REFORMING THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEM: WHAT ROLE FOR NATIONAL DEMOCRACIES?

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Who has been in charge of, driven the reforms to the international financial system that have followed the global financial crisis? Elected politicians or unelected, powerful, independent technocrats? And does it matter? Does it matter in terms of the quality of the reforms, their design and their likely life expectancy? Does it matter for their legitimacy? Does it matter for public understanding of and support for the reform programme[1]?

Those questions might seem odd given the Dodd Frank legislation here in the US, the swathes of legislative acts in the EU, in individual European nations, and across Asia. We have Volcker, Vickers, Liikanen, the first two of which especially are incredibly prominent in their home jurisdictions but are barely known outside --- surely they are testament to jurisdictional autonomy in regulatory reform? So if I told you that, amongst technocrats, each of those measures is quietly regarded as a sub-plot in efforts to build a more stable financial system, would you be surprised? Why, for example, do domestic US politicians and domestic lobby groups debate the details and the merits/demerits of the Volcker Rule quite so much if it's *only* a sub-plot? If the suggestion is that the real action is in international initiatives, why weren't domestic politicians talking about those more?

Put like that, one can sense the shadow of the argument advanced by Dani Rodrik a decade or so ago that there would prove to be a fateful tension between globalization, autonomous nation states, and democracy.

Up to a point Rodrik's thesis wasn't news to international economists and policymakers. It had long been recognized that a country could not choose all three of national control over domestic monetary policy, a fixed exchange rate, and liberalized capital flows. It could have two out of three. Until the collapse of the Bretton Woods exchange-rate regime in the early-1970s, most countries outside the US more or less surrendered domestic monetary autonomy. But they did so on condition that the US tied itself to gold, a commitment that it could not sustain given a domestic appetite for inflationary finance during the 1960s and '70s. Since then, the international compact has been that the leading economies will allow their exchange rates to float. Technically, each is free under IMF rules to adopt capital controls, but the strong norm has been that they will not do so. This was a world, most thought, in which monetary policy spillovers would be confined to shifts in exchange rates, leaving national economies to manage their own domestic *monetary* course in the interests of their own citizens.

The 2007-09 crisis, with the painfully slow economic recovery that has followed, presents a challenge to some elements of that late-twentieth century international economic order, which aspired to combine

[1] My thanks to Steve Cecchetti for discussions on the issues discussed here.

free trade with national autonomy in macroeconomic policy. Even putting to one side the emergence of massive economies that chose to operate according to different norms, the past few years have seen increasing concerns about monetary spillovers that go beyond standard exchange-rate channels. The cross-border carry-trade is not only a reality, there is evidence that it has produced systematic returns and, thus, is likely to persist[2]. When, as over the past few years, the 'cheap' currency to borrow is the world's main reserve currency, carry-trade strategies can reach epic proportions, driving up local asset prices and loosening credit conditions in 'recipient' countries, which become exposed to internal financial-stability threats. That has raised the prospect of selective capital controls or, as I would prefer, new 'macro-prudential instruments' being employed more frequently to preserve domestic stability in the face of strong inflows of 'hot' money[3]. Those essentially defensive policies can spillover to others, if only by deflecting capital flows to alternative destinations. Moreover, whether externally generated or, as with the US sub-prime implosion, internally generated, a stability crisis in one country is liable to infect the rest of the world to a greater or lesser extent. The upshot: each country has a stake in each other's stability policies and practices. The consequence: a burst of vigour in setting common international standards for financial system resilience.

In other words, the lessons from the global financial crisis (and, indeed, from the 1990s' Asian crisis before it) meet Rodrik's critique of modernity in what Dirk Schoenmaker has termed the 'financial trilemma'[4]. The following cannot be squared: national control over financial policy, international financial integration, and financial stability. The apparent bridge to Rodrik's mega-theorem should be clear: if the world opts for financial integration and financial stability, then democratic nations will not have autonomy in policies on the financial system. Since it is hard to imagine people opting to embrace recurrent financial *in*stability, the apparent choices available on this analysis are either to give up financial globalization and thereby sustain domestic democratic control (at the level of the nation state) or, alternatively, to retain financial integration and to relocate democracy to the global plane (the dream of cosmopolitan democrats). Except of course that there is a third logically feasible course, although it can hardly be termed a choice: to maintain international financial integration, set financial policy globally, and accept the dilution of democracy! Is that what has been going on, by default?

I am going to proceed in three stages. First, I shall put a bit more colour and substance around the need for financial policy to be made collectively. Second, I shall try to provide a framework for thinking about the legitimacy of international policy making, and especially international policy making by agencies,

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[2] For a summary, see Craig Burnside, M Eichenbaum and S Rebelo, "Understanding the profitability of currency-trading strategies", NBER Reporter 2012, Number 3: Research Summary; and "Carry trade and momentum in currency markets", 2011. Brunnermeier M, S Nagel and L Pedersen (2009), "Carry trades and currency crashes" make the connection to macro conditions. Earlier research on the 'forward-premium puzzle' attracted less interest in macroeconomic policy circles

[3] Tucker, "The International Monetary System: Contagion and Spillovers", lecture at the Lee Kuan Yew School of Public Policy, Singapore, 17 March 2014.

[4] Dirk Schoenmaker, "Governance of International Banking: the Financial Trilemma" 2013.

such as central banks and financial regulators, that are typically 'independent' within their domestic states. And third, I shall offer some thoughts on how the various dilemmas or trilemmas can be mitigated *without* abandoning any of democracy, financial internationalization or the goal of stability. Those potential mitigants will cover both substantive policies and some thoughts about democratic practices and modalities.

Spillovers in a world of freely flowing goods, services and capital: the unavoidability of collective policy-making

Thankfully, we live in a world where the truly big policies are made by democratically elected politicians. In recent years, at a crucial moment the G20 Leaders did just that. Communiques are a pretty tedious read even for aficionados, but once in a while they say something important. Underling a commitment initially made in Washington during the most chaotic phase of the crisis, at Pittsburgh in autumn 2009 the Leaders declared thus: "Today we agreed….to maintain our openness… We will fight protectionism." And elsewhere in the summit's package, "It is imperative we stand together to fight against protectionism…. We will keep markets open and free…. We will not retreat into financial protectionism, particularly measures to constrain worldwide capital flows, especially to developing countries." The Leaders thereby committed themselves not to repeat the protectionist mistakes of the 1930s, a collective-action hazard from which they sought to insulate themselves by, as it were, holding hands in public[5].

By so committing, they consciously accepted a system that risks cross-border economic spillovers, but pledged to make the financial system less prone to driving or amplifying such spillovers. More research is badly needed on how far financial openness underpins or qualifies the gains to citizens around the world from trade in goods and services. Meanwhile, in the wake of the crisis policy could not wait. It had to be framed and implemented. Could policies designed to make the system more stable have been pursued other than collectively? No.

Forty years ago this year, Bankhauss Herstatt failed in Germany. So far as I know, it had no physical presence, indeed no meaningful commercial business in the US, the UK or elsewhere, but it changed the face of banking policy throughout the world. When Herstatt failed it had outstanding deutschemark/dollar foreign exchange transactions, on which it was due to deliver dollars. Before the shutters came down, the bank had received the DMs it was owed, but because of the time difference it had not fulfilled its reciprocal obligation to deliver dollars. The costs of its failure crossed the Atlantic, as had the Viennese CreditAnstalt's collapse in the early 1930s. The international response to the mid-70s crisis was threefold. Most famously, the G10 central bank governors created the Basel Supervisors

[5] Although the commitment was initially made in 2008 at the Washington summit , I think Pittsburgh is significant because the leaders, their legislatures and their publics had by then had time to rethink after a semblance of stability had been restored earlier that year.

Committee, setting in train a process of convergence in bank regulation standards and supervision. Second, in a quarter-century-long project, the infrastructure for settling foreign-exchange transactions was completely reconfigured with a view to eliminating such daylight credit exposures. Third, a division of labour emerged on lender-of-last-resort responsibilities, with a presumption that host authorities would meet immediate local liquidity shortfalls.

All this amounted to central bankers and banking supervisors catching up with the consequences of shifts in the international monetary system. Moves to full currency convertibility for capital-account transactions as well as for current-account transactions and the associated progressive lifting of capital controls in the 'advanced economies' had facilitated a ratchet in the gradual re-birth of cross-border banking.

The authorities had to play catch-up again during the recent crisis, recreating a network of inter-central bank swap lines that, foolishly, had been allowed to lapse during the 1990s. Narrowly, the US is bound to be the final lender of dollars to the rest of the world, and that is a meaningful prospect so long as the dollar is the world's key reserve currency. But the US can fulfil that role (which some would see as an unavoidable responsibility) without exposing itself to risk if it takes as collateral the currency of counterparty central banks it regards as undoubted.

Two things (at least) were not immediately addressed in this newly reestablished set up. First, where a swap line is *not* available, the local central bank and prudential authorities need to ensure that, for the sake of their country, their local financial system and economy does not accumulate foreign currency-denominated liquidity exposures that they, the *local* authorities, would not be able to cover from their fx reserves or by themselves going into the fx markets to raise the liquidity. If, instead, local authorities lacking both currency-swap lines and large fx reserves do not constrain such exposures *and*, further, their financial system or economy is big enough to affect the rest of the world, the resulting vulnerability to systemic risk is a legitimate concern for the international community. Effective surveillance by the IMF and others of those risks is unfinished business[6].

The second and more profound issue raised by the recent crisis was what happens if the problem is one of fundamental solvency rather than merely of liquidity? That is not addressed by either common supervisory standards or compacts on liquidity provision. This problem was exposed, glaringly and painfully for people across the world, when Lehman failed in late-2008. That the panic was as great and as widespread as it was owed something to the network of counterparty exposures which could transmit distress across the planet. And it was made excruciatingly obvious that the authorities did not have regimes, policies or plans for handling the cross-border resolution of an internationally active financial group in an orderly way without throwing taxpayer money at the problem.

That issue has been at the heart of the programme of financial system reform that has been underway since Lehmann's failure. The substantive initiative and drive behind the core reforms came from international meetings, fora and debate. That goes for all of the following: requiring derivatives to be centrally cleared or, for non-standard contracts, subject to minimum collateral requirements; requiring

[6] The issue was raised during the 2014 triennial review of IMF surveillance.

information on derivative transactions to be held in a new kind of infrastructure, trade repositories; requiring banks to hold more capital and liquidity, and ratcheting up those requirements for banks whose failure would unambiguously have systemic consequences; seeking to address risks from shadow banking; agreeing standards and protocols for the resolution of cross-border financial institutions by putting losses to uninsured creditors rather than to taxpayers[7].

Those policies have filtered down into national legislation and standards. In the US, that has been barely acknowledged, but on the whole the implementation has been pretty faithful to the global acquis. If anything, the issue raised by US policies is an attempt at extra-territorial control --- a strategy liable to backfire if and when rapidly growing economies become more active members of the top table. By comparison, in Europe the international origin of many of the policies has been more openly acknowledged, including by former Commissioner Barnier, but there has been more wriggling in transposing the details of the global package into EU directives. Meanwhile, on both sides of the Atlantic, at the level of nation states various supplementary measures have been taken, particularly around the structure of banking, that might cut across the collective goals of combining safe(r) finance with an open international system.

Perhaps in anticipation of those wriggles and divergent local initiatives, the various international standard-setters took steps to monitor compliance that mark a step-change from the past. For the first time standard-setters are monitoring and publishing assessments of the degree to which their member jurisdictions are faithfully implementing the agreed standards. In the past few weeks this has seen a peer review by the Basel Supervisors Committee find fault with both the US and EU implementation of what's known as the Third Basel Capital Accord (or Basel III). That prompted the following statement from the Economic Affairs Committee of the European Parliament, which is a co-legislator for EU directives and regulations: "A large majority of Members of the European Parliament cannot accept that the Basel Committee puts into question the tools to finance the economy….Even if we aware of the necessity of international cooperation, the European law is made by the European Parliament and the Council of Ministers. The opinion of a body that is working *without legitimacy* and without any transparency cannot modify the decisions taken democratically by the European institutions." (My emphasis)

There has not been a similar comment from Congress --- perhaps because the peer review of the US was more favourable; perhaps because, compared with Europe, there seems to be lower awareness in the US of just how much policy is made at international tables; or perhaps because, as I shall come on to discuss, Congress is not a formal player in the details of domestic regulatory policy.

That's not to say that US legislators are indifferent to the role of international policy organisations. That's been apparent recently in the obstacles to delivering reform of the IMF prompted by changes in the world order. And it surfaced twenty years ago when, in 1994, the question of the Fed finally

[7] Note that these issues do not just fall to central banks and banking supervisors, but must involve securities regulators too. For a recent example of securities regulators recognizing that, see Mary Jo White, Chair of the US Securities and Exchange Commission, "Enhancing Risk Monitoring and Regulatory Safeguards for the Asset Management Industry" 11 December 2014.

becoming a formal member of the Bank for International Settlements and taking up its vacant board seat was up for consideration. The then chair of the House of Representatives subcommittee expressed concern "whether this would put the Federal Reserve at some point in time….in conflict with the domestic independence they exercise"[8].

So here we have it:

-absent a reversion to financial autarky, stability policy must in large degree be made internationally given the extent and social costs of spillovers in the international financial system. (As former Bank of Japan Governor Masaaki Shirakawa put it, financial stability is a jointly produced global public good[9].)

-the standards are drawn up very largely by unelected officials from agencies that are independent in their home jurisdictions

-those standards are pointless unless compliance is not faithful and consistent across the world

-but the standards are not legally binding

-instead they are implemented as a matter of choice by local legislators or rule-makers

-where majoritarian bodies are involved in domestic/regional policy making, international criticisms of incomplete implementation are sometimes regarded as an intrusion on democratic authority and autonomy.

As those European parliamentarians point out, they and their member-state executive branch colleagues are elected whereas the policymakers around the tables at Basel, the International Organisation of Securities Commissions (IOSCO), and the Financial Stability Board are not[10]. As one of those unelected policymakers during the key years following the crisis, this has been greatly on my mind, then and since.

Democratic legitimacy for international policy-making by independent agencies

The spectre, then, is of policy slipping out of the hands of elected representatives of the people without anyone quite grasping what is going on. There are two broad variants of this nightmare. In the first, democratic states enter into a multilaterally binding legal agreement (a treaty) that delegates

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[8] Rep Paul Kanjorski, quoted in Beth A Simmons "The Future of Central Bank Cooperation", BIS Annual Research Conference 2005. His objection concerned the legitimate courses of action available to a body created by Congress. The Fed did join the BIS.

[9] Masaaki Shirakawa, "International financial stability as a public good" Bank of Japan, October 2012.

[10] The FSB is different from the Basel and IOSCO committees in so far as finance ministries are at the table, and in parliamentary democracies they are typically led by elected politicians.

responsibility to a formal international organization, but it turns out that they did not fully appreciate what they were doing done and, crucially, that they lack reasonable mechanisms for appropriately balanced collective control, so that the staff of the international institution become the key drivers of policy. Under the second, quite different variant of the 'democratic deficit' nightmare, democratic nations first delegate an area of policy to domestic independent agencies, and then those agencies gather internationally to coordinate their policies or set common standards which they each undertake to abide by faithfully. Questions about the International Monetary Fund revolve around the first nightmare. Questions about Basel, IOSCO and the FSB revolve around the second; ie of independent central banks in the BIS Tower or of independent securities regulators at IOSCO making global policy without democratic checks and balances[11]. The latter threatens a 'double whammy' democratic deficit unless two conditions are met: the independent agencies individually enjoy legitimacy at home, and the outputs of their collective international gatherings and deliberations enjoy legitimacy too.

Without setting this out in too much detail here, it seems to me that there are four necessary components of or dimensions to the legitimacy of both domestic independent agencies and international policy organisations (whether of the treaty/IMF variant or the transnational/Basel variant). They are that[12]:

1) There should be democratic endorsement of either the organization itself or those of its policies that are binding.
2) The organization should be subject to the rule of law, so that arbitrary power is constrained and abuses of rights are protected against
3) Policy formation and outputs should be sufficiently transparent to benefit from public debate and scrutiny, so that society/countries can decide whether to maintain the regime
4) Locating policy-making in the autonomous body should promise, and *ex post* actually deliver, better outturns than could be achieved by national political policy makers.

One immediate observation is worth making about those legitimacy tests. The fourth 'instrumental' or 'consequentialist' test does not feature in all justifications of democracy itself, which some seek to

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[11] In the language of international relations theorists, Basel and IOSCO are special kinds of transgovernmental organisations, a concept coined by Robert O Keohane and Joseph S Nye Jr, "Transgovernmental Relations and International Organizations" 1974, which as it happens was the year the Basel Supervisors Committee was created. They are a special variant as, in contrast to such bodies comprising executive-branch delegates, their members are to a greater or lesser extent insulated from day-to-day politics in their home countries.

[12] For domestic independent agencies, these tests are a high-level summary of the Principles For Legitimate Delegation set out in my 2014 Harvard Kennedy School Gordon Lecture "Independent Agencies in Democracies: Legitimacy and Boundaries for the New Central Banks". In that paper, I separate the principles into two groups, with more granular criteria for *whether* to delegate and for *how* to delegate. For international organisations, the four broad tests in this paper can, I believe, be mapped into those in the 'complex standard for legitimacy' set out in Allen Buchanan and Robert O Keohane "The Legitimacy of Global Governance Institutions" 2006.

warrant on intrinsic grounds alone[13]. But while views can reasonably differ on whether or not democracy itself needs to deliver instrumental benefits in order to enjoy legitimacy, better results *are* a necessary test for delegation away from democratic decision-taking, whether domestically or to an international body, precisely because of the dilution of democratic control. That poses two questions: why better results might in principle be achieved by delegation; and how to preserve an appropriate degree of democratic involvement.

Whether in a domestic or international setting, I see the broad instrumental justification for delegation being that it can sometimes reduce the risks of a more political policymaker diverging from the agreed objective, ie departing from a collectively agreed public interest. This comes in two variants. First, delegation might help to solve a problem of credible commitment (the standard motivation for an independent domestic monetary authority). Second, in certain circumstances (but not always) delegation might help to reduce the risk of policy-makers being captured by sectional interests.

Separately, international policymaking is typically warranted by the need to solve or mitigate a collective action problem. In our case of the stability of the international monetary and financial system, a shared regime can reduce the incidence of beggar-thy-neighbour macro policies; or of protectionist prudential policies that impair the efficient allocation of resources and, thus, the benefits of international trade in goods and services; or of a race to the bottom that leaves the international system horribly fragile. For example, if international banking markets are to be permitted, with the inter-bank credit exposures they entail, many countries will be better off with a common equity/assets standard of X% than they would be applying 2X% to their own banks while other countries applied 1/2X% to their (foreign) banks. In the latter circumstances, the country with the higher capital requirement would plausibly regard all foreign banks as undercapitalized and so ban its banks from participation in international markets, and ban foreign banks from its home markets. In a similar vein, if countries have an explicit or implicit objective of their banks acquiring market share, there could be a race to the bottom, with the global banking system as a whole ending up chronically undercapitalized. That last motivation was the typical refrain and reasoning of the first few chairs of the Basel Supervisors Committee.

The two sets of factors --- insulation from day-to-day politics and mitigating collective action problems ---can come together in international financial policy. At the international table each national policy maker can it find it easier than in a purely domestic setting to escape the reach of those powerful national lobby groups whose domestic clout would otherwise threaten the national interest. I am fairly sure that I have observed that. Similarly, an international accord can act as a reasonably powerful commitment device.

But if instrumental performance can in principle be improved, what of avoiding the circumvention of democracy? That, after all, is the problem here!

For the international monetary system, the world chose a treaty-organisation, the IMF, whose decisions are binding on members and are taken on a weighted-voting basis at a board/governing body

[13] Those intrinsic justifications are typically freedom or equal political status and respect.

comprising representatives of (typically) the executive branch of government of member countries[14]. For democratic countries, their IMF vote is therefore typically under the control of democratically elected representatives. Even in a US-style structure of government, those executive branch representatives are accountable to the legislature (Congress) in so far as it must decide whether to stay in the system or withdraw.

By contrast, for the international financial system, standard setting is in the hands of less formal transnational bodies. There are advantages in having a 'mixed system' combining the more formal IMF and World Bank with the more flexible 'Basel' system[15]. The standards that issue from Basel, IOSCO and similar organisations are not legally binding on their members, but are implemented at the discretion of each country. The question about a democratic deficit, therefore, relocates to the domestic sphere. I think it could be addressed in one or other of two ways:

- The independent agency has full discretion to implement the international standard subject to (i) full and proper domestic consultation, and (ii) its acting under a domestic statute that frames its purposes and goals in a clear way and, ideally, sets a substantive standard that should run through its rule-writing.
- The independent agency's domestic incorporation of the standard is subject to veto by the executive branch and/or legislature.

The first is more or less the course chosen by the US, whereas the EU has adopted the second. This difference is striking and interesting[16].

In the US, the detailed substance of nearly all financial regulation, including that implementing international standards, is set by independent agencies via rules after extensive public consultation (in the jargon, 'notice-and-comment rule-writing'). There is no formal *ex ante* role for the executive branch or for the legislature. Big picture, although Congress could in principle pass legislation overturning agency rules, it is not a player in the details but, rather, sets the high-level framework of delegation. In some cases, however, the enabling legislation sets only vague purposes and goals, and does not incorporate a substantive standard. Exacting requirements for consultation and representations are set by the Administrative Procedures Act and by an accretion of common law determinations by the courts. The legitimacy question is whether that is enough.

In addition, there is a question of whether US (and other countries') independent agencies can credibly commit to the international standards to which they are party. There are two dimensions to this. First, will domestic consultation raise points that were not taken into account when the standard was framed? Up to a point, that can be addressed by twin-tracking international and domestic consultative

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[14] The fairness in the system of weighted-voting is partly what quota reviews are about. A few countries, eg Germany, are represented at the IMF board/governing body by their national central bank.

[15] A further difference is that Basel is less universal. That is essentially because its standards are designed essentially for those countries' financial systems that are materially relevant to global stability.

[16] By focusing on the US and the EU, there is no implication that other countries at the Basel or IOSCO tables should carry less weight in international policy making.

processes. At the least, national authorities should encourage wide participation in international consultations. The second issue is whether the decision-making modalities of national agencies enable them to commit at the international table. That could in principle be a problem in any country whose national regulatory agencies do not have a sole decision taker, but I raise it here because there is good reason to think it is a problem at some US agencies given comments by their commissioners. I shall return to both of those issues in the concluding section.

In contrast to the US, the EU employs the second of the two approaches to generating democratic legitimacy for regulatory rules. International financial standards get translated into EU legislation (directives or regulations) by the Council of Ministers and the Parliament. To the extent that the details need to be filled out, that is done by the relevant regulatory agencies --- for example, the European Banking Authority or the Securities Market Authority --- whose core rules are subject to veto by Council or Parliament[17],[18]. For many EU member states, that process entails greater involvement for majoritarian institutions than would feature in purely domestic regulatory measures. One might wonder, therefore, what the Econ Committee of the European Parliament was so vexed about when it issued its recent anathema against Basel. Why was the Basel Committee's peer review determination of "materially non-compliant" something to complain about given that it must have been a conscious, democratic choice in the EU?

Assuming that the assessment was careful, reasoned and accurate, the peer review's determination might, more understandably, be something for the rest of the world to worry about. An objective assessment of each member country/region's implementation serves an international need, helping to underpin the mitigation of the collective action problem. Because the terms of its implementation are determined by majoritarian institutions, the EU puts democratic authority behind its decisions. But the rest of the world is entitled to know the degree of compliance; and if other jurisdictions were to conclude that, in consequence, they wanted their institutions to carry more capital against exposures to EU banks, that would be their entitlement under what is cast as a *minimum* international standard.

Having said that, the international regime would be eroded if multiple countries were to pitch in materially below the agreed common minimum standard. The *strength* of non-binding transnational governance is that it gives more room for countries/regions to adopt regimes set or vetted by their local majoritarian institutions. The EU exercises that option, whereas the US relies on extensive consultation to deliver a form of interest-group populist legitimacy. The corresponding *weakness* of non-binding transnational governance is that, if lots of countries opt to dilute the international standard in their

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[17] Technically, such 'Level 2 Rules' are formally approved and issued by the European Commission. Since the Commission is itself a non-majoritarian agency, it cannot directly confer democratic legitimacy and so its role in revising EBA, ESMA, EIOPA rules needs to be scrutinized carefully by the majoritarian fora. I have therefore simplified by leaving the Commission out of the summary in the main text.

[18] In addition to not discussing the role of the EU Commission (see previous footnote), I have also omitted from this review the intra-European debate about whether greater legitimacy is achieved through policy being set by unelected independent national technocrats accountable to their domestic legislatures or by a collective process entailing material influence for the EU Commission and Parliament alongside a Council of Ministers operating on a system of weighted voting (in EU parlance, Qualified Majority Voting).

jurisdictions, the collective action problem is not solved and the instrumental goals of international delegation are not secured.

One can think of the G20 Financial Stability Board as an attempt at an institutional solution to the potential problem of non-compliance and one which reinserts some majoritarian policymakers into the process. As well as the usual cast of independent-agency technocrats, FSB representatives include the executive branch (typically a deputy finance minister) of the member countries. Not only does that bring executive branch perspectives to the FSB's oversight of the standard setters, it also forms a better bridge to the G20 Finance Ministers and Leaders.

This structure, strengthened shortly after the crisis broke, opened up the hazard of political interventions in standard setting motivated by short-term electoral objectives (ie party-political interest rather than the public interest). Instead, what I observed in my years on the FSB was a process that transmitted top-down political urgency into the reform programme while largely insulting the standard setters from pressures to compromise the Leaders' declared goals.

But if that is what I observed sitting at the table, could the public, commentators and domestic legislators see the same? I have to say that I'm less confident about that, which matters both for its own sake and because the benign integrity of the system is not a law of nature and so could fluctuate over time.

We are, therefore, back full circle to where I began. If so much policy is made internationally, why aren't we, the public, told about it?

'Fessing up' to international policy making

There are no simple solutions to the issues I have been outlining. It is unavoidably, intrinsically complicated because we have a hybrid system of international standard setting, domestically controlled implementation, varying degrees of majoritarian involvement in those domestic (or in the EU's case, regional) choices, and relatively untested arrangements for exposing and adjusting to incomplete compliance.

Nevertheless, I offer the following as measures that, each of themselves and collectively, could help.

The international standard setters should consult openly, encouraging responses from far and wide. Moreover, the chairs of the key groups and subgroups should give speeches, wearing their international hats, explaining the evolution of their group's thinking. That would help to avoid periods of radio silence between formal consultation documents, which has been a problem occasionally.

Further, domestic agencies should do what they can to ensure that there is broad domestic knowledge and understanding of the international deliberations, and of the extent to which their agency's domestic policies are being framed in the light of or to comply with international standards. Casual empiricism suggests that performance on this front is highly variable.

Those same domestic agencies should ensure that they can reconcile their institutional decision-making processes, which often are enshrined in law, with international policy making. That might mean granting delegated authorities or commissioners/governors being available (at odd times of day or night) for conference calls. If that cannot be achieved, the domestic legislature ought (morally) to be told, with an assessment of whether or not, in a world of open capital markets, the agency can realistically achieve its statutory objectives absent participation in and acceptance of international standard-setting. This is a question domestic regulators should ask themselves.

As will be clear from the drift of those propositions, agency regulators and the executive branch should be much more open in legislative-committee hearings about the extent to which domestic policy is framed in the light of international discussions and agreements.

Likewise, leading members of the legislature should be open with the rest of their legislature, and with the public. They should, moreover, try to situate their purely domestic initiatives (eg the Volcker rule) in the context of the broader global initiatives they fit into.

In combination, those measures would, over time, enhance the level of public understanding of where and how public policy is made, and why; the why being the incapacity of any nation on earth to set its own financial-stability policies independently absent capital controls and, separately, if it expects its financial institutions to be free to operate abroad.

I have to admit, however, that some of those propositions will strike some people as utterly unrealistic. I understand why. It might seem expedient for executive branch and agency officials to pass over the extent of their international work. And it is hardly attractive for domestic legislators to be open that they are sharing power with their overseas counterparts and, worse, with faceless bureaucrats. But just think about what that would mean. It would be perverse. It could even look like a conspiracy of silence. Not to pursue the kind of steps I have described --- in particular, not to come clean with the people --- would amount to democratic institutions qualifying, even undermining, their democratic credentials. The public can be misled by sins of omission just as easily as by sins of commission, but only for so long.

At which point, I want to return to substance. Throughout this review of the legitimacy of international policy-making, I have deliberately maintained a distinction between the international monetary order (under the IMF table) and the reform of the international financial system (under the Basel and IOSCO tables). But, in fact, the crisis reminded everyone of the extent to which --- within national economies, and across the global system --- macro and finance, money and credit, are intertwined. On to the stage walks macro-prudential policy, under which regulatory requirements might be, and in some countries are being, dynamically adjusted to maintain a desired degree of system resilience in exuberant phases of the credit cycle and/or in the face of potentially destabilizing inflows of ‘hot’ capital. Thus, just as the international community has been seeking to improve the legitimacy of processes for global agreements that set *static* standards, there emerges a need to provide a framework to cope with *dynamic* regulatory policy.

In terms of our theme, there is good news and challenging news here. The good news is that the availability of dynamic macro-prudential policy means that a country is not left defenseless if international regulatory standards prove materially inadequate or if there are stability-threatening spillovers from other countries' macro policies. That is good news for democratic legitimacy, as it means countries have greater room for manoeuvre *within* the international regime. Countries surely have a right to manage their 'national balance sheet' in the interests of domestic stability, and arguably they have a moral obligation to do in the interests of contributing to global stability. This could be a world in which contagion is contained but financial openness continues to facilitate gains from trade in goods and services.

The challenging flipside is how to avoid the almost revolutionary innovation of dynamic national macro-prudential policy opening up room for abusive beggar-thy-neighbour policies, the avoidance of which is one of the motivations for having an international regime in the first place[19]. This is a field where the whole spectrum of international tools lies open: from information-exchange at one end, through co-operation, to co-ordination at the other end of the spectrum. Information-exchange, underpinned by comprehensive public explanations of macro-prudential policy settings, is the minimum. How far beyond that policy-makers should go, I shall not address today. But what is clear is that this remains a gap in the international regime that needs filling if domestic politicians and publics are to understand what their governments and financial authorities are doing.

Conclusion

I opened these thoughts by setting out a series of unattractive options. One was to give up financial globalization and thereby sustain domestic democratic control (at the level of the nation state). The G20 Leaders rejected that course five years ago. A second choice was, in theory, to retain financial integration and to relocate democracy to the global plane. But the dream of 'cosmopolitan democrats' is just that. A third logically available option was to maintain international financial integration, set financial policy globally, and quietly accept the dilution of democracy. Not only would that be wrong, it would prove unsustainable.

I have, therefore, tried to thread my way through the various trilemmas by identifying the extent to which democratic checks and balances are in place in varying degree across the world, and by proposing some steps to bring the process of international standard-setting closer to the people.

On the first, the EU standards are incorporated into law by or under the control of elected politicians. This can put them at odds with global policy, and it remains to be seen how material that will prove to be. In the US, the various agencies have more autonomy in composing rules and regulations, but they are subject to strict public law requirements designed to bring all the cross-cutting strands of the public interest into the room. They operate under the authority of Congress, and I suspect that legitimacy would be enhanced if their enabling statutes set clearer purposes and incorporated a substantive

[19] See Tucker Lee Kuan Yew School Lecture 2014, *op cit*.

standard of desired resilience for the financial system. At the international level, the Financial Stability Board includes executive-branch delegates, and builds a bridge to the collective political deliberations of the G20 Leaders. The collective goals of global stability policy need to be forged there.

But that underlines my various proposals, which amount to executive branch policy-makers and independent-agency leaders being open with the legislatures about international policy formation; and legislators being open with the public. That way, purely domestic initiatives should be given primacy in public presentation only when they truly are the most important policies. 'Invented here' can be something to be proud of, but is not a reliable test of relative importance.

What I am describing lacks the analytical elegance of the false choices presented by the Cartesian logic of the trilemmas. But it has the practical virtue of reflecting the complex world in which, by accepting openness and globalization, we have chosen to live. It also, I would suggest, has the merit of increasing the openness of financial policy making, giving the people a better basis for participating in the important debates about how to combine, how to reconcile openness with safety and soundness.