Research paper

The Role of Public and Private Institutions in Global Financial Governance

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Introduction

In recent years and especially after the world financial crisis, the international and transnational attempts to create an effective system of financial regulation increased dramatically. The system of global governance and global financial governance in particular consists of multilevel, interacting with each other, layers of institutional rules and processes, in which the decision made in one institution affects the decision-making process in other institutions. In globalized world influence is often mediated through institutions, which open up the possibilities for a "skewed participation" (Shaffer, 2007, p.131), which allows more powerful actors indirectly influence the decision made there, but their power can also be restricted by institution rules and procedures. Thus, to understand the functioning of the system of global financial governance, it is very important *to estimate the role of public and private institutions, functioning in this system*, because they do not only shape the system itself and elaborate the implied regulation within the system, but more precise look at institutions, which function in the system of global financial governance, can also help to understand the power relations within this system. This explains the relevance of the research question.

The introduced research question sets, in its turn, the following goals for the research conducted: to describe the phenomenon of global financial governance, its features and aims, to analyze the current system of public and private institutions in global financial governance, and also to describe the problems with which the institutions in global financial governance face.

According to the outlined aims of research the paper has the following structure: introduction, which explains the relevance of the chosen research question and elaborates the aims which should be reached by the conducting research; main part, which includes three sections: the first section explains the phenomenon, features and aims of global financial governance, in the second section the public and private institutional mechanisms are reviewed, which function in the current system of global financial governance, this institutional regulation is considered to be multilevel: local, regional and global; and diffuse in character: both public and private sectors are involved. In the third section it will be analyzed to the problems with which the institutions in global financial governance face; in the conclusion the main results of the research will be presented.

Phenomenon, aims and features of global financial governance

The development and changes of the world financial market determine the model of global financial governance, which is being developed to respond to new challenges, emerged because of the world financial market changes. Among such changes, appeared in the last decades, one should mention the growing degree of liberalization of capital flows, which increases the risk of unfolding of financial crisis in a state and its vulnerability to contagion from crises emerged in other countries; and it can also lead to the appearance of inefficiencies due to the excessive inflow of capital, which can distort domestic asset prices; and a government ones liberalized capital flows limits for itself the political options to control and regulate it (Abdelal, 2007, p.33). Other developments in the global finance could be characterize as the mix of real estate finance and securitization, which started from the USA and could be explained as “originate-to-distribute model” (Angeloni, 2008, p.13) in relation to the risks which according to this model should be spread from originating bank to other specialized institutions; and the last decade could also be described as the prolonged period of asset price inflation, that means that the asset prices regulated more by expectation of investors, who may not pay attention to the basic asset value and therefore underestimate the risks (Angeloni, 2008, p.14). To sum up all these features shows the increase in the interdependence of the international financial system, high degree of capital mobility and risk transferability.

The developments in the word financial system, enumerated in the previous passage, are the challenges, which the system of global financial governance should address and they formulate the aims of global financial governance: to improve global level of efficiency, and to facilitate distribution of financial resources between societies. Three major elements of the efficiency concept should be mentioned: efficient allocation of investment and the most productive use of capital; to ensure the stability of international financial flows to avoid financial crises and volatility; and the lowest possible transaction costs (Mosley, 2005, p.9).

To the characteristics of contemporary global financial governance refer: financial institutions and markets, in which they operate, became transnational, while the regulation and supervision remain mostly national, and because of these regulation and supervision gaps the system becomes more self-regulated, which is promoted by liberalization and innovation of financial markets and emergence of “competition state”, which uses liberalization as a tool to attract investment (Tsingou, 2003, p.8). Another feature of global financial governance is an active involvement of private actors in financial policy: they participate actively in the transnational policy community, within which debates are conducted and decisions are made about the structure, regulation and supervision of financial activities and institutions are taking place; there are several organizations, which are at the core of this community, like G30, which brings together public officials and financers and provides both formal and informal settings for them to reach a settlement on the general and specific of financial architecture (Tsingou, 2003, p. 8-9).

Institutional mechanisms, which operate in the system of global financial governance

Global finance is not a subject to a full control by sovereign world government, but still there is a complicated and multilevel but imperfect system of global financial governance, which is changing under the influence of liberalization and globalization of financial markets. But in spite of these changes, states remain key-actors, which adopted multilateral strategies of global finance management through interstate, transstate and suprastate mechanisms (Scholte, 2002, p.9). But due to the processes of globalization new trends emerge: private market agents take an increasing role in the regulation of global finance through transnational policy networks, public-private partnership, regulatory mechanisms based in private-sector agencies, which formulate general rules and design specific outcomes for state and non-state actors (Underhill, Zhang, 2008, p.535). In the system of institutions of global financial governance one can point out three major trends, which are developing due to the globalization process: a shift from hierarchies and formal rules to pluralism involving networks and informal rules; a shift from the development of material resources to knowledge-based resources which are perceived as a source of power and wealth, and the third trend is a shift in international affairs from hegemony to multilateralism.

Public institutions in the system of global financial governance

To examine a great variety of multilateral institutions operating in the system of global financial governance one should use a classification scheme to make an analysis simpler. In the first subsection of this section the public sector international institutions will be analyzed, which could be classified into following groups: formal global intergovernmental organizations like the IMF, the Bank of International Settlements (BIS), the World Bank, the Organization for Economic Cooperation and Development (OECD), and The International Organization of Securities Commissions (IOSCO); informal public sector groupings like G8, G20, the Basel Committee on Banking Supervision (BCBS), the Financial Stability Forum (FSF), the International Association of Insurance Supervisors (IAIS), and the other Basle-based committees; and the third group of regional groupings like the European Central Bank (ECB) and the Chiang Mai Initiative (Porter, 2008, p.10).

M. Walzer uses another classification of international financial institutions involved in global financial governance; he divides them into the following groups: universes, clubs, and neighborhoods (Drezner, 2003, p.8). To universes the following international organizations are referred: the IMF, the World Bank; to clubs model counts such institutions as the G-7, the OECD, which are characterized by exclusion of states with different preference orderings, very little democratic accountability, and benefits bestowed for in-group members to ensure collective action (Drezner, 2003, p.8). Neighboring IGOs have a limited membership, which is based on geographical principle, these IGOs can be used by a regional hegemon for reach a coercion of economically dependent allies to adopt their position on a subject of global financial governance (Drezner, 2003, p.8); to this group refer ASEAN, the Council of Europe.

After the classification of public institutions, operating at the world financial market, the interactions of these formal and informal public institutions with each other and their role in the system of global financial governance will be discussed further. The IMF is one of the core institutions in the global financial governance, to its functions, specified in the IMF's Articles of Agreement refer: fostering consultation and collaboration on monetary matters; support of exchange stability, multilateral payments system, and balance of payment problems and the provision on financing; the provision of specific advice on the domestic regulation of financial systems (Porter, 2008, p.21). The interrelationship of these functions has been the biggest source of the IMF's influence on the international financial system. The IMF through its universal membership, which grants legitimacy to its decisions, weighted voting and conditionality, through its ability to lend, was able to create an effective, asymmetrical order, in which the poorer developing countries are forced to adopt practices, developed by IMF and financed by wealthy countries, which deemed to be optimal for asymmetric system and countries involved in it (Mosley, 2005, p.14). The provision of financing and the production and use of knowledge are those functions, which especially run into trouble due to the IMF's relations with other formal and informal international institutions like ISDA, non-IMF collaborative agreements between central banks such as Chiang Mai Initiative, which contribute to the increased ability of potential borrowers to avoid conditionality of the IMF's programmes, and internal problems of the organization like its declining ability to use conditionality as an instrument of power, because of increased ability of potentially countries-borrowers to use capital markets, official reserves, as means of capital accumulation, one should also add to it limits of the willingness of wealthy states to supply money to the IMF (Porter, 2008, p.21-22).

Other formalized and bureaucratic IGOs participating in global financial governance are the World Bank, OECD, the BIS, and IOSCO. The World Bank was primarily focused on providing financial assistance to developing countries; it has gradually grown into a complex development institution, comprising four organizations, which collectively provide financial assistance, risk guarantees, technical assistance and policy advice to both public and private sectors in developing countries (Stone, Wright, 2007, p.2). The World Bank Group faced dilemmas: how to define the areas of its special competence with the IMF, and how to interact in areas of overlapping jurisdiction; in response to changing global economic conditions the Bank and the Fund established, respectively, the Extended Fund Facility and structural adjustment lending, and later the Fund established the Structural Adjustment Facility, but these attempts to answer to new trends in global economy have increased the degree of overlapping responsibilities (Feinberg, 1997, p.229): both the Fund and the Bank provide macro-economic advice to developing countries, using the mechanisms of conditionality and surveillance. The primary focus of the World Bank was the long-term financing for economic restructuring, whereas the IMF focused on short-term loans; as an organization the Bank undergone some dramatic reforms and become more open actor (Stone, Wright, 2007, p.1), in comparison to the Fund the Bank has much greater capacity, to link macro-economic analysis to development policy, closer relations with civil society actors: NGOs, private actors; and it is less dependent on member-states contributions (Feinberg, 1997, p.226).

The OECD's functions in financial sphere include: the liberalization of cross-border capital flows, which is framed by the Code of Liberalization of Capital Movements; the OECD specializes in analytical and statistical information, including financial and monetary; it is functioning also as arena for member-states negotiations on particular issues (Porter, 2008, p.). Compared with the IMF, the OECD has more restricted membership, and it less focused on balance of payments issues, the membership in this organization can help to reduce significantly the cost of rising capital in private-sector markets, especially when this is referenced in other regulation like Basel capital adequacy standards about risk mitigation costs on non-OECD states (Porter, 2008, p.22-23).

The primary role of the BIS is to promote monetary and financial stability, to lead statistics and analytical research about international money and finance, to support central banks and authorities in charge of financial stability, and to facilitate discussion and policy analysis and information-sharing between the member-states' central banks and within the international financial and supervisory community. (Porter, 2008, p. 23) The BIS concentrates its activities in many committees: Central Bank Governance Group and Central Bank Governance Network, which are functioning as a forum and focuses on the institutional and organizational settings in which central banks pursue monetary and financial policies (BIS official website); Basel Committee on Banking Supervision (BCBS), which contributed to the reforming of international financial architecture by elaborating and implementation of the Core Principles for Effective Banking Supervision in 1997, which defined the minimum standards for banking supervision in all countries to increase safety and soundness of the banking markets (Wood, 2000, p.52); the Committee on the Global Financial System, the Committee on Payment and Settlement Systems; other committees resemble relatively informal groupings of regulators with secretariats at the BIS: the International Association of Insurance Supervisors (IAIS), International Association of Deposit Insurers (IADI), and the Financial Stability Forum created by the G7 in 1999.

As these regulatory groupings within the BIS were developing, there was a parallel trend to involve informal, exclusive groupings, forums in the system of global financial governance; the creation of G7 in 1975 gave the beginning to the formation of the club model which is broadly used today in the system of global financial governance today; these groupings, deciding about the reforming of global financial architecture, tend to gain more legitimacy to their decisions including in such groupings 'systematically important' countries, the example of it could be G20. The real power of such groupings comes not from a creation of the set international law, but rather from their ability to implement agreed political decisions by member states and international organizations, like the IMF; one more reason, that the decision are made by the policy-makers, thus, these informal groupings, in fact, are superior to the formal organizations. (Porter, 2008, p.12)

Private institutions in the system of global financial governance

The analysts count approximately 225 private sector associations in different sectors and from various regions, involved in transnational finance and engaged in advocacy, standard-setting, education and member services (Porter, 2008, p.16). The reasons of rise of private actors reflects their increased importance in global exchange and attempts to overcome the shortcomings in traditional modes of intergovernmental regulation – the compliance problem, thus, the private actors, especially the business and financial components, became involved in regulatory regimes, shifting in some realm from "multilateral cooperation" governance to "transnational and transgovernmental cooperation" (Mosley, 2005, p.8).

The international private sector institutions can be classified into two groups: international private-sector associations directly or indirectly involved in financial rule-making like the International Accounting Standards Board (IASB), the rating agencies, the World Federation of Exchanges (WFE) and the Institute of International Finance (IIF); and market practices, like derivatives contracts (Porter, 2008, p.16).

The rise of private financial sector institutions at global level is evaluated both as new opportunities and challenges for public sector institutions: to opportunities one could refer the ability of regulators to engage private sector institutions more effectively in the activity of IGOs, thus bounding them with collaborative contracts for collective actions, and in this way reducing their own costs in the case of crises; among challenges from private institution to public institutions in the global financial governance are the problem of de-legitimization of the public institution policy because of the intense lobbying of private-sector and increase in the system instabilities because of the establishment of new institutions and practices at the global financial market with poor understanding of risks , which emerge, as for example in the situation of retail-oriented hedge funds. (Porter, 2008, p.17-18)

The challenges to the contemporary system of global financial governance

The contemporary system of global financial governance faces the systematic problems, which became evident due to the series of financial crises in the end of the 20th and the beginning of the 21st century. These problems could be divided into two groups: the first group of challenges is connected with the major multilateral institutions which emerged out of the Second World War architecture: the IMF, the World Bank and also regional development banks in general; the second group include the problems originated in the developing countries, to which the IMF failed to fulfill its surveillance function (CIDSE, 2008, p.18).

The problems of Bretton Woods institutions will be discussed further: the IMF has failed to fulfill its role of preventing of global imbalances and failed to broker the coordination between exchange rates among hard-currency issuers (CIDSE, 2008, p.18). In the Monterrey Consensus of 2002 were discussed the problems of the Bretton Woods Institutions: the unequal participation of developing countries and countries in transition in the governance of the Bretton Woods Institutions, and in the voting structure, the use of accessing variables that favour the developed countries and systematically underestimates the economies weight of developing countries, like the GDP-formula (Ossa, 2003, p. 10); the failure to adopt a double-majority system of voting which would gave advantages to the developing countries (CIDSE, 2008, p.18); the Bretton Woods Institutions try to elaborate and implement the universal recommendation for both developed and developing countries, based on neo-liberal principles.

The world financial crisis showed that standards meant for universal application should be designed with universal participation. This shows the problem of inclusion of developing countries into the process of standard-setting, because even if these standards are implemented in the developed countries which participated in their elaboration, they could have a big influence on development and access to credit for non-participating countries. But this problem is hard to address because the design of these standards goes outside the scope of any public debate, for example the key international accounting standards are designed by the International Accounting Standards Board (IASB), which represents exclusively the corporate interests.

Conclusion

This research paper attempts to answer the question: what is the role of public and private institutions in Global Financial Governance; and discusses the following aspects of this question: phenomena, aims and features of global financial governance; institutional mechanisms, both public and private, which operate in the system of global financial governance, and the challenges to the contemporary system of global financial governance.

The public and private institutions in the system of global financial governance play an important role in the governing of world finance: they set key international standards for the operation world financial market, serve to implement these standards and to achieve the compliance of actors operating at the world financial market. Three trends in the institutional system were pointed out: a shift from hierarchy and formal rules to more pluralistic arrangements, which involve informal rules, which are designed inside the club-model institutions, and networks; the second trend is a shift from hegemony to multilateralism, which is proved by more active participation of private actors in the system of global governance; the third trend is the growing importance of knowledge and communication as a source of power (Porter, 2008, p.30).

The successful governance of global finance could improve the overall allocation of investment and with it help to provide more chances for equal and efficient development. But the system of global financial governance has some problems, which is shown by world financial turmoils; these shortcomings are in the system of public and private institutions, which govern global finance: in uneven decision-making capacity of developed and developing countries, in attempts to implement universal standards, primarily designed for developed countries.

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