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

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The incentive to give prominence to domestic initiatives

- Volcker Rule, Vickers, Liikanen: all incredibly prominent locally
- But s*ubplots* in the great scheme of things?
- The main action has been at international tables: do the public know?

Globalisation trilemma

Dani Rodrik: a fateful tension between:

- globalization,
- autonomous nation states, and
- democracy.

Financial stability trilemma

Dirk Shoenmaker: cannot have all of

- national control over financial policy,
- international financial integration, and
- financial stability.

Options that flow from that debate

(1) Give up financial globalization and thereby sustain domestic democratic control (at level of nation state). *G20 Leaders rejected at Washington 2008 Summit.*

(2) Retain financial integration and relocate democracy to the global plane. *Unrealistic.*

(3) Maintain integration, set financial policy globally, and quietly accept the dilution of democracy. *Wrong and unsustainable*.

Structure of remarks

- Why policy making is collective: spillovers, collective action problems
- The legitimacy issue
- Mitigants

Statement on Basel by Economics Committee of EU Parliament

"A large majority of Members of ..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."

Chair of House subcommittee on monetary affairs, 1994

- On the Fed formally joining BIS: expressed concern “whether this would put the Federal Reserve at some point in time….in conflict with the domestic independence they exercise”. Rep Paul Kanjorski
- The Fed did join.

The trilemma

- Absent a reversion to autarky, stability policy must in large degree be made internationally given the extent and social costs of spillovers in the international financial system.
- Financial stability is a jointly produced global public good.
- Standards are drawn up by unelected officials from agencies that are independent in their home jurisdictions

Trilemma (2)

- But the standards are not legally binding
- 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.

Criteria for Legitimacy

(1)There should be democratic endorsement of either the organization itself or those of its policies that are binding ; formally autonomous agencies, whether domestic (the Fed) or international (the IMF) need the former, internationally agreed policies need the latter

(2)The organization should be subject to the rule of law, so that arbitrary power is constrained and abuses of rights are protected against

Legitimacy Criteria (2)

(3)Policy formation and outputs should be sufficiently transparent to benefit from public debate and scrutiny

(4)Locating policy-making in the autonomous body should deliver better outturns than could be achieved by national political policy makers.

Conditions for domestic IAs to agree global policy (1)

- Independent agency has full discretion to implement the international standard subject to (i) full and proper domestic consultation, (ii) it acts 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.
- US may not meet last condition

Conditions for domestic IAs to agree global policy (2)

- The independent agency’s domestic incorporation of the standard is subject to veto by the executive branch and/or legislature.
- EU route. Not available in DC?

Solutions (1)

(1) International standard setters should consult openly, encouraging responses from far and wide.

(2) Chairs of key groups should give speeches, wearing their international hats, explaining the evolution of their group's thinking.

Solutions (2)

(3) Domestic agencies should do everything 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.

Solutions (3)

- 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 not, legislature ought to be told, with an assessment of whether the agency can realistically achieve its statutory objectives.

Solutions (4)

- Agency regulators and 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 agreements.
- Likewise, leading members of the legislature should be open with the rest of their legislature, and with the public.

The new challenge of *dynamic* macro-prudential policy

- Regulatory requirements might be 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.

The good news

- 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.
- 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
- arguably they have a moral obligation to do in the interests of contributing to global stability.

The Challenge

- How to avoid this opening up room for abusive beggar-thy-neighbour policies
- whole spectrum of international tools lies open: information-exchange , through co-operation, to co-ordination .
- Information-exchange, underpinned by comprehensive public explanations of macro-prudential policy settings, is the minimum.
- This gap in international regime must be filled if domestic politicians are to understand what their governments and financial authorities are doing.