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POLICY DEPARTMENT
ECONOMIC AND SCIENTIFIC POLICY A

Financial, Economic and Social Crisis

GLOBAL IMBALANCES AND GLOBAL GOVERNANCE

Compilation of Briefing Papers

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DIRECTORATE GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICIES

SPECIAL COMMITTEE ON THE FINANCIAL, ECONOMIC AND SOCIAL CRISIS

GLOBAL IMBALANCES AND GLOBAL GOVERNANCE

COMPILATION OF BRIEFING PAPERS

Abstract

This compilation of briefing papers was written by two members of the expert panel to the Special Committee on the Financial, Economic and Social Crisis. Its aim is to support the committee discussions on key questions arising from the crisis and thus feed into the preparations of the final report.

The briefing papers outline the role of the IMF, the FSB and the G20 transatlantic dialogue as well as briefly discussing the political implications of a "Europe speaking with one voice".

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TABLE OF CONTENTS

Global imbalances and global governance (Kapoor) 5

Introduction 8

What are these global imbalances? 8

What can be done about them? 10

Who can tackle these imbalances globally? How? 12

What interest and role does the EU have in this? 14

Global imbalances and global governance (Mrak) 15

1. INTRODUCTION 18

2. GLOBAL IMBALANCES 19

2.1. Concept of global imbalances 19

2.2. Global imbalances volumes and trends 19

2.3. Causes of global imbalances and proposed policy responses 21

2.4. Possible developments of global imbalances after the crisis 22

3. GLOBAL ECONOMIC AND FINANCIAL GOVERNANCE 23

3.1. Concept and evolution of global economic and financial governance 23

3.2. The current crisis and its implications on global economic and financial governance 24

3.2.1. Emergence of the G-20 at the level of heads of states and governments 25

3.2.2. Reform of the IMF

3.2.3. Conversion of the Financial Stability Forum into Financial Stability Board 27

4. CONCLUSIONS 28

References 29

DIRECTORATE GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICIES

SPECIAL COMMITTEE ON THE FINANCIAL, ECONOMIC AND SOCIAL CRISIS

Global imbalances and global governance

BRIEFING

by Sony Kapoor, Managing Director Re-Define

Abstract

While global imbalances may not be bad, the renewed build-up of what are generally considered to be unsustainable levels of imbalances is potentially destabilising and reduces global welfare. While the EU as a whole is not a major contributor to them, we have a very strong self-interest in working through mechanisms of global governance to tame these imbalances. This is driven by 1) the dangers of getting caught in the cross fire between surplus and deficit countries, 2) our stake in an optimal growth-enhancing solution at the global level, 3) the fact that the international debate mirrors the ongoing euro area imbalances, and 4) the possible lessons that we, as the European community, might have for better global governance. This brief starts with a discussion of the imbalances and then analyses how best the G-20, IMF, FSB and Transatlantic dialogue could work towards a coordinated global response and the importance of the EU speaking with a single voice for this response to succeed.

TABLE CONTENTS

Introduction 5
What are these global imbalances? 8
What can be done about them? 8
Who can tackle these imbalances globally? How? 10
What interest and role does the EU have in this? 12

Introduction

Even cab drivers are bashing China over its role in global imbalances and talking about the urgent need for global rebalancing. This raises four immediate questions

1) What are these global imbalances?
2) What can be done about them?
3) Who can tackle these?
4) What interest and role does the EU have in this?

These are the four questions we try briefly to answer in this brief.

The first section deals with what these imbalances are and why they might pose a problem for both the world economy and for the EU. The second section of the paper looks at what the various prescriptions are to address the problems raised in the first section. This will look both at various policy measures being suggested and in the next section we will look at the main national and international actors in the debate with a particular emphasis on the IMF, FSB and G-20. And the last section deals with the interest and possible role of the EU in discussions about tackling imbalances particularly through these institutions and a role for the transatlantic dialogue. Finally we conclude with some immediate suggestions for EU policy makers.

What are these global imbalances?

Countries trade with each other and both private citizens and governments borrow from and lend to citizens and governments in other countries. As long as we do not deal with Martians, the surplus of countries will be balanced out by deficits faced by others. Or in other words, to every surplus there is a deficit and vice versa. This implies that the "surplus good, deficit bad" label that is often attached in the current debate makes little sense.

As a person, the difference between your income and expenditure (current account for countries) has to be matched by a change in your savings (capital account for countries). So it is also for countries, where any deficits on the current account need to be financed by surpluses on the capital account or vice versa. In the case of China, for example, the flipside to its current account surplus is the capital account deficit it runs by sending money abroad in the form of purchases of reserve assets such as US and EU government bonds.

Just as people can increase their welfare by saving or borrowing, ie they are not forced to match their income to expenditure every year, so for countries the possibility of running imbalances in the form of surpluses or deficits is a fact of life and increases global welfare. Why then, one may ask, is there so much fuss about global imbalances which are most commonly defined as the gross sum of all current account surpluses and deficits?

Global imbalances, in themselves, are neither good nor bad. However there are two main sets of problems associated with them.

1) The current magnitude of global imbalances is high, expected to increase further and is widely believed to be unsustainable. The danger then is that these imbalances make the global economy more vulnerable and as observed in the present crisis their rapid unwinding can be a source of welfare-reducing instability.
2) A significant amount of money (in the capital account) is flowing from fast growing developing and emerging economies to slow growth mature economies where the rates of return on investment are much lower. This goes against mainstream economic logic; it would increase source country and global welfare if this money were invested domestically instead.

In the years up to 1990, global imbalances added up, on average, to less than 1% of global GDP. However, these imbalances grew very significantly and in the decade leading up to the crisis they amounted to more than 5% of global GDP per year. Moreover, they have been growing at an unprecedented rate of around 11% per year compared, for example, to a growth in global trade of around 5%-6% per year.

There are a number of political, economic financial and technological factors that explain how and why this happened. Perhaps the most commonly accepted explanation is the continuing success of the export oriented growth model, for example in the case of China and the deliberate policy of many of these economies to build-up foreign exchange reserves as a bulwark against crises of the kind that struck East Asia in 1997-98. Reserve and Sovereign Wealth Fund build-up by commodity exporting countries has been another major contributor to the persistence of imbalances. This growth has also been facilitated by a number of other factors such as the capital account liberalization, financial deepening and technological development seen across the world.

This explanation is supported by the fact that the imbalance in flows (current account) shows up as large and rising stock of reserves and sovereign wealth funds. Reserve levels held by developing/emerging economies now exceed USD 6 trillion (around USD 2.7 trillion held by China alone) having increased from about USD 1 trillion in 2002. Sovereign Wealth Funds now have close to USD 10 trillion in assets. This accumulation is the flipside of the much disputed current account surpluses registered by countries such as China.

While the precautionary motive of guarding against a repeat of the Asian crisis was the likely driver for the start of this accumulation, consensus opinion is that the stock now exceeds any level justifiable by this insurance motive alone. This has given rise to widespread allegations that some countries, notably China, are holding their exchange rates down to give themselves an unfair advantage in exports by increasing reserves. China's large investment in US government bonds has also been targeted as a contributor to the crisis by having enabled excessive US borrowing at very low interest rates and allowed dodgy CDO security markets to flourish. China in turn, has accused the US of deliberately following a policy of excessively low interest rates as an indirect means to lower the value of the dollar vis-à-vis other currencies. There is perhaps some truth in the arguments from both sides though the real picture is far more complex.

Whatever the motive and the nuances, a number of facts are now clear.

1) Without active policy intervention, it seems unlikely that global imbalances will diminish. Despite a significant fall during the crisis (driven by the temporary collapse of trade and capital flows) imbalances are now back to pre-crisis levels.
2) Several longer term trends are contributing to imbalances, including demography, increasing financial system development, more capital account liberalization and perhaps most importantly the rapid shift of economic weight from advanced to emerging economies.
3) Under current economic structures and given the fiscal vulnerability and weak growth faced by many advanced countries, the level of prevailing imbalances is not sustainable and is likely to result in financial instability.
4) The continuing investment of poorer country capital into mature economies is economically and socially suboptimal, channeling resources away from much needed investment in developing countries and fueling dangerous asset bubbles in developed countries.
5) Shifting economic weights and imbalanced growth are now driving very large amounts of private investment into emerging economies, with inward flows in 2011 expected to be close to USD 1 trillion.

In summary, export surpluses have facilitated the development of asset bubbles in developed countries while the combination of export surpluses and inward investments is driving a lot of money into emerging markets such as China, India, and Brazil etc. This is putting an upward pressure on exchange rates for these emerging countries and is endangering financial stability through potentially inflating asset bubbles around the world.

In response (and out of precautionary and mercantilist motives), these countries are using a variety of tools that fall either in the category of 1) building up reserves or 2) a management of exchange rates or capital accounts in order to resist this pressure and reduce potentially destabilising inflows. This is the background under which the so called 'currency wars' are taking place.

We have deliberately left the EU out of this discussion so far. This is because at an aggregate level, the EU (the euro area in particular) does not have a particularly large imbalance with the rest of the world. The euro area is in fact plagued by persistent and large current account imbalances internally between surplus countries such as Germany and deficit countries such as Spain. The unsustainability of these internal imbalances has been one of the main drivers of the ongoing Euro crisis. This is discussed later in the paper.

What can be done about them?

We have seen thus far that global imbalances 1) are unsustainable 2) are driven by a mix of precautionary and mercantilist motives on the one hand and 3) responses to shifting economic power from advanced to emerging economies on the other 4) are probably welfare reducing 5) have a deficit and a surplus side.

The consensus is that active policy intervention is needed to tackle these large, persistent and growing imbalances. That is why the G20 has repeatedly underscored this as one of its policy priorities and the IMF has highlighted the urgency for action. Not much has happened as there is widespread controversy on which country should take which specific measure in particular because interventions will have distributive consequences across and within countries.

Using the analogy of a person again, few would disagree that the freedom of manoeuver of someone who is saving (spending less than they are earning) is much greater than the person who is borrowing to finance current expenditure. The market, i.e. lenders exert some form of restraint and discipline on how much can be borrowed and also more intrusive checks on what the borrowed money can be used for. So it is for countries. Deficit countries, as a matter of course, face far more pressure than surplus countries. Deficit countries often face market pressure to reduce their deficits while surplus countries face none. This is problematic because deficit-surplus relationships between countries are the result of policy choices at both ends.

If no means exists to incentivise surplus countries to adjust their policy choices the whole burden of adjustment for reducing imbalances will fall on deficit countries. This is politically hard and may not be economically sensible, for example under the circumstances that all deficit countries try to reduce their deficits simultaneously through either exchange rate devaluations or through fiscal adjustments in the form of austerity measures. The first choice will lead to self-defeating competitive devaluations and the second to a global recession. Neither of these is in the interest of either surplus or deficit countries, so a coordinated response amongst all deficit and surplus countries will be the only one that will produce optimal economic outcomes. Note that a similar debate on policy choices and the surplus-deficit country adjustment dilemma is playing out in the euro area. **An agreement to share the burden of adjustment equitably between surplus and deficit countries would work best.**

One potential barrier to agreement here is that for political economy reasons, surplus countries may be reluctant to agree. It is politically easier to blame lost jobs and growth on the actions of deficit countries than to take responsibility for domestic actions that reduce a surplus, even if the consequences are the same. This is why stronger international coordination is needed.

Another problem is that there is no global lender of last resort which will support a country facing financial trouble of the kind being faced by Thailand in 1997-98 and Ireland and Greece now. The IMF comes closest to fulfilling such a role but is 1) too small 2) mostly lends under stringent conditions that are often unpopular amongst the electorate and 3) is not seen to be legitimate in many parts of the world. The sensible thing for most countries to do then is to try to run current account surpluses and self-insure through the build-up of reserves for a rainy day. **Putting in place a precautionary mechanism in the form of an effective and legitimate global lender of last resort or an international reserve asset (see companion paper on reform of the International monetary system) would help mitigate one of the main drivers of imbalances.**

As mentioned previously, large private sector flows of capital are putting pressure on several emerging market economies and can drive up imbalances and trigger financial instability. In response, many emerging markets such as Brazil have responded with levying taxes or imposing other restrictions on inflows that mirror capital controls. These sometimes work but often simply divert flows to other similar countries. The pressure for these is coming both from fundamental shifts and differentials in growth between emerging and advanced economies as well as the very loose monetary policy in much of the developed world that is driving investors and speculative capital to emerging economies in a 'search for yield'. This has provided the backdrop for the now famous phrase 'currency wars' used by Brazil to describe the situation. **Sound financial regulation, a strong use of macro-prudential tools such as capital requirements, liquidity buffers and capital management techniques such as transaction taxes and quotas provide a toolkit to prevent an outright currency war or competitive devaluation from breaking out. Any possible loss of efficiency is still better than the alternative of a currency war.**

Broadly speaking, deficit countries need policies to encourage private savings, reduce fiscal deficits and encourage exports for example through an active use of domestic interest rates, financial regulatory policy, fiscal incentives and structural changes to reduce overall demand and to skew consumption towards domestically produced goods and services. Surplus countries, on the other hand, need to stimulate domestic consumption, local financial system development, expand fiscal spending where possible, reduce the need for and incentives provided to save, stimulate domestic investment in infrastructure and welfare provision and stop subsidising exports, where relevant. **A bevy of widely understood complementary demand management and supply side policies need to be applied by both deficit and surplus countries to facilitate adjustments with a view to reducing global imbalances.**

In summary

1) The global imbalances are driven by a set of many political and economic drivers both in the short and long term
2) Hence, solutions discussed in the popular press, such as a revaluation of the Chinese Yuan, are not silver bullets
3) What is needed is a combination of many of the policy steps discussed above and this will involve action at the multilateral level and at the national level by both deficit and surplus countries
4) Despite the fact that the discussion thus far has focused primarily on the US and China, other emerging economies, smaller developing countries, Japan and the EU are important stakeholders and actors in any possible solution.

5) In the absence of global coordination, policy choices made by countries will necessarily deliver solutions that are economically and socially detrimental to the world and often to them given the large externalities involved, the risk of financial and economic instability and the likelihood of retaliatory action.

Who can tackle these imbalances globally? How?

A prudent, fair, stabilising and welfare-enhancing strategy would be one where stronger mechanisms for global governance enable coordinated economic decision making so the build-up of large new imbalances is thwarted by appropriate action and persistent imbalances are unwound gradually.

Without co-ordination the adjustment policy response of each country can generate large negative spill-overs on other countries and suboptimal global outcomes. For example, if large deficit countries engage in trade protectionism with a view to reducing these deficits it will have negative impacts on other countries and once retaliatory responses are factored in perhaps on the initiator state itself too. Unilateral and nationalistic responses lead to large negative global impacts. These are exactly the sort of actions that led the world to economic disaster and made the Great Depression far worse than it would have been.

Because the solutions will need to involve both deficit and surplus countries and as decisions made will necessarily have significant externalities on countries whether they are sitting around the table or not, lasting agreements can only be hatched under a good framework for global governance. This is the only bulwark against self-defeating unilateral action again. Moreover, guarding against the build-up of future imbalances will be an ongoing task, not a one-off job.

The advantages of globally coordinated action were clearly highlighted in this crisis when the tremors triggered by the fall of Lehman Brothers forced the world's leading economies into a 'fellowship of the lifeboat' where everyone believed that they would swim or sink together. This produced the **G-20** which was upgraded from a more technical lower level forum to the premier economic policy body that also met at the leader level and which has since largely replaced the G-7/8. While the G-20 was, by all measures, successful at helping avert the worst of the crisis and a repeat of mistakes made in the 1930s, 1970s and 1980s, it seems to have lost some of its effectiveness since. The contrast between the spirit and the outcome of the London summit and the most recent Seoul summit is large and much of the united front and agreements have given way to a fractious debate.

Institutions need to be legitimate and have credible enforcement power in order for global governance to work. The G-20, hitherto seen to be effective, needs to restore some of that reputation under the current French Presidency and deliver a good solution to the serious problem of imbalances. G20 nations represent around 88% of world GDP and 65% of the population so is widely seen to be more legitimate than other powerful institutions such as the (now largely defunct) G-7/8 and the UN Security Council.

However, 35% of the world's population and 80% of countries do not have a voice around the table. Both because smaller and poorer countries will need to be part of any lasting solution to the global imbalance problem and because corrective action by systemically significant G-20 members will necessarily impose externalities on these states, the G-20 quickly needs to find a credible way of bringing these voices into its deliberations. It could do this either through a constituency based system such as at the International Financial Institutions or through the use of a bicameral system where the G-20 could be made accountable to a body such as the UN General Assembly or the ECOSOC.

Because it is widely understood that the G-20 is here to stay and because at the leaders' level discussions can range across a whole set of financial, economic, environmental and security related issues, the G-20 can have credible powers of persuasion with repeated

engagements with other member states ensuring that everyone gets a fair deal and no none cheats (too much). Also, the wide range of issues that can be discussed means that grand bargains are possible. The G-20 should be and needs to be the main decision-making body on how best to tackle global imbalances. The discussion on the reform of the International Monetary System taken on by the French Presidency is part of this (see our companion paper for more details).

When the **IMF** was set up in 1944 the world looked radically different than it does today. At that time, there was a fixed exchange rate regime, capital controls were wide spread and financial institutions and markets were mostly national. The IMF, which failed to prevent the current crisis despite its role as the premier global body for economic coordination, suffers from enforcement problems, a legitimacy problem and insufficient resources. All three factors impeded the institution's past and current effectiveness.

The Fund clearly has more leverage on countries that need help than those which do not. This is the asymmetry between the surplus and deficit countries we discussed above and is further distorted by the asymmetry between those countries that need to borrow from the fund vs. those which do not. It is important for the Fund to increase its surveillance capacity and be aided in its enforcement by the political weight of the G-20.

The current balance of economic power in the world is not reflected in the Fund's power structure. Emerging markets must gain greater weight in the Fund, as they have become important economic players in the world. Simultaneously, European countries must lose votes because they are overrepresented. Unfortunately, the negotiation of quota reform has taken a long time and the end result does not go far enough. Although the emerging markets will be better incorporated, the Fund will continue to see Western dominance. It needs to go much further with quota reform in order to be seen as legitimate.

Allocating more power to emerging economies is also linked to the problem of insufficient resources. If the emerging markets are given more power at the Board, they will also be expected to contribute much more to underwriting the Fund's balance sheet. The vast reserves carried by many developing countries give them the capacity to pay.

The IMF, together with existing regional arrangements in the EU, Latin America and Asia, must set up a credible global safety net for countries and make its lender-of-last-resort function more credible. Not only must the IMF increase the size of its funds, it must also drastically reduce conditionality so that countries feel more secure about the availability of aid at times of distress. This, in turn, will help countries to reduce their sub-optimal build-up of national level reserves. The IMF also has an important role to play in monitoring exchange rate management by countries as an independent arbiter and as a provider of expertise.

The **Financial Stability Board** (FSB), an upgraded and expanded version of the Financial Stability Forum, is the club of global financial sector regulators. Given the role played by financial under-development, poor regulation and excessive speculation in the crisis, the FSB's role in tackling global imbalances should be focused on

1) fostering financial development in emerging and developing economies including through special differential treatment on regulatory standards where appropriate;
2) coordinating through the G-20 the regulatory reform drive currently underway,
3) helping devise macro-prudential solutions to the build-up of excessive risks and imbalances, and
4) monitor the build-up of systemic risk including persistent imbalances.

What interest and role does the EU have in this?

Europe is not a primary contributor to the current global imbalances. However, the ongoing tussle between the US and China as well as the many policy responses taken by emerging economies in response to large inflows of capital both affect the EU and the euro area in many ways. For example, in the absence of adjustment in the US-China exchange rate and at a time when Brazil and others are trying to manage their capital accounts, a disproportionate burden of adjustment will fall on the Euro and other EU currencies, thus inducing excessive volatility and miss-pricing in key EU bilateral exchange rates. This can seriously threaten a highly vulnerable EU economy so it is in the EU's self-interest to address global imbalances. As a more externally balanced entity the EU can credibly play the role of an honest broker at the G-20, IMF and FSB.

Even when steps are taken by the US and China to make appropriate adjustments, their external impacts mean it is essential that the EU be involved in discussions so it can safeguard its interests. Since multilateral solutions such as an increase in the resources of the IMF and changes to its governance are also an indispensable part of the solution to the problem of global imbalances, the EU as the entity with the largest vote share of at the IMF has a leading role to play in this reform.

The EU is seeing a smaller version of the global imbalances debate unfold within the borders of the euro area. The mistakes made and the lessons learnt as well as the solutions adopted in the EU will serve as an important benchmark for global discussions. It also imposes a sense of urgency on the euro area to get its act together as solutions such as building a lender-of-last-resort or sharing adjustment between deficit and surplus countries have no chance of global success if they cannot even be adopted in the highly politically and economically integrated euro area. What happens in the EU will define the limits of what can happen globally.

Outside of the euro area, the **transatlantic dialogue** between the EU and the US is very important to the question of addressing imbalances for a number of reasons. The first is that in the medium to long term, demographic trends and the maturity of the economic structures will put the EU and the US on the same side of the debate in discussions with the BRIC countries on how best to prevent future imbalances. For this, a united stance and basis for analysis and negotiation would be critically served by the transatlantic dialogue.

As an externally balanced entity, the EU can offer neutral but rigorous solutions to the United States for its part in the adjustment process of unwinding global imbalances.

Finally, EU and US cooperation will be critical to the success of G-20, IMF and FSB initiatives. The US and the EU will remain for the foreseeable future the two largest economies in the world with the largest share of votes in the G-20, IMF and FSB. In these arenas, anything that fails the muster of a transatlantic agreement is unlikely to work.

In forums such as the Financial Stability Board, it makes sense for the EU, which is enacting a system of standardised financial reforms at the EU level, to speak with **one voice**. At the IMF, the Euro area countries, which share a currency and only have aggregate imbalances with the rest of the world, should speak with one voice which would be heard much more loudly and would provide a good counterweight to the US veto. Non euro area countries, such as the UK, should continue to speak with a different voice as long as they are not members of the euro area. At the G-20, it makes sense for the EU to coordinate stance on critical issues but the advantages that come from having a number of 'voices or seats' around the table saying the same thing, outweighs the advantage that might accrue from having a single but more powerful one EU representation. In transatlantic affairs, while member states continue to have good bilateral relations with the US, it makes sense for the EU to speak with a coordinated single voice in issues of strategic importance to the US-EU relationship.

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POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICIES

SPECIAL COMMITTEE ON THE FINANCIAL, ECONOMIC AND SOCIAL CRISIS

Global imbalances and global governance

BRIEFING

by Mojmir Mrak, University of Ljubljana

Abstract

Already before the current crisis, large global imbalances coupled with strong currency fluctuations among the main global currencies had been a clear confirmation of the fact that the global economic and financial governance – which was largely created at the Bretton Woods conference more than 60 years ago – needs to be drastically changed. The current economic and financial crisis has just intensified these needs. The document discusses the following two subjects: (i) trends of and the reasons for global imbalances prior and during the crisis as well as approaches for addressing them, and (ii) main characteristics of global economic and financial governance and the adjustments and innovations being done in this area over the last two years through the creation of the G-20, the IMF reform, and transformation of the Financial Stability Forum into Financial Stability Board.

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TABLE CONTENTS

1. INTRODUCTION 15

2. GLOBAL IMBALANCES 18
2.1. Concept of global imbalances 19
2.2. Global imbalances volumes and trends 19
2.3. Causes of global imbalances and proposed policy responses 21
2.4. Possible developments of global imbalances after the crisis 22

3. GLOBAL ECONOMIC AND FINANCIAL GOVERNANCE 23
3.1. Concept and evolution of global economic and financial governance 23
3.2. The current crisis and its implications on global economic and financial governance 24

3.2.1. Emergence of the G-20 at the level of heads of states and governments 25
3.2.2. Reform of the IMF 25
3.2.3. Conversion of the Financial Stability Forum into Financial Stability Board 27

4. CONCLUSIONS 28
References 29

1. INTRODUCTION

Over the last decade prior to the current financial and economic crisis, large current account imbalances have mounted around the globe. On the one hand, current account deficits of the US had increased to an annual level of between USD 706 billion and USD 804 billion in the years 2005 – 2008 what was equivalent to between 4.9 and 6.0 per cent of its GDP (IMF, WEO Database, April 2010). There had been some other countries with current account deficits expressed in GDP terms even higher, such as the Baltic states and also some of the euro area Members States, especially, Greece, Portugal and Spain. On the other hand, there had been several other countries with large trade and current account surpluses at that time. China, for example, runs a current account surplus of USD 426 billion in 2008 what was equivalent to 9.4 per cent of its GDP (IMF, WEO Database, April 2010). Large surpluses have been registered also by Japan, Germany and several oil exporting countries. The current economic crises accompanied by the decline of the world trade flows has reduced the volume of imbalances at least temporarily but at the same time no systemic solution of the global imbalances problem is insight.

Large global imbalances coupled with strong currency fluctuations among the main global currencies had been already before the current crisis a clear confirmation of the fact that the existing international monetary system – its structure and governance structure was largely created at the Bretton Woods conference more than 60 years ago – needs to be drastically changed. The current economic and financial crisis has just intensified these needs. It is true that certain adjustments have been done in the global financial governance over the last two years through the creation of the G-20 and FSB and the IMF reform. The question, however, remains unanswered whether these reforms are sufficient to address systemically and thoroughly the weaknesses of the existing international monetary system and its governance. For members of the EU, these reforms have an additional dimension. It is namely becoming more and more obvious that in an increasingly globalised and multi-polar world EU Member States can play much more important role if they "speak with one voice" than in case that they "speak individually".

The main objective of this briefing paper is to address two closely interlinked subjects – global imbalances and global governance. In addition to this Introduction and Conclusions, the paper consists of two main substantive with each of them addressing one of two main subjects.

2. GLOBAL IMBALANCES

2.1. Concept of global imbalances[1]

The term global imbalance has in fact two closely interlinked dimensions. The first and the most frequently used one is the current account imbalance – surplus or deficit[2] – which is in fact the difference between domestic savings and investment. In a hypothetical case of a completely closed economy, domestic savings must be equal to investments and therefore the current account of the country must be in equilibrium. In a normal, open economy, these two macro-economic aggregates are not equal. If a country invests more than it saves, then domestic savings must be complemented with foreign savings, i.e. with a net inflow of savings from abroad. If, however, domestic savings are higher than investments then these surplus domestic savings are channelled abroad as a net outflow of savings. The difference between domestic savings and investment is just another expression of the current account disequilibria or imbalance. Countries with current account deficits are net capital importers as their investments are higher than domestic savings. And vice versa, countries with current account surpluses are net capital exporters as their investments are lower than domestic savings[3].

The second dimension of the global imbalance term is the capital and financial account. If a country has a current account deficit it needs foreign exchange to finance it. Foreign exchange can be generated either through private sector capital inflows – in the form of equity and / or debt financing – and/or through reducing the country's foreign exchange reserves. As far as current account surplus country is concerned, it can use its extra foreign exchange generated through larger exports than imports either for investment abroad – again in the form of equity/debt financing – and/or for accumulation of its official foreign exchange reserves.

Large net capital inflows/outflows caused by current account deficits / surpluses have direct implications on exchange rates. For a current account deficit country, financing of the deficit through running down foreign exchange reserves is not sustainable[4] over a longer period and as consequence the country is typically forced into exchange rate depreciation. On the other hand, current account surplus countries have two options to address the problem of large foreign exchange inflows. One option is sterilisation of net capital inflows by the central bank whereby it buys the inflows and accumulates foreign exchange reserves. Another option, however, is that the country allows appreciation of the domestic currency. This may cause some risks, such as the decline of the country's international competitiveness.

2.2. Global imbalances volumes and trends

The trend of growing balance of payment imbalances as known today started in early 1990s as a consequence of intensified globalisation processes. This was a period characterised by fast global economic growth and expansion of international capital flows. The current account deficit of the US increased from 1.2 per cent of GDP in 1989 to 4.2 per cent in 2000. This was caused mainly by sharp increase of US investment which exceeded significantly the increase of domestic saving driven primarily by fiscal consolidation efforts. The savings-investment gap was more than filled with a net inflow of equity investment funds. High demand for US assets by foreign official institutions (mainly central banks) resulted in significant appreciation of the dollar throughout that period. The main counterparts of widening US current account deficit in the 1990s were

[1] If not specified differently, the term global imbalances is being used in this paper to represent global current account imbalances.
[2] It includes four categories of economic transactions between residents of a country and residents of all other countries: (i) goods (merchandise trade), (ii) services, (iii) income, and (iv) unilateral transfers.
[3] In both cases, this conclusion holds if foreign reserves remain stagnant.
[4] The only significant exception is United States with the dollar as the main international currency.

Japan and emerging Asia. In Japan, the current account surplus was a consequence of a sharp decline of investment caused by prolonged economic crisis in the first half of the decade while in emerging Asia investment collapsed after the 1997 crisis.

After a brief recession of industrialised countries in 2001 when balance of payment imbalances narrowed temporarily the trend of widening imbalances continued until 2008. On the current account deficit side, the US continued to be the major factor as it participated with about two-thirds in global current account deficits with the European deficit countries contributing about another quarter (see European Parliament, Future development of global imbalances, 2010, p. 4). The US deficit increased from 3.8 per cent of GDP in 2001 to an annual average of over 5 per cent of GDP in the period 2006 – 2008. This time, the current account deficit was caused by very different drivers. Even though US investment declined compared to the 1990s, domestic saving dropped even sharper mainly as a consequence of growing fiscal deficits. Financing of the current account deficit changed as well as. While equity inflows fell in importance foreign purchases of US debt instruments increased significantly.

Another region accounting for significant current account deficits in the period prior to the current economic and financial crisis were European transition economies, many of them also the "new" EU Member States. Relatively high deficits were registered also in some of the "old" EU Member States, such as Greece, Ireland, Portugal, Spain and UK. In many of these countries the deficits were driven primarily by significantly increased investment caused very often with asset price booms. These deficits were made possible by an easy access to foreign financing at very low prices.

Major counterparts to the above deficits were current account surpluses of China, emerging Asia, some northern EU member states, especially Germany, and oil exporting countries[5]. China alone increased its current account surplus from USD 17.4 billion in 2001 to as much as USD 426.1 billion in 2008 or from 1.3 per cent to an average annual level of 10 per cent of GDP in the 2006 – 2008 period. As a consequence, foreign exchange reserves of China increased dramatically. While at the end-2004 their level was just about USD 600 billion by the end-2008 they increased to as much as USD 2,400 billion (State Administration of Foreign Exchange, People's Republic of China). Significant increases of foreign exchange reserves have been registered by several other current account surplus countries as well.

Further widening of current account imbalances in the years prior to the crisis was accompanied by significant exchange rate developments. After the peaking in early 2002, the dollar started to depreciate against major international currencies. The depreciation of the US currency – as well as of the yuan and currencies of oil exporting countries that are tied to the dollar currency – was especially dramatic against the euro. In the period 2001 – 2008, the euro appreciated for almost 100 per cent against the dollar. It is worth mentioning in this context that growing current account deficit of the US at that time was caused to a large extent by the trade deficit vis-à-vis China and other Asian countries and not vis-à-vis the euro area.

The current financial crisis that was transformed into a full-fledged economic crisis after the Lehman Brothers collapse in September 2008 had significant implications on current account imbalances. In 2009, the imbalances narrowed sharply a consequence of global recession, dramatic decline of practically all forms of international capital flows and significant corrections of exchange rates, asset prices and commodity prices.

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[5] It is worth mentioning that current account of the euro area as a whole remained in broad balance throughout the period before the current crisis. This overall balance, however, hides significant differences in current account positions of individual euro area Member States with Germany and some other northern and central European states, such as Austria, Denmark, Finland, Luxembourg and Netherlands, having current account surpluses and with France, Ireland and several southern European countries, such as Greece, Italy, Portugal and Spain having current account deficits.

2.3. Causes of global imbalances and proposed policy responses

Global imbalances are probably the most complex macroeconomic issue facing economists and policy makers. They reflect many factors, from changes in private and public saving behaviour over changes in current and expected productivity growth, changes in foreign exchange reserve policy and movements in commodity prices to shifts in investors' attitude towards risk and liquidity (Blanchard and Milesi-Feretti, 2009, p. 3 and p. 19).

There are different views about the primary causes of global imbalances. A mainstream view is that current account factors including exchange rate policy, private sector behaviour, fiscal developments and competitiveness issues are the main causes of imbalances. Another view, however, puts the capital account as the main imbalances driver. In his 2005 paper, Bernanke, for example, argues that a "global savings glut" caused by savers in surplus countries allowed the US to keep long-term interest rates at historically low level. This policy has consequently allowed the US households to reduce their savings while at the same time it has resulted in excess consumption and unsustainable asset prices bubble.

At a global level, there is no need for current accounts to be in equilibrium. On the contrary, it is desirable that savings go to places where they are more productive. In this context, imbalances have a positive role if they emerge from differences in savings behaviour, from return on capital differences and from differences explaining different degree of risk and liquidity associated with investment in various in asset classes.

Nevertheless, imbalances can also be caused by numerous distortions and risks. The can be classified into four major groups (Blanchard and Milesi-Feretti, 2010, p. 4 to 7): (i) *domestic distortions*, such as high private saving that reflect lack of social insurance forcing people to engage in high precautionary savings or low private saving driven by bubble-caused asset boom; (ii) *systemic distortions*, such as accumulation of large foreign exchange reserves of many emerging countries after the Asian crisis aimed at self-insuring themselves; (iii) *domestic risks*, such as real appreciation of domestic currency in circumstances of large capital inflows or high domestic demand financed largely by foreign sources that exposes a current account deficit country to a high liquidity risk; and (iv) *systemic risks*, such as the risk of "disruptive adjustments" in the country with the largest current account deficit as this risk is closely associated with net asset positions and large reserve positions of central banks.

Being aware of potential problems associated with growing global imbalances the IMF launched so-called "multilateral consultation on global imbalances" in 2006. The report presented in June 2007, i.e. just before the current crisis erupted, made several recommendations deemed to be crucial for reduction of current account imbalances. For the US, the report recommended an increase of private savings and decrease of fiscal deficits while for China real exchange rate appreciation together with an increase of private consumption were recommended. Further on, the Report, recommended an implementation of structural reforms to support productivity growth in the euro area countries and Japan.

There is a consensual view that the current financial and economic crisis has its immediate causes in the financial sector (Dunaway, 2010, p. 13). The standard set of causes include historically low interest rates, inadequate regulation and supervision of certain financial sector segments, development of increasingly complex financial instruments, questionable role of the rating institutions and inappropriate incentive structures at financial institutions. Nevertheless, the crisis could hardly taken such a proportion without the presence of large imbalances in the global economy. The precise impact of these imbalances on the crisis is impossible to measure, but there is a

consensual view that high savings of Asian countries as well as their foreign exchange reserve accumulation have fuelled the domestic credit boom in the US. It has eventually collapsed indicating the beginning of the crisis (Collignon, 2010, p. 18).

2.4. Possible developments of global imbalances after the crisis

It has been mentioned already that global imbalances narrowed in 2009 as a consequence of the crisis. This has been partly caused by factors of a temporary character, such as substantial decline of commodity prices, sharp contraction of domestic demand and diminished appetite of foreign investors to finance large current account deficits.

On the other hand, there seems to be some other factors at work that may contribute towards more lasting reduction of the imbalances. For example, if the crisis has contributed towards a systemic increase of private saving in US this may imply lower US current account deficit and thus reduced global imbalances. Or, tighter financial regulation and consequently higher cost of capital may also contribute towards reduced imbalances as investment in current account deficit countries will be significantly lower than before the crisis. Also the appetite of foreign investors for buying bonds of current account deficit countries has been reduced as their country ratings have been by and large downgraded. There are, of course, also factors at work that do not bode well for a more permanent unwinding of global imbalances. For example, in order to prevent excessive appreciation of domestic currencies capital inflows into several emerging economies have been increasingly sterilized what contributes to further grow of their foreign exchange reserves. There is also a very limited move of China toward real exchange rate appreciation what makes no or very limited room for substantial decrease of its current account surplus.

3. GLOBAL ECONOMIC AND FINANCIAL GOVERNANCE

3.1. Concept and evolution of global economic and financial governance

The current global financial and economic crisis has confirmed the increasing interdependence of the global economy and consequently of the need for stronger coordination of national economic policies at the global level. The term "global economic and financial governance" entails a set of supranational institutions, such as the IMF and the World Bank, of informal groupings, such as G-7 and recently G-20, as well as of other international relations that have an effect on international economic and financial transactions. The latter two segments of the global governance are important for improving global coordination in all those areas where decisions have been retained at the national level. These kinds of decisions are primarily in areas of macro-economic policy coordination as well as in areas where agreed prudential standards and codes of operation are considered appropriate (see two speeches of J.-C. Trichet, 2010).

Why is global economic and financial governance needed? At a conceptual level, it could well be argued that no market can function properly without an institutional structure composed of regulatory and supervisory institutions as well as without a set of rules governing the relationship among various market players. Even more important than at the national level are these rules important at international level where market players are confronted with multi-country jurisdictions. Global governance is aimed at smoothing international economic/financial flows and at reducing their transaction costs.

The central feature of the post World War II economic and financial governance were the two international organisations with the IMF being responsible for stability of exchange rates and balance of payment financing and the World Bank assuming an important role in long-term development financing. The planners of the Bretton Woods economic governance structure intended to create also a third multilateral institution, but the establishment of the proposed International Trade Organisation was dropped for political reasons and was replaced with a less ambitious arrangement called General Agreement in Tariffs and Trade. This Agreement was transformed into a full-fledged international organization only in 1994 as one of the results of the successfully completed Uruguay Round of trade liberalisation negotiations (Boughton, 2009).

Over the 60 years from the end of the World War II until the current crisis global economic and financial governance had not changed significantly. It was dominated by the three multilateral institutions, the IMF, the World Bank and the World Trade Organization (GATT prior to 1994) and by the G-7 as the main informal forum for global economic governance. Even though the global economic and financial landscape has changed dramatically due to the significantly increased importance of emerging economies in the global economy – measured not only in terms of population but also in terms of their economic size and financial power – very little has been changed in the basic structure of these global institutions. For example, the voting share of China in the IMF was in 2009 equivalent to only 3.7 per cent when its share in practically all other indicators was significantly larger; 12.6 per cent in GDP at PPP, 8.9 per cent in trade, 29.4 per cent in foreign exchange reserves, and 19.8 per cent in population (Kawai and Petri, 2010, p. 5). Similar distortions have been characteristic for some other emerging economies, like India or Brazil, as well. On the other hand, there have been some industrialised IMF member states, many of them from Europe, with their voting shares well above their relative importance in the global economy. In effect, pre-crisis voting shares in the IMF, and similar is situation in the World Bank, reflects to a large extent decision made still at the 1944 Bretton Woods conference.

Though important, inappropriate allocation of voting rights is just one of the problems faced nowadays by international financial institutions. As argued by numerous sources in the years prior to the crisis, global financial institutions and the G-7/8 informal forum

were to a varying degrees fragmented, unrepresentative and ineffective. Further on, they were generally suffering from a decline of their legitimacy. The IMF, for example, was marginalised in the years before the crisis as its net lending to the member states had fallen to practically zero. Many developing economies had used ample private funding availability at low cost for early repayment of their IMF debts. In this way, these countries had reduced their reliance on the institution whose image was compromised as a consequence of its highly criticised role in the 1998 Asian debt crisis (Kawai and Petri, 2010, p. 1). The G-7/8[6] informal structure has outlived its usefulness as a global consultation forum for economic and financial issues as well. In the changing balance of demographic and economic power in the world it had become increasingly obvious that no internationally important issue can be effectively addressed within this organisational forum and that therefore new essential players have to be systemically integrated into the process. In 1997, under the so-called "Heiligendamm Process", five new countries – Brazil, China, India, Mexico and South Africa – became permanently associated with the G-8 forum. This broader leadership forum has become effective in pushing institutional changes in individual international organisations. Similar objective had the G-20 group of ministers of finance and focused on the IMF reform (Bradford and Linn, 2007).

3.2. The current crisis and its implications on global economic and financial governance

It has been mentioned already that markets cannot operate efficiently without rules and that the crisis has strengthened the arguments of those saying that better regulation is conducive to better functioning of international markets. The crisis has confirmed that the scope of international cooperation has to be broadened significantly in order to close gaps the system of global economic and financial governance has in terms of its effectiveness. The crisis has also confirmed that there is an absolute need for the system to become much more inclusive meaning that it has to integrate systemically key emerging economies into its structures.

The evolution of the system of global economic and more precisely of financial governance has been carried out during the crisis through a creation of new informal forums as well as through a process of strengthening the mandate of existing international institutions. In the continuation of this sub-chapter the following three key institutional developments aimed at transforming the global governance system are presented and discussed in some details. The first one is the emergence of the G-20 as a new informal forum at the level of heads of states and governments. The second one is a substantive reform of the IMF. And finally, the transformation of the Financial Stability Forum into the Financial Stability Board aimed at including all systemically important emerging economies into the main global financial stability structure.

There are some other forms of global economic and financial governance that have strengthened during the recent crisis. One of them is enhanced cooperation of central banks. In response to the crisis, the central banks of major countries and areas have offered currency swaps to each others and involved many other central banks of the world into the system. While these swaps were of crucial importance for cross-border transactions during the crisis they have also been associated with certain weaknesses. These arrangements are not only ad hoc in their character and therefore lack transparency but they may also involve elements of political motivation as mentioned by some observers. It has been mentioned, for example, that ECB agreed to swap lines with major central banks, including those ones of Denmark and Sweden, but has not offered these lines to any country in emerging Europe even though they may have also wished to receive this kind of support (Future development of global imbalances, 2010, p. 10 and 11).

[6] Russia became a formal member of the now G-8 (before G-7) in May 1998 (Kawai, Masahiro and Petri, Peter, 2010, p. 4).

Another form of global economic and financial governance that will not be addressed specifically in the continuation of this sub-chapter are regional arrangements, such as the Chiang Mai initiative developed in Asia are the 1998 crisis in the region. There is little doubt that these kinds of initiatives do have merits but on the other hand their capacity is rather limited in case that a region as a whole is exposed to a symmetric external shock (European Parliament, Future development of global imbalances, 2010, p. 11).

3.2.1. Emergence of the G-20 at the level of heads of states and governments

The emergence of the G-20 at the level of a heads of states and governments is by far the most important institutional innovation in recent years and maybe even decades aimed at strengthening global economic and financial governance. Global governance and associated collective decision making process is always confronted with a trade-off between efficiency and legitimacy. Decisions at informal forums composed of a relatively limited number of more homogeneous players may be taken quickly and their implementation may be easier. However, legitimacy of these decisions may be put under question not only by those ones who do not participate in this decision making process but also by the legislative branches in countries being represented in the forums though their executive branches. In contrast, decision making in formal international institutions has higher level of legitimacy as decisions are consistent with the commitments made by both, the executive and legislative branches of national authorities. This higher legitimacy, however, usually comes at a cost of lower efficiency.

As an immediate consequence of the deepening of the current crisis after the collapse of Lehman Brothers in September of 2008 and in order to address quickly and decisively the immediate danger of the global meltdown, the international community has agreed to upgrade the G-20 forum of ministers of finance into the G-20 forum of heads of states and governments. The G-20 at the leaders level established in November 2008 includes both industrialised countries and emerging economies – 11 of them – and therefore has a much stronger legitimacy and efficiency for tackling the global issues than its G-8 predecessor. Countries participating in the newly created G-20 namely account for 83 per cent of global GDP in PPP, 75 per cent of global trade and 66 per cent of global population (Kawai and Petri, 2010, p. 6).

This new, informal leaders' forum has evolved into the main forum for informal governance of international economic and financial policy cooperation or to a kind of a steering committee of the global economy. At the beginning, the forum was acting primarily as a crisis resolution mechanism. One of the main emphases of the April 2009 London summit was to strengthen the multilateral financial institutions. On the one hand, financial capacity of the IMF was increased significantly and commitments were made towards reforms in the voting shares as well as in management and stuffing of international financial institutions. Leaders also agreed that heads and senior officials of international financial institutions should be appointed through open, transparent and merit-based selection process. At this summit, the G-20 leaders also reached an agreement to establish a new Financial Stability Board as a successor of the Financial Stability Forum. It includes all G-20 countries, the Forum's countries, Spain and European Commission. The London summit demonstrated that the G-20 would act primarily as an informal forum for setting new cooperation agenda and for articulating priorities for institutions while implementation would rely on national governments and on formally constituted international organisations (Woods, 2010, p.6).

By the time the G-20 forum has been evolving increasingly into a crisis prevention vehicle. The Pittsburg summit in September 2009 endorsed the decision whereby it established G-20 as the premier forum for our international economic cooperation. It is within this context that the Summit made strong commitments for stable, sustainable

and balanced growth. The leaders adopted the "Framework for Strong, Sustainable and Balanced Growth" which is aimed at addressing one of the main shortcomings of the pre-crisis global economic and financial governance, namely the lack of effective instruments that would ensure that macro-economic and structural policies of individual countries take into consideration potential negative spillovers of their policies on other countries as well as on the overall financial stability. The Framework is a kind of a successor of the IMF multilateral surveillance initiative that has not been particularly successful. It remains to be seen whether a similar initiative to be carried out within the framework of the G-20 forum with a higher level of legitimacy will be more successful.

3.2.2. Reform of the IMF

The IMF is the main international institution with the mandate in areas of macro-economic and financial stability. After the 1998 Asian crisis substantial progress has been made in establishing sound macro-economic policies in many emerging countries of the world. As a consequence, the need for the IMF funding was drastically reduced in the pre-crisis years. The institution had also suffered from a legitimacy deficit because of out-dated distribution of voting rights, a restrictive leadership selection process and unsustainable way of financing it operations. Last but not least, the IMF had suffered a credibility problem caused by at least questionable policy advises and conditionality applied during the Asian debt crisis. A direct consequence of this problem had been a stigma that was attached to the IMF activities in many of those member states that had typically borrowed from the institution. Insulation of a country from potential external shocks and the reduction of its eventual reliance on the IMF funding had been often cited as the key reason for hoarding large foreign exchange reserves.

Even though burdened with all these problems, the current economic crisis has also provided a unique opportunity to the IMF for a new start. This institution is the principal global financial institution with the mandate in areas of macro-economic and financial stability. To achieve objectives in these two areas, the IMF has basically two main instruments – surveillance and balance-of-payment financing – and under the auspices of the G-20 forum, both instruments have been strengthened over the last two years though to a different degree.

As far as surveillance is concerned, the IMF is now supporting the G-20 forum at the technical level in fostering a closer coordination of national economic policies. It has been mentioned already that this is a very important but at the same time also a very ambitious task. There have been also some doubts expressed whether the IMF is able to identify and address adequately macro-economic and financial risks. The doubts emerge at least partly from past experiences when IMF has not been able to anticipate various crises and/or to provide the most effective advice for dealing with the crises when they break broke out (Kawai and Petri, 2010, p.10).

On the lending side, the IMF has actually made a major breakthrough. At the G-20 London summit in April 2009, the leaders made a bold decision to give the IMF access to some USD 500 billion of new resources and, thus, to equip the institution with the funds that would be sufficient for effective managing and containing of the economic crisis. Even though the increase of the IMF resources has targeted emerging economies, the institution has become instrumental also in managing the euro area sovereign debt crisis.

Based on strong and extensive criticism of the IMF's conditionality practice in the decade prior to the crisis and particularly during the 1998 Asian crisis, the institution significantly changed the conditionality practice associated with its lending operations. Conditionality is now focused more narrowly on macro-economic and financial sector stability measures. In addition to its traditional lending operations, such as stand-by agreements, the IMF has also introduced a new financial instrument – the Precautionary

Credit Line – through which countries with sound macro-economic performance and based on pre-qualification may get an access to the IMF's funds. These funds, which so far have been requested by countries such as Poland and Mexico, are being used to prevent crises from spreading by allowing strong-performing countries to insure themselves against external shocks.

The essential problem of the IMF's legitimacy has been addressed as well during the last two crisis years even though the comprehensiveness of the reforms does not go that far as it would be needed. Based on the G-20 framework decisions taken at previous summits, the leaders reached an agreement at the October 2010 Seoul summit on the following set of reforms for the IMF's governance: (i) an increase of voting power of under-represented emerging economies by over 6 per cent, (ii) movement of Brazil, China, India, and Russia into top 10 shareholders of the IMF, (iii) protection of voting rights for the least developed countries, (iv) enhancing emerging market and developing country representation in the IMF's Executive Board.

As a part of the agreement and based on the argument of its over-representation Europe has agreed to give up 2 out of 24 seats in the Executive Board. There is no doubt that there has been a strong argument in favour of reducing Europe's voting power in the IMF and representation in the institution's Executive Board. Nevertheless, the deal would seem much more balanced from the European perspective if these decisions would be made as part of a more significant restructuring of the institution where reduction of Europe's combined quota and consolidation of its seats would be traded-off for the US giving up its veto power. The veto power of the US was, indeed, appropriate under the Bretton Woods international monetary system with the dollar having officially an exceptional position (the dollar was the only currency directly convertible for gold). However, with the break of this system in early 1970s this argument does not hold anymore in the same manner as before.

3.2.3. Conversion of the Financial Stability Forum into Financial Stability Board

One important set of reasons for the building up of the current financial and economic crisis includes weaknesses in an international financial regulation and supervision system. The pre-crisis system was simply not capable of regulating, monitoring and supervising effectively huge and quickly growing volumes of cross/border financial flows. In order to address this serious problem, G-20 leaders decided at their first summit in November 2008 to convert an existing Financial Stability Forum into a larger and more powerful Financial Stability Board.

The institution FSB has received a mandate to collaborate with the IMF in providing early warnings of macro-economic risks as well as in addressing these risks. As such, the Financial Stability Board is aimed at contributing its share to strengthening the international financial architecture and global financial stability. In order to address the legitimacy concerns, the membership of the Board has been expanded from the Forum's membership and now largely corresponds to G-20 membership.

The enhanced legitimacy of the Financial Stability Board and its strengthened mandate provide a good basis for this new global financial regulatory and supervisory body to start delivering. But as it usually happens with new institutions, the resources and human capacity of the Board are limited in relation to the extremely ambitious mandate it received from the G-20. Another potential problem for the institution is that it will basically provide guidelines for the work of national regulators and supervisors. This in practice means that the success of the Financial Stability Board depends decisively on the readiness of national regulators and supervisors to cooperate within the framework set by this new international institution (Kawai and Petri, 2010, p.10).

4. CONCLUSIONS

Even though warnings have been voiced about the growth of unsustainable global imbalances and the risks of their disorderly adjustment already prior to the crisis the world has still not developed an effective mechanism for influencing effectively those macro-economic and structural policies of main economic powers that are of crucial importance for the global economic and financial stability[7]. In order to do this, significant changes of the global economic and financial governance would be needed both through the work of international institutions as well as cooperation of national authorities.

Emergence of the G-20 informal forum at the leaders' level has been an important breakthrough in global economic and financial governance as by encompassing all main emerging economies into the structure the forum has gained a lot in terms of the legitimacy. Nevertheless, many of the policy orientations articulated by this forum would have to be implemented by the relevant international financial institutions. Effective global economic and financial governance would, thus, require continuation of intensive reforms in the existing institutions, especially in the IMF, as well as effective operation of newly created institutions, such as the Financial Stability Board.

[7] At the euro area level, the issue of how to address excessive current account imbalances among the member states has been tackled in the proposed reform of its governance structure.

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