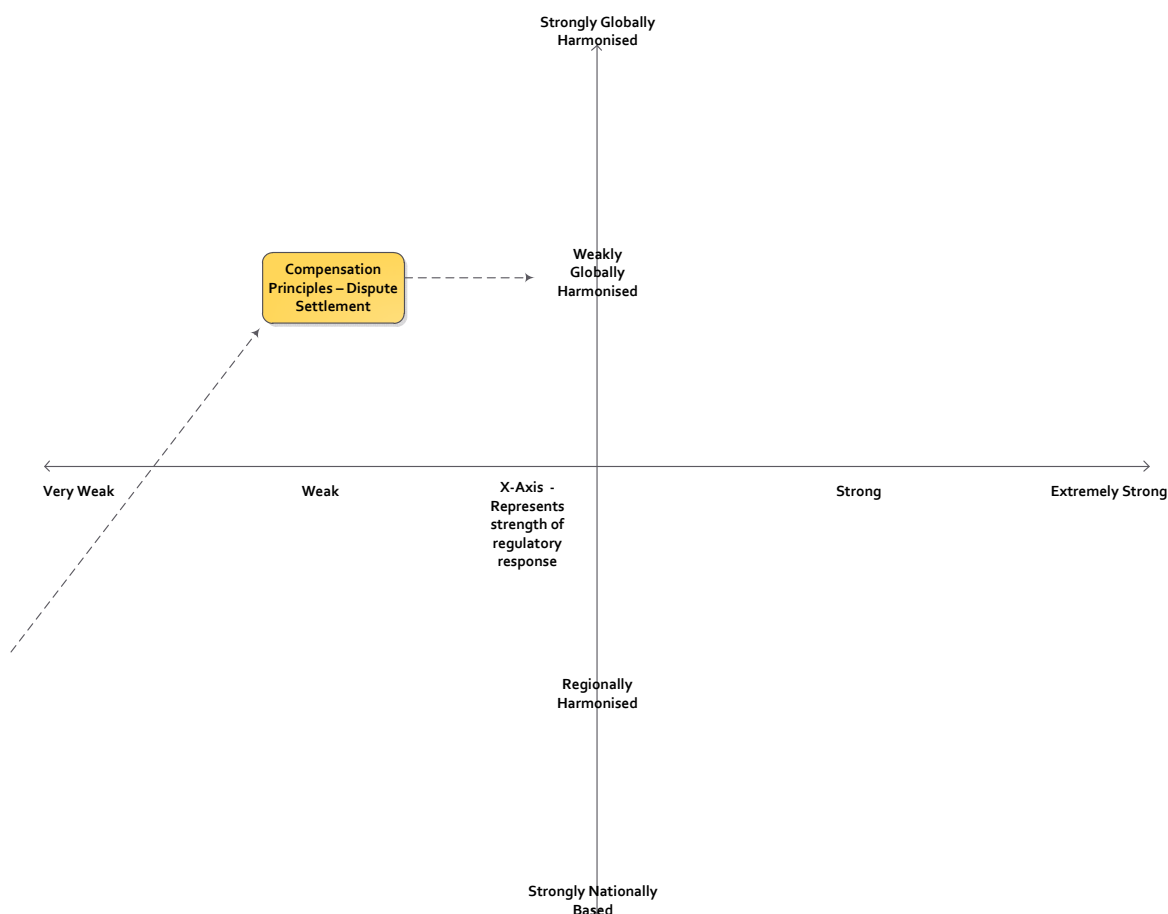


Figure 5.6 Movement of Compensation Policy in Policy Reform Matrix

5.8 Regulating shadow banking

‘Shadow banking’ refers to unregulated financial markets in which firms and investors provide bank-like services of credit intermediation (i.e., extending credit) and maturity transformation through alternative means such as money market funds, complex securities markets, structured investment vehicles (SIVs) and special purpose entities (SPEs), hedge funds, private equity, and the overnight repo market (FSB, 2011a, 2011b; Gorton, 2010, 2012). Lenders and borrowers transact bank-like business but outside the regulated commercial banking space, with no prudential oversight and no capital to strengthen the system. The size of shadow banking markets is massive. In 2011, it was estimated at US\$67 trillion, or equivalent to 111 percent of the G20’s GDP (FSB, 2012d, p. 3).

The crisis demonstrated that these markets and the actors within them could be potentially dangerous if the combination of a firm’s actions, size, leverage, and interconnection to others (especially commercial banks) in the financial system resulted in contagion and creating systemic risks to the wider economy (Maclean and Nocera, 2009).

At the Seoul Summit in 2010, G20 leaders tasked the FSB with building a framework to address the potential systemic risks posed by the shadow banking sector. They tasked the FSB Task Force on Shadow Banking (Chaired by Adair Turner from 2010 to 2012) to develop recommendations. The FSB-BCBS community hoped to contain the risks of the shadow banking sector *indirectly* by discouraging and/or restraining commercial banks from entering shadow sector activities via mechanisms like onerous capital charges for risky assets (in Basel III), and avoid aggressively regulating the entire shadow sector. There was also a more prosaic reason for a delay. Key FSB policy makers within this small community have only so much technical and intellectual bandwidth. It is simply not possible for the limited number of leading FSB figures to target all regulatory failings and all gaps simultaneously. So they dealt with the most pressing issues in 2008 and 2009 (bank capital and regulation), and in late 2010 focused on shadow banking.

The task force report in October 2011 concluded central banks and supervisors should cast the net wide in terms of what non-bank activities they were monitoring, but also simultaneously to narrow the focus (FSB, 2011d) to the systemic actors and activities dealing with maturity transformation, liquidity transformation, risk transfer, and leverage, which posed most serious risks going forwards. This FSB analytical framework implies in the future particular actors and markets in the shadow banking sector may be subject to greater scrutiny,

not greater regulation. Should firms and markets grow in size and interconnectedness to an extent they pose a risk to the wider economy, then regulation could still follow. But if supervisors can see what is going on within markets, and inside large systemically important firms, they can (it is hoped) make an informed judgment about future systemic risk and the need for reporting or possibly action. The Task Force recommended a series of high-level principles for monitoring the shadow banking system, which set out matters of scope, process, data gathering, monitoring innovations and mutations, and regulatory arbitrage issues to be considered by national regulators.

In this instance, a principles approach was seen as more appropriate for a number of reasons. First, what poses risk in one country within the shadow banking sector may be entirely different in another. In the U.S., an unregulated non-bank housing sector was the source of contagion. In another G20 country, the conditions may be entirely different and the risks may emerge in other financial industries.

Second, what is of concern today may diverge from what is most dangerous tomorrow—the next black swan of Taleb’s imagined night time terrors (Taleb, 2010). The FSB is, therefore, seeking to aid domestic supervisors with frameworks for the analysis and understanding and measuring future risks. These are tools, not rules.

Third, since prohibition of shadow banking activity is off the table as a regulatory approach within the FSB, the only way to aid central bankers in getting their arms around these markets is via a general scoping process aiding national deliberations and determinations of who and what may pose systemic risk in a market at one point in time.

Fourth, it is national supervisors who must identify and regulate the actual shadow banking firms and look into their risk-taking activities. The FSB has neither the manpower nor the necessary crystal ball to do so. So a framework for a common understanding of what factors to consider in making the decisions is the default. The FSB does not want to create moral hazard by implying responsibility for all actors in yet more and more financial markets. So they seek to be vigilant and yet specific and focused in their actions, as Turner’s Task Force urged them to be.

Placement in the policy matrix: The shadow banking sector had never been regulated previously, so the current position on the matrix reflects this: It is placed in the far left lower

quadrant signifying ‘very weak’ standards. Since the task forces’ recommendations are not supposed to be applied but are instead to provide analytical guidance to policy makers, they cannot be said to move the policy forward to a great degree, and movement across the landscape is therefore not seen at this time, even though analytical frameworks and tools are, of course, needed and potentially valuable.

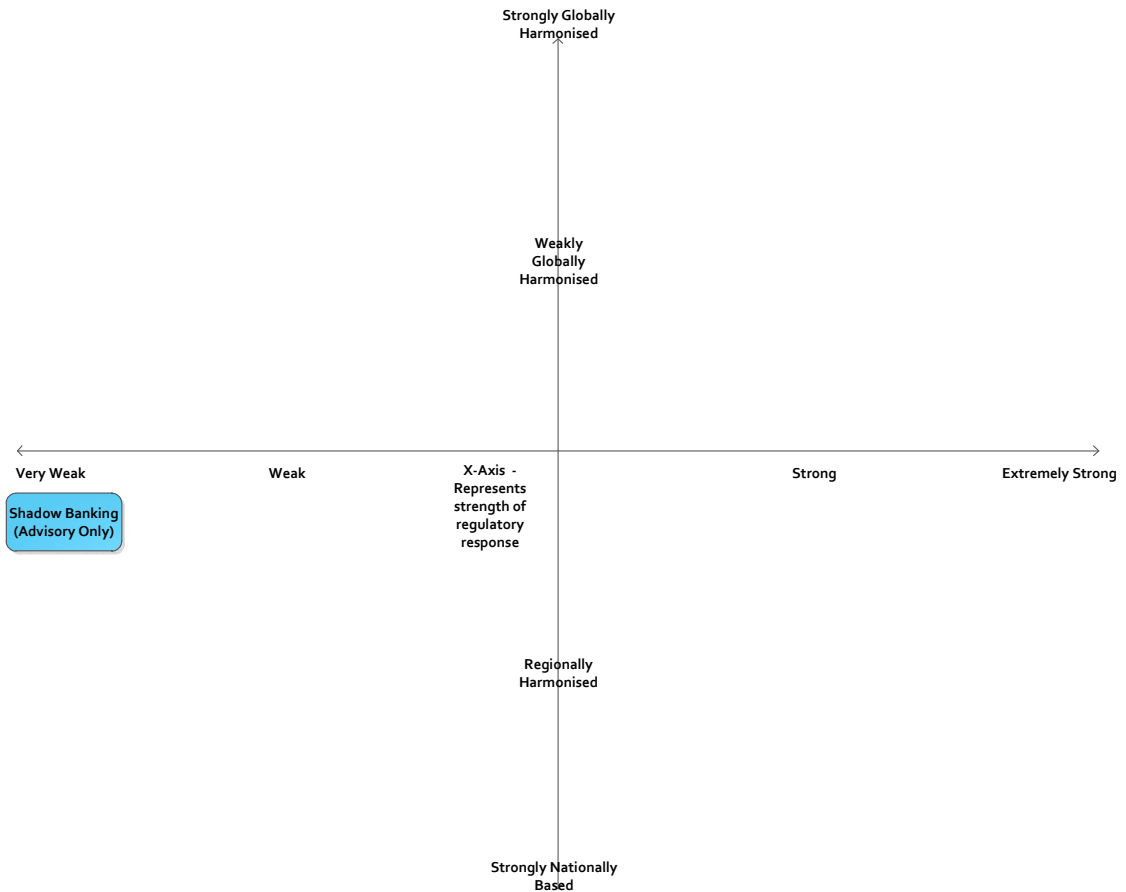


Figure 5.7 Shadow Banking on Policy Reform Matrix

5.9 Too big to fail

Of all the policy areas still of concern to supervisors and central bankers, the most vexing and intractable is ‘too big to fail’ (TBTF). G20 leaders, central bankers, and supervisors since 2008 have chanted a mantra: All banks, however large, interconnected, and complex should in principle be able to fail, or go bankrupt, in an orderly fashion. Systems already exist in some G20 states to permit small-to-medium size banks to fail; from 2007 to 2013, 482 banks failed and were closed by the U.S. FDIC without systemic problems (FDIC, 2013). The problem rests not with the minnows, but instead with the whales, the RBSs, the Citigroups, and the UBSs of the banking world.

The world’s largest banks play significant roles in the economy and financial system, through maturity transformation, in credit extension, in their roles as market makers, and as counterparties in markets across the globe. They are highly interconnected across borders and amongst themselves, creating intertwined relationships and complex contractual links difficult to untangle in normal times, and especially during crises, when these giants are most likely to be at risk of collective collapse in part because of those interconnections, as happened during 2007-2008. The consequences of such collapses were viewed as simply too damaging to the commonwealth. It was not just that a particular bank might be TBTF, but also that in the heat of the crisis there were too many to fail (Brown and Ding, 2009).

Since the crisis, another mutation of the phenomenon that underscores the seriousness of the TBTF problem has been seen in the HSBC case. The bank was accused by the U.S. of widespread systemic breaches of money laundering, antiterrorist, and sanctions laws in the U.S. Evidence showed the alleged huge scale of violations aided and abetted by senior management and legal counsel. Ultimately, HSBC paid a US\$1.9 billion fine for its acts (Rushe and Trenor, 2012), but it was not prosecuted. U.S. and UK regulators concluded that if HSBC was prosecuted, the firm would collapse, and the economic damage was ruled too great. HSBC became the first bank deemed ‘too big to prosecute’ (Wilson, 2012).

Post-crisis supervisors in the FSB stress TBTF must be addressed. However, a strong faith in the need to end the moral hazard that comes with TBTF does not make it a policy reality. In fact, since 2008 there has been greater sector consolidation, reinforcing TBTF, not a lessening of this trend. Moral hazard still exists and is worse than it was in 2007. Investors today know just how far governments will go: very, very far indeed. Ratings agencies

underscore this by giving these TBTF firms credit ratings up to three notches higher than their competitors who do not get the TBTF moniker because of the continued implicit government guarantees, and this is worth up to US\$83 billion for U.S. banks (Lopez, 2013), and tens of billions of dollars a year to banks in other G20 states (Caruana, 2011; see also Haldane, 2012b). The biggest firms at the end of 2012 are larger, more dominant, and more systemically important, suffering from moral hazard and in receipt of G20 government guarantees, explicit and implicit.

The FSB moved, in response, to increase the capital tax on large firms, to add countercyclical buffers, to add a surcharge on systemically important financial institutions, and to include the right to levy a further 1 percent if the firm is taking excessive risks, and the leverage and liquidity requirements need to be seen in light of the TBTF problem. The aim is to tie down TBTF institutions and ensure their own liquid capital is available in times of crisis, so no state bailout is necessary in the future.

5.9.1 Resolution regimes and living wills

Two additional methods of attempting to address TBTF include the creation of resolution regimes whereby firms might be wound down and dismantled without damaging the financial system, and the creation of 'living wills' to explain how the particular firm can be dismantled in a crisis. The G20 and FSB at Seoul in 2010 stressed: 'All jurisdictions should undertake the necessary legal reforms to ensure that they have in place a resolution regime which would make feasible the resolution of any financial institution without taxpayer exposure to loss from solvency support while protecting vital economic functions' (G20, 2010b). FSB members continue the work on the features of effective national resolution regimes for financial institutions, including non-bank financial institutions, and have published the *Key Attributes of Effective Resolution Regimes*. Multiple SSBs overseen by the FSB are working on this area including the BCBS, IOSCO, and the International Association of Insurance Supervisors (IAIS). Once complete, this work will be the equivalent of a best practices or principles approach to this complex issue. This area of extreme legal complexity means principles or 'key attributes' are, it is said by supporters, the only real option available to FSB policy makers as a means of gradually pointing the way towards harmonization of disparate legal approaches.

The FSB and national supervisors are also using living wills to strengthen firm-level focus on risk before a collapse. Under the living will process, major financial firms are required to lay

out how they would be dismantled in the event of their failure. This requires executives to assess the nature of their business activities and the risks associated with different practices and mechanisms for dealing with those risks and the firm's possible failure. This self-examination is positive. Boards and management must examine their frailties and consider the implications of their business decisions. Supervisors also benefit from getting a fuller picture of how a firm might be unwound from the firm's management. But living wills are no panacea, and the maintenance of the living wills must be an ongoing process if they are to be meaningful; a single report sitting on a shelf gathering dust will be of little use six months hence. It is also reasonable to ask how much of a firm's management resources should be dedicated to planning for their death rather than focused on innovation and growth.

Notwithstanding both above FSB work streams, on resolution and living wills, the different legal systems of bankruptcy, of contract law, and commercial law make closing or allowing a large international bank to go bankrupt extremely difficult, or, more likely, impossible. For example, Citigroup operates in 100 to 160 countries (the firm itself cannot supply a definitive number); it owns major banks in emerging economies such as Mexico and Brazil and has subsidiaries, assets, and liabilities scattered across the globe. Are the mechanisms in place today to allow Citigroup to fail? Certainly not.

The FSB TBTF response indicates the complexity of the issue and demonstrates negotiators groping their way forwards to agreements absent solid legal and related foundations. In this area FSB members have a consensus, but it is a weak and nationally conflicted one. FSB actors agree that TBTF is a menace and should be addressed. But they cannot agree on robust steps forward for each state because each player seeks to defend its models of banking and finance and national financial market peculiarities and differences. The UK defends the City of London and its national champions. The French support their universal banks. The Germans back particular firms and state-owned banks, and so on. Scores of these banks are systemically important and thus too large or too systemically important to fail.

On both of these policy responses, had the FSB tried for a binding agreement or a rules-based approach, lacking a strong consensus, they would get no agreement, and international negotiations would be stymied. So FSB leaders grappled with the complexity of TBTF trying to address the structural and the institutional weaknesses of the evolution of these massively complex interconnected international financial institutions (Haldane, 2010a, 2012c, 2013) with advisory documents, and thus win sets do still occur.

5.9.2 Working within the limits of the new paradigm

The FSB approach to TBTF points to the outer limits of the paradigm shift within the FSB and the extent to which key actors operate inside self-imposed consensual boundaries within which the policy solutions are made. The new policy consensus does not extend to all options and all possible solutions. The need for consensus rules out logically superior solutions which are not politically viable. The simplest and most effective solution to TBTF and resolution regimes is completely off the table—namely, limiting bank size (Johnson, 2012; Onaran, 2013) and if necessary breaking up the biggest banks to address the systemic risk they cause.

Some insider outsiders, such as Mervyn King and Paul Volcker, have suggested such break-ups or size limits (G30, 2009a; King, 2009b). They have been joined by other policy makers (Bair, 2012; Federal Reserve Bank of Dallas, 2012). But these voices are raised well outside the community consensus. Break-up has a logical appeal and its simplicity avoids the need for aggressive complex regulations (Haldane, 2012b, 2012c). Such solutions, which are potentially lower cost and easier to implement, are outside the policy consensus. Instead, the policy options selected are more intrusive, more complex, and perhaps less effective. Break-up is off the agenda because in all states, the size, power, and influence of the major financial firms are such that opposition to downsizing remains the consensus, even though the regulatory paradigm has shifted. So taxation (i.e., capital charges) is preferred instead of prohibition (based on size and other factors).

In conclusion, the supervisory community is attempting to address TBTF, but they are falling short of real solutions. An inability to confront size and complexity head-on via limits to banking activities or a break-up of the banks leads to a series of nonbinding advisory processes, which, while perhaps the best option of a bad bunch, are far from optimal. Allowing big banks to fail remains a dream, not a reality. Even if legal resolution regimes and living wills structures are in place, could national governments allow a bankruptcy of Citigroup or RBS to happen? Would they be allowed to fail? The answer is probably not. Regulators intuitively recognise this; hence, the piling on of additional international and national Basel-plus regulations that have the effect of charging higher and higher taxes on such banks for the privilege of scale and implicit guarantees, hopefully making their business less profitable and less risky.

Placement in the policy reform matrix: Central bankers and supervisors are focused on TBTF, resolution regimes, and living wills. It is all designed to allow large firms to fail without unacceptable collateral damage and public costs. But they are not close to finding a solution. Basel III and the GSIFI surcharge is increasing capital markedly, but not enough to make size a prohibitive economic cost so as to spur firms to significantly downsize. In fact, for stronger firms, the dynamics of the market operate in the opposite direction. There is pressure to grow and merge, and the political influence of the firms themselves halts relatively simple, serious steps which might address TBTF. Reformed antitrust laws could break up the behemoths, as was done in the ATT case or with Standard Oil in an even earlier era, but these options are ruled out by the policy-making community; it is restricted by the limits of the new paradigm. In 2013, global banks remain, as Haldane notes, like male elephant seals on a beach: hugely powerful but highly vulnerable (Haldane, 2012b). So TBTF does not move a distance diagonally left to right in the policy matrix; instead, it slips backwards, notwithstanding the advisory efforts of the FSB leadership.

On resolution regimes and living wills, the progress in terms of discussion and national actions to force this type of ongoing reflection by boards of financial firms is occurring, and this is a positive but limited outcome. Both policies remain some distance away from globally harmonised principles or a rules-based approach. So the movement in the matrix is again limited in scope, although larger for living wills, since every systemically important bank must now have a self-destruct manual.

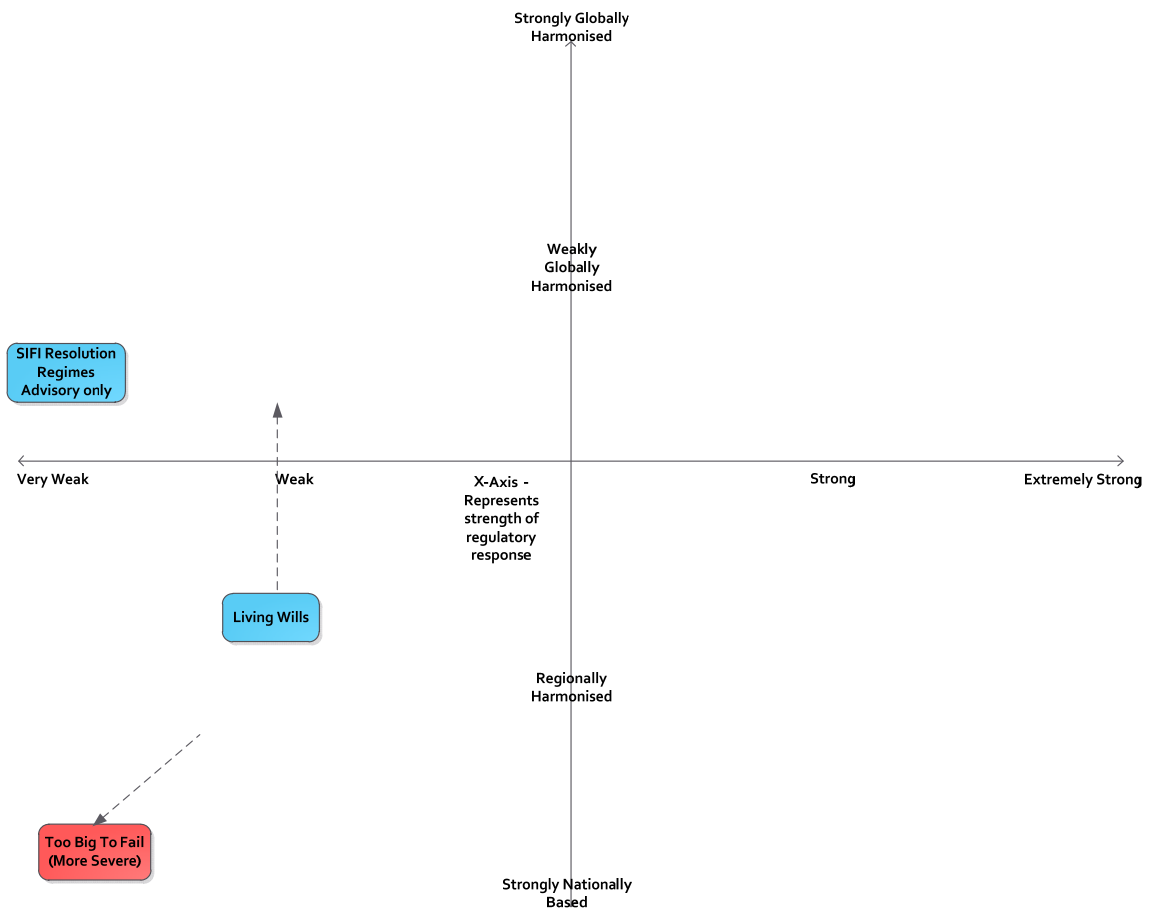


Figure 5.8 TBTF, Living Wills and SIFI Resolution Regimes Movement on the Policy Reform Matrix

5.10 Accounting standards

Right from the start of the G20 process, leaders underscored the need for a single set of improved, high-quality global accounting standards, and they had looked to the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to complete their work on this by the end of 2011. But this was a policy-making pipe dream rather than a reality. No substantive progress has been made on reconciling U.S. Generally Accepted Accounting Principles with International Financial Reporting Standards (IFRS).

This is due to different stances between the U.S. and EU over standard setting, but this time it is not a principles versus rules argument but a direct clash of one set of rules versus another. The U.S. pays lip service to the need for a single global accounting standard, but in reality views the IFRS (overseen by the IASB) as excessively dominated by UK and French officials. Each party defends its own entrenched, long-standing system of accountancy and each is resistant to agreement on a global standard. As with all things related to accounting, matters are extremely complex, and different standards are applied on many issues in the U.S. and EU, resulting in major firms having to report their accounts in each system. Hence, there is some demand for change. Below the global firms, however, there is no agreement on the need for such reforms; in fact, there is defence of each side's status quo and a clash of accounting paradigms and different policy positions, not pressure for convergence.

The failure to act on G20 and FSB demands may also be in part because, while a significant complicating factor, accounting standards in the U.S. and European Union were not seen by the policy-making community and central bankers as a major causal factor in the crisis. Accounting rules did amplify the swing during the crisis period. For example, mark-to-market accounting—the requirement to value assets very frequently—often daily—and adjust accordingly—boosted profits on the upswing as assets constantly were revalued upward, and hastened the collapse when toxic assets were repeatedly revalued as being worth less and less. Accounting standards on both sides of the Atlantic were procyclical, and accounting practice allowed firms to obscure risks taken and the dangers they faced. But the issue was at its base viewed by central bankers leading the process and crisis response as one of a credit boom gone bust. The existing standards' differences were only contributory, not causal. Effective, prudent supervision could have made a greater difference. The pressure for change in these rules is just not enough to overcome internal resistance. The leadership of the G20 and FSB was focused elsewhere, on other macro issues. Finally, central bankers leading the

FSB do not control this policy area. Neither accounting SSB is as tightly bound into the new structure as other SSBs. Only the IASB is inside the FSB structure as a member. Arguably, the pressure for reform is weaker outside the coordinating structure overseen by the FSB; i.e., the FSB can resist pressure and is less exposed to it because the organization is not directly part of the process.

Placement in the policy matrix: Accounting standards will remain 'strong', because they are binding within their respective jurisdictions, but are only 'regionally harmonised' within the matrix, given the lack of progress on this important but second-rank policy area. Neither the G20 nor the FSB appears able to force reform. It is not worth the political effort for the former, and the latter has no regulatory power to do so, with the U.S. accounting SSB sitting outside the structure and not properly integrated in the manner of the BCBS and IOSCOs. Finally, powerful national level-two interests, the accounting lobbies and firms used to existing practice, defend their own standards. Thus, we see national paradigm clashes, not a consensus on reform among standard setters.

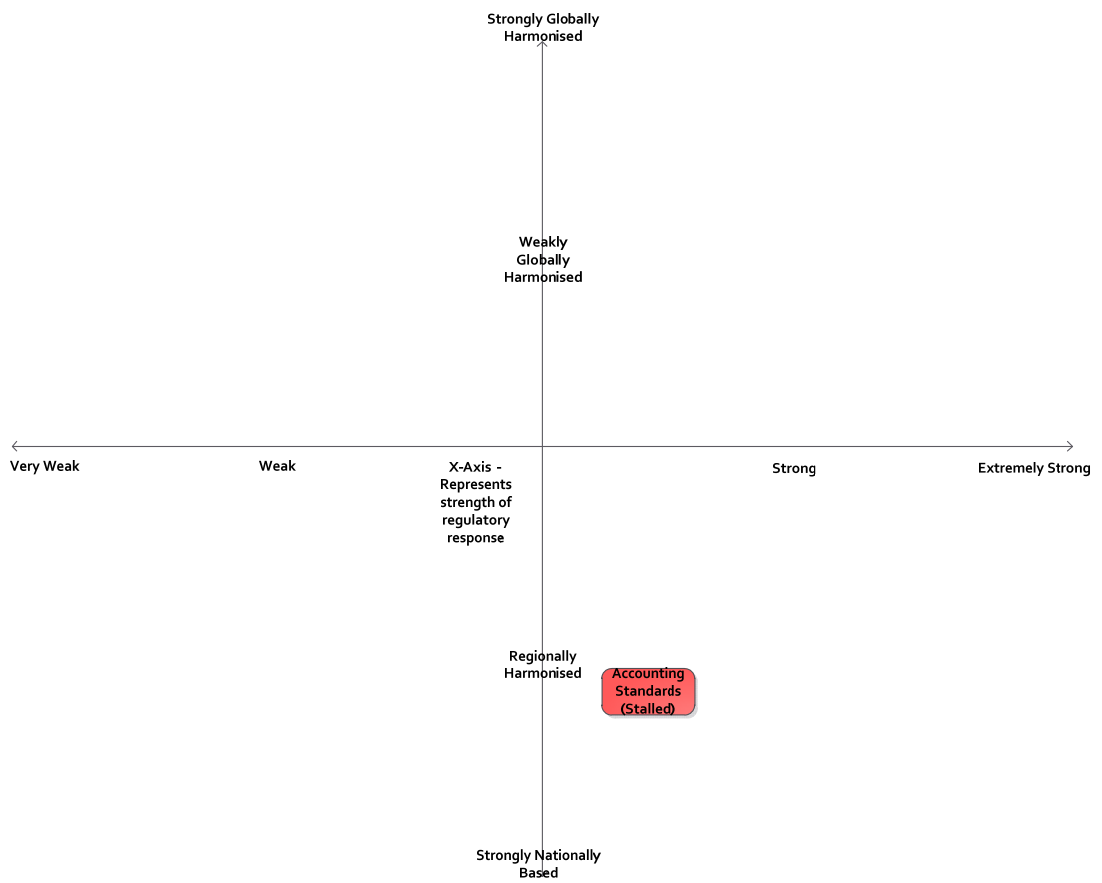


Figure 5.9 Accounting Standards on the Policy Reform Matrix

5.11 Early warning exercises, the mutual assessment program, and peer review

'What you see coming is never quite what gets you, it is the stuff that you can't see coming that gets you'.
(Bretton Woods Committee, 2010)

This section will comment briefly on the early warning exercises, mutual assessment process, and the review processes. These FSB roles overlap with IMF roles and surveillance functions, and as such the efficacy of surveillance is addressed fully in Chapter 6 within the context of the role and operation of the IMF.

5.11.1 Early-warning exercises

The FSB was tasked by the G20 in November 2008 with coordinating with the IMF and monitoring the global economic outlook and providing early warning exercises. The early warning exercises are designed to assess low-probability but high-impact risks to the global economy and to identify policies to mitigate them, and they integrate macroeconomic and financial perspectives on systemic risk. They are not new. The IMF has been conducting similar modelling for years, without making a difference to country practices. Conceptually they may appear a good idea, but operationally they are difficult to make work. This is an exercise in attempting to institutionalise contrarianism—to empower a small number of analysts to raise the alarm, to take contrary positions, which may prove unfounded, repeatedly during booms and in normal times. Are such cries of wolf taken seriously by a policy-making and investor community which has shown an ability time and time again to be deaf to purveyors of bad news in boom times? Ask Nouriel Roubini, or Raghuram Rajan, both economists that raised the alarm prior to the crisis. Such voices are usually ignored.

Nonetheless, the FSB-IMF is attempting early warning exercises. Analytical tools that raise red flags and economists that ask the right questions when the next boom begins are useful. They might assist in alerting the supervisory community and the boards of financial firms to be more vigilant, to worry, for instance, more about overperformance instead of underperformance (G30, 2012). Nonetheless, for a variety of reasons institutional, psychological, and cultural, a majority will not see the next crisis coming until it is too late. The research found no interview subjects who were confident that early warning exercises or IMF surveillance could detect the next crisis and warn people in a manner they would pay attention to.

5.11.2 *The Mutual Assessment Process and peer review*

Early in G20 summitry, FSB members agreed to participate in a Mutual Assessment Process (MAP) and to ‘undergo periodic peer review using amongst other evidence the IMF/World Bank Financial Sector Assessment Program Reports’ (FSB, 2009, p. 9). The MAP and peer review process is overseen by the FSB, but it is staffed in coordination with the IMF, which has the mandate and resources to undertake much more detailed surveillance than is possible via the FSB process.

By 2013, the FSB-related work on MAP had slowed. It was conceptualised as an FSB review of compliance with IMF standards and reports, but it was resisted by IMF officials who viewed a FSB role as duplicative, which it was, and interfering, which it might have been (Interviews 22 and 34, 2012). Asking the FSB to perform additional surveillance of IMF surveillance reports did not prove useful for FSB officials, who have moved away from the process, conceding implicitly that the IMF should lead in this area. Why the MAP in this area was supposed to be more effective than a wide-ranging IMF surveillance reporting involving scores of people and much larger resources is unclear. There was no requirement for FSB members to act on the views expressed in a MAP, so there was no real sustained evident pressure.

In contrast, FSB thematic peer reviews continue and are viewed by participants as useful. This reporting compares standards application (for instance, on compensation, risk disclosure, governance) across all G20 states in a way which highlights differences but stops short of making judgments on effectiveness of implementation. Each review compares implementation across the FSB membership by states and key actors. At most, the thematic review process has a modestly positive impact, in two ways. First, it pressures the national supervisory authorities to explain how they are complying or plan to comply with the standards, and some jurisdictions (not all) react with gradual moves to implement the standards. Second, it involves surveying the actual practices across the globe as to how states and actors (in the case of compensation) apply agreed standards internally; this might have resulted in modest improvements in internal procedures since those surveyed knew the regulators could share these results if sufficiently alarmed (FSB, 2010a).

Despite this, thematic reviews cannot achieve a great deal. They are, in the end, just brief surveys and self-reported results to a small staff at the Board. The author participated in the

Thematic Review on corporate governance, and it amounted to a brief reporting exercise with no compliance aspects. Moreover, the FSB data gathered is indicative, not qualitative; it is self-reporting of status, not an assessment of actual practice by supervisors and firms (and is much weaker than the Basel III process). An FSB review does not make judgments as to actual efficacy; instead, it is an indication of whether regulatory or supervisory initiatives are underway to implement the principles and standards (FSB 2011b, 2011c). G20 countries are not being assessed on the actual application or implementation.

There is little evidence peer reviews embarrass or shame regulators who fail to act. The reviews make no determination that state X's application is effective while state Y's is not. Reviews make no judgments, implied or otherwise. At best, therefore, the reviews are a status report, a modest prodding of each FSB member to report regarding particular standards implementation. Perhaps the very act of having to report to the Board may be modestly helpful. The reviews can provide gradual soft pressure, but they are not enforcement. Smaller countries may be embarrassed into taking action. Key actors in larger markets, such as the U.S., the UK, or China, can still ignore them after reporting to the Board, just as they do with IMF surveillance.

Looking at the nature of the Board as a Westphalian forum dominated by powerful state actors (albeit technocrats) and driven by a power-based consensus with no independent voice or mandate of its own makes it improbable the Board can publish critical monitoring or peer review reports of key states, their actions, or failures to act. Differences may be papered over, avoided, or set aside. If this type of conflict avoidance happens (and it has in the past), rigorous reporting will not be seen. Supervision and oversight needs to be independent and at times forthright. It is unlikely the FSB can speak truth to power when such reports are being written by and agreed by its members supported by (not led by) a small seconded staff in a relatively weak institutional position.

The above discussion of FSB monitoring processes demonstrates that when FSB members lack a particularly strong consensus, or where they do not control an area of policy, this results in weak monitoring. A problem within the FSB Charter is exposed: its failure to create any obligations and enforcement duties for signatories. A state's commitment on standards, therefore, can be still be an exhortation with little perceived obligation to comply, especially if there is weak consensus amongst the community of technocrats tasked with executing

implementation; all know little will occur if states ignore FSB reporting of a failure to adhere to agreed norms or standards.

Finally, this type of reporting instead of compliance is made more problematic because of the total lack of transparency of the Board itself. The Board's operations and decision-making processes are opaque and inscrutable. Advocates maintain opacity allows free and frank exchanges during the reporting process. But external observers cannot judge whether critical observations are aired and addressed or instead covered up and ignored. Supporters of the FSB hope for adherence driven not by compliance mechanisms but by the creation of new international norms of behaviour. They hope to form norms similar to customary international law. According to Helleiner, this is a 'hardening of the soft law quality of the pre-FSB regime' (Helleiner, 2010; p. 9). It is indeed possible for standards to gradually achieve the effect of law if enough states adopt them within their borders and adhere to them; but if this does occur, it will be a slow process.

Placement on the policy reform matrix: MAP and peer reviews are new but relatively weak reporting instruments that only marginally impact policy implementation via the mechanisms of peer pressure. There is little evidence that the EWEs will be effective. These policies do not amount to enforcement processes. As surveillance tools they appear on the matrix but at this stage are "weak" and the policies move only slightly across the matrix.

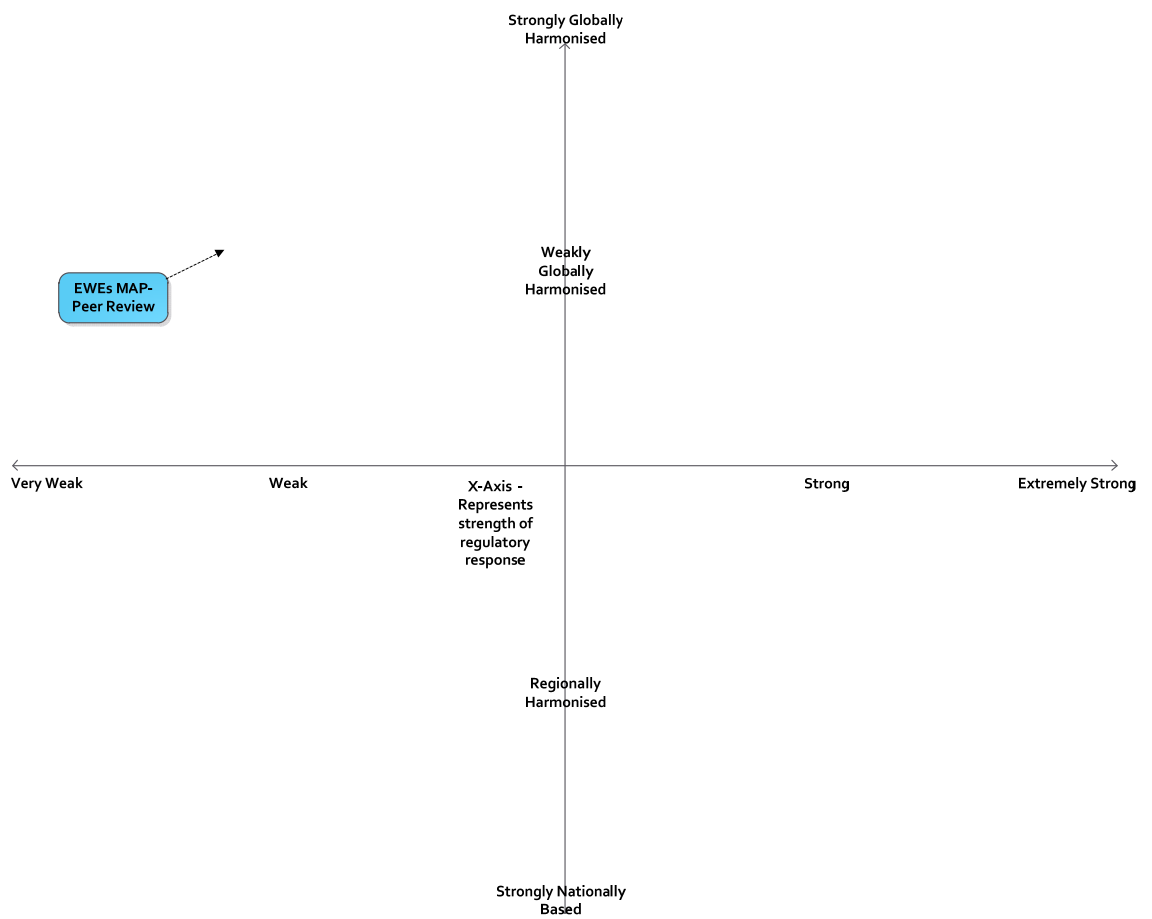


Figure 5.10 EWEs, MAP and Peer Review Movement on the Policy Reform Matrix

5.12 Conclusion: Strong policy requires a strong consensus to be made real

Ideas and narratives determine the boundaries of financial regulatory policy making and are essential to our understanding and analysis of the relative success or failure of the FSB and its policy output. This chapter shows that the output of the FSB varies from strong, to weak, to insufficient. The process is impacted by the extent to which that community has a collective recognition of systemic weaknesses and failures, the strength of the epistemic community in the policy space, and the extent to which a community adopts a new policy consensus and narrative to underpin the policy response. When all three factors are in place, a paradigm shift or third-order change is possible (Hall, 1993). When they are not, lesser outcomes are seen.

5.12.1 Policy coordination at a new level

A key output of the G20-FSB reforms is a process one with policy implications: the creation within the FSB of a more effective means of policy coordination and cooperation. The FSB is the general contractor for regulatory reform, and is central to the policy output. Without an effective coordinating mechanism whose structure and leadership fosters collective action towards common goals, the implementation of policies is harder to achieve. Compared with its predecessor, the FSF, the FSB's coordination is more effective, multi-layered, deeper, broader, and more dynamic. It is arguably a third-order shift in policy coordination at the international level, and thus can be considered a paradigm shift in international financial regulatory coordination.

In 2013, the Board has many of the characteristics of a permanent organization, with a growing staff, new resources, and a legal basis. The Board has structural components and processes that support coordination and cooperation and facilitate direction and policy convergence, through the agency of the Chair, Steering Committee, Standing Committees and Working Groups, and the Plenary. The Board is the principal venue for intensive engagement by key central bank governors, supervisors, and finance ministry officials, who lead the forum and direct their deputies in other subsidiary FSB committees and SSBs. Below the leadership strata, the Board demands the commitment of hundreds of other officials through its working groups, work streams, and in national policy implementation. The FSB is the concrete expression by the G20 and particularly the central banking community's shift in financial regulatory narrative. FSB participants are clear there is a qualitative and quantitative

improvement over past practices and mechanisms (Barnier 2011; Bussey, 2011; Tarullo, 2009, 2010; Trichet 2010c).

As the venue for the central coordination of the collective policy response, the Board succeeds where past forums failed or underperformed. The success rests on the demonstrated commitment of the Board's European and North American leadership coupled to the backing of the G20 political leadership throughout phases one, two, and three of the crisis response. Demands from those inside (to join the steering group) and those outside (to be better consulted via the Regional Consultative Groups) are reflective of that success.

The commitment of North American and European leaders to the Board's processes also signals the recognition by a declining hegemon and its allies of the need for a broader backing for their policy goals, albeit altered by the new worldview and paradigm. A politics of inclusion (Germain, 2001) and this functional cooperative mechanism—the FSB—is essential to engender cooperation and deliver desired policy outcomes.

5.12.2 Macro-prudential policy, the Basel III Accord, and the policy consensus

The Basel III Accord is the maximal response by the community of independent central bankers and supervisors acting through the FSB and BCBS. Their response—the adoption of a series of macro-prudential central bank policy measures and tools contained in Basel III—is recognised as a shift in the policy consensus by some of those present (Blanchard *et al.*, 2012, Constancio, 2010; Smaghi, 2008). That consensus shift and the independence and strength of the central banking community behind it made it possible to secure a relatively strong accord in 2009-2010.

The accord's various measures, together, constitute a third-order paradigm shift in financial regulatory policy. The accord marks the rejection of laissez-faire neo-liberal beliefs by the technical community. It signalled the reassertion of collective state power and regulatory authority over markets and banks. It is a new (to Western policy makers) approach to supervision and oversight of markets and firms. Basel III is the central core of the reform wave that started in 2009 and which continues today as paradigm defence and maintenance.

Its importance to the FSB community is underscored by the strong implementation measures created to support it. In this case, the community's collective narrative and new policy

consensus supports a more meaningful compliance and monitoring regime amongst their own membership. This results in an FSB-BSBC process which, for the first time, can make actual judgments on national implementation and regulation. This is not a small matter. Neither the FSF nor the BCBS previously had such a role. It is an example of the expert community engaged in paradigm maintenance and defence against those who might fail to implement properly. It is a recognition that the accord's implementation is essential to the new collective re-regulatory policy consensus and paradigm shift that has begun.

But is the accord enough? Critics think not. Wolf has called Basel III the mouse that did not roar and suggested 'tripling almost nothing does not give one very much' (Wolf, 2010). In this, Wolf is joined by others calling for higher capital requirements (Admati and Hellwig, 2013). This chapter has shown that many of the accord's strongest supporters would have ideally wished for higher standards, and many of these hawkish central bankers have gone on to apply Basel-plus national requirements. Perhaps the accord, had it been struck later, after the slew of banking scandals that occurred, could have been stronger. Given the opposition, such an outcome is doubtful.

The G20 and their central banking epistemic community experts were right to rush to reach a deal quickly. The negotiating win sets that opened up post-crisis in 2009 had to be exploited. Better to press an accord with the crisis still fresh in central bankers' minds and when the bank lobby was cowed by events and G20 leadership was strongly engaged than to drag out negotiations over a longer time frame, which could have permitted level-two win spaces to shrink and domestic pressures against a deal to rise.

From a purely practical and diplomatic standpoint, it was better to strike a politically possible deal than to reach for too much and get nothing or less in return. Having secured the deal, with backing from emerging countries and their leaders, the FSB community is now defending the macro-prudential paradigm through stronger implementation. Nonetheless, the use of taxation measures rather than prohibitions remains a weakness that is indicative of the outer boundaries of the paradigm shift. Continued vigilance will be needed to avoid a return of gaming and, hence, the importance of the implementation process in the future. It is too soon to make a final judgment on the fluid process of implementation.

It is also too soon to gauge the full effect of Basel III (implementation will not be complete until 2019), but it is reasonable to view the accord as the highest point in the financial

regulatory paradigm shift. Because of the strength of the initial accord, its multifaceted nature, and the improvements in the monitoring regime, this policy moves the furthest within the landscape of the policy matrix.

5.12.3 The further away the FSB is from control, the less uniform the process

When the FSB central banking community leadership is further away from the direct responsibility for policy creation and implementation, the output can be more mixed and ‘lumpy’, that is, the national application of G20-FSB agreed standards can vary to a greater degree and monitoring can often be less effective.

The analysis of the OTC derivatives reforms demonstrates this dynamic. Agreement at the G20 and FSB leadership level is not quite matched by the policy outcome from the national legislative and regulatory processes. Progress in this policy area has been substantial. Where previously there was no national regulation of derivatives, today all major G20 jurisdictions are implementing CCPs, margin requirements, and greater market transparency. But where new legislative and regulatory action was needed, state-to-state, domestic pressures and lobbies are applying pressure and seeking exemptions, undermining the goal of trading substantially all derivatives via CCPs. This contrasts with the Basel III example in which FSB leaders, as independent supervisors, were unencumbered by any need to consult level-two interests (i.e., the banks) during the drafting process of the accord in 2009-2010.

In the OTC derivatives space, the FSB had to pass the regulatory process down to the IOSCO as the oversight and coordinating SSB; the central bankers do not have regulatory responsibility in this area. The leadership of the process is thus removed from the actual policy making and the IOSCO, and its sub-state officials, are institutionally less powerful and hence less able to force the pace of change. This area consequently has a less robust monitoring process, with reporting but no judgments on the strength of respective regulatory fixes. As a result, the policy moves less distance in the policy matrix.

5.12.4 Compensation principles and institution building by stealth in the FSB

The FSB leadership in one case produced an important innovation in the face of disputes. This was achieved in the implementation of FSB compensation principles and practices across G20 states. Implementation differences led to complaints by various private sector

actors of unfair practices by their rivals. The FSB leadership reacted by constructing a bilateral disputes settlement procedure with a quasi-judicial role, creating potential institutional strength out of weakness. The new procedure has yet to be tested (as of September 2013), but it is potentially institutionally significant (Interviews 24 and 34, 2012).

The construction of an FSB institutional compliance and judgment process, may strengthen the FSB, moves away from mere reporting towards judgments, precedent setting, and the creation of customary practice. The policy moves in the matrix towards being weakly globally harmonised in the matrix, but there is clearly potential, once the dispute settlement procedure begins, for the policy to become stronger and codified. This is an example of institution building by stealth, led by the central banking community.

5.12.5 FSB standards and the limits of the regulatory paradigm shift

Some areas where ostensible agreement exists, have less promising outcomes, for instance, on the need to end Too Big To Fail which seems almost impossible to solve. This is due to the complexity of the area, and because the issue rests at or beyond the limits of the paradigm shift. As a result, the FSB community wrestles with the issue via resolution regimes and living wills, but in reality, the largest banks would not be allowed to fail, so the impact of the advisory policies remains weak and unsatisfying, and the position of TBTF deteriorates in the policy matrix rather than improves. The TBTF case demonstrates that the FSB consensus, as with any paradigm once in place, limits the options considered by the community. Thus, the break-up or regulatory limiting of the largest banks is not considered. Such a simple option is off the table because the FSB community consensus considers them heretical.

5.12.6 No consensus and paradigm conflict means no progress

Finally, there are also circumstances in which the G20 demands action, on new global accountancy standards, for instance, where the G20 and FSB leadership supports the goal. But there is no consensus below the G20-FSB level, and neither leadership party controls or oversees the standard setters in this case. Here, the differences between the two communities are just too large to bridge, i.e., Putnam's level-two disputes result in no win sets, and no progress is possible.

5.12.7 Gauging success in FSB policy making

Looked at as a whole, the FSB policy making has advanced international regulatory reform considerably on many fronts, as shown in the policy matrix (Chart 5.11). The general movement diagonally upward left to right across the landscape implies improved globally harmonized standards are being created. The FSB, its processes, the Basel Accord, derivatives regulation, and compensation standards all move across the landscape in a positive direction and are the most significant shifts. But the policy results are of varying strengths, with TBTF and related policies much weaker. Moreover in September 2012 the policy process is still underway, and the policies are still subject to attack.

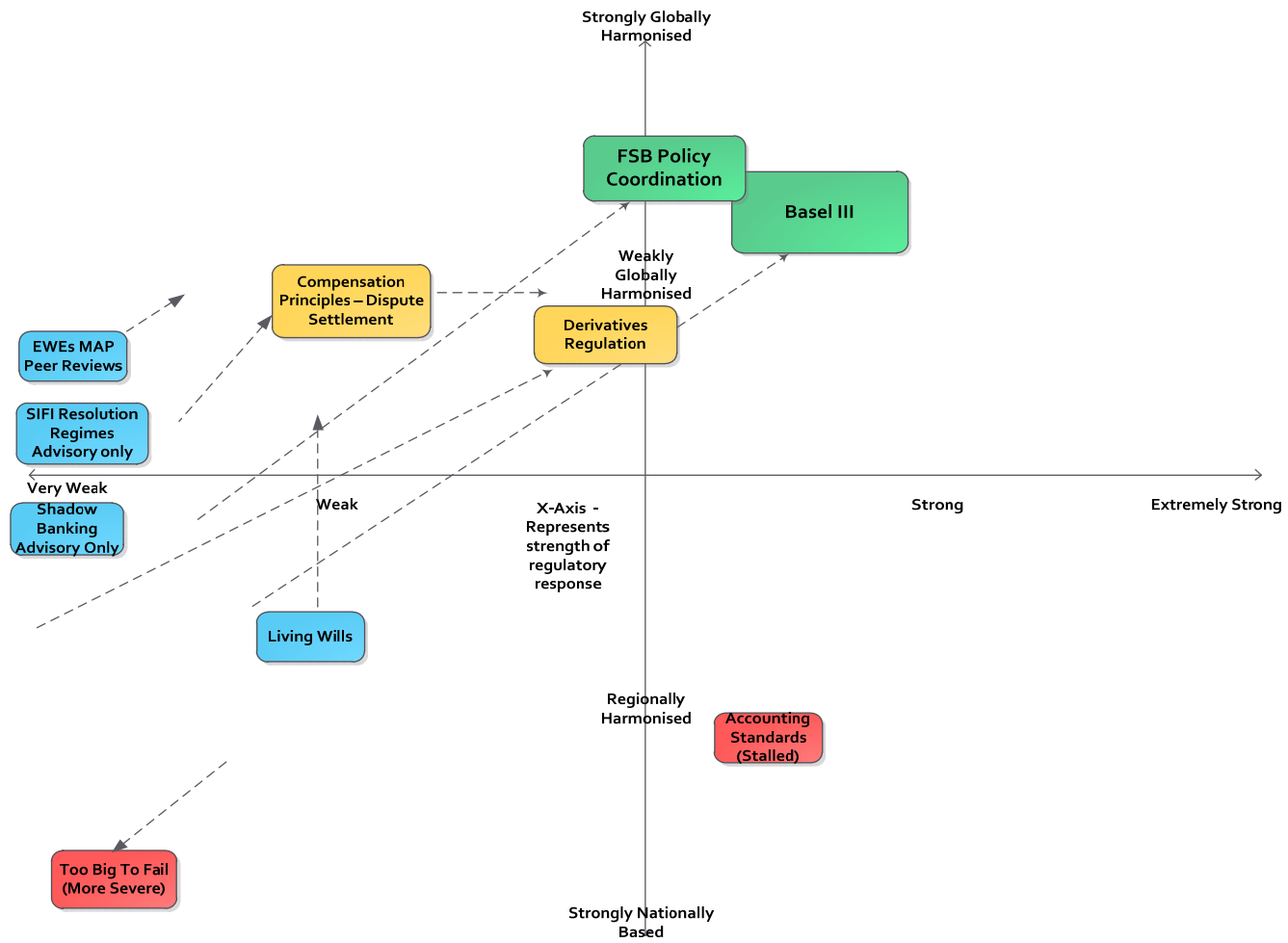


Figure 5.11 The Landscape of the Policy Reform Matrix

The FSB-led reregulatory paradigm shift underway is still limited. It does not extend to macroeconomic matters outside the regulatory reach (or beyond the consensus within which) the technical community operates. It does not imply the neo-liberal economic ideas have been overturned, only that the *laissez faire* deregulatory strain of thinking has been rejected by the central banking community and its supporters.

Have the policy changes been a success in making the markets more stable and less prone to crises? It is too soon to determine. In September 2013, the observer may be viewing this reform process from a contorted perspective and angle, riding on and up against the wave, with not all of it visible at a glance. The reform process is not over. Many policies remain to be fully implemented, and definitive judgments as to the final success of the output cannot be made. In the G20-FSB reforms, one is ‘witnessing an extended process rather than the result of a single moment.’ (Helleiner, 2010, p. 625) ‘We are in the early stages of a reformation of finance.’ (Haldane, 2012d, p. 2)

The FSB expert community is still constructing the reforms, strengthening the regulatory paradigm, and defending it against opponents, backed by the G20 summitry, and despite some visible weakening of political consensus in the third phase of the G20’s evolution.

Are the reforms enough? It depends how you view the reform wave. The G20 and FSB community has to deal with political and diplomatic realities. They are working within the new consensus that delineates the limits of the policy-making space. But key institutional and policy reforms are much more robust than would have been possible absent the galvanizing effect of the crisis. The FSB would not have been created, a body that now plays the key coordinating role. Basel III and its monitoring functions would not exist. Other reforms are of varying strength, but all add to the amplitude of the wave of the re-regulatory paradigm shift. Looked at as a whole, the policy reforms are evidence of a real and potentially lasting shift.

Four years after the start of the process, the FSB reforms are driving bank deleveraging, requiring capital raising, pressing down on the excesses seen pre-crisis through market mechanisms, and changing firm-level strategies and practices. This suggests a possible cultural shift in how banks are viewed and how they should conduct their business. If these cultural changes take root, they will strengthen the new re-regulatory policy paradigm. Is this window dressing or for real? Once again, looked at individually, such cultural changes may seem paltry. But viewed in totality, they may perhaps indicate the financial reform process is

being strengthened by adjustments to cultural norms and practices in global markets and amongst individuals firms, country to country, market to market. If that proves to be the case, this would be an indicator of the strength of the re-regulatory consensus and new paradigm as it is converted into regulatory policy and into economic, political, and cultural outcomes.

Chapter 6. Reform of the IMF: The G20 Takes Charge

6.1 Introduction

This chapter analyses the steps taken by the G20 to reempower the International Monetary Fund (IMF) in response to the global economic crisis that began 2008. That process had several strands. Of most importance, the G20 agreed to massively increase IMF resources, and the chapter dissects how and why the G20 re-energised the IMF and sought to better equip it to act in its traditional lender-of-last resort role and as an essential conduit for stabilising flows of funds to states in crisis.

G20 summit diplomacy also resulted in a number of relatively modest evolutionary governance and voice reforms that have had the effect of drawing emerging countries back into a stronger commitment to an IMF within which their role and voice would also be potentially more influential. Taken as a whole, the IMF reforms will be seen to be incremental, first- and second-order reforms, emblematic of a slow gradual rebalancing of power and influence away from the old core and towards the emerging countries within an existing structure and organization. Reform of the IMF is an important facet of the global regulatory redesign, even though the IMF is not the key player. Unlike other parts of the regulatory architectural redesign galvanised by the G20 post-2008, the reforms in the IMF case suggest reluctance by G20 states and the IMF staff to make more major post-crisis changes.

As the G20 leaders and their technocrats took charge and drove reform at the IMF, they went only so far. Coming out of the crisis the IMF would be a stronger, more relevant institution, but it would not be at the centre of the financial reform architectural redesign. Rather, the IMF would be driven by the G20 leadership and have only a marginal role in financial and regulatory reform matters. Compared to other new structures designed by the states leading the response to the financial and economic crisis, the IMF would not be at the heart of the policy response. Despite this apparent demotion, the G20 memberships' collective recommitment to the IMF (especially emerging countries' recommitment) is still noteworthy, particularly given how weak and irrelevant the IMF had become prior to the onset of the 2008-2009 crisis.

The G20-led reform of the IMF would make it once again a relevant, better-financed, marginally reformed organization, tasked with assisting in the collective macroeconomic and financial response to the crisis. The G20 used the IMF to channel financing from states with excess surplus reserves to those states in crisis, swiftly but with conditions, to achieve identified common goals. The IMF's resource boost, internal reforms, and policy changes depended on G20 summit deals among somewhat reluctant advanced economy leaders and more eager emerging-country leaders intent on seizing a greater degree of control over the IMF in return for their money.

But memories of past perceived IMF failures in the 1990s lingered and as a result the IMF was pushed to become to a degree subservient to the G20, to serve the G20 agenda and objectives. Today, compared with the other actors—the G20 and the Financial Stability Board (FSB)—the IMF has a 'limited role and visibility' (Beeson and Broome, 2008, p. 393). Why is this? It is because the IMF performed poorly before the crisis and lacked legitimacy. In the end, 'it comes down to a failure of the IMF, a failure to identify the crisis, and a failure to act' (Interview 19, 2012, p. 1). G20 actions would ensure that, in 2013, the IMF is reinforced as the global lender of last resort to states facing balance-of-payment crises. The IMF once again has an important macroeconomic crisis-fighting role to play but it is not in the lead.

Reforms mark a gradual evolution of the IMF away from one led and dominated by U.S. and European officials, as the balance of state power shifts within the institution and emerging countries demand a larger role, albeit haltingly, and with many discordant voices. Ultimately, the G20 reforms should result in an institution that more closely mirrors changes in the relative economic power and importance of developed and emerging countries. But it will take time for these reforms to alter the nature of the organization and its culture, ideology, practices, and policy stances. Taken together, the reforms amount to first- and, at most, second-order changes (Hall, 1993).

This research suggests there has been no paradigm shift inside the IMF, in its central neo-liberal economic ideology, in its lending practices, or in its operation. Despite the organization's past failures, there has been no real rejection of existing 'truths', no revolution from within, and no adoption of a new approach to IMF macroeconomic oversight and management of the global economy. There is no evidence of a fundamental reappraisal of the IMF's mission, overall ideology, or functioning. Despite the IMF's pre-crisis mistakes, the

number of anomalies was not enough to force a major shift in worldview amongst the staff or state shareholders. The research found an internal policy consensus successfully resisting change. The community view within the IMF is neo-liberal, creditor-focused, firmly power-sensitive, member-driven, and remaining internally ideologically resilient.

Today, the IMF remains an organization staffed by officials largely supportive of the neo-liberal worldview professed by key states representatives, echoed by a staff of like-minded, similarly trained economists (Chwieroth, 2007). This is the case even as, at the very top, the French leadership pushes the IMF to adjust its view of the merits and speed of austerity and the merits of capital controls policies to halt capital flight (in Europe at least).

The IMF is a member-driven organization, and the member states' refusal to take more radical reform steps shows their diverging national positions and the limits of the G20 policy consensus on the future role of the IMF. The IMF serves its creditor members' interests first, and its lending and surveillance work reflects this reality, and neither will change with any rapidity. IMF shareholders control the rate of policy evolution, operating within an existing institutional structure, driven by national political and economic concerns. Unlike examples described elsewhere in this research (see chapter 5), the IMF is adjusting but not fundamentally altering its nature and ideology.

6.2 Background

The history and evolution of the IMF has been discussed in detail by many authors (see Babb, 2007; Bluestein, 2001; Fischer, 2005; G30, 2009a; Helleiner, 1994; James, 1996; Kenen, 2002, 2007; King, 2006; Peet, 2010; Thacker, 1999). At the IMF's creation in July 1944, representatives of 45 countries agreed on a framework for the international monetary system, to be established after World War II. Delegates saw a need for collective institutions tasked with ensuring a stable international monetary system that would protect and promote a market-based alternative to the Soviet Union (Beeson and Broome, 2008). This market system would be a regulated one characterised by limited capital flows and currency markets managed by governments to maintain stability (Ikenberry, 1992). A regulated system was championed by the U.S., the U.K., and their allies in Europe. It was anchored by the U.S. dollar pegged to gold and managed in concert by the key IMF shareholders. The IMF was a key part of the U.S.-led embedded liberalism of the period (Helleiner, 1994; Ikenberry, 1992;

Ruggie, 1982) and it proved ‘extraordinarily successful’ (Gilpin, 2001, p. 234) in fostering postwar economic stability and growth.

6.2.1 *The end of the Bretton Woods system and the beginning of market fundamentalism*

The managed exchange rate system delivered decades of postwar stability and ensured there were very few banking and financial crises (King, 2011a). Ultimately, in the early 1970s, the Nixon Administration decided not to keep the dollar-to-gold window open at US\$35 per ounce; the Administration sought greater individual national economic policy room to manoeuvre, something that was not possible if the U.S. continued to act as the anchor of the global international monetary system (Gowa, 1983).

U.S. abandonment of the managed exchange rate system commenced a period characterised by the progressively rapid liberalization and growth of the global financial system, of complex markets and capital mobility, and an increased frequency of crises and volatility (Hoogveldt, 2011). This was underpinned by an emerging adjusted neo-liberal political and economic ideological worldview that provided *ex post* justification for the global financial market changes underway (Patomaki, 2011). This paradigm came to eventually dominate policy, academic economics, and financial markets as the established orthodoxy in the decades prior to the 2008 crisis (Beeson and Broome, 2008; Padoa-Schioppa, 2010a; Subacchi, 2008; Turner, 2011).

The IMF responded to the liberalisation and deregulation of the international monetary system with alterations to its mission. It stressed the balance-of-payment support it could provide to the weaker states funded by creditors at the core (led by the U.S.) together with the supposedly even-handed surveillance advisory role delivered to its membership. In pivoting towards individual country surveillance, the IMF may have partially lost sight of the global financial stability role that it was still meant to play. In focusing on an advisory role, the IMF faced countries that often did not wish to listen.

Although the U.S. had abandoned the gold standard, it continued to dominate IMF decision making (supported by the U.K. and other advanced states). The U.S. backed a developing neo-liberal laissez faire, pro-capital, pro-conditionality worldview known as the ‘Washington Consensus’ (Williamson, 1993, 2004) by its backers or as ‘market fundamentalism’ (Stiglitz, 2008) by its critics, which had been under construction by the IMF for decades prior to the

1990s (Babb, 2007). The 10 policy prescriptions of Williamson's Washington Consensus underpinned an ideological approach which assumed that states and central banks must ensure the financial markets function with as few barriers as possible, that client states of the IMF (borrowers) had to 'stabilize, privatize and liberalize' (Gamble, 2009, p.85). During this period, the IMF staff and leadership, as well as other major international institutions (including the World Bank), internalised this economic and ideological stance as the new orthodoxy. Critics such as Sachs (1999) and Stiglitz (2002, 2008) pilloried this Anglo-American policy prescription, arguing that it sought to apply one-solution-fits-all to states regardless of their level of economic development, culture, or economic model. It would take a series of linked economic crises to shake the legitimacy of this IMF worldview—crises that led many IMF member countries to essentially abandon the institution and look elsewhere for their future national financial stability and prosperity.

In the 1990s, the Mexican, East Asian, and Russian financial crises brought the lending policy conditionality and political bias underpinned by the ideology within the IMF into stark, unflattering relief. Currency and balance-of-payment or capital account crises in Indonesia, South Korea, Malaysia, Mexico, Russia, and Thailand were dealt with by the IMF with variants of the orthodox solutions of tax increases, government spending cuts, interest rate rises, the floating and devaluation of currencies, and demands to rapidly liberalise markets. In some especially egregious cases, such as South Korea, the IMF included requirements that were especially controversial, such as demanding the wholesale restructuring of South Korea's major industrial conglomerates (Bluestein, 2001), calling into question its export-driven economic growth model. The staff and the Western leadership of the IMF were seen to be challenging East Asian capitalist development. It was a straight paradigm clash between Eastern and Western development models (Gills, 2000).

During and after these multiple country crises, the IMF was accused of 'being used by the U.S. and its allies as a vehicle to achieve [their] own ends' (Meltzer, 2000). The IMF and the Washington Consensus solutions it demanded in this key period in the 1990s were condemned for aggressively pressing counterproductive conditionality on Asian and other states (Stiglitz, 2002). Of course, not all agreed with this view (Fischer, 2005; Rogoff, 2002; see also Kaufman, 2010).

Leaders of the East Asian states that faced national economic calamity largely agreed to the policy demands of the IMF and the affected countries rebounded, most with IMF financial

support. But severe damage was done ideologically and politically to the organization's credibility. East Asian leaders, deeply angered by the IMF's policy solutions, took steps to ensure they did not face the same choices again. The events of the mid-1990s proved to be a paradigm clash, between the Asian viewpoint, led by Japan, and the U.S. and IMF's ideological position (Wade, 1996). The result was a negative one for the IMF; its legitimacy was greatly weakened instead of strengthened by the scale and hostility of the clash of economic ideologies and models. Asian states responded by moving away from the Bretton Woods paradigm (Kapur and Webb, 2007).

Emerging market countries that could do so engaged in a rapid build-up of central bank reserves as self-insurance against future market volatility and capital flight (Chin, 2010). This move exacerbated imbalances and drove down global interest rates, contributing to a search for yield amongst investors and fuelling asset booms in the U.S. and Europe. Member countries' self-insurance activity also pushed the IMF into increasing irrelevance, and the organization's value to its membership dropped precipitously as the member countries moved to stop relying on the IMF for funding in crisis situations.

6.2.2 An organization facing an existential crisis

By the mid-2000s, the IMF was a hollowed out and greatly weakened international financial institution. It was suffering from a gaping legitimacy deficit. It was seen as an institution run by the few at the core to the periodic detriment of those at the periphery. Emerging-country leaders were leery and highly critical of the IMF because of its lending history, the effect of conditional medicine dispensed, their underrepresentation within the institution, the policy biases evident in the U.S. and European domination of the Executive Board decision-making processes, and the related IMF staff ideology. Many governments, most notably Argentina and Brazil but also Algeria, Bulgaria, and Uruguay, made clear their dislike of the IMF's internal balance of power and policy making, by repaying loans ahead of schedule (Swann, 2007). This was indicative of the emergence of real funding alternatives, as well as changes in investment flows as seen, for example, in China's increasing lending to and investments in Sub-Saharan Africa.

By 2007, the IMF had only one remaining large borrower: Turkey. With almost no members borrowing funds, and with its income depending on interest payments from these loans, the organization confronted a negative projected income of 59 million SDRs (IMF, 2007a, p. 7),

and layoffs commenced. The late Andrew Crockett, former General Manager of the Bank for International Settlements, was tasked with finding a solution. He recommended selling a portion of the IMF's gold reserves to generate sufficient income to keep the doors open on Pennsylvania Avenue in Washington, DC (IMF, 2007b).

Prior to the 2008 financial and economic crisis, the IMF's mission was seriously in doubt. It was an organization in decline with few supporters and was suffering an 'existential crisis' (Eichengreen, 2007, p. 153). In fact, it was unclear whether the world needed the organization anymore. Such was the general prevailing wrongheaded paradigm about the stability and strength of global financial markets and firms that few observers identified the danger of a major black swan event (Taleb, 2010) or fat tail risk in 2006-2007. 'Serious people were asking whether [the IMF] should be closed down' (Eichengreen, 2009). What a difference a global crisis makes.

The case for reform of the IMF, for increased resources, and improvements to governance has been recognised by many observers (BIS 2008; Eichengreen, 2007; Griffiths, 2010; G30, 2009a; IMF, 2009c; Kenen 2007; King 2006; Thimann, Just and Ritter, 2009; Truman, 2006 and 2009). But until the 2008 financial and economic crisis, support for reform was largely lacking in national capitals of the principal shareholders (except the U.S.). The severity of the 2008 crisis clarified thinking on the need for reform. It forced a convergence of positions and pushed level-one negotiators together. It opened up level-one and level-two win sets internationally and domestically (Putnam, 1988) that did not previously exist. It made agreements by the G20 leadership possible on reform that would have previously been impossible. A recapitalization of the IMF would be needed in order to prevent the crisis from becoming a painful, prolonged global economic contraction, i.e., another Great Depression.

6.3 The G20 Takes the Lead

The post-2008 history of the IMF is one in which reforms are directed by the G20 leaders agreed by the leadership of both advanced states and emerging countries acting in concert seated around the same table for the first time. This dynamic, in which the G20 leaders' forum sets the broad reform agenda, reforms the IMF, and in effect determines the IMF's objectives, is clearly seen in the output of the summits.

The G20 forum today provides *de facto* leadership of the IMF via the summits' and members' dominance in the International Monetary and Finance Committee (IMFC), a role previously held largely by the U.S. and its allies from the West. G20 summitry appears to drive IMF reforms. Indeed, the G20 summit decisions signal a modified collective narrative adopted by the G20 on the utility of the IMF, an emergent adjusted policy consensus comprised of:

1. An implicit agreement on a modified, improved, but simultaneously diminished, position of the IMF within the global architectural superstructure;
2. An agreement on considerably increased IMF resources;
3. An agreement on modest governance changes and adjustments in the relative power of emerging market countries within the IMF itself to reflect global macroeconomic realities; and
4. An agreement on modest adjustments to the IMF's surveillance role.

This evolving G20 policy consensus on the IMF's position and role does not, taken as whole, change the nature of the institution in the short to medium term. Rather, it shifts the IMF's position in the regulatory architecture and changes the makeup of its creditor base and decision-making processes. These architectural, resource, and governance reforms are first- or at most second-order changes. The internal surveillance policy adjustments are themselves so incremental as to not constitute anything more than first-order changes (Hall, 1993).

6.3.1 *The G20 dominates the new architecture*

The new G20 consensus on the IMF leads to an outcome that places the IMF below the G20 in the new architectural superstructure, and, for matters related to financial market reform, side-by-side with the FSB (see figure 3.1, p.79). The G20, in this schema, is dominant in a manner not seen in the case of the G7, which did not, stand at the top of the 'as was' superstructure. The G7 met and pontificated on macroeconomic matters, usually ineffectively. Its members would occasionally intervene on currency issues (with the Plaza Accord, for instance). But the G7 was and is a loose grouping; its summit communiqués are famously vague and rarely result in actions.

In contrast the G20 summitry in phases one and two was more assertive in its application of collective state power to common problems. Importantly, the G20 is also backed by and

supported by the coordination process overseen by the technocrat community in phases one, two, and three. The G20 sits as the apex of the new architecture, assisted by the FSB in its reforms and an IMF that is downgraded in the hierarchy.

Previous financial crises responses were led by the IMF supported by the U.S. and G7 allies (such as the Mexican crisis or Asian crises). They concerned the failings of the emerging countries, and the U.S. and its allies left the IMF to dole out the conditional medicine. In 2008 and since, this has not been the case. This crisis occurred within the U.S. and Europe, those leaders were not about to defer to the IMF for their remedies. Instead, the G20 leaders determined the resources, roadmap, and required outcomes in close consultation with the IMF and other actors (such as the European Central Bank). The IMF was then put to work in support of the G20 goals.

As G20 leaders moved to strengthen the IMF during 2008-2009, they thwarted an attempt by the IMF's managing director to take the lead role in financial reform. The Strauss-Kahn–Draghi letter of November 2008 should be read in that context (IMF, 2008a). It was a victory for the G20 and their central bank governors and technocratic elite in the struggle with the IMF leadership over who would direct financial reform below the G20. It is notable that a similar clash, between Andrew Crockett, first chair of the Financial Stability Forum (FSF), and Stan Fischer, Deputy Managing Director of the IMF, as heated but less significant institutionally, also took place when the FSF was created in 1999 at an earlier time of crisis (Bluestein, 2012). In 1999, Fischer won, and the IMF continued to lead global financial crisis management. That did not happen in 2008.

At its most basic, G20 leaders and their central bankers did not trust the IMF in 2008 to take on responsibility for financial reform. The G20 actors viewed the IMF with continued suspicion, given its past failures, and did not believe it had the right skill set to deliver on regulatory reforms. Therefore, leaders and central bank governors maintained control, with the latter strengthening their policy roles and prerogatives and emerging from the crisis stronger not weaker, even though they, too, had failed to see the economic crisis before it hit.

In 2008, the IMF-FSB clash was less of a struggle and more of a pushover because there was no likelihood that G20 leaders would hand over the financial reform agenda to an institution that national leaders and central bankers viewed with suspicion; saw as being bureaucratic, and highly dysfunctional (Interview 24, 2012); or saw as simply not suited to the task of

financial regulatory redesign (Interview 20, 2012). Neither advanced nor emerging-country leaders would agree to trust financial reform to a universal institution they each mistrusted for their own, different reasons.

Post-crisis, G20 decision making and summitry appear to provide the intellectual and policy lead to the IMF's own agenda (Interview 20, 2012). The IMF has reacted by structuring its own internal decision processes and work programme to produce results in advance of the G20 summit timetable so as to maximise its impact and influence. The pressure is not unidirectional: The rotating G20 Presidency pushes and pulls against demands from other members and the IMF. Large states such as the U.K. and the U.S. can and do control the policy and summit declaration writing process during their Presidency, and have to alter their positions based on demands from other leading G20 states (as in Washington, London, and Pittsburgh). Not so on IMF reforms, which in phases one and two saw reforms driven by the leading states. The IMF was largely on the receiving end of G20 policy directions.

The dynamic is not the same with emerging-country G20 Presidencies. During these summits, smaller states are, aided by the IMF leadership and staff, but in a manner that also pushes the IMF's own agenda (Interview 20, 2012). In Toronto and Seoul, smaller G20 Presidency states played a weaker role with respect to other G20 states, and they also do so with respect to the IMF; the IMF leadership simply has more resources and more levers to pull to influence outcomes in a way that a weaker G20 Presidency is unable to match. Despite this, it would be wrong to conclude that the IMF staff is in a strong position vis-à-vis its G20 members who act in leadership roles for the IMF. They are not.

Leadership of both the G20 and IMFC is often the very same political figures wearing different hats for back-to-back meetings which are hosted by the IMF, acting in an ad hoc secretarial role (the G20 has no permanent staff). After summits conclude, the G20's impact continues to be felt. Below the level of the IMFC, within the Executive Board of the IMF, the G20 representatives dominate this consensus-based, decision-making body at the top of the IMF (Interviews 14, 19, and 20, 2012).

6.4 The G20 and IMF Resources

G20 leaders from 2008 through 2012 would agree an almost 400 percent increase in funds from shareholders, advanced and emerging. This constitutes a major recommitment of

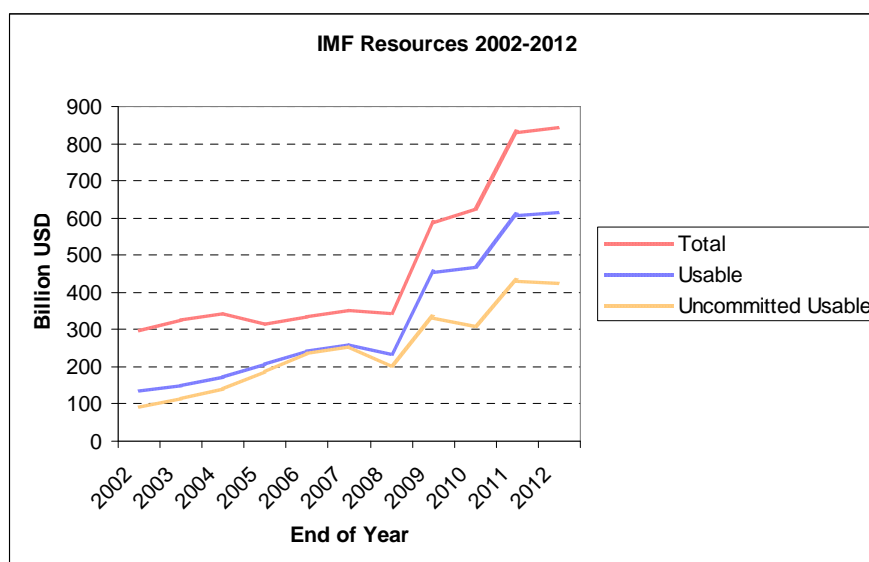
members to a strengthened IMF. To get there would require much negotiation, debate, and manoeuvring around the increases. Successive managing directors would push for increases in resources, but the engine of reform is clearly provided by G20 leaders via the summits rather than being driven by the IMF itself. The G20 would agree to multiply the IMF resources and let the IMF get back to work as lender of last resort for countries *in extremis*. The resource increases would come in waves in response to the peak of the crisis in 2008, the post-crisis reform movement in 2009, and the Eurozone crisis during 2011-2012. The resource demands and commitments are impacted by national domestic interests and by economic and political constraints that also affect the extent to which collective action is possible by IMF member governments.

Overall, the G20-led IMF resource increases do permit a modest growth of emerging-country influence within the IMF, but they do not produce cultural or institutional paradigm shifts inside the IMF. The funding reforms could ultimately alter the functioning of the IMF, and eventually its internal ideological stance, lending actions, and surveillance behaviour. Although it is too soon to see concrete evidence of this at present, interview results suggest that a gradual power shift has begun as the balance of creditor shareholder power. The G20 moves, taken as a whole, are an important part of the global response to the crisis addressing the immediate financing needs of members whose economies were worst hit by economic crises. The G20 recapitalization moves include numerous resource injections:

- ❖ At the 2009 London Summit, the G20 agreed a tripling of the current funds available, up to US\$750 billion, including US\$500 billion for the New Arrangements to Borrow (NAB); total NAB commitments ultimately provided were 370 billion SDRs, or US\$565 billion (IMF, 2009d).
- ❖ G20 leaders agreed to the 14th quota review in December 2010, amounting to a doubling of SDR quotas to 476.8 billion, or US\$733 billion (IMF, 2010d).
- ❖ In response to the Eurozone crisis, G20 leaders and the IMFC agreed a further US\$461 billion in boost to IMF resources, in Los Cabos, Mexico in 2012 (IMF, 2012b).

Figure 6.1 illustrates part of the increase in funds provided by members to the IMF in response to G20 summit decisions, broken down by total resources, usable resources, and uncommitted usable resources available to the IMF from 2002 through April 2012. Prior to the crisis, usable and uncommitted usable resources were almost identical because member

states were not borrowing from the IMF, hence its crisis of mission and its operating deficit. The leap in all three categories of funds in 2009 is a result of the London Summit commitments. As resources jumped during 2009 through 2012, borrowing also increased in response to crises. (Note: The figure does not include the full 14th review quota increases or the US\$461 billion in further financing in response to the Eurozone crisis. Once in place, the total resource increases amount to a jump of close to 400 percent from pre-crisis levels.)



Source: IMF.

Figure 6.1 IMF Financial Resources and Liquidity Position to 2012

‘The G20 is best when it is brokering resource deals at the highest levels and thrashing out compromises’ (Interview 19, 2012, p. 3). IMF resource commitments agreed by the G20 are of that type—big picture, headline numbers suited to summitry and periods of crisis and rapid collective governmental policy response. The increase in resources for the IMF, enables the IMF to provide balance-of-payment support for solvent member countries seeking to buttress their financial position against the crisis and liquidity concerns. Mexico and Poland, for example, received funds via the Flexible Credit Line. The IMF has also provided funds to support states actually confronted by imminent financial and budgetary crises such as Cyprus, Greece, Ireland, and Portugal, via traditional IMF lending programmes.

6.4.1 Diplomatic manoeuvring and IMF resources

The agreement to increase IMF resources involved at the outset leadership from the core, as well as significant support and input from emerging countries. Then-U.K. Prime Minister Gordon Brown played a leadership role in London in 2009 in pushing for a deal on IMF

finances aided by others, notably U.S. Treasury Secretary Timothy Geithner, who insisted on the higher, US\$500 billion, NAB figure ultimately agreed at the summit (Interview 5, 2011; Interview 12 2012; see also Brown, 2010). Japan also acted as a major source of funds (Interview 32, 2012). Emergency NAB funds committed in 2009 broken down by contributor (in billion SDRs) show the still important role of the core: U.S. - 69 billion; Japan - 69.9 billion; Germany - 25.3 billion; France - 18.6 billion; U.K. - 18.6 billion. The enhanced financial role played by emerging countries is also clear: China - 31.2 billion; Brazil - 8.7 billion; Russia 8.7 billion; India - 8.7 billion (IMF, 2012a). But it is still a minority stake in this IMF resource boost.

In 2009, leaders in the G20 acted swiftly and collectively. Major states from the core and emerging countries stepped forward and did so at low risk to their sovereignty, since they would not be borrowers but creditors (Kaya, 2012). In the midst of the crisis management and reform phases of the response, leaders, advanced and emerging, agreed on the need for additional resources and, within that, on the financial, economic, and diplomatic necessity of including emerging countries' cash and recommitment to the IMF, since the former needed cash and buy-in from the latter.

The pressure of the collective crisis created a policy convergence and consensus on resource reforms. Leaders in Washington and London looked over the cliff into the abyss of financial collapse, and they knew they had to act, and act fast. Normal level-two domestic concerns appear to have been overridden by clear level-one goals that overlapped and intersected at the moment of greatest peril. No one could afford to return home from London without a major deal (Interview 5, 2011; Interview 17, 2012).

The London Summit saw the emerging countries take a larger role as creditors to IMF programmes. This was a power play by emerging countries within the organization, as well as a recommitment to an organization they had previously disdained. Emerging-country leaders understand that the larger the creditor, the greater the influence. The larger role for emerging states also reflects the relative fiscal weakness of advanced economy member states in 2009 and since, with the largest currency reserves residing in the emerging countries' central banks; in China and Saudi Arabia, for instance.

The IMF resource increases were backed by the U.S., which sought, not for the first time, to change the balance within the IMF Board and governance process. The U.S. backed the NAB

increases, the recapitalization via the 14th quota review and a doubling of SDR quotas, and an increase in the votes held by emerging-country Executive Directors. This was in line with longstanding U.S. policy preference to gradually rebalance the financing and the power within the IMF (Interview 12, 2012) away from an excess representation of Europeans on the Board.

Since 2010, additional cash infusions have been more difficult to achieve. The sovereign debt crisis in the Eurozone, which worsened in 2011 and 2012, created considerable tensions within the G20 over how to provide yet more finance for the IMF. Demands for further cash occurred at a time when the G20 leaders' policy consensus had frayed and they were no longer in accord over whom was to blame for the latest phase of the economic crisis, what should be done, and just who should pay the bill. Disagreement rather than a policy consensus was seen in and on the Eurozone. A strong common policy narrative was lacking even as all agreed that a Eurozone collapse, multiple unmanaged sovereign defaults, had to be averted. In this manner dissension and disunity in phase three was fuelled by conflicting national interests.

The U.S. and others took a strong line that Europe must deal with its own crisis, that the Euro is a reserve currency, and the EU states have the resources, political and fiscal; they should act first (Interviews 14, 19, and 21, 2012; see also Blackenden, 2012). The U.S. position reflected domestic realities; a split Congress would not vote on further IMF funding before the 2012 presidential election. Although U.S. officials indicated they would not block a deal financed by others, initially U.S. negotiators had no win-space because domestic opposition meant U.S. officials lacked an overlap between their level-one and level-two positions. Divergent international and national negotiating concerns could be seen amongst other IMF states, as well.

Europeans were opposed to additional finance from emerging countries if this meant an additional quota and voice shifts in the IMF; i.e. a loss of institutional influence and power; level-one blocking issues in Putnam's terms (Putnam, 1988) (Interviews 20 and 21, 2012). The U.S., also balked at any immediate additional watering down of their voting power, arguing they would be, after the 14th review, underrepresented (Interview 17, 2012), given the size of their economy as a percentage of global GDP, a credible complaint supported by others (Interview 32, 2012).

Emerging countries faced their own political and domestic constraints. Leaders reportedly did not wish to commit yet more cash to the advanced countries' economies without clear changes in quotas and votes; level-one negotiating concerns (Interviews 16 and 21, 2012). Emerging countries were resistant to financing bailouts of European states even as their own economies slowed and required action, because their populaces viewed the bailing out of rich Europeans as a bad use of funds, a level-two domestic political concern that impacted positioning and win sets (Interview 21, 2012).

Ultimately forced by the pressure of the external economic crisis, continued widespread market volatility, panic, growing yield spreads between the Eurozone core and the periphery, and a recession in Europe, i.e., a still deepening crisis of global impact, US\$461 billion in additional funds was agreed by the G20 and IMF in Los Cabos. This was a success for both the G20 and IMF, although the total was less than Managing Director Christine Lagarde's maximum demands (Interview 30, 2012). The cash came predominantly from Europe (US\$200 billion-plus) as exceptional bilateral financing, which addressed U.S. demands that Europe bail itself out.

Funds from IMF members did not involve additional quota increases that would have required governance changes opposed by the U.S. and Europeans. No cash came from Canada or the U.S. (Harding and Jones, 2012); neither had the domestic room to manoeuvre. Overall, the deal reinforced an IMF firewall with EU cash, avoided further immediate fights on governance, and sidestepped the problem of zero financing available from the U.S. On balance, Los Cabos delivered a nuanced deal with a large additional resource boost which was sensitive to the negotiating constraints faced by all the players at that stage.

To conclude, the resource increases and associated political jockeying had different phases, driven by the nature of the crisis, first global, then concentrating in the Eurozone, and its oscillations, as well as diplomatic and domestic policy drivers. *In extremis*, the G20 process worked well in both 2009-2010 and 2012. Major resources injections were provided to the IMF as governments reacted to the crisis and began to reform the global architecture. Yet more funds were provided during a period of increasing disunity, as diverging national demands began to complicate matters and fracture the G20 policy consensus and coordinated crisis response.

6.4.2 *A lot more cash but no paradigm shift*

IMF resource injections, are not evidence of a paradigm shift or third-order change within the organization, because the IMF's lending policies and objectives, practices, or orientation in reaction to events before, during, or after 2008 remain essentially the same. This is in contrast with the more aggressive FSB shifts, which are overarching in their scope. The G20 simply provided the IMF with more fuel and pressed the IMF accelerator; it would get back to work, using essentially the same policy instruments that were in place.

The increased funds re-energised the organization (Eichengreen, 2009), but the organization began lending without major changes in its policies and approach. Giving the IMF more money to do what it is supposed to do—bail out countries facing balance-of-payment or currency crises—does not constitute a third-order change. Today, it is back to business as usual, with a bulked-up IMF. Nonetheless, several tentative observations and conclusions can be made, drawing on the considerable existing academic work on IMF lending programmes as to how the new funds will be used by the organization, one with a gradually changing leadership and balance of power.

6.4.3 *Lending to friends and allies first and foremost*

Research on IMF lending processes demonstrates its dynamics and shows that politics and economics intrudes into the lending process, with substantial influence being seen by major shareholders (Steinwand and Stone, 2008). Lending can be impacted by the political persuasion of the country in question (Bird and Rowlands 2001; Stone 2002). The likelihood of receiving a loan can be affected by various factors including the recipient state's political and economic linkages to the U.S., as well as its relative size and Executive Board representation in the IMF (Barrow and Lee 2005; Thacker 1999).

The conditions attached, and the type of loan monitoring are both affected by the country's ideological linkages to the U.S. (Williamson, 1994). Linkages are seen between IMF lending decisions and the actions of states, their membership in the UN Security Council, or voting correlation with the U.S. and EU at the UN (Dreher and Vreeland, 2008; Thacker, 1999). Research suggests that the degree of enforcement of conditionality is impacted by the size of the borrower and its closeness to the U.S. (Steinwand and Stone 2008). Military links and geopolitical links also impact decisions on loans and their sizes (Reynaud and Vauday, 2008;

Thacker, 1999). Thus, IMF lending criteria can be seen to be bound up in maintaining U.S. influence and global hegemony.

Other critical academics suggest the IMF lending policies process is not only biased but also actually negative and counterproductive for countries in crisis (Sachs and Radelet, 1998; Stiglitz, 2002). Critics see IMF lending policies as excessively draconian and an instrument of U.S. foreign policy (Beeson and Broome, 2008; Gills, 2001). This has led many, including in the recent past numerous IMF shareholders, to view the IMF as a tool of the U.S. and Western Europe. At this juncture, although the G20-led resource increases come in part from emerging states, this does not imply existing lending biases will disappear, at least in the short to medium term. Instead they may gradually evolve.

Currently, eligibility criteria to access the US\$500 billion in emergency NAB funds agreed in 2009 exclude most African and many Latin American countries. Instead, the funds are flowing, as was the obvious intent, to key and peripheral states in the Eurozone. Precautionary lending is going to Mexico and Poland, and emergency and standard lending programmes are being applied to Cyprus, Greece, Ireland, and Portugal. All are allies of the major IMF shareholding states.

It is likely no coincidence that key IMF member creditor states have banks that are overextended and exposed to losses and possible bank failures within those same markets (Buckley, 2012). The IMF loans serve to protect the banks of key U.S. and European members of the IMF. The US\$461 billion in firewall funds agreed in 2012 will of necessity predominantly go towards attempting to halt the crisis in Europe. That is what is intended. Although the Los Cabos Declaration states additional funds may go to any state that needs them, in a nod to frustration from emerging market creditors, the reality is that the funds will mostly be spent in Europe.

In the handling of the Eurozone crisis and lending, it is possible to see existing biases in effect. Closer allies of the U.S. and main European creditors get softer treatment (Ireland, Portugal). Other states, viewed in a more hostile manner, get IMF deals that are harder to swallow (Greece and Cyprus). If Spain were to apply to the IMF for a programme, its conditions would likely be moderated by its importance to the EU and the U.S..

How the evolving new internal balance of resources and of shareholding power will impact the IMF and its lending policies is hard to judge. But viewed as a whole, existing research implies that the new funds will be directed towards allies of the leading IMF shareholders, both old and new. In other words, the breadth of possible recipients may change, but not necessarily the background reasoning and decision making. Despite the probable slow nature of changes in lending policies and the list of borrowers, the post-crisis move by emerging countries to secure a larger shareholding in the institution is still significant. It indicates emerging countries, in particular Brazil, China, and India, have determined that a refinanced, empowered IMF is strategically important to them and their international economic policy goals. This is concrete evidence of a G20 IMF policy consensus that includes emerging states in a growing leadership role in the organization and of their recommitment to a body of which they were previously highly critical. Measuring power shifts can be done by looking at changes in resource commitments, and in the IMF, creditors get all the respect.

Evolutionary change is underway even though a shift in the ideology or lending worldview of the institution itself and the staff is harder to detect. Emerging countries will continue to demand a larger share in the institution, as well as enhanced influence, authority, and power within the consensus-based structure, in return for their cash and political capital.

It is possible that the number of countries considered for lending support will shift and evolve over time, as policy preferences of emerging creditor countries impact lending behaviour by the IMF and its staff, but it is too soon to observe this empirically. If such effect is present, it is obscured by the severity of the crisis in Europe and the requirements for support of the Eurozone states.

If emerging states become marginally more assertive of their rights, the degree to which new creditor states will diverge from the conservative creditor mindset and general support for conditionality (flexibly applied as regards one's allies, of course) in lending is unclear. Emerging market countries as major creditors could husband IMF funds in a similar protective and self-supporting manner, as is currently the case for the U.S. and Europe. Interview evidence suggests that emerging-country representatives in the IMF have pressed for tougher conditionality when faced with the crisis in the Eurozone countries, signalling they are not about to lend their resources to rich (non-client) states without strict conditions (Interview 20, 2012). How the newly assertive emerging countries would react when lending

to their own client states in Latin America or Africa is less clear. Perhaps their stance could be different in such cases.

In conclusion, the resource increases are significant in their magnitude. The IMF is once again a properly financed, relevant institution. The increased resources are indicative of G20 leaders recommitting to the IMF, especially emerging state leaders, who seek, in return increased influence within the organization. Evolutionary change is underway, but it is not yet visible in the lending behaviour of the institution. However, when the above resource increases are combined with the governance and voice reforms also agreed by the G20, the direction of evolutionary change can be seen more clearly.

6.5 The G20 and IMF governance: leadership, voice, and votes

The governance, voice, and vote changes agreed by the G20 constitute a potentially important rebalancing of power and influence within the IMF. The reforms are another concrete manifestation of the IMF's evolutionary move away from developed states and towards rapidly growing, central-bank-reserve-rich, emerging-country member states. Viewed at the end of 2012, the governance reforms do not constitute a paradigm shift, but are instead second-order changes at best. Only with a further shift to emerging-country votes and leadership within the IMF (and this could take many years) might this be a potential paradigm shift for the institution, its worldview, and policies. In 2013, the G20-mandated reforms have not yet resulted in significant alterations to the functioning and management of the institution. The adjustments are incremental because each government plays the diplomatic game, within the existing institutional structure to their own maximum national advantage.

Unlike the crisis-driven dynamism seen in the FSB, in the IMF the game is played by the existing rules and is informed by political factors, priorities, and drivers of the national finance ministries. Amongst IMF national representatives there is a political and diplomatic process defined by a desire to defend one's own position and prerogatives, and little willingness by the IMF shareholders to make more major changes. Governance reform is limited by the willingness of advanced developed states in the G20 (especially in Europe) to support an emerging member country power shift inside the IMF.

This is why greater power shifts are not seen: Americans and Europeans do not want more significant reforms at this stage. There are three facets to the IMF governance reforms agreed

by the G20: (1) open competition for the position of IMF Managing Director; (2) a reallocation of two Executive Board seats to emerging countries from European states, and the use of elections to the Board in the future; and (3) an increase in the Board voting shares of emerging countries, elevating China to become the third-ranking position in the Executive Board, and bringing India and Russia into the top 10 creditors within the IMF.

The governance reforms now underway may eventually change the leadership and possibly the nature of the IMF, its ideological tone, and its institutional functioning, and turn it gradually away from an organization whose decision making, policies, lending, and actions are dominated by the lead shareholder, the U.S., and its allies in Europe. They constitute real but incremental first- and second-order changes. Overall, the reforms' impact on the balance of power and policy-making dynamic within the organization may be more significant in the long-term than the short to medium term.

6.5.1 Leadership matters

Until the G20 agreement on the selection of the IMF Managing Director, the post had always been selected by European states. This arrangement lacked legitimacy and was an anachronism (Truman, 2011). Given the G20 decision to open up the contest, an opportunity for a break with the past arose with the arrest, detention, resignation, and political banishment of Managing Director Dominique Strauss-Kahn in 2011. The ensuing contest pitted French Finance Minister Christine Lagarde against only one heavyweight emerging-country candidate, Agustín Carstens, Governor of the Central Bank of Mexico.

Europeans backed Lagarde and drew others to their candidate amid complaints that 'a stench of colonialism is wafting around' (Reuters, 2011). But Europeans were always going to back their own, regardless of the open nature of the contest. Crucially, emerging countries failed to agree on one candidate. Brazil refused to support Carstens but offered no alternative. Russia backed a candidate from Kazakhstan; China and India were silent. The U.S. signalled it could support an emerging market candidate but no sufficiently strong candidate was offered. In the end emerging-country bickering fatally undermined their chances of securing the leadership slot (Interview 31, 2012; see also Reuters, 2011). Lagarde exploited the split amongst non-European votes drawing China to her side (*China Daily*, 2011a), assuring she would win.

The failure of emerging countries to grasp the opportunity was their own fault. They did not back a common candidate and played their hand poorly. Unlike the Europeans, who operate a system of close economic diplomacy on a daily basis via European Union mechanisms, emerging-country states do not have a long history of multi-state diplomacy and trust. They come from different positions and ideologies and can have strong rivalries, making agreeing to common positions very difficult.

The election contest for the top job at the IMF demonstrates that emerging countries may be desirous of making changes to the power dynamic within the IMF, but they have yet to learn how to cooperate effectively to seize the leadership. Securing the Managing Director role could have been a major victory and could have helped hasten the evolution of the organization and its policies away from an excessive European bias (Interview 31, 2012). A new leader from outside the core would have buttressed other reforms, and sent a clear message that it was no longer business as usual, been able to impact the selection of senior staff and the tone set at the top.

Lagarde's performance since the contest shows leadership does matter. The influence of two back-to-back French Managing Directors, as well as senior officials including Olivier Blanchard (IMF Chief Economist), can be seen in adjustments to the organizational policy stances including a more sympathetic position vis-à-vis stimulus over excess austerity in the Eurozone (Jones, 2012), and a marked shift on the usefulness of temporary capital controls in times of crisis (IMF, 2011e). These adjustments do not mean the IMF is abandoning its ideology, but they do underscore that leadership matters. Mishandling the leadership race meant emerging countries failed to grasp the opportunity of Strauss-Kahn's disgrace.

As a result in 2013 there is an 'interregnum in global governance—an extended transitional phase' (Chin, 2011). For the IMF to move from the beginning of the end of the old order within the organization towards the eventual birth of the new requires the election of an emerging-country Managing Director. That will occur only if the newly assertive emerging-country shareholders offer better candidates and cooperate. Only then can they maximise their institutional and policy impact and make a more permanent mark on the institution and its worldview.

6.5.2 *Votes and voices within the IMF*

The Executive Board of the IMF has general control over the Managing Director and the organization (IMF, 2008b). The Board is composed of 24 national representatives of the membership. Leading shareholders each have one seat and the smaller states are grouped into constituencies, with the Board role rotating amongst the constituency members. Each member of the Board has a percentage of votes determined by a quota formula. An 85 percent majority is required for any decision. The U.S. has veto power because it alone has more than 15 percent of total votes.

Table 6.1 shows the G20 shifts via the 14th quota review 6 percent of voting share from advanced to emerging countries (IMF, 2010c). Once fully in place this heralds a small but important change in the balance of power in the IMF Board. . These changes are not yet implemented. As of September 2013, not all states have ratified agreed reforms, with the U.S. Congress still to ratify the voice and votes reforms.

After this change leading emerging countries will have just under 15 percent of the votes, so the U.S. veto remains intact. China is now the third-largest player after the U.S. and Japan. Brazil, India, and Russia each join the top 10 major players within the Board, as creditors and voting powers.

As part of the IMF governance reforms, Europeans agreed to relinquish two of their seats on the board; prior to this they had six Executive Directors and eight Alternative Executive Directors (29 percent of the total). The voice reform therefore only marginally changes the overrepresentation of Europeans on the board.

| Country | Post-2010 Reform - Total % Voting Block for Each Major Shareholder | Increase/Decrease % Voting Share |
|----------------|--|----------------------------------|
| United States | 16.479 | -0.248 |
| Japan | 6.138 | -0.087 |
| China | 6.071 | 2.265 |
| Germany | 5.308 | -0.495 |
| France | 4.024 | -0.262 |
| United Kingdom | 4.024 | -0.262 |
| Italy | 3.016 | -0.138 |
| India | 2.629 | 0.292 |
| Russia | 2.587 | 0.201 |
| Brazil | 2.218 | 0.504 |

Source: IMF, 2012.

Table 6.2 IMF Executive Board Voting Share Changes

Table 6.1 shows the continued dominance of the U.S., the EU states, and Japan in the IMF. Note that with the reforms, emerging countries can potentially have greater influence. This is particularly the case if Japan were to align itself on occasion with the BRICs (Brazil, Russia, India, China, and South Africa) and move away from its perennial support of U.S. goals. If this unlikely scenario were to happen, a new block could have an effective veto on Board decisions. This has yet to occur in the Board; it would be foolish to say it could never occur, but internal board processes seek to avoid such head-to-head clashes.

Looking ahead, in the medium term, after the 15th quota review, in 2014-2015, emerging creditor nations could conceivably have more than 15 percent of the votes, still a minority stake, but a slowly growing one, because of future adjustments in SDR share. If so, this would be enough to counter the current U.S. veto on the Executive Board, which would be a potentially significant power shift and one which could diminish U.S. influence in the Board. But this shift can only happen if emerging countries begin to show cohesiveness in policy positioning as a group. To date, this has not occurred. To the contrary (Interview 31, 2012), emerging-country leaders are generally disinclined to cooperate to their mutual collective benefit. China's goals are at odds with those of Brazil. India is no friend of China. Emerging country dissension is the norm not cohesion.

6.5.3 Consensus decision making maintains U.S. power

While voting weight matters, Board members report that votes are almost never taken (Interview 17, 2012). Since practically all decisions are arrived at by consensus, issues that do not have the required 85 percent backing do not get sent to the Board (Interview 16, 2012). Informal soundings before decisions avoid the explicit use of the U.S. veto, but also avoid direct clashes with new coalitions. This process and the balance of power allows the U.S. to still largely control the agenda; when you carry a big stick (veto), you do not need to use it. Currently, the Board consensus almost always includes the U.S. and Europeans. As with the selection of the Managing Director, for this to change, emerging countries would have to create new coalitions of interests with either Japan or the Europeans. As of 2013, there is little or no evidence they have done so.

It would be wrong to conclude, however, that the nature of the organization means there is no change in the decision-making process; senior current and former officials interviewed for the research indicate that gradual changes are being seen in how the Board works. Emerging countries, especially the larger players ‘are contributing much more to the debate’ in the Board (Interview 20, 2012, p.4). Other members understand their current and future importance to the IMF. They are ‘much more visible, influential in the discussions’ (Interview 6, 2011, p. 4).

These countries are taking steps to boost their profiles. For example, China has elevated the seniority and quality of the officials sent to the IMF, and they are more actively contributing to the consensus that is developed within the Board (Interview 20, 2012). The effectiveness of the emerging-country voices, individually and collectively, depends on a mix of power politics and the personnel. A higher SDR voting total means those voices are taken seriously; when combined with senior national representation, emerging countries can be more persuasive than the smaller European states, whose power is diminishing (Interview 20, 2012). Thus, the 14th quota review, even before fully in place, has a modest impact on the IMF.

6.5.4 Governance: A slow march towards meaningful change

An evolving core group of creditor nations will continue to control the IMF (Fratanni and Pattison, 2004; Truman, 2010). Today, as in the past, key shareholders exercise ‘bloc holder

power' (Kahler, 2006, p. 259). The realities of the power politics in the IMF mean that proposals for more radical reforms will amount to very little, whether they are centred on strengthening the autonomy of the Board (De Gregorio *et al.*, 1999), halving the Board's size (van Houtven 2004), consolidating the Euro area seats into one representative (Bini Smaghi, 2006; see also Leech and Leech, 2005; Truman, 2006), or making the Board nonresident (Interview 24, 2012).

G20 leaders have only marginally reformed the governance of the IMF. They are not about to engage in a sudden burst of further reformist zeal such as they undertook with the creation of the FSB. The forced clarity and policy convergence caused by the heat of the 2008-2009 crisis has dissipated, and national goals and interests have returned and resurfaced. Further governance reforms, other than the next quota review are unlikely. IMF vote and voice reforms and their limited scale do not suggest a paradigm shift in governance of the IMF has occurred. Instead, slow evolutionary change is circumscribed by an existing worldview within which negotiations and deal-making take place.

Operating within this institutional framework, foreign and finance ministries of advanced states gave up just enough to move the reform process within the IMF forward—the U.S. willingly and Europeans reluctantly. Emerging countries got small but meaningful changes to their quotas and votes in return for their recommitment to an institution they had largely abandoned prior to 2008. Each side benefited. The U.S. and Europe needed emerging market cash and political backing of the institution. Emerging states wanted an IMF that would begin to reflect new geopolitical and economic realities.

Post-crisis, the IMF governance reforms will have a gradual impact on the functioning of the institution over the medium to long-term. The Brazilians, Chinese, and Indians can play the long game. They have an enhanced role within the IMF today. That role and emerging countries' authority and influence can only grow. But it will take many years before the full impact of the shift in the balance of power within the IMF becomes apparent and explicit.

6.6 IMF Surveillance, the Mutual Assessment Process, and Early Warning Exercises

'Surveillance is like a private detective sitting in a parked car observing what is going on through a pair of binoculars'.

(Interview 19, 2012, p. 6)

When dissecting a crisis, communities, actors, and the victims of the crisis wish to understand what went wrong and how to prevent a future reoccurrence. They debate and analyse, consider options, and then hope to learn from the mistakes. This is a natural process of critical reappraisal. The G20's approach to IMF macroeconomic reporting and surveillance reform follows this same pattern. Changes in IMF surveillance policy, the mutual assessment programme, and early warning reforms agreed by the G20 leaders since 2009 are designed to improve IMF macroeconomic reporting, bilateral country surveillance, and systemic risk analysis. The reforms are incremental, first-order changes; there is more reporting and there is some change in focus, but the reforms are not a significant reordering of IMF policy or a paradigm shift in overall approach.

The G20 leadership and summit declarations are clear on the importance of surveillance. In 2009, in London, they pledged to: 'candid, even-handed, and independent IMF surveillance of our economies and financial sectors, of the impact of our policies on others' (G20, 2009a, p. 3). Each summit since London has reiterated the importance of surveillance. The following discussion and analysis will show that the actual outcome of the adjustments to IMF reporting and surveillance may still amount to only marginal, first-order changes, at best; powerful creditor shareholder states do not listen to advice from the IMF the current 'reforms' do not change that reality.

The G20 summits sought to reinforce the IMF's ability to analyse and critique member countries' economic, fiscal, monetary, and regulatory policies and external effects via support for a new Integrated Surveillance Decision (ISD) (IMF, 2012c). The ISD focuses, again, as did the 2007 decision before it, on spillover effects of major economies on other states in the global economy. There are three related mechanisms, two new and one existing, that are meant to secure the goal of better surveillance. They are:

1. The Mutual Assessment Process (MAP): Agreed by G20 leaders at the Pittsburgh Summit in 2009, it is designed to 'evaluate the consistency of G20 policies and frameworks with members shared growth objectives' (IMF, 2011d, p. 2). The MAP is managed by the IMF and the FSB.

2. Early Warning Exercises (EWEs): In November 2008, the G20 asked the IMF and the FSF/FSB to collaborate on regular EWEs. They are meant to assess low-probability but high-impact risks to the global economy.
3. IMF Surveillance: Existing IMF surveillance policies and practices (Article IV reviews, Financial Sector Assessment Programs, Review of Standards and Codes).

6.6.1 *The Mutual Assessment Process*

The MAP agreed in Pittsburgh required the IMF to report periodically on G20 macroeconomic policies and to use IMF technical help to assess ‘whether policies pursued by individual G-20 countries were collectively consistent with the G-20’s growth objectives’ (IMF, 2012d). This amounts to more reporting at the behest of the G20, but little meaningful output in terms of policy impact. The IMF staff re-purposes its global bilateral and global macroeconomic analysis and spillover assessments to comment on G20 country economic policies. The IMF views the MAP as a form of normal country technical assistance.

The IMF is being forced by the G20 summits to respond to demands for reporting and for technical assistance to the G20 summits. But institutionally is a somewhat reluctant participant. IMF leaders do not want to serve the G20 rather than its wider membership. That is to say, there is little desire within the IMF to act as a reporting mechanism for the G20 (Interview 1, 2011). The political reality, however, is that the IMF cannot avoid the G20 demands and must respond, albeit reluctantly. In addition, what the IMF is being asked to do is hard to deliver.

As chapter 3 showed, there is no G20 consensus on global macroeconomic policies. G20 leaders agree to the importance of balanced and sustainable growth, but what that means to each national leader is different and a matter of repeated dispute at the summits, especially in phase three. In practice, the new reporting under MAP may make observations and press particular issues, but it has little impact; there is no mechanism to force a change in national creditor country policies as a result of the MAP. EWEs face similar challenges.

6.6.2 *Early Warning Exercises (EWEs)*

It is very difficult to provide early warning of crises. It requires an ability to see the black swan, to sound the alarm, and to be taken seriously even if the particular black swan you saw on that occasion might be an illusion. A MAP risk assessment is provided in confidence to

the IMFC twice a year (IMF, 2010d, 2010e), designed to highlight emerging risks. There is low probability, however, that the IMF, in collaboration with the FSB, working on global macro and financial risks, respectively, will be able to warn of the next crisis.

Although the MAP and EWEs add to the IMF's reporting responsibilities and to their surveillance of systemic risks and trends, the impact will be minimal. G20 states are enmeshed in yet more reporting exercises with the IMF, from the traditional Article IV reports, to Financial Sector Assessment Programs (FSAPs) to the MAP, and EWE discussions. But how valuable these additional surveillance exercises are is unclear.

6.6.3 Surveillance: weak then and weak now

Looking at the history of the IMF's surveillance leads to the conclusion that post-2008 surveillance reforms may not be terribly effective, may not identify crises as they develop, and may not be taken seriously by leading state powers within the institution. Surveillance, bilateral, thematic, global, or otherwise, remains a weak tool. Available evidence and the interviews conducted for this research, indicate continued weaknesses in the IMF's surveillance system, and the first- and second-order changes made by the G20 and the demands regarding MAP and EWEs.

Academic work on the factors impacting IMF surveillance underscores the weak nature and susceptibility of the process to both bias and political economy factors (Fratzscher and Reynaud, 2010). IMF macroeconomic surveillance is often overly optimistic, and generally more effective if the state was a borrower and not a creditor (Lombardi and Woods, 2007). IMF advice can prove to be drastically wrongheaded and miss red flags, as it did prior to the East Asian Crisis of 1997 (Sachs and Radelet, 1998).

More recently, the IMF's own *ex post* dissection of events before 2007-2008 noted that it 'provided few clear warnings about the risks and vulnerabilities associated with the impending crisis before its outbreak' (IMF 2011a, p. 1). Take, for example, the IMF's 2006 *Global Financial Stability Review*. The report focused on the derivatives markets but parroted the then-dominant conventional policy narrative stating that these instruments 'enhance the transparency of the market's collective view of credit risks maximizing the efficiency of the market, market discipline, and market stability' (IMF, 2006, p. 51). That turned out to be wildly off the mark. In a similar vein, its Article IV bilateral surveillance of the U.S. and the U.K., published shortly before the financial crisis, endorsed the light regulatory stances, policies,

and financial practices that fostered the rapid growth of complex financial instruments which contributed to the crisis and its severity when it occurred. An IMF source noted that had the IMF conducted FSAPs for the U.K. and the U.S. prior to the crisis, they would not have raised the alarm (Interview 19, 2012), because the IMF was ill-equipped to be contrarian and followed the existing flawed policy consensus on the merits of self-regulation and financial liberalization.

In this manner the IMF staff remained wedded to a neo-liberal stance prior to the crisis. They could not see what was rapidly approaching. Instead, they chastised more cautious conservative supervisors and central bankers. A senior central banking source recalls how the IMF criticised Australia and Canada for being too conservative and risk-averse in the supervision of their banking systems (Interview 19, 2012), urging them to liberalise and lift the onerous weight of regulation from their financial sectors. Of course, the conservative, prudent supervision in those markets turned out to be more effective, and those economies weathered the crisis better than most.

6.6.4 *A neo-liberal institution and staff resistant to change*

A key reason for the repeated failure of IMF surveillance is the nature of the IMF as an institution and the consensus ideological narratives within which IMF reporting takes place. Institutions and their ideologies and policy narratives are resistant to change. IMF senior staff, most of whom are U.S.- or European-trained PhD economists from a few elite schools, are generally of a neoclassical, neo-liberal mindset. They are part of the same community. They operate in the same circles. They adhere to similar ideological and policy assumptions (Chwioroth, 2007; Peet, 2010) as regards (until very recently) the desirability of the liberalisation of capital controls, for example. Although the IMF does not constitute its own epistemic community, the staff and the leadership do operate within and defend their own policy stances. As such, IMF surveillance reporting is constrained by the limits of the tarnished Washington Consensus, albeit adjusted slightly to reflect French leadership at the top.

Certain positions are not considered legitimate because they reflect neither the beliefs of the staff nor the demands of the IMF membership; they fall outside the parameters of the policy debate and paradigm within which problems and possible solutions are dissected and scrutinised. That is not to say staff views are monolithic within the IMF. Disputes and turf battles exist, between for instance, the global macroeconomic staff focused on financial

markets reporting and the bilateral reporting staff, the former being more critical of country behaviour than the latter, who can become ‘captured’ by their clients to a degree. But such disputes still take place within the established ideological and institutional framework. There are few arguments over the validity of the overall ideological and economic approach. There is a neo-liberal stance based on the still operative facets of the Washington Consensus which is held to by staff members.

This limits what is considered by the economists, what they will comment on, and the conclusions they may draw from their analysis. Capital market liberalization, capital mobility, and flexible exchange rates are championed. Privatization and unrestrained growth in financial markets are supported. Capital controls and limited convertibility were, in contrast until 2012, off the table, as were limits on financial market scope and firm activities. In other words, the ideological views of the IMF staff impact the outcome and output of the whole reporting process, including the identification of potential systemic risks central to their broader financial stability mandate.

This type of mindset is what led critics to accuse the IMF of having an ‘addiction to neo-liberalism’ (Buckley, 2012, p. 102; see also Vines and Gilbert, 2004), ‘on the grounds of faith rather than the foundation of proven science’ (Peet, 2010, p. 116). The tenets of this economic worldview blocked out alternatives as effectively as an addict refuses changes to their behaviour and drug of choice. As previously discussed, the extremes of this neo-liberal stance are what alienated East Asian states after the crises of the 1990s.

The IMF staff, as a group, is still supportive of a type of disciplinary neo-liberalism (Gamble, 2009) in which the conditionality of the Washington Consensus plays an important part. Today, this approach continues to be evident in the IMF’s policy stances (Chwieroth, 2007). It is seen in its surveillance reporting, and in the prevailing deregulatory narrative the IMF has internalised. Outsiders may critique this worldview as being wrongheaded, but those inside the institution are not paying attention. As a result, the community makes repeated mistakes of judgment and analysis. This tough conclusion is not just that of its critics (Stiglitz, 2002), but also of the IMF’s own Independent Evaluation Office’s post-crisis dissection. It reported that the staff suffered from “‘groupthink” intellectual capture and inadequate analytical approaches’ (IMF, 2011b, p. 17). To outsiders, ‘it is now obvious that this dominant ideology was wrong’ (Turner, 2012, p. 53). Turner may have recognised this, but it is far from clear that the IMF as an institution and its staff do.

6.6.5 *Powerful states resistant to IMF lectures*

As if conducting long-distance surveillance using ideologically distorted binoculars was not bad enough, IMF surveillance advice is also adversely impacted by the importance and power of the member country being analysed, in a similar manner as was observed for IMF lending policy and practice. The larger the country, the greater the bias, and the more likely IMF surveillance is to be ineffective (Maurini, 2010). Article IV consultations of politically influential states tend to be more supportive, and play better in the markets (Fratzscher and Reynaud, 2010), and IMF surveillance policy reflects political economy bias in the outcomes. Surveillance of allies is often defensive in tone, i.e., it protects the larger borrowing states and close allies of the U.S. and Europeans from criticism instead of acting as a neutral arbiter of policy actions and outcomes for the global macroeconomy.

The G20 IMF reforms require all states to submit to FSAPs for the first time, and this is a small step forward; the U.S. and China had until then refused to participate. In practice, however, whether these key states will pay much attention to the conclusions of either global macroeconomic reports or FSAP reports, and whether such reports are sufficiently rigorous, i.e., whether the staff is capable of asking probing questions and drawing critical conclusions, notwithstanding the G20's exhortations, is doubtful.

Surveillance reporting is visibly adjusted due to political pressure. China refused to undertake an FSAP prior to the crisis, and this was not pursued by the Board or staff. Pressure was also seen elsewhere. In China's 2006 Article IV report, the IMF is silent on the management (or manipulation) of the value of the Yuan, and the report fails to address this distortion and resulting imbalances. This caused the late Mike Mussa to excoriate the IMF and its work, despite being a former IMF Director of Research. He wrote: 'The application of Fund surveillance to China's exchange rate policy constitutes gross misfeasance, malfeasance, and nonfeasance by the Managing Director and more generally by the IMF' (Mussa, 2007, p. 5).

This pattern continues. The China FSAP, finally completed in 2011, is also an exercise in conflict avoidance and weak IMF surveillance reporting. The draft report excised a reference to the Yuan being 'substantially' undervalued. Chinese pressure forced this key change and also caused the removal of a footnote that estimated an undervaluation at up to 27 percent. The Chinese-demanded expurgation was supported by Brazil, and was opposed by a dissenting but silent U.S. representative on the Board (Reuters, 2010). This is naked state

power politics in action within the IMF Board and displays the limited efficacy of surveillance reporting on large creditor states, according to current and former IMF officials. China is not an isolated example of ideological, political, and economic bias, and of pandering to powerful members by the IMF and its staff.

Even when surveillance is occasionally on target, the reaction differs depending on to whom it is addressed. Officials note that smaller states tend to bend to the IMF demands more; their reputation is at stake and it matters more to them what the organization thinks and says (Interviews 22 and 24, 2012). On target reporting can be ignored by members, especially main creditor states, according to former officials (Interviews 14 and 31, 2012). This was the case in the 1990s, as the IMF investigators noted: ‘In no case would it be right to claim that the Fund had more than a marginal occasional impact on national policy decision making processes’ (IEO, 1999, p. 48).

This remains the case today. As Raghuram Rajan, incoming Governor of the Reserve Bank of India, states: ‘Some of the largest industrial countries see themselves as more sovereign than others, and their politicians brook no interference in their own domestic policies’ (Rajan, 2008, p. 114). For example, Gordon Brown, Britain’s Chancellor of the Exchequer and then Prime Minister, was a vocal champion of the IMF, the IMFC, the FSF, and international economic diplomacy. But the cheerleading only went so far. A national IMF official recalls that Mr. Brown often intervened and objected if IMF staff reports sought to raise relatively mild concerns over the management of the U.K. economy and its financial sector prior to the 2008 crisis (Interview 14, 2012).

Refusal to listen is still seen. The 2012 IMF *World Economic Outlook* warned leaders of a further global slowdown and of macroeconomic dangers ahead caused by excessively rapid austerity. The U.K., for instance, was urged to balance austerity with tax increases to better achieve its budgetary goals (IMF, 2012e). But the U.K. dismissed the Managing Director’s advice as incorrect and unwanted. So the long history of the creditor states ignoring IMF advice continues unabated. Although in 2013 IMF general macroeconomic advice, particularly on the need for a better balance between austerity and growth, has taken a different tone, the audience of key leaders in creditor states ignores the advice.

So even where the IMF succeeds in identifying a risk and seeks to warn the membership, a relatively rare occurrence in itself, major creditors often refuse to hear the message or

demand that the advice be excised from the final report released to the public. As one actor notes: ‘It has powers of persuasion that are more limited the larger the country’ (Interview 22, p. 7). As a result of these political and power-related limits, it is questionable whether the latest G20-led efforts will deliver real concrete national policy improvements.

6.6.6 *Can improved IMF surveillance deliver?*

Strengthening surveillance, as the G20 is attempting to do, is understandable and even desirable. A crisis demands action, so some modest policy adjustments and reforms are to be expected. The IMF is the only institution with the staff and resources to carry out such detailed surveillance reporting and to publicise the risks to the global economy as they develop, if, and this is a big if, they can identify them in advance.

Demands by the G20 mean surveillance has been adjusted in its focus towards spillovers and possible threats to stability, but it is likely to continue to be inadequate, weak, and ineffectual. It will give the powerful a pass and weak borrowers the stick. The MAP processes demonstrate this continued procedural weakness. Countries report on agreed G20 goals. But what one country may view as a good response (more stimuli in the U.S.) another may view as the wrong solution and opt for the reverse (more austerity in the U.K.). Nonetheless, both these countries report on their actions as part of the MAP, and the IMF makes no meaningful judgment on the appropriateness of one policy versus another in their reporting process.

If the IMF leadership and staff leans slightly towards stimulus versus austerity, under French leadership from Lagarde and Blanchard, the impact is still limited. The U.K. government took no notice of IMF macroeconomic advice illuminating the dangers of yet more austerity. The IMF in 2013 warned against excessive austerity in Greece and Portugal, advice that was discounted by European leaders, especially the Germans. European creditor member states were not listening, as the IMF macroeconomic advice ran counter to their own national policy narrative, which holds that austerity will lead eventually to economic growth and rejects the need for further stimulus.

Increased surveillance reporting and a renewed focus on spillovers will not fundamentally change powerful member states’ policy decisions, even as the power balance within the IMF evolves because of the governance changes previously discussed. Creditors and their allies (albeit a broader group) remain in charge. The staff’s pliability and the internal ideology of

the IMF will reflect this even as it slowly evolves, over a generation at least, to adjust to policy positions and the inclusion of an intake of emerging market economists perhaps less wedded to the neo-liberal school.

At its most basic, in the absence of enforcement options, all you have is adjustments to existing monitoring and reporting processes. This is the case for the IMF as it is for many of the FSB's areas of endeavour. So G20 leaders opt for yet more reporting, again relying on the IMF staff with *de facto* G20 oversight via the IMFC and Executive Board. In the short term, for a limited period after each crisis, surveillance may become more pointed, a little less pliable, and a little less anodyne, as national officials are chastened and IMF staff emboldened to be more critical.

This happens in the national context: Witness the tougher capital and oversight stances adopted by central bankers and supervisors across much of world. A similar effect is seen within the IMF in their analysis of the current merits of austerity in the Eurozone. But because the IMF has few enforcement levers (except in the case of borrower nations), such changes in tone will tend to be impermanent. The further away one recedes from the crisis, the less stringent the analysis may eventually become.

6.6.7 Warning? What warning?

As to warning of the next crisis, few have any expectations of future success. Numerous senior current and former IMF officials and national representatives interviewed for this research were in agreement: The IMF is not equipped to identify or stop the next crisis (Interviews 14, 16, 19, 20, 21, and 30, 2012). This is a frank admission of the weakness of surveillance and early warning processes, old and new. If so, IMF staff may yet again perform poorly as the key macroeconomic lifeguard on the lookout for the next freak wave of the financial system. Thus do national and IMF officials prepare the way for the next IMF failure and their subsequent disavowal of national or institutional blame. According to this view, you cannot see the black swan coming (Taleb, 2010). In the run-up to a crisis, it is not what you see that gets you, it is what you cannot see that gets you (Kohn, in Brookings 2011). The IMF, it is said, lacks the capability to anticipate major crises (Berg, Borensztein, and Pattilo, 2005), and IMF surveillance, early warning systems have failed in the past, and they will fail again.

In that case, G20-demanded changes in the surveillance arena will produce only marginal benefits. They are an example of first-order incremental changes within an existing paradigm, policy consensus, and IMF processes.

This chapter has shown that you cannot place the blame for current and future surveillance failures solely on the resistance amongst IMF staff to conduct more rigorous reporting or to question their own internal community worldview. The IMF is membership-driven. Powerful creditor states call the shots. Their representatives agreed the IMF reforms, but they went only so far. There was no improved enforcement of surveillance and reporting. Nonborrowers and large creditor states can and do still ignore advice offered. The IMF is still left without the tools to address global imbalances, despite that being enshrined in its founding articles.

6.6.8 Surveillance and imbalances

Fundamentally, G20 summits resulted in only marginal surveillance reforms, because the leaders cannot agree on real enforcement powers for the IMF. They increased funds massively, but leaders refused to give new enforcement levers of any strength to the IMF. Crucially, they could not agree on the major outstanding problem facing the international monetary system after the crisis, namely what to do about global imbalances.

Massive imbalances helped create the conditions that caused the 2008 crisis, and the imbalances persist today. But as Chapter 3 made clear, disputes over global imbalances and what, if anything, the G20 should do about them, are a repeated area of tension, discord, and disunity. There is no G20 policy narrative consensus on global macroeconomic imbalances. Voices were raised in Pittsburgh. Fingers were pointed and blame laid in Toronto. Arguments got yet more strident in Seoul. The discord continued during the French Presidency and the Cannes Summit. The Los Cabos Summit came to no major breakthroughs. Instead, we have small data and reporting changes and agreements to continue work in this area.

Lacking an agreed narrative or policy framework at the G20 level, the IMF is left with enhanced reporting, because real tools to control imbalances that contribute directly to financial crises cannot be agreed and are unwelcome in the creditor capitals of Beijing, Brasilia, Riyadh, or Berlin, even as they are demanded by a weakened debtor economic hegemon in Washington, DC. The failure to grasp real reforms on surveillance and global

imbalances is caused by a resistance by staff, but more so by the lack of agreement over a common policy narrative at the G20 leadership level.

6.7 Conclusion

As late as fall 2007, the IMF was viewed as increasingly irrelevant. Advanced countries controlled the organization, as they had since its creation. Emerging countries had abandoned the IMF's solutions and funding, and instead built up their own precautionary reserves as insurance against future crises. The organization's *raison d'être* was seriously questioned. But the economic crises of 2008 created win space and room to reform the IMF. The G20 took the lead and increased the resource base by almost 400 percent. The G20 agreed quota and governance changes began, slowly, to change the nature of the organization. In this sense, the IMF can be said to have had a good crisis. It is in 2013 once again the global lender of last resort for countries facing balance-of-payment or financial crises.

6.7.1 The G20 forum and its states are dominant

This chapter underscores that, post-crisis, the IMF is being led and directed to a great degree by the G20 forum, through the summit process and via G20 member dominance in the IMFC and Executive Board. The leadership grouping is larger than in the past and more representative (than the G7), but this still results in tension among the universal institution, its leadership, and non-G20 members, and those states that dominate via the G20 process. That tension is here to stay (Interviews 6, 2011; Interview 16, 2012) so long as the G20 sits atop the new global financial regulatory architecture.

6.7.2 No paradigm shift inside the IMF

Unlike the effect of the crisis on the central banking community, and through the creation of the FSB, the events of 2007-2008 did not shock the IMF and its staff out of their existing worldview. Instead, the institution, its functioning, its staff, and the consensus policy stance and ideology within which they operate appeared resilient and resistant to this huge exogenous shock. To be sure, the organization was pilloried for its failures by critics and by its own Independent Evaluation Office postmortem. But, post-crisis, the IMF consensus remains largely unaffected. As a result, policy reforms are weaker, incremental, and set within the existing institutional framework. This indicates that an institution can effectively

resist recognition of severe anomalies, even those clearly visible to critics, if the critics are too few in number or external to the organization. This failing is not specifically an IMF one, but is also seen in other institutions and policy fields.

6.7.3 G20 states avoid major reforms

Looking at the G20's policy consensus and approach to IMF reform and the actual policy outcomes seen, the picture is one of agreement on incremental changes within the existing institutional structure. G20 states were not willing to make major changes within the IMF, a defence of national prerogatives and positions was seen and, as a result, only modest reforms were begun in 2009.

At the Executive Board level, the same power-based rules apply in decision making, in lending policy, in the conditionality applied, and in the willingness or refusal of creditor states to listen to the surveillance advice being offered by the IMF staff. There is the maintenance of a creditor, a membership-driven mindset, and a reluctant reform stance from the leading G20 members reflective of their own national goals acting within the diplomatic and institutional framework of the organization.

Since there is no G20 consensus for more dramatic IMF reforms, staff will not move far from neo-liberal lending practices, or from their deferral and understandable sensitivity to major creditors and their allies. They will not act counter to their worldview or the expressed positions of leading shareholder states on the Executive Board and amongst the membership.

6.7.4 An IMF re-capitalised as the G20 responds to the crisis

The nearly 400 percent increase in total IMF resources shows the G20 at its best when confronted by the crisis, and demonstrates the continued state power dynamics and differences in play over IMF quota reforms. *In extremis*, in Washington 2008 and in London 2009, all G20 leaders understood the need to act. Leaders agreed massive infusions of bilateral funds backed by advanced and emerging countries. The crisis concentrated minds and forced convergence (Interview, 21, 2012). It created win sets internationally and domestically; all understood that a failure to act would severely negatively impact all those sitting at the table. Financial shock and awe was needed and was delivered by Brown,

Geithner *et al.* Emerging-country leaders also committed resources on a scale not previously seen.

Quota increases were agreed in 2010 and near completion in 2013. They were supported by the U.S. and emerging countries and agreed to but resisted by the Europeans. As the crisis continued and mutated into a Eurozone sovereign debt debacle, however, the collective commitment to yet further resource increases weakened. A further shift in power within the IMF was opposed by the U.S. and the Europeans. Ultimately, the crisis was of such severity that a deal was done that delivered a further US\$461 billion in bilateral funds with no changes in the balance of power.

So on resources for the IMF, the G20 delivered, in the extremes of a crisis, during phases one and two, and even in phase three as dissention among G20 states reemerged. But the deals done had each player defending their own national political, diplomatic, and economic positions, jockeying and adjusting according to crisis and their own demands. As to lending policies, it is reasonable to expect that IMF lending practices will not change markedly because of this huge cash infusion. Currently, the funds continue to be directed at allies of the main creditors. Conditionality is still seen, and is somewhat more sympathetic to borrowers that are allies (Mexico, Poland, Portugal), than those perceived as being troublesome outliers (Cyprus, Egypt, Greece), as demonstrated by demands that Egypt remove bread and petrol subsidies in advance of any new emergency loan (Coleman, 2013). Lending continues to be driven by the demands of key creditors, and is yet to be visibly impacted by the emerging countries. On balance, this may be because their goals are largely in line with those of the advanced economies; that is: Stop the crisis in Europe.

6.7.5 *Votes and voices change, but slowly*

Emerging countries not only committed more resources, they also are seeing their votes and voices increase within the IMF. The reforms are also incremental second-order changes; that is, a small (still to be completed) increase in quota-related voting weight, two fewer European seats on the Executive Board, and an open competition for the leadership of the IMF. The changes show that the IMF is being forced to evolve by G20 decisions. But the pace of that evolution will only proceed as swiftly as advanced countries permit; witness their refusal to further adjust quotas in response to the need for a financial firewall for the Eurozone.

At the Executive Board level of the IMF, gradual evolutionary changes are being observed. The voices of the smaller European states are more muffled and less often raised. Interview sources stress that key emerging-market representatives have a correspondingly louder voice, and their views are given great weight in the deliberations and consensus decision-making process. Some emerging-country players are more effective than others (Interview 5, 2011; Interviews 17 and 21, 2012). The Board remains a highly political place, and all are acutely aware of the quota and vote balance, with the U.S. still being *primus inter pares*, although votes almost never occur (Interview, 17, 2012). Because of the consensus nature of the process, the influence of a country also rests on the personal and diplomatic skills of the individual in question, and therefore not all representatives are equally influential (Interview 5, 2011; Interview 21, 2012).

Over time, there may be a gradual shift in the Board's key voices and their relative influence. Indeed, emerging countries are staffing their representations at the Board (and at the senior level within the IMF), with more influential national figures; for example, the current Deputy Managing Director, Min Zhu, is a former Deputy Governor of the People's Bank of China. When a country has a great deal more cash and political capital committed, the stakes are higher and the IMF roles are viewed in a different light domestically and internationally.

As the emerging-country voices are raised in the Executive Board, there may be gradual changes in the applied power of emerging countries on lending policy, but this will take time to become clearly evident, since lending choices may eventually change as the list of client states is widened to include the client states of Brazil, China, India, and Russia. It is quite possible that new creditor nations will guard their resources and resist a weakening of loan conditionality. But it would be a stretch to assume that IMF lending activity will remain unchanged as power within the Board adjusts, and modest changes in the makeup and lending approach may therefore gradually be seen.

6.7.6 *The role of emerging countries*

To become maximally effective, emerging countries in the IMF must become, on occasion, more assertive and cohesive as a group. At this point, this is not being observed. Witness the failure of emerging countries to coalesce around and agree a joint candidate for Managing Director. In this important instance, emerging countries failed a test of maturity and farsightedness. It would have been better for Brazil, China, and India to agree on a candidate

and seize the leadership. But instead, emerging-country leaders bickered and split while the Europeans quickly coalesced around Lagarde, ensuring she would win. This shows that emerging countries share one thing in common but that other interests may not coincide.

The next major test for the emerging countries will be whether they can plan ahead and back a single candidate when Lagarde finishes her term. This chapter has underscored that although the IMF is now being directed by the G20 forum and summitry process, leadership does matter. Emerging countries need to grasp the next opportunity to lead the IMF and to begin altering the IMF's policies and tone, much as Lagarde and her staff have done.

As to the possible ideological evolution within the staff itself away from neo-liberalism and towards economic views espoused by emerging countries, to date there is little evidence of such changes. It is too soon to have occurred or to be observable. It will take years for new economists to come on staff and rise in seniority and influence, who might collectively exhibit a more diverse economic mindset and worldview. At this point, just how much staff turnover will impact the lending mentality of the institution cannot yet be judged and it will require a cultural change in recruitment of IMF staff and will by definition be a slow process.

As emerging countries take a gradually larger role, they will take greater ownership of the institution. They may gradually change it as well as support its continued global macroeconomic relevance, albeit in a subsidiary supporting role to the summitry-driven direction supplied by the G20 leadership.

A recommitment does not mean emerging countries are placing their political and economic capital only with the IMF. Aware of the IMF's past failings, China is investing bilaterally across the globe. For example, the China Development Bank, which invests both domestically and internationally, particularly in Africa, held US\$984 billion in assets in 2011, up 50 percent from 2008 (Ho, 2012). This is more than three times the total assets of the World Bank, which stood at US\$314 billion in the same year (World Bank, 2012). Emerging countries have also announced the creation of a new development bank, with US\$50 billion in seed money (McGroarty and Maylie, 2013). So emerging surplus creditor countries are recommitted to the IMF, but they are keeping other options open. They will not again be placed in the position of relying solely on the IMF.

Compared with the period before 2008, the recapitalised and reformed IMF is an improvement. Leading emerging countries have a larger monetary and political stake in this still key, reformed, but also downgraded global financial institution—one that they had almost totally abandoned prior to the financial and economic crisis of 2007-2008.

As these rising states take a greater share of, and assume influence over, the running of the IMF, it is unclear how these key actors will use their new authority and power. Will it be purely to defend national prerogatives, or will it also be in support of resilience of the international monetary system? It is too soon to tell. Critics, usually from advanced economies, ask whether China is ready to lead, with the implied answer being ‘no’. But perhaps the timeline most are looking at is too short. It may take at least one or two decades (and a change in Managing Director) before the degree and nature of the change in leadership balance, and any ideological shift becomes more fully apparent.

Looked at from another perspective, in the short to medium term the U.S. got what it wanted as a declining hegemon; that is, re-engagement in the existing Western-designed structure by emerging countries.

6.7.7 A diminished likelihood of paradigm conflict – For now

With the new resources and the shift in votes and voices, the U.S. secured one of its long-standing policy goals via the G20 using IMF reform: A closer reintegration of the leading emerging countries into the international institutional regime of rules and systems within the IMF. The U.S. used the crisis to push the Europeans to agree to a diminution of their voice and power. The reforms are modest. But by drawing leading rising emerging states and the leaderships back into a commitment to the IMF, which they had previously viewed highly negatively, the U.S. potentially prolongs its influential leading position within the institution.

The reforms draw emerging countries back into an institution and processes which contains existing norms and ideological biases in favour of the U.S. and its allies. Viewing IMF reforms from the perspective of the U.S., it may have thus succeeded in strengthening existing norms, rules, and systems of international cooperation, all of which the U.S. itself designed after World War II (Steil 2013; Subramanian, 2011). In this way, U.S. policy makers view drawing emerging states further into an altered international superstructure of cooperation, coordination, and negotiation as beneficial, because it cements the structure of

the system even as relative U.S. power slowly declines. In the short to medium term this reinforces rather than diminishes American power.

The reforms, therefore, avoid or postpone head-to-head hegemonic competition or paradigm conflict of the type seen between the U.S. and Japan in the 1980s and 1990s within the World Bank (Wade, 1996). More severe conflict outside of the existing norms and rules of institutions could be disruptive and destructive of the international system; far better for such disputes to take place within the G20, the IMF, the IMFC, and IMF Executive Board.

In the short to medium term, the continuity provided by a modified but largely unchanged IMF with its neo-liberal policy stance still in place in 2013 reinforces American power rather than diminishing it. The U.S. gave up votes and allowed modest changes in the Board in quotas in exchange for continuity within international institutions, instead of the prior risk that emerging countries would continue to spurn the IMF.

In this, the Chinese and Indians may also be playing a long game. Indeed, major reforms and ideological changes within the IMF have historically taken decades to effect; it started managing a fixed exchange rate system; decades later it switched to surveillance and advocacy of the Washington Consensus. The rising powers can afford to wait it out. In the meantime, the U.S. and the Europeans prolong their influence and have, via G20 decisions, reinforced an institution that was previously distrusted by emerging-country leaders.

6.7.8 A surveillance disappointment

G20 states recommitted to the importance of IMF surveillance during the summits, but as individual actors they also understand the limits to the process and are ready to disregard surveillance. IMF surveillance reform shows the tension between the goal of reinforcing the IMF and a general G20 desire to limit its ability to meddle in the domestic economic and fiscal policies of key states. As a result, surveillance reforms are disappointing, first-order changes. There is more reporting, more analysis, but little evidence that the new surveillance processes will permit the IMF to speak truth to power, assuming it grasps the 'correct' truth and if one in fact exists, or would be listened to by major creditor states, such as the U.S. or China (Interview 20, 2012).

The research finds the contrary: Reporting will not likely make a marked difference in the policies and actions of key member states. The job which takes up the lion's share of the IMF's resources will continue to produce mediocre results, amenable to adjustment by

leading states or simply ignored when they see fit to do so. Smaller states, and borrowers, can and will pay attention when the IMF makes a judgment call on their economies; they have to or risk negative market reactions and lending outcomes. Not so the major creditor states.

6.7.9 Early warning no panacea

‘New’ early warning processes—really, a rebranding of the existing processes—are similarly unlikely to result in major national policy changes. No IMF figures interviewed believe that the organization will successfully sound the alarm in advance of the next global economic and financial crisis. To have a chance of doing so, the IMF would have to embed within the institution contrarian voices permitted to shout ‘crisis’ in a crowded macroeconomic space repeatedly, and often erroneously. This is almost impossible to do. It certainly cannot be done within an institution which has resisted change to its worldview, even when faced with severe unexplainable anomalies linked to a neo-liberal ideology and groupthink that contributed to a failure to warn about the imminence of the most severe global economic crisis since the Great Depression.

It is not that it is impossible to see the black swan ahead. It is, instead, that when an existing policy paradigm and narrative remains strong and cohesive amongst its adherents inside the IMF, that change is slow and incremental. Roubini, Rajan, White, and others did see the black swan ahead. They were right, but they were too far in advance of the community worldview to be heard and listened to seriously, and instead such views were discounted.

In the future, if the policy and ideological alarm is raised too soon, it will be ignored by the IMF, which still holds to a modified Washington Consensus and creditor mindset as its policy narrative. If and when warnings are raised in the IMF outside of clear global crisis conditions that clarify minds and forces action, it is unlikely that officials in Executive Board offices of major creditor finance ministries will listen.

As the work of Kuhn (1962), Hall (1993), and others on paradigm shifts makes clear, only when a sufficient number of recognised anomalies and failures occur which call into question the validity of the existing worldview and the usefulness of its main assumptions, does a progressively critical mass of actors adjust their positions. Only then do competing ideas move from the realm of the improbable and become a credible alternative reality and worldview.

Such a tipping point, a paradigm shift, did not occur within the IMF. This is despite the inclusion of more critical emerging-country voices within the IMF, and despite gradual changes in the policy stance over austerity versus stimulus, and on capital flows that have been possible under French leadership. At the time of writing, in late summer 2013, there is no alternative macro model being discussed inside the IMF, only smaller adjustments to existing policy and practices. Remarkably, the global crisis of 2007-2008 was not severe enough to cause a shift in the community view. A reform of the global international monetary system was not attempted and no shift is seen.

In conclusion, G20-led IMF reforms have been relatively modest, first- and second-order changes. There has been no ideological or policy paradigm shift within the institution and within its policies. The reforms are the result of the interaction between reluctant G20 leadership and a cohesive, resistant neo-liberal IMF staff. The outcome has nonetheless reinforced the redesigned international financial architecture, albeit altered to reflect the IMF's no longer leading role in crisis fighting. Today the IMF stands better resourced and with a significant buy-in from emerging countries, which did not exist prior to 2008, and whose presence within the leadership of the IMF is likely to be felt more and more in the years ahead.

Chapter 7. Conclusion

7.1 Introduction

This research analysed the response of leaders and central bankers from advanced and emerging countries as they responded collectively to the most severe global economic and financial crisis in over 70 years, with a burst of crisis management, architectural and institutional creation, and a series of significant regulatory policy reforms to financial markets and firms across the globe. The research found a crisis-induced narrative shift amongst political leaders, and especially technical leaders, away from an emphasis on market authority and towards a reassertion of state authority.

This is not the first cycle of boom and bust, of a response involving crisis management, reform, redesign, and a return to disunity. National cycles of financial crises and shifts exhibit similar phases. But in this case, the height of the wave of economic crisis and the concomitant wave of crisis response by G20 leaders and the central banking community appears to be of greater amplitude, indicative of a rarer event, a paradigm shift in the consensus policy and international regulatory framework and in the architectural and policy response. This is what Hall found takes place, namely, ‘long periods of continuity punctuated occasionally by disjunctive experience of paradigm shift’ (Hall, 1993, p. 291; see also Wilson, 2000, p. 427; Gould, 1990). This research demonstrates that severe crises can ‘act as turning points in the governance of international financial markets’ (Helleiner, 2009a, p. 1). This crisis created space for a financial regime change (Wade, 2008).

This research identified the beginning of a paradigm shift, a rejection of tenets of laissez-faire neo-liberalism and its replacement with a state-led, collectively coordinated redesign and re-regulation of financial markets and firms within a new architecture. It is not a full global economic paradigm shift (i.e., a rejection of neo-liberal economic solutions overall) but is rather at this stage a financial regulatory phenomenon. The narrative shift started at the peak of the crisis in 2008, it was supported by the G20 leaders and driven by the central banking community. At the London Summit in 2009 the re-regulatory policy narrative and reforms were laid out in detail. The rapid policy evolution this signalled is still underway in 2013. It faces criticism, and is stronger in some policy areas and weaker in others. But the shift in regulatory worldview, and the policies this led to are potentially lasting, and it is

reasonable to conclude that there will not soon be a return to the unbridled unregulated global markets and firms of the pre-2008 era.

The new era is characterised by a reassertion of state power over markets and firms, of the application of enhanced macro-prudential regulation and supervision designed to buttress the financial stability of the system as a whole, of major markets, and of the world's largest banks and financial firms. This shift will not be easily abandoned or deconstructed. Instead, it is being defended by its technical creators and their community.

At this early stage, five years into the crisis response and regulatory redesign, research conclusions must of necessity remain tentative. As such, additional work on the height, breadth, and depth of the reform response and its components will need to be done in the years ahead. Observers will need to revisit the functioning of the reformed G20-Financial Stability Board (FSB)-International Monetary Fund (IMF) architecture as it operates to make further judgments on the shift's long-term impact and solidity of the paradigm shift. Each policy area and each sector will merit continued close analysis to judge whether the totality of the reforms are fully implemented and greater temporal distance from the crisis and response is possible.

7.2 Responses to Specific Research Questions

The following addresses the specific research questions raised at the beginning of the thesis and the conclusions that can be drawn from an analysis of the material.

❖ How should the observer view and understand the construction of the new global financial regulatory architecture commenced by leaders and their proxies in response to the 2007-2008 crisis?

In answering this core question, the research examined the shift in ideas, the emergence of the G20 and its summitry, the creation and actions of the FSB, the reform of the IMF, and the outer limits to the paradigm shift and process of altered financial regulatory construction.

The research identified the political and diplomatic dynamics during three phases in the G20's creation and evolution: crisis management, concrete reform, and a return to dissension among leading states. The research provided evidence of a narrative and paradigm shift made

by leaders during 2008-2009 that signalled a major alteration in approach to the regulation of global financial markets and firms. This shift amounted to a third-order change (Hall, 1993) in the overarching narrative away from laissez-faire neo-liberalism. Leaders and technocrats backed a re-regulation of global markets and signalled the end to the previously dominant paradigm of deregulation.

An elite-driven consensus forced a paradigm shift in response to the crisis in its first acute phase and in the reform response that immediately followed. The strength and breadth of the policy adopted as a result was impacted by this narrative shift among the technical elite central banking epistemic community.

It can be viewed as a series of related Kuhnian narrative waves, as per Figure 7.1, which shows the financial crisis wave in 2008 producing a rapid convergence of diplomatic (G20 level), economic (at the G20 and state-by-state-level), and technical (at the collective central banking and regulatory level) policy consensus and narratives which rapidly rise and peak at the London Summit in 2009. At that key juncture, all three policy narratives supported one another, in phases one and two of the crisis response. These narrative waves converge and support action by the G20, the creation of the FSB and the reform of the IMF. But overall the paradigm shift remains limited to re-regulatory aspects of laissez faire neo-liberalism.

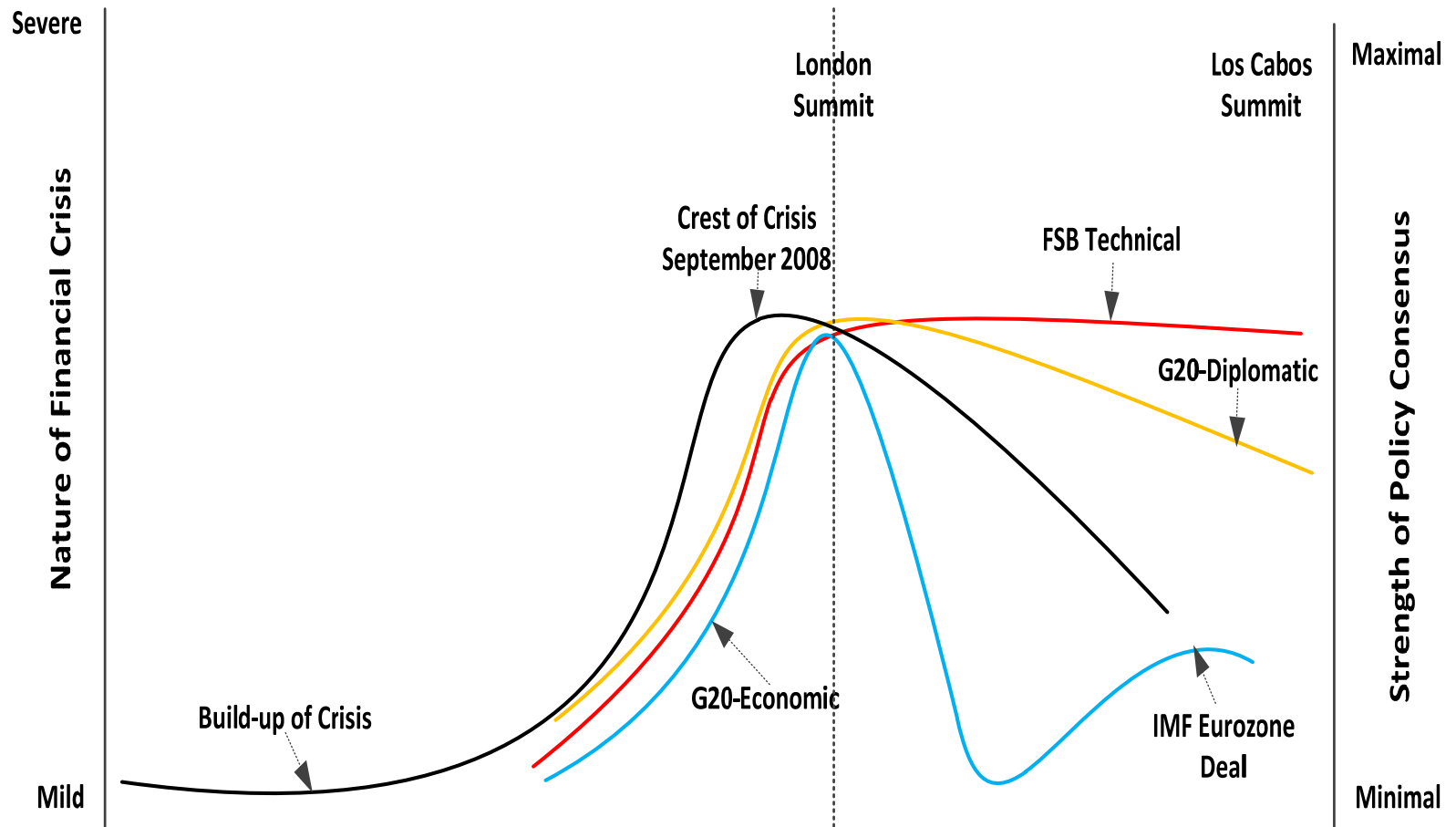


Figure 7.1 The 2008–09 Financial and Economic Crisis and Policy Consensus Waves

The findings presented here indicate that, after 2009, the economic policy wave dissipated, with disputes arising between Keynesians and ‘austerions’ (Krugman, 2012), only for the economic consensus to re-form in a smaller wave as leaders sought a Eurozone deal in 2012. The diplomatic G20-led wave also weakened in phase three as dissension returned. In contrast, the technical regulatory policy wave, supported by the key central banking epistemic community in the FSB, was and is the most resistant to erosion. This research showed that this new technical policy consensus and its community exerted a positive upward pressure on the diplomatic state-to-state narratives and on the work stream agreed in the G20 summits. Neither this broad, multifaceted consensus policy shift nor the convergence seen during 2008-2009 would have occurred without the crisis.

Subjects interviewed used the evocative imagery of being on a cliff, of looking into the abyss, of having no alternative. It was found that G20 leaders acted swiftly and in a manner that previous G7 and G8 summitry could not have achieved. A related conclusion is that the G20 forum has permanently supplanted these smaller, less legitimate groupings; these groupings continue to meet but now are less relevant; major global economic and financial regulatory decisions are now a G20 matter (Subacchi, 2009).

A ‘unifying’ effect of the crisis at G20 summits was identified in this research, where deals were secured in phases one and two, and even *in extremis* in phase three. It is also particularly seen at the FSB technical level, where national central bankers reached accord on level-one goals due to enlarged win sets, and could, to a greater degree, disregard normal national level-two goals. It was even observed to a lesser degree in negotiations over IMF resource boosts, reforms, and institutional evolution.

This research on the G20 summitry identified a financial crisis understood and modified Putnam-style two-level game process (Figure 2.2, p. 40). The severity of the financial and economic crises initially pushed national negotiators together. Both level-one and level-two goals converged, or, alternatively, level-one goals overrode level-two goals as negotiators temporarily disregarded short-term national concerns. The economic crisis enlarged win sets and new agreement possibilities. It increased the chance of breakthroughs that, in the absence of a crisis, would not have been politically possible. As would be expected, once the immediate severity of the crisis dissipated, win sets shrunk, and national level-one goals began to diverge and level-two goals once again interfered with efforts to extend the scope of the reforms contained in the new paradigm.

The research presented here showed that once a paradigm shift occurs, it still has limits imposed upon it by the boundary of the scientific knowledge it includes or—in this case—the extent of the financial regulatory worldview and consensus it reflects and rests upon.

The shift does not extend to global macroeconomics or national political economy matters. The new consensus does not include a rejection of neo-liberal economic ideas, even as many (but not yet a majority) in the community question their validity.

In addition this research found that even after a paradigm shift in regulatory ideas has begun, and policies that reflect the new stance are being promulgated, critics will remain vocal, and the shift's validity from place to place, policy to policy, will be tested. Copernican theory and Galileo's empirical discoveries were resisted mightily by the Catholic Church after that scientific paradigm shift. Similarly, today many bankers and their fellow travellers resist the new re-regulatory and macro-prudential paradigm, especially as it is first being promulgated. In other words, the regulatory consensus and paradigm shift is underway, but its application via new policies is resisted by some and continues to be challenged.

This research also found that the consensus narrative and policy shift does not grow at the same rate in all dimensions or at an exponentially rapidly expanding rate. In this case, the crisis response produced a consensus and a sudden burst of action (during 2008-2009) followed by a more gradual rate of reforms (during 2010-2013), with the later evolutionary changes being based on and taking place within the limits of the new re-regulatory policy paradigm. This finding is in line with Hall's conception of paradigm shift in the economic sphere and the three different orders of change seen, as applied to the international crisis-driven process in this case.

A third-order paradigm shift is visible in some key fields, such as international coordination and macro-prudential regulation, indicative of the shift underway. These changes are followed or accompanied by a high second-order shift in other areas, such as derivatives regulation. Finally, in the midst of a paradigm shift, there are weaker first-order changes (such as that on 'too big to fail'). This is how a paradigm shift in ideas is made real: policy by policy, step by step. Some are strong responses, others less so.

❖ *Is there a reassertion of Westphalian state power in the global economy via the G20 and FSB, and how has the power of key state actors been affected by the growth in importance of the G20 and FSB? What role are emerging market players performing?*

The creation and actions of the G20 are at base a rejection of the previous Anglo-Saxon laissez-faire neo-liberal deregulatory paradigm. There was a transnationalisation of state authority over global financial markets and private sector financial actors. There is a reassertion of collective state soft and hard power over global financial markets, firms, and actors. The policy implementation underway throughout the G20's and FSB's recent history amounts to the extension of state power through new and reformed institutions and internationally coordinated regulation.

This research demonstrated that the G20 summitry and FSB processes were essentially a Western project addressing Western failings led by North Americans and Europeans from 2008 to 2012. Leaders from Europe and North America retained control of the design and financial reform process, notwithstanding a partial handover of technical leadership in 2013. Even as more actors joined, the structures were fashioned formally and informally by those at the core. The agenda was and is driven by a small number of actors in this community. Today, even for those inside the process, as in *Animal Farm*, all are equal but some are more equal than others (Orwell, 1946).

At the G20 level the response is underpinned by a cohesive and predominantly Western elite expert epistemic community of central bankers and supervisors clear on the causes and possible solutions. The community engaged in 'the creation of collective meaning' and fashioned a new policy narrative (Adler and Haas, 1992, p. 369). The central banking community exhibits the defining features of an epistemic community: a shared set of normative and principled beliefs, shared causal beliefs, shared notions of validity, and a common enterprise (Haas, 1992a, p. 3). The crisis created the shock which overcame institutional inertia, and major shift was possible.

This research illuminated that the Western central banking community provided expert advice and was deferred to by G20 political leaders desperate for actionable reform. The G20 delegated the policy reform process to the same community. The size of the community does not matter—it was quite small, an international elite; it is what is done with the power and

policy influence that counts (Adler and Haas, 1992, p 380). The research demonstrated the technocratic nature of the elite community and the community's cohesiveness; its small size and strong leadership facilitated the rapid post-crisis policy-making process, especially in phases one and two.

In 1992, Kapstein observed that central bankers were 'not yet an epistemic community', but they were acting increasingly like one (Kapstein 1992, p. 267). Partly as a result of the crisis, this same group has clearly matured and in 2013 can be said to be the dominant international epistemic community addressing global financial regulatory reform. The research has shown the nature of this opaque, particularly powerful elite community and the effect the crisis had, further increasing the concentration of decision-making and policy-making power within a small (albeit marginally enlarged) number of individuals. This small, closed community conceived the FSB, led the FSB, and dominates the decision making. Backed by the G20 and through the FSB, this community acted to address the crisis and to defend their centrality and prerogatives in the policy-making process. As a result, the central banking community emerges greatly strengthened, despite having collectively failed to see the impending 2007-2008 crisis.

The common policy narrative amongst central bankers and supervisors was not monolithic. There was dissension from the new consensus and some opposition to the aggressive re-regulation of banks via new macro-prudential policies. Some actors leaned more towards the community position (and away from national positions), and others (a much smaller group) stood behind their national positions. This conclusion is in line with the work of Mitchell *et al.*, which finds that national differences are evident and expressed in expert communities to varying degrees (Mitchell *et al.*, 2007, p. 762).

Despite these differences, the community as a whole agreed to the shift, to re-regulation, and to the macro-prudential approach. Chief negotiators in 2009 converged on their level-one goals. They disregarded their level-two constituents (that is, national commercial banks). Instead, they agreed the application of the community's state re-regulatory reforms. FSB leaders pursued their 'own conception of the national interest in the [now crisis-altered] international context' (Putnam, 1988, p. 457).

Emerging market principals are not missing in this reassertion of state power and the summitry process. Indeed, emerging countries supported the shift in worldview, which was in

line with their domestic approaches, and today they are gradually increasing their influence. But they did not play a major role at the beginning of the process. As they individually take over the presidency of the G20, and lead parts of the FSB technical process, however, they are starting to impact the outcome and shape its contours. It is probable that their influence, and their confidence in applying that influence, will continue to grow as the G20-FSB-IMF reforms mature. This is only a prediction as to the long-term consequences of the alternative crisis narrative and institutional changes constructed by the elites in the first acute phases of the crisis.

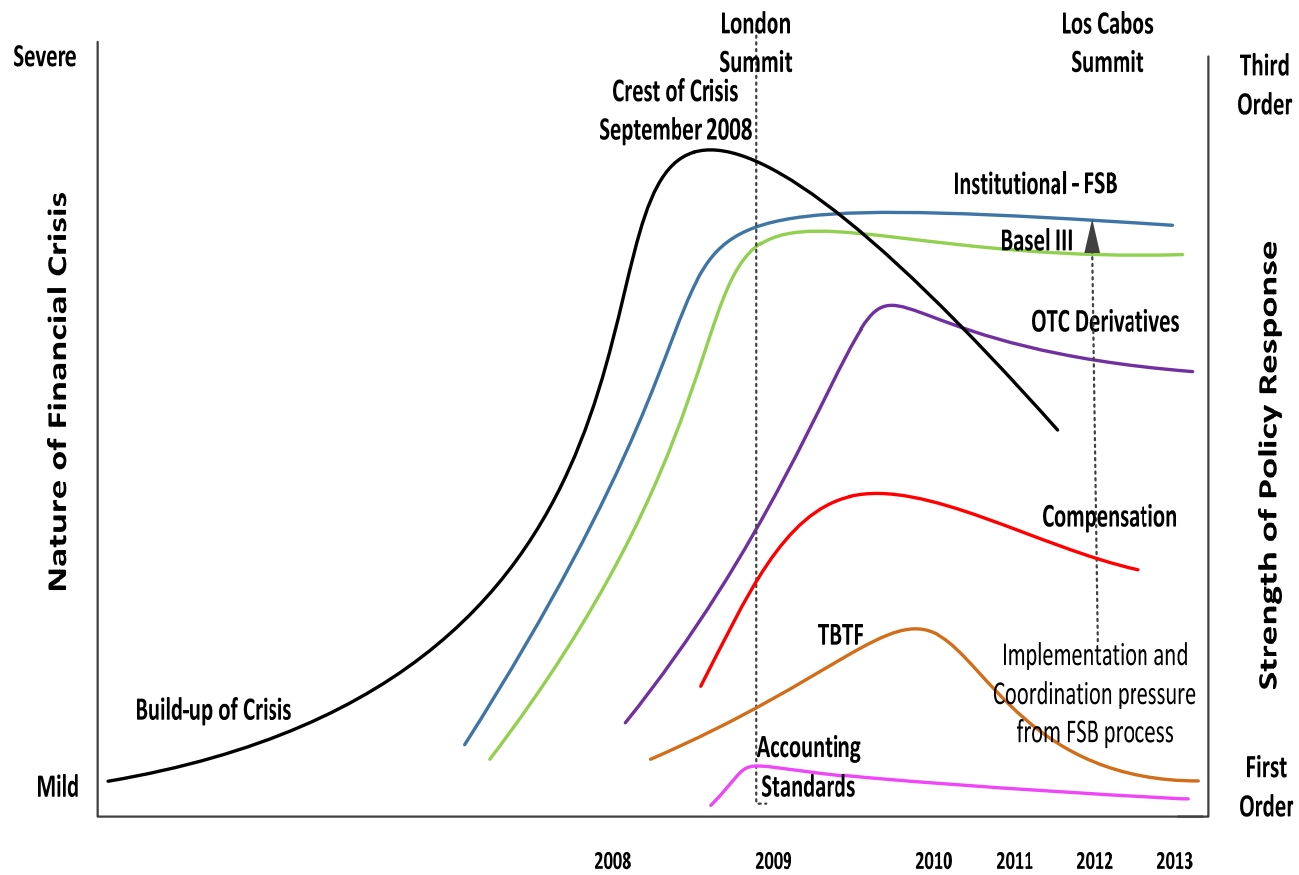
❖ *Are there parallels to be drawn from the cycles in past national financial crises and responses and the rise of the G20 and FSB?*

There are parallels with national episodes of financial crises, which also often result in cycles of crisis management, reform, and relapse. The difference in this case is the magnitude of the crisis and the observed response and reform wave. Actors' responses in this crisis resulted in a new narrative concept of what was required for systemic stability the institutional and policy tools needed to implement this (principally via the FSB and, to a much lesser extent, the IMF). As with national ideological shifts, because the G20-FSB response involved a paradigm shift, it may be more durable and resistant to erosion. But the cyclical nature of the process suggests the shift also has elements of eventual impermanence. Just as national ideological shifts do not last indefinitely, so too the current shift may eventually be challenged. So the cyclical process of crisis, response, and relapse will continue. At best, the frequency and amplitude of the cycle may be altered by the reform response in 2008 and since then, but a judgement on this cannot be made until the new structures are tested by a future global crisis.

❖ *Can we gauge how effective the G20 and FSB are as forums and in their broader policy goals – that of enhancing economic and financial stability?*

The research found that the G20 was relatively effective in the crisis management phase and in providing support and political capital for the reform agenda in the reform phase. Even as public tensions rose amongst G20 leaders in phase three, the leaders were still able to act, and they backed deals (such as the Basel III accord, fashioned by their technocrats) and institutional changes (to the FSB). But the cyclical nature of crisis response and the informal nature of the G20 results in a reactive process, not one which retains its intensity as calm

returns. The impact of the later summits has been less marked, and the G20 is somewhat less effective now than in the heat of the crisis. This policy process and outcomes can also be viewed as a series of interlinked waves, as shown in figure 7.2 (these policy waves are linked to and supported by the G20 and technical narratives waves discussed previously and shown in figure 7.1).



Note: TBTF = too big to fail.

Figure 7.2 Policy Reforms as Waves

Figure 7.2 shows the various policy responses analysed in the research as a series of related Kuhn/Hall waves. None would have occurred without the crisis as the precipitating event. Each wave's height depends on whether the response is a first-, second-, or third-order shift. The peak of an initial policy response occurs at the summit, when the G20 agrees a common policy goal; thus, not all policy reforms begin simultaneously. The size and temporal durability of the crest of each wave depends on the outcomes as judged thereafter. Thus, the central banking institutional FSB response and the key Basel III reform are the strongest and most sustained waves. Other responses vary in height, strength, and durability, with TBTF (too big to fail) and accounting standards being the least impressive of all.

The research findings show that the FSB's creation and evolution resulted in a significant qualitative and quantitative improvement amounting to a third-order change in international regulatory coordination; a paradigm shift in coordination. The Board, its community, and leading Western voices exert an upward pressure on all policy outcomes, as per figure 7.2. Participants involved in the process recognise this. The research demonstrates that the central banking epistemic community was and today remains pivotal to the paradigm shift and policy coordination that facilitates and underpins the reforms and their national implementation.

Hall noted that 'policy makers are likely to be in a stronger position to resist societal [in this case banking] interests when they are armed with a coherent policy paradigm,' (Hall, 1993, p. 290). The central hypotheses and principal finding of this research is that this is what is occurring in the FSB policy-making process. Given a series of recognised critical anomalies, the stronger the epistemic community in policy making, and the stronger the new policy consensus, the more significant the resulting paradigm shift may be and the greater the strength of the concomitant policy outcomes that may occur (this is also pictured in figure 2.2 p. 33).

This leads to the conclusion that if the central banking community, which has undergone an paradigm shift, controls the policy levers and determines policy outcomes, then the form of policy response and its robustness, that is, its success, in terms of potentially insuring greater future financial stability, is enhanced. In contrast, when the FSB leadership is separated from the policy process or where other weaker less cohesive SSBs and communities are driving the outcome, it is likely to be less robust, in large part because the policy narrative and consensus may also be flimsier in such cases. In other words, increased dissension amongst elites

produces a weaker policy implementation and also curtails innovation of further global regulatory reform policy overall.

It was found that as Figure 7.2 shows, the strength of policy outcomes varies. At one extreme there is the relatively robust response designed and dictated by the lead central bank community. Other policy outputs are less strong and indicative of disagreements amongst the G20 leaders, within FSB and amongst other policy-making communities over aspects of the policy narrative. In some cases, even with general agreement on goals, complexity and cultural differences intervene to undermine the outcome. In other cases, no agreement is possible at all because the national technical policy-making communities do not agree and block movement despite G20 demands that they act.

The research indicates that in addition, national private vested interests (level-two actors in Putnam's sense), have a fluctuating impact on the policy waves. At the peak and immediately following the crisis, the level-two interests are disregarded and least influential. During the crisis, they are not impacting the immediate policy response waves in 2009. But as the crisis wanes national level-two interests have a greater negative impact on the waves' amplitude and duration; the outcome can be first limited to first and second order changes..

These findings of different policy outcomes as a result of a paradigm shift are in line with Hall's conception of first, second, and third orders of policy change, all of which can take place within a new paradigm. This research presented here also shows that policy narrative and material factors interact, i.e., that ideological shift and policy outcomes are influenced by power relationships and technical community relationships, where some have greater influence than others around the same negotiating table (Porter, 2011, pp. 14-16).

What is also visible is the continued (though somewhat altered) asymmetric structure of global power within the paradigm shift identified here. The dominant powers of the previous paradigm still retain overall dominance in the new paradigm. In this important sense, there is structural continuity within the institutional and policy changes produced by the crisis and its elite responses. The paradigm shift is limited to certain areas (principally financial and regulatory), in which consensus was possible among the elite technocratic community, and where the dominant community was more able to effectively address the acute phases of the crisis.

In 2013, and at this point in the re-regulatory paradigm shift and resulting policy reform process, a final definitive determination of success as regards economic and financial stability is not possible and would be ill-advised. International paradigm shifts take time to become fully visible. Further, research will be needed to determine the final scope and effect of the new constructs and architecture on financial stability.

But a potentially significant directional shift toward stronger harmonised global standards is visible when the policies are each placed in the policy reform matrix (figure 5.11, p. 208). The matrix shows a shift in regulatory policies as a whole toward stronger, more globalised processes and solutions. Each particular policy reform moves a different distance—and on occasion backwards or down the chart—within the landscape according to its particular set of influences and pressures. What is clear is that the old policy consensus is gone. The new consensus is being contested as it is being formed in response to that paradigm shift.

Epistemic policy evolution, according to Adler and Haas, has four phases: innovation, diffusion, selection, and persistence (Adler and Haas, 1992, p. 373). At this point, innovation is clearly visible. The community framed the problem and defined the issues. They engaged in policy diffusion and coordination through the FSB structures. The same community largely selected the policies that expressed the G20 leaders' collective interests, defining the reform agenda as a whole. The crisis created an opening—an ideal time, to make this major shift. What has yet to come fully into focus is the element of persistence—i.e., the long-term strength of the different policy elements of the new paradigm backed by the lead epistemic community.

The epistemic community members are the architects of the shift, but it is still being contested. National lobbies resist it to varying degrees. This is to be expected; there will always be clashes of national interests and divisions and divergent goals, underpinning the power relations within the G20. The research findings indicate that the community has, however, been able to fashion a common stance and consensus that can defend the new paradigm and which can go beyond individual national positions and seek collective goals.

❖ *What challenges and limitations do these forums face as they move from crisis management to financial reform to confronting new tensions and a return to disunity?*

The research findings show that the G20, in phase three of its evolution, confronts the outer limits of the paradigm shift. Remaining macroeconomic issues, which range from global imbalances to currency and reserve management matters, to the future of the international monetary system, remain outside the boundaries of the new policy. As such, disputes and discord within the G20 occur as national paradigms and growth models clash rather than converge. This should come as no surprise. History since the collapse of the Bretton Woods agreement in 1971 includes numerous global macroeconomic disputes (creditor versus debtor, exporter versus importer) of this type. The research finds that the new re-regulatory consensus has limits; it neither extends to contested issues related to global macroeconomic balances or currency policies nor encompasses issues of national economic policies or models. The G20-FSB-IMF architecture process confronts other institutional and legitimacy challenges, as well.

Within the limits of this new worldview, legitimacy matters (Aslund, 2009; Brookings Institution, 2011b; Elson, 2011; Vestergaard, 2011), and the research identified a continuing tension within the G20 and FSB structures between the desire for efficacy and demands for enhanced legitimacy. Critics complain, and the research presented here shows that the G20 and FSB are exclusive, exclusionary, opaque, and (especially in the case of the FSB) little understood by outsiders. The structures are a reversion to interstate power diplomacy and away from the use of universal institutions, including the IMF. The research highlighted the tension between those inside exclusive forums which are fast and flexible (Slaughter, 2001), and those outside who prefer universal institutions in which they have a voice, but which by their nature tend to be slower, less responsive, more bureaucratic and hidebound. These complaints are a reaction to the further increase in the concentration of global decision-making power in relation to the financial system, and away from universal treaty-based institutions.

The research found that G20 leaders and the central banking community prefer these exclusive structures. They reflect G20 members' distrust of the past performance of universal institutions, especially that of the IMF, a distrust that resulted in the IMF being blocked in its attempt to lead the response in 2009. The exclusive construction also reflects the central banking community's highly secretive approach to policy making. The G20 and FSB forums are also an artefact of the nature of crisis response and rapid reform. In a crisis, leaders seize what they believe to be most effective in securing their own goals, engage in crisis

management, and press reforms. Only later do leaders turn to issues of transparency, openness, and inclusion, because these are subsidiary concerns.

Accusations of illegitimacy will continue. Supporters of universal treaty-based institutions were never going to support the G20 and FSB processes, except as a temporary crisis management tools. The research shows G20 and FSB members are resisting, and will not soon agree to, a process whereby the two forums slide toward ever wider membership. Despite this tension (or rather perhaps because of it), the forums are slowly becoming marginally more inclusive as a result of external pressure.

The FSB is affected by demands for further institutional evolution. As the most successful institutional expression of the new re-regulatory worldview, it faces pressure to enlarge and respond via the expansion of the steering committee membership and creation of the Regional Consultative Group. Its structure is also becoming more formalised, and may become less flexible in the process. As the Board evolves, its mode of operation and processes will further develop. The danger is that if this goes too far, via membership creep and formality of process, some elements of the Board's efficacy may be sacrificed in the name of legitimacy, transparency, and inclusiveness.

❖ How was the IMF affected and reformed in response to the crisis and what role does it play in the new architecture?

There are three principal findings related to the IMF.

First, the IMF was not in the lead in the response to the crisis, as was the case in prior financial crises in the 1990s and earlier. In 2008, the G20 and the FSB seized that role, and the leaders' forum is now the agenda setter on global macroeconomic and financial regulatory matters, advised by the central banking community. In this important sense, the IMF has been demoted structurally within the global architecture. Smaller states would prefer a return to the centrality of universal institutions in financial crisis management and a greater use of the IMF in the crisis response process. The research concludes that this is unlikely to take place. The IMF will not take a lead role in financial regulation and crisis response going forward; it will be a conduit for funds, but it will be only one player at the table, as was the case in the negotiations over the US\$461 billion Eurozone firewall. Notwithstanding this structural demotion, the crisis was a good one for the IMF. It went from near irrelevance to

being refinanced and reformed thanks to agreements articulated within and via the G20 process. In this manner, this exclusive political summitry paid real dividends for the IMF.

Second, the IMF's political leadership internally did not (unlike G20 leaders and their technocrats) undergo a paradigm shift in worldview. Instead, smaller first- and second-order incremental changes were made to the IMF's existing policy stances. The research concludes that a French-modified Washington Consensus still operates inside the IMF amongst its staff and its key finance ministry shareholder representatives in the Executive Board acting as creditors. Previous suggestions of the possible birth of a new IMF development paradigm (Gore, 2000) were then and are now premature. It will take many more years for an internal economic and ideological shift to take place inside the IMF; in 2013, there appears to be little desire for such a change within the organization. The research also finds that this continuation of aspects of the Washington Consensus occurs within the new regulatory paradigm.

Third, the reforms agreed, on resources, votes, and voice, were nonetheless effective in drawing the emerging states back into greater support of, and engagement with, the IMF. Countries that had abandoned the IMF have recommitted to the organization and are increasing their engagement. This is a significant development given the near irrelevancy of the organization prior to the crisis. The reforms strengthen both the IMF and the position of the U.S. within the organization, an outcome preferable to conflict and clashes outside the existing structures between the U.S. and China, in particular.

❖ Does the phenomenon that led to the sudden emergence of the G20 and FSB—a robust reassertion of state power—complicate their further evolution post-crisis?

The reform response and the cycle within which the paradigm shift took place is dialectic. The crisis response and reforms seen in phases one and two of the G20's evolution helped restore economic and market confidence and relative calm. At that point, the collectively applied G20 state power which made the process effective in the first two phases reverts to national positions, divergent goals, and demands in phase three. This discord acts as a block to a further extension of the regulatory worldview to other areas of global macroeconomic dispute, and the outer boundaries of the paradigm are reached. The G20 process relies heavily on state-to-state power relationships within a consensus-based forum. It has no momentum of its own, in contrast with treaty-based organizations with distinct mandates. The G20,

therefore, is more dependent on commitment, engagement, and agreement amongst states, and this may be lacking post-crisis.

What mitigates this to a degree is the robustness of the FSB structures and the agenda at the level below the G20. The FSB interlinkages between independent sub-state actors and the system of policy-making coordination and monitoring they include, exhibits elements of institutional strength that may partially counteract the political and national state-power-driven centrifugal forces pushing actors apart once again at the G20 level. This is already happening. It was seen in Seoul (2010), where a public currency war at the summit did not stop the G20 from signing the Basel III accord. Disputes in Cannes (2011) and Los Cabos (2012) did not halt the FSB technical policy-making processes, although G20 leaders were simultaneously arguing over issues beyond the limit of the paradigm.

In this third phase of the G20-FSB response, the policy-making community has moved to paradigm maintenance and defence, which suggests a willingness to protect their new creation from attacks and to strengthen the FSB as the key forum. The technical central banking community continues to construct the institutional underpinnings of the new paradigm, showing their active support for the Board's continued evolution as the concrete expression of the new international regulatory and cooperative architecture. This is paradigm maintenance and construction in action. It is institutional evidence of the gradual evolution of the forum and of its policy mechanisms, even as the speed and intensity of the reform process slows in phase three. Some steps are small, others are larger; taken together, they demonstrate that institutional evolution continues to underpin the reform process even in 2013.

The reformed architecture appears relatively robust. But the possibility of failure of the new institutional structure cannot be fully discounted. It remains possible that dissension may result in a breakdown in practice, that is, a failure to consolidate the new system of state authority, of transnationalised state authority over globalised financial markets and private sector actors.

❖ *What do the reform responses in the G20, FSB, and IMF cases signal for the future evolution of the global financial architecture?*

The operation of the G20 forum and its technical progeny, the FSB, has altered international economic and financial diplomacy and drawn in the rising powers; they no longer need rely

on occasional invitations to meetings. This is a meaningful shift in power relations—a recognition of the decline of U.S. hegemony and a rise of the new powers.

Yet, the creation of the leaders' forum by the United States also ensures that it extends its influence over the consensual process. It is clear that in the new financial regulatory architecture, certain states, leaders, and their technocrats matter more than others. So the economic and diplomatic impact is one of change, but also one of continuity. The research finds a significant element of asymmetry in the global power structure. The redesign of the regulatory system still preserves both key aspects of 'Northern hegemony' over the global economic system and, in this way, the perpetuation of a strategy for Western global hegemony.

The crisis has elevated the status of certain emerging country challengers and the counterhegemonic forces amongst emerging powers. This may have long-term implications which cannot be predicted. Including rising powers in the architecture and policy processes prolongs Western hegemony. It postpones a direct paradigm clash with the rising powers. These rising powers may begin, as a result, to act as more enthusiastic system supporters, or they may force the rate of evolutionary institutional change. It is too soon to judge.

7.3 The Challenge Ahead

Internationally significant paradigm shifts in economic or financial regulatory policy narratives are rare events. When they occur, they are gradually reflected through policy changes of varying magnitudes. Just such a shift in the internationally coordinated financial regulation of global markets and firms commenced in 2008-2009 and is still under way in 2013. In the years ahead, observers will need to watch for evidence of a consolidation, a continued cementing of re-regulatory policies that implement the underlying narrative and ideological paradigm shift.

In 2013, the G20, central bankers, and national regulators have seized back control over global financial markets, and they are collectively and individually driving the policy agenda. It is still early in the process and the final end result of this burst of institutional and policy-making action remains somewhat unclear. At this stage, the observer is too close to the wave of reform and the shift in worldview to fully comprehend its scope. Participants continue to ride the reform wave as individual surfers on the new paradigm. The old previously dominant

deregulatory framework has gone; a new re-regulatory paradigm is emerging but its full impact will only be properly understood in the years ahead.

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Note: Interview 1 through Interview 34 were conducted by Stuart Mackintosh, author of this thesis, and are cited in the text as Interview 1, Interview 2, and so forth.

Interview 1. World Bank official, 30 August 2011.

Interview 2. Former G20 finance ministry official, 10 October 2011.

Interview 3. Former G20 finance minister, 21 October 2011.

Interview 4. National IMF official, 1 November 2011.

Interview 5. Former G20 sherpa, 7 November 2011.

Interview 6. National IMF official, 8 November 2011.

Interview 7. G20 principal supervisor, 7 December 2011.

Interview 8. Former G20 finance minister, 8 December 2011.

Interview 9. G20 central bank, former deputy governor, 9 December 2011.

Interview 10. G20 central bank, deputy governor, 9 December 2011.

Interview 11. Advisor G20 central bank, 9 December 2011.

Interview 12. G20 finance ministry official, 27 January 2012.

Interview 13. Prime ministerial advisor, G20, 7 February 2012.

Interview 14. National IMF official, 11 February 2012.

Interview 15. G20 central bank governor, 16 February 2012.

Interview 16. National IMF official, 28 February 2012.

Interview 17. G20 presidential advisor, 3 March 2012.

Interview 18. G20 sherpa, 6 March 2012.

Interview 19. National IMF official, G20 former treasury official, 12 March 2013.

Interview 20. National IMF official, 13 March 2012.

Interview 21. National IMF official, 23 March 2012.

Interview 22. Former G20 finance minister, central bank governor, 1 May 2012.

Interview 23. Former IMF official, 15 May 2012.

Interview 24. G20 central bank governor, 2 July 2012.

Interview 25. G20 principal supervisor, 3 July 2012.

Interview 26. Academic observer, 10 July 2012.

Interview 27. Academic observer, 15 July 2012.

Interview 28. FSB official, private sector observers and academic; 23 September 2012.

Interview 29. Finance ministry official, 18 September 2012.

Interview 30. National IMF official - follow-up second interview, 12 October 2012.

Interview 31. Former director, IMF, 16 October 2012.

Interview 32. Former chief economist, IMF, 21 October 2012.

Interview 33. Senior finance ministry official and G20 lead, follow-up meeting, 14 November 2012.

Interview 34. G20 central bank, deputy governor, and former finance minister, 13 June 2013.

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