THE GLOBAL FINANCIAL CRISIS AND ITS IMPLICATIONS FOR GLOBAL FINANCIAL GOVERNANCE

By

Gerald Flanagan

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Supervisor: Dr Karen Smith

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DECLARATION BY CANDIDATE FOR THE DEGREE OF MASTER IN THE FACULTY OF HUMANITIES

I, (*name of candidate*)

Gerald Flanagan

of (address of candidate)

The cottage, Newtownpark, Blessington, Co. Wicklow, Ireland

do hereby declare that I empower the University of Cape Town to produce for the purpose of research either the whole or any portion of the contents of my dissertation entitled

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CANDIDATE'S SIGNATURE DATE

ABSTRACT

This thesis explores how the global financial crisis (GFC) has impacted on the distribution of power within the international financial architecture (IFA). In order for us to be able to study the effects of economic power there must be some way in which we measure it or identify its presence. Traditionally this has been done by measuring national gross domestic product (GDP) as the best indicator of market size. In light of the shifts in global economic power – evidenced through the rise of the emerging powers, and exacerbated by the global financial crisis, this study seeks to assess whether the global financial crisis has affected the relevance of market size, liquidity and the current account as economic power indicators in the international financial architecture.

While the study reflects on the broader context of global financial governance, the focus will be on the G20 as the most significant piece of the international financial architecture. It starts off by distinguishing the different groupings within the G20 based on available data for the various indicators of economic power, and then investigating whether there has been any change in the G20 which might correlate with the different groupings. This is done along two tracks of power: structural and relational.

With regard to structural power the results of this study paper provide a clear indication that market size remains the most effective measurement. With regard to relational power, the outcome is more nuanced. While it does appear that the ability to pursue objectives internationally is still defined by market size, the strength of countries in the alternative indicators for economic power - liquidity and the current account - does determine the original position of countries at the negotiating table, either conferring an advantage or a disadvantage. However, because both advantage and disadvantage are directly linked to areas where these indicators are the most relevant factor, this strength cannot be seen as an indicator of an overall economic power position. What can be said is that in every financial crisis these factors are likely to be crucial and so liquidity and the current account positions are and will continue to be good indicators of each country's stance in times of global financial turmoil, providing a useful tool for categorising the primary negotiation position of states within the IFA.

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GLOSSARY OF ACRONYMS

ASEAN Association of South East Asian Nations

BIS Bank of International Settlements

CGFS Committee on the Global Financial System

CPSS Committee on Payment and Settlement Systems

FATF Financial Action Task force on money laundering

FSAP Financial Sector Assessment Program

FSF Financial Stability Forum

GFC Global Financial Crisis

IAASB International Auditing and Assurance Standards Board

IADI International Association of Deposit Insurers

IAIS International Association of Insurance Supervisors

IASC International Accounting Standards Committee

IFA International Financial Architecture

IFS's International Financial Standard's

IOSCO International Organisation of Securities Commissions

ISO International Organisation for Standardisation

OECD Organisation for Economic Cooperation and Development

OFC Off-shore Financial Centre

ROSC Reports on the Observance of Standards and Codes

CHAPTER ONE

1.1 INTRODUCTION

Global finance has in recent years seen its position within the global economy rise exponentially. In the banking sector alone the growth has been startling, in 2011 the total international assets of the private banking sector were valued at 35, 279.3 billion US$ as compared to 991.4 billion US$ in 1996. International debt securities in December 2004, were valued at $13,939.7 billion, by 2006 it was $17,080.8. The value of total contracts on Over The Counter (OTC) derivatives outstanding in December 2004 was $257, 894 billion; by June 2006 it was $369,906.

As the size of global finance has increased so too has the size of the crises that accompany it. Total subprime related losses alone were calculated by the IMF to be $1.4 trillion and by the Bank of England to be $2.8 in October 2008. It is the direction of these trends of both increased value and higher volatility which have provided the impetus for this research, which I hope shall add some small amount of information to the literature on; financial crises and the governance of the international financial architecture (IFA).

There is always a vast array of issues that converge during a crisis but invariably in international relations, there is the dimension of power. The how, what and the why of that power can, and does, change. The presence of multilateral institutions currently does not rule it out; rather it changes its nature, the range of issues and the forum within which it becomes relevant. So how has the global financial crisis (GFC) impacted on the distribution of power within the international financial architecture? Perhaps the most conspicuous trend, to which this question is relevant, is the rise of the emerging powers. How power is calculated in those areas where it is relevant is a crucial basis for understanding any of these developments. This paper seeks to understand these changing power dynamics by assessing whether markets size remains the only relevant measure of economic power during a crisis. This shall be carried out by investigating the theoretical significance of power in various areas within the IFA, once the incidents of particular relevance are established then they shall be investigated using the relevant methodological techniques in order to establish the explanatory power of the various economic power indicators.

1.4 RESEARCH QUESTIONS AND HYPOTHESIS

In order for us to be able to study the effects of economic power there must be some way in which we measure it or identify its presence. Traditionally this has been done by measuring national GDP as the best indicator of market size. This paper wishes to establish whether this remains true during a crisis period or whether liquidity and the current account become more accurate measurements of economic power in the functioning of the IFA.

This thesis asks whether the global financial crisis has affected the relevance of market size, liquidity and the current account as economic power indicators in the international financial architecture.

It will do this by first exploring the relevance of different forms of power within the IFA during the GFC. Based on this theoretical analysis, the appropriate circumstances within the IFA will be investigated in order to address the relative importance of the indicators of economic power.

This investigation shall distinguish the different groupings within the G20 based on the data for the various indicators of economic power. Having done this, the paper shall investigate whether there has been any change within the G20 which might correlate with the different groupings. This will be done along two avenues: membership of the "club" and negotiating power within the "club".

While the study reflects on the broader context of global financial governance, the focus will be on the G20 as the most significant piece of the international financial architecture. The motivation for this choice is based on the declaration by this organisation that it is the principal governing body within international finance, this will be further explicated in chapter 2.

In order to address this question the following sub questions will be explored:
To what extent;

1. Is the IFA defined by club standards?
2. Has the GFC changed this?
3. Are membership and negotiation issues the two key areas for assessing the relevance of the various indicators of economic power?
4. Do the various G20 members possess the indicators of economic power

The period that shall be considered as the crisis is late 2007 until early 2011. Given that tremors of the crisis existed as early as 2006 and that the crisis has not yet been fully resolved in 2012, these years will also be considered. In accordance with the theoretical framework the study population is the G20.

The indicators of economic power being considered are; market size, liquidity and the current account. The areas where I expect to find the effect of these power indicators are in; the membership of the club's and the policy outcomes of the G20 process.

The indicators being used for economic power are:

Market size	Liquidity	Current account
GDP based on Purchasing Power Parity (PPP), as a percentage of world total Sum of stock market capitalisation covering: bonds, equities and bank assets	Foreign currency reserves, in convertible foreign currencies Ten year Government bond yields Gross national debt, in percentage of GDP	Measured in dollar value Measured as relative to domestic GDP

The indicators being used for membership and policy outcomes are:

Membership	Policy outcomes
Membership of the G20, also of the BCBS, FSB and IOSCO	Capital controls
Voting strength in the BCBS and the IMF	Exchange rate regimes
Chair positions in the IMF, BCBS, FSB and IOSCO	IMF reforms (Financial safety net)
	Trade and commodity futures

The hypothesis put forward by this paper is that during crisis, liquidity and the current account assume significance as indicators of economic power, independent of market size.

1.5 Literature Review

There is a limited but growing collection of literature on governance and regulation within the IFA. The literature spans the fields of international relations, international political economy and international law. This multi-disciplinary literature is necessary in order to grasp the complexities of the workings of the IFA. The literature is dominated by a number of particularly prominent names, such as Barry Eichengreen, Daniel Drezner, Stanley Fischer, Dani Rodrik, Eric Helleiner and Kenneth Rogoff. There are of course many other authors who have contributed significantly to both academic literature and policy formation, but this list summarises the ones which appear most commonly throughout the literature. There is a close relationship between those who write in the academic circles and those who work on policy papers within certain institutions and while both of these groups are part of the literature it is the academic side on which this review shall be written. The reasons for this are that the academic literature tends to provide a clearer summary of issues without a need to read behind the intentions of political institutions as well as showing less volatility apropos their positions.

Within the analysis of the IFA there are a number of different approaches which are taken. These approaches tend to focus on one predominant driving characteristic: power, regulatory content or on a constructivist understanding of learning processes.

Those authors who approach the IFA with a focus on power can be divided into two main categories; state vs. state power and transnational networks vs. state power. Those concerned with the former state centric focus provide a useful analysis which sees the state as the crucial institutional level. These authors must not be confused with those who take a state vs. state approach in broader international relations theory, such as neo-realists. As these writers highlight; there are good reasons to take a state-centric approach within financial regulation as a single issue area. The power significance of the USA, UK and arguably the EU within finance is enough for some to claim that the power imbalance keeps the key unit of analysis at the state level. Added to this, the characteristics of the IFA strongly suggest a system with club standards.

Daniel Drezner's *"All politics is global" (2007),* published just before the outbreak of the crisis, provides a useful game theory perspective on the process of international regulation formation. In his case study on the IFA Drezner clearly sets out his reasons for his conclusion that the IFA is characterised by club standards. This book shall provide the main backdrop with which to compare this paper, as Drezner summarises the commonly held position on what constitutes power within the financial system. An article written by Beth Simmons (2001) is also deserving of comment. While a very good article at depicting the power of the USA and the UK within the IFA it does suffer from some weaknesses. Firstly she claims that the USA is an "unconditional first mover", which was a questionable assumption before but has certainly been completely refuted since the present crisis.[1] This as well as an incorrect prediction about the scale of the negative externalities possible within the securities market are two flaws in an otherwise very accurate article which provideds' useful typologies for the pre-crisis era.[2] A comparable argument is outlined in the paper by Mark Beeson and Stephan Bell (2009) who describe something similar to Drezner's club but refer to it as "group hegemony"[3]. Interestingly the main point of their article is that purely structural power based around this incorporationist group hegemony is unable to explain the IFA and the G20, and that relational power between the actors is at times quite important. The duality of both the broader structural power in forming the IFA and the relational power play of the actors within the G20 is something which is a key basis of chapter two.

The other major focus within this power approach is on transnational networks. This literature deals with the issues of regulatory capture by private interests and the state as a non-unitary actor. This is an area of the literature which tends to have a definite element of normative judgment, with those against transnational networks decrying the lack of oversight and democratic participation, a noteworthy example being Andrew Bakers *"Deliberative equality and transgovernmental politics in the global financial architecture" (2009).* On the other hand there are those reports that commend this aspect of the IFA, such as the Meltzer report for the US congress, based on a claim of increased ability to produce regulatory reform.

That literature which focuses on regulatory content primarily addresses political economy concerns, it is divided into two broad sub-sections; analysis based on neo-classical economics and an embedded economics analysis, with the former traditionally predominating in mainstream studies. The first of these, the neo-classical economics, positions its self as the inquiry into economic *laws*; the universal principles of economics applying unambiguously to "homo economicus". A number of works have been done on the growth benefits of financial

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[1] For further explanation of why there is no hegemony in international finance see Braithwaite and Drahos (1999)

[2] For other authors who also take this state centric focus to financial regulation see; Busch (2002), Fischer, Globalisation and Its Challenges (2003), Jordan and Majnoni (2002), Moravcsik (1997), Morgan (2011), Persaud (2009), Reuters (2009), Rodrik (2009), Giovanoli (2009).

[3] Beeson and Bell (2009), 68.

liberalisation, a lot of the work has been done by the IMF. For more tentative support there is a section in Eichengreen's (2004) book titled: *"When does capital account liberalisation help more than it hurts?"* The implications from this literature require the reform of regulation in order to allow the markets to function properly.

There are two important aspects of this brand of the pre-crisis literature. Firstly, it was solely concerned with the need for reform in the developing world. This south orientation gave a very specific dynamic to this literature, with the focus being on the position of the IMF and its ability to act as a lender of last resorts while trying to mitigate the effects of moral hazard which such an institution might incur. The focus on the south led to numerous papers on the need for reform of institutional strength in dealing with financial crises and the legitimacy of the governance of those institutions; the IMF and World Bank.[4] The second aspect is that there was a prevalent underlying assumption that any reform must converge on western best practice as espoused by the standard-setting bodies such as the Basel Committee on Banking Supervision. The article by Cally Jordan and Giovanni Majnoni (2002) is a good representative of this pre-crisis strand of the literature. The over-reliance exhibited here; on the rigour of market discipline and internal regulation for major institutions was one of the most disastrous factors leading to the present crisis. The emphasis on market discipline in response to the perceived need for the south to engage in less state intervention has certainly been challenged by the present crisis as it has been the southern countries with large nationally owned foreign reserves and sovereign wealth funds which have weathered the crisis best. This branch of the literature has certainly had to re-evaluate some of its assumptions. An understanding that sequencing of trade and capital account liberalisation are important in providing a country-specific learning curve in order to deal with the variant institutional needs of states is now widely acknowledged. This has forced a moderate reconciliation between the neo-classical and embedded approaches although their policy directions are still significantly different.

The post crisis work by Barry Eichengreen serves as a good comparison with his earlier work; there is a stronger emphasis on the need for counter-cyclical market corrections, higher transparency of the financial tools being used by financial institutions and higher capital requirements for systemically important institutions.[5]All of these are in recognition of the failure of the markets to self regulate. These policy recommendations all implicitly require substantive IFA reform but while there are some low difficulty recommendations the overall implication of the need for a World Financial Organisation remains highly unrealistic, something which the embedded literature is quick to point out.

The embedded economy approach retains the mainstream principles of economics but focuses on the need for varieties of institutional set ups in order to best pursue these principles within localised conditions. The

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[4] Ahluwalia (2001), Davies and Green (2008), Meltzer (2002), Stiglitz, Freedom to choose? (2003), Jordan and Majnoni (2002)

[5] A look at the papers put out by the G20 also exemplified these broad economic principles G20, Macroprudential policy tools and frameworks (2011), G20, Report on global credit market distruptions (2008, October)

broader literature was pioneered by writers such as Peter Hall and Dani Rodrik. What is important to note is that this strand of economic analysis was most popular with developing countries and those criticising the IMF previous to the crisis. The failure of the IFA during the present crisis has forced mainstream economics to deal more openly with the arguments put forth by this strand of literature. The excellent work done by the Warwick commission on international financial reform, shows a more cognisant understanding of the power dynamics of both the pre and post crisis possibilities for reform. The trend in this report towards a greater emphasis on the state as a regulator has been echoed in the work of Eric Helleiner *"International financial reform after the crisis: The cost of failure"* (2011) and Dani Rodrik (2009).

Finally there is an approach to financial reform which places the emphasis on the learning potential of institutions and actors within them. While this is situated within the neoliberal insitutionalist understanding of the repeated game theory scenario, an explicit emphasis on learning potential is unsuited to a study of the IFA at the present. Generally, the policy recommendations in this literature highlight the need for increased participation and grater equity in standard-setting in order to create a more efficient environment for learning. While these are both noble recommendations they don't sufficiently deal with the here and now process of standard formation. This paper does rest on the general assumptions of the neoliberal framework the driving force being focused on is power and not learning potential. For more on this work the articles by Jeffery Chwieroth, Leonard Seabrooke or Ismail Erturk have provided some insightful post crisis understandings of the need for reform.

An overview of the economic literature provides the necessary background understanding to the various issues which come up within the IFA. Discerning if and how power relates to a specific issue within the IFA is dependent on this understanding.

1.6 Theoretical Framework

International coordination within the IFA operates through a variety of organisational forms and relational dynamics, which are all contextually specific. However some broad theoretical lenses are indispensable to the study of the IFA, particularly the neo-liberal institutionalist framework. The level of interdependence in international finance has developed to the extent that the international governance of this regime is an unavoidable political reality; as such international institutions are a determining factor for international coordination. The cost associated with the failure to internationally coordinate a response to the GFC heightens this relevance of international institutions. For reasons which will be explained in chapter two, power is also a determining feature of the structure of the institutional regime as well as in specific relational circumstances within the regime.

Further clarification of the relevant details of the international institutions requires a specific look at the scope given by the research question. The focus is the IFA during the time period of the GFC and based on this there are a number of characteristics of the institutional framework which can be generalised as follows. Firstly, the

IFA is best described as a regime in which the "principles, norms, rules and decision-making procedures" are drawn from different international organisations, rather than visa versa.[6] This is due to the issue specific nature of the organisations, which with their restricted mandates only have relevance within the overall structure of the regime. Secondly, the stage of institutionalisation within the IFA is quiet young in parts and the regime as a whole is still more soft law than hard law.[7] Thirdly, the operation of the organisations within the IFA resembles more closely the role of either a forum or an instrument, depending on the organisation and time period. The significance of the organisations as actors independent of their constituent members is ruled out. There are a number of reasons for this, namely;

1. Many of the organisations are still quite young and with very limited secretariats.

2. The explicit organisational hierarchy within the IFA leads to organisations at the highest levels which have the most restricted permanent structures.

3. The time period of the crises has reinforced the pre-eminence of the state as the key actor with the IFA.

The third determinant of the scope is the relative importance of the different indicators of economic power. There are two elements to the stated importance of power; firstly the work of Daniel Drezner provides sufficient reason for the bases of this claim, in that it highlights the club standards system within the IFA. The original premise about the importance of structural forms of power is then added to, through an understanding of the role of the GFC and the linkages to wider policy area's from macroprudential imperatives. This second development of power highlights the existence of specific relational instances where certain forms of power become the determining factor in the international negotiation process. Through the theoretical development of the relational importance of power the specific instances in which power is a concern become apparent, the result is that the scope of the paper encompasses the G20 and specific issues.

It is important to note that the process of international economic diplomacy is one which this paper recognizes to be determined by a number of dynamics. In chapter two the analytical spectrum of international economic diplomacy is covered and those instances where power is deemed the crucial determinant are selected. The purpose of this is not to argue that power is always and everywhere the most important factor in international relations, rather these circumstances are identified in order to allow this paper to fulfil the objective set out in the research question. That is, to attempt to determine the relative importance of indicators of economic power in international financial governance.

1.7 METHODOLOGY

The methodology of this thesis was developed as the most effective manner of addressing the research question, the result is that a combination of a quantitative statistical and a qualitative case study approach. The

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[6] Rittberger and Zangl (2006), 7.

[7] Giovanoli (2009), 80-84. Taylor and Arner (2009)

need for this combination is a result of the theoretical approach of this paper, namely the focus on both structural and relational power. Based on the characteristics of these different forms of power and the methodologies used to address them by established academic authors, two particular methods have been chosen; a statistical analysis and a critical case study analysis.[8]

To start with the statistical approach, it has been chosen as the most effective means of analysing the nature of structural power. In order to explain this, the dual conceptual dimensions of power formed by Barnett and Duvall are useful.[9] The first dimension is how power is expressed - through interaction or constitution. On one hand power can be expressed by the interaction of its possessor with another. In this instance power is similar to an attribute of the actor which he can use at his discretion. On the other end of the spectrum is the power of constitution whereby power is "irreducibly social".[10] Here power cannot be reduced to the attributes of an individual pre-given actor but is completely dependant on the social context. The second dimension of power used by Barnett and Duvall is the "specificity of social relations of power", whether they are direct or diffuse.[11] On one end of the spectrum are relations that are direct, where there are tangible interactions between the actors with a logically necessary cause and effect. On the other end are diffuse relations that are indirect or mediated through some social norm.

Using this taxonomy there are four forms of power, as illustrated below.

		Relational specificity	
		Direct	*Diffuse*
Power works through	Interactions of specific actors	Compulsory	Institutional
	Social relations of constitution	Structural	Productive

As the purpose of this paper is to address the relevance of indicators of power for specific actors, we are concerned only with direct relational power, both compulsory and structural.

To return to the particular research method best suited to each of these forms of power let use start with structural power. The social relations of constitution make it necessary to broaden the research area as any one instance where structural power seems to be benefiting one particular actor may be attributable to many causal factors. For this reason it is necessary to use a broad statistical analysis which will allow us to aggregate a wide range of indicators. It is envisioned that this will prove more useful in indentifying patterns within the

[8] Hague (2007)

[9] Barnett (2005)

[10] Barnett (2005)pg 41

[11] Barnett (2005) pg 47

structure of the IFA. The use of a statistical approach is also made possible by the availability of the data used for the indicators; this is something which is not true of compulsory/relational power within the IFA.[12]

One of the specific statistical tools used in Chapter Three requires explanation as it is an original method. The tool is the optimal average, which is the average of a group covering every consecutive top rank. As an example, let us take a scenario where we wish to understand how the membership of a particular institution, group A, is determined. Let us say that group A has ten members. Firstly we must establish the relevant study population from which this group is chosen - let us assume it is 200. Next we must establish the indicators for the particular factors which are likely to influence the membership, indicators 1, 2 and 3. Having done this we can create a ranking system of the entire population across all three indicators. In order to convert these ranks into workable numerical form we shall consider first place as having a value of 1 and second place as having a value of 2, and so on. Once this is done it is possible to find the average rank of group A in each of the three indicators. This information should provide us with the basis for making a comparison of the relevance of each of the factors in the constitution of group A's membership. Now say that we wish to compare these relationships at time X and time Y. Taking indicator 1 at time X, let us say that the average ranking of group A is 9 and at time Y this average has changed to7. In this comparison the use of simple averages are sufficient to draw out the pattern on increasing significance, however if we change the comparison to between group A at time X and group B at time Y a problem arises. Let us say that group B has a membership of 20. Even if group B holds every top rank in indicator 1 and group A only holds the ranks from 15th place to 5th , group B's average will be considerably larger as a result of its increased membership. What this does is blur the actual relevance of indicator 1 in each case. One way around this is to consider the optimal average. The optimal average for a group with 10 members is 5.5 and for a group with 20 it is 10.5. By comparing the actual averages of groups A and B against what their best possible average could have been, in other words, the optimal average, we get a figure which allows us to more clearly compare the changing relevance of indicator 1 between two groups of different size over different times.

It might be asked why not just use the raw figures for market size instead of using a world ranking, as is done in Chapter Three. By using a ranking system for the different indicators we can see the relevance of these indicators in the formation of these groups vis-a-vis the rest of the world. This is very useful when asking not only what factors are important but why some countries are chosen over others. What the ranking system does is provide a considerable amount of information which can then be used in tangent with the qualitative study in Chapter Four. The combination of using a ranking system and the optimal average condenses substantial analysis into an easily accessible numerical figure.

[12] The term relational power used in this paper refers to the instances where power works through the interactions of specific actors and the specific social relations through which it works are direct, the term used by Barnett and Duvall is compulsory power. The two terms, structural and relational, have been chosen based on their use in IFA literature rather than choosing terms from the literature directly concerned with power. I apologise for the lack of clarity.

The second method of research used is an archetypal case study approach, as the most suitable method for dealing with the characteristics of relational power. According to Hague and Harrop, an archetypal case study is one which deals with an instance of critical significance to the category to which it applies.[13] In our case we are exampling the G20, which is the undisputed leader within the IFA during the crisis. The advantage of this case study approach is that it allows us to study particular power interactions on which there is limited official data available. What a case study approach does is to prove a much more comprehensive analysis of the ambiguous data available. The intention is that the in-depth analysis will rule out errors to as great an extent as possible, but unfortunately this research method is still dependent on the researcher's discretion and as such is likely to contain errors.

The problem of researcher bias in the interpretation of the qualitative research is, however, alleviated by the volume of the resources analysed and the use of the statistical analysis, in tandem. Also the economic and theoretical premises laid out in chapter two provide a relatively narrow corridor of investigation and almost entirely pre-determine the negotiation issues. Thus both the interpretation and the choice of focus are prevented from succumbing to researcher bias.

This paper will combine the literature from academic, political and media sources with a comparative data analysis from institutions such as the IMF. This paper recognizes that all causal relationships are implied. They will be based on the literature, the correlation between the economic power and membership and policy outcomes. The data sources being used are from the IMF (primary), BIS and OECD.

1.8 LIMITATIONS

The need for analytical focus is something which this paper takes seriously but the unfortunate consequence of that is the necessary exclusion of some issues from the purview of the research. The focus on economic power ignores the forms of power that have a relational specificity that is more diffuse. The time frame of the research also raises questions about the applicability of any findings. As every crisis seems to exhibit considerable uniqueness a study of any one crisis will be of most use within a framework which considers the nature of other crisis.

The limitations concerning the available data are; firstly this paper is entirely dependent on the data collected by the major international institutions such as the IMF and the World Bank. The problem here is that the data made available to these institutions by states is not without defect. The accessibility of the IMF to some of the more sensitive economic data can be hindered by some states. The data limitations apply particularly to Saudi Arabia. There is also a problem in comparing government bond rate yields because of the difficulty in isolating the credit risk as opposed to inflation rate payment. This is a particular difficulty in chapter four in the section on membership, which requires a numerical comparison that this paper was unable to perform.

[13] Barnett (2005)

The connection between trade related negotiation and some of the financial negotiation issues dealt with by the G20 is the greatest limitation of this paper, as the ongoing negotiation process within the World Trade Organization (WTO) is something which is likely to impinge significantly on certain parts of the G20 agenda. However the WTO is beyond the capabilities of this paper to analyse in a way that is consistent with the qualitative research method used for specific agenda issues.

1.8 Chapter outline

In chapter two this paper shall explore the importance of club standards in the analysis of the IFA. This will depend on the work done by Daniel Drezner. Chapter two will also include a critique of Drezner's analysis subsequent to the crisis, followed by an identification of the relevant forms of power and the specific instances in which they are most likely to have effect. Chapter three consists of a complete collection of the data of the indicators of power. The patterns and groupings are highlighted and explained. Chapter four uses the theoretical focus from chapter two and the grouping from chapter three in order to address the research question. There are two particular avenues through which this is done: an examination of membership and of the political outcomes of the G20 process in those areas identified in chapter two. Chapter five provides the concluding remarks.

Chapter two: Club standards in the IFA

2.1 Introduction

This critique of club theory will explain the arguments as to why the IFA is constructed according to the desire of the main powers to maintain international regulatory coordination within a club setting. The most prominent articulation of this theory belongs to Daniel Drezner (2007), his work also represents the most up to date arguments without actually dealing with the GFC, and therefore it is Drezner's book that will be the subject of this critique. Subsequently what shall be demonstrated is that although Drezner's arguments accurately depicted the pre-crisis IFA, the GFC has changed a number of his premises. The result is that while regulation within the IFA is still defined by club standards, both the composition and nature of the club has changed.[14] Crucial to this change in the club is that the regulatory direction has also changed to include macroprudential regulation, something which has necessitated the expansion of the club as well as drawing regulation into far more controversial and nationally sensitive areas. Consequently consensus formation within the club is now defined by negotiating power to a much greater extent than it was before the crisis. The critique of Drezner's work draws attention to two forms of power within the IFA in particular; structural and relational power.[15] Once the theory has established the position of power this chapter concludes with an explanation of the selection of power indicators chosen as alternatives to market size; liquidity and the current account.

2.2 REGULATORY COORDINATION AND CLUB GOVERNANCE

An explanation of the evolution of the governance of the IFA starts with the evidence highlighting the growth of the global financial sector, which has already been given. This exponential growth serves as the background to arguments that this section of the paper makes. The initial international governance reaction to this growth was that international externalities from national financial crises were small and therefore no bargaining core existed for enhanced coordination.[16] The continued growth of global finance and the various financial crises of the 1990 have changed that.[17] Drezner explains how the crises of the 1990s served to spur on international financial coordination, basing this conclusion on the exponential rise in the number and breath of international standards, the creation of the FSF, the success of the club in having the standards accepted within the IMF and their success in enforcing compliance with the more reluctant states.[18] It is clear that the vast majority of the pre GFC financial standards stem from during or subsequent to the crises of the 1990s, this includes the 12 key financial codes and standards. The development of global governance is therefore relatively young and the

[14] This applies to the short run only, it is possible that some of the changes due to the crisis may be the beginning of a slow death for club governance within the IFA, but for now the club has held strong and acted quickly and effectively as a crisis manager. We are not sufficiently free from the crisis at the time of writing for us to be able to consider the new club in a time of normality.

[16] Drezner (2007) 131.

[17] A comprehensive assessment of these crises and their effect of pushing coordination, particularly those in south East Asia, is Andrew Walters (2008) book "Governing Finance: East Asia's adoption of international standards".

[18] The example given is the FATF which was particularly successful at enforcing anti money-laundering regulation on a number of states in the early 2000's.

forces at play are still being worked through. The ongoing nature of this development has lead to a number of completing explanations of the forces at play.

The requirement of international standards led to deeper international coordination during this period, but there are alternative explanations of what form this coordination took. The next three paragraphs highlight the key failings of the alternative explanations of this international coordination.

The arguments emphasising structural economic forces provide little insight in understanding this process. The race-to-the-bottom hypothesis fails to explain why over this period there was a sustained drive for higher standards in international forums. The capital dominance arguments claim that capital operates through transnational networks and those regulatory outcomes can be explained by the operations of these networks within international and regional organisations. Drezner points to the very diverse issues which have seen ratcheting up, and the organisations that are responsible. This diversity is also a difference in the development of the transnational networks, prior to the standard setting. He points to the difference between the transnational ties in banking regulation and the relatively un-networked ties in securities regulation as an example of how variable the degree of networking is across the whole policy area, all of which saw policy coordination.

On a critical note; while Drezner's arguments about transnational networks are valid, they are perhaps his weakest point and require further exploration. While networks cannot provide a systemic theory of the process of financial integration for the very reasons that Drezner mentioned, it still has a substantial amount of explanatory power within subsets of the IFA, particularly banking regulation. Andrew Baker (2009) drew on this in his paper on transgovernmental networks, and highlighted the level of discretion that some technocratic elites have within the IFA.[19] Drezner also fails to address the manifest capture of the domestic regulatory bodies in the principle financial centres as an example of the level of discretion in the hands of transgovernmental networks.[20] Of course domestic regulatory capture is not the same as international regulatory capture and domestic influences might not prevail in an international forum. While the IFA might not necessarily succumb to these domestic pressures they are still worth considering, especially when these pressures emanate from the core financial centres. Domestic regulatory capture is now certainly seen to have been the case in the EU and the US before the crisis.[21] The networks based in these countries and active within the IFA cannot be ruled out as un-influential during this period. The development of the GFC in 2007/8 has significantly altered this. While transgovernmental approaches did provide some useful analysis in the pre – crisis era the effect of the crisis has been to raise public scrutiny of regulatory bodies, both internationally and domestically. The high cost to governments and taxpayers of the crisis has provided a well of discontent aimed

[19] Baker (2009), 196.

[20] Regulatory capture is something which has received a lot of attention recently and was possibly below the radar when Drezner was writing, see Rogoff and Rienhart, This time is different: eight centries of financial folly (2009), Johnson (2009)

[21] Miller and Dinan (2009), 6-7.

at the financial sector. The democratically elected officials that may have previously been willing to allow significant discretion to the regulatory networks now find that they are compelled to take a much more proactive approach to domestic and international regulation. This has been particularly acute in the international domain and has radically shifted the direct control by states, re-enforcing their pre-eminence as the key analytical level within the IFA.[22]

Drezner's critique of the ideational approaches refutes the claim that shared causal beliefs have led to policy change within the IFA. He claims that the variation in "ideational consensus" is inconsistent with the actual pattern of policy. Expert consensus's existed across the entire range of issues including the role of the IMF, governmental structure and standards. Yet only standards that were in line with the G7/8 consensus saw policy activity.[23] In fact there is and has been a consensus that the failure to expand the role of the IMF and the governance structure of the IFA are two of the greatest blocks to securing international financial stability.[24]

The policy outcomes subsequent to the crisis of the 1990 are best explained as a case of club standards. The revisionist approach to neo-liberal institutionalism focuses on the level of the state as the key actor in international regime formation. The positions of each state are derived through a cost benefit analysis. The outcome of the cost benefit analysis is taken as the state preference and is put through a suitable game theory scenario depicting the relevant players. This is regime and issue specific.

Let us consider the national preferences for international financial regulation. For the developed nations there was a number of benefits from higher international regulatory standards, such as lower transaction costs on international capital flows, less cost associated with regulatory arbitrage and protection for their domestic population who invested internationally.[25] The cost of the bureaucratic capabilities required to implement more stringent international regulation was comparatively minor, although this does increase marginally for a federal state.[26]

The benefits for the developing world are not as certain. There is a general consensus that higher financial coordination and more open capital accounts lead to higher growth, in the long run. However this is not as clear cut as neo-classical economics predicts. There is considerable literature which highlights the lack of conclusive

[22] The spotlight on the G20 meetings was unprecedented as a publicity opportunity for leaders; it did not suffer from anything like the negative protests attached to the G7/8 meetings. The financial crisis has barely left the top policy objective position on any of the advanced economies domestic agenda's.

[23] This was also pointed out by Tony Porter when he talked about the form of change in IFA standard setting that took place around this period; "The strong and overt political guidance exercised by the G7 over the FSF was a marked change from the earlier heavily technical governance of the regime". Porter, The G7, the Financial Stability Forum, the G20 and the politics of international financial regulation (2000), 10.

[24] Eichengreen, From the Asian crisis to the global credit crisis: reforming the international financial architecture redux (2009), 18.

[25] Private investors lost approx $100 billion on Russia's 1998 default alone. Drezner (2007), 128.

[26] A federal state would face a higher cost in the form of political battles in order to enact top down reform of the regulatory system, whereas a unitary state would not. Drezner (2007), 126.

evidence to support this position.[27] Compared to these uncertain benefits the costs are substantial; higher capital volatility, the dominance of portfolio investment over FDI, the political elites loss of the ability to provide financial patronage to their supporters, and compared to GDP the costs of restructuring the bureaucratic framework and investing in human capital would be considerable.[28]

Using the analysis of state preferences outlined above and the opportunity for forum shopping for the developed nations, Drezner makes this prediction:

".... one would predict global governance in financial matters to follow a club standards model. Attempts to harmonize international financial regulation should originate in club based organisations dominated by the economic great powers – the United States and the European Union."[29]

After this prediction Drezner goes on to show how the structure of the IFA supports this prediction, particularly subsequent to the East Asian Crisis. In response to the crises of the 1990s the G7 finance ministers delegated Bundesbank president Hans Tietmeyer with the job of developing recommendations for new institutions to facilitate cooperation and coordination. The result was the FSF, designed to favour the interests of the G7 and to coordinate the activities of other clubs within the IFA such as the BIS, BCBS, OECD, FATF and CPSS as well as the activities of the universal membership organisations such as the IMF, World Bank, IAIS and IOSCO.[30] This also applied to two Private international standard setting bodies that are largely determined by transnational networks; IASB (accounting) and IFA (auditing). It was the FSF which pronounced the 12 key financial codes and standards that form the basis of IMF's Reports on the Observance of Standards and Codes (ROSC's), these quickly became the uncontested global standards.[31] These standards represented a considerable ratcheting up of most countries regulation to the level of the developed powers, something which was only possible because of the use of club forums in which to formulate them. In tandem with the successful formulation of standards there was also the successful enforcement of these standards. This took place along three tracks: firstly, the use of the IMF and World Bank by linking the standards to conditionality.[32] Secondly,

[27] Fischer, Globalisation and its challenges (2003), Stiglitz, Globalisation and its discontents (2002), Arteta, Wyplosz and Eichengreen (2004)

[28] Drezner (2007), 126-130.

[29] Drezner (2007), 130.

[30] The situation with IOSCO is slightly more complex than its membership of 115 would suggest. Almost all of the provisions of IOSCO come from the technical committee, which is in effect the steering committee. The membership of this is restricted to the economic powers within the club, see table 4.1 for a brake down of membership.

[31] Policy and review development department (2001), 3.

[32] The 12 standards now form the entirety of the IMF's ROSC's, regardless of the opposition this faced in the IMF. However they were not completely successful in attaching them to conditionality as they are not nominally compulsory, even if they are in effect. Drezner (2007), 140.

the use of club organisations to sanction uncooperative countries where necessary.[33] Thirdly, the use of market-led enforcement through public disclosure of compliance.[34] These events that took place support the revisionist approach and highlight the accuracy of a club standards model.

An important question remains: why was the IMF not chosen as the forum for developing international standards as a result of the 1990s crises? It had the facilities and some of the most prominent economists in the world. In addition, almost all of the academic literature perceived it as the logical place for developing international financial governance. From the G7 communiqués in the mid 1990s it is clear that they were reluctant to engage the IMF as the primary forum. Instead they endorsed the Bank of International Settlements (BIS) and its emanations and created the Financial Stability Forum (FSF), a "club for clubs".[35]In fact it was openly observed by some western officials that club based models of governance were much better suited to international finance than universal membership organisations like the IMF.[36] However there are reasons to suggest that the IMF is at least partially a club of the great powers. If this was the case then Drezner's revisionist approach would predict that it would remain the focal point for developing new standards. Firstly; what are the reasons for thinking of the IMF as a club? The club characteristics of the IMF are: that it allocates voting rights by economic size rather than equality. The developed powers retain permanent seats on the IMF executive board. The IMF managing director has always been a European. While these do indicate the existence of club dynamics within the IMF, Drezner points out the strong norm of consensus decision making within the executive board. The delegation of policymaking power to the interim committee (which does not have any formal voting rules).The size and professionalism of the IMF staff which like any substantial bureaucracy wields considerable independent power. The IMF is always in the limelight as in need of reform adding uncertainty and unwanted public attention. All of these factors contribute to why the IMF was not considered to be sufficiently club-like to be the correct forum to develop international standards by the G7.

A final note on Drezner's work is that in it there is an implicit understanding of power. Essentially it is the idea that there are relevant issues and institutions for any given form of power, that an increase in a form of power will affect first those issues to which it is most relevant. As an example; this logic would predict that an increase in the military power of a state would be likely to primarily manifest itself in issue areas connected to security. This paper would suggest that the extent of the connection of relevance is increased within a crisis situation. The urgency of a crisis makes certain issue areas paramount while at the same time affecting the balance of the

[33] By 2001 the FATF had successfully used the threat of sanctions to enforce compliance on; The Bahamas, Cayman Islands, Cook Islands, Dominica, Israel, Lebanon, Lietchinstein, Marshal Islands, Niue, Panama, Philippines, Russia, St Kitts and Nevis and St Vincent and Grenadines.

[34] Drezner (2007), 140.

[35] Drezner (2007), 132.

[36] Padoa-Schioppa and Saccomanni (1994), 265. Meltzer (2002), 108.

relevant forms of power.[37] This logic allows Drezner to approach the task of identifying manifestations of power which would otherwise be far too diffuse to accurately address. It remains true that even with the most focused and isolated sources of power that there will invariably be a spill over into the over-arching power position of a state, effecting all areas. However as it is reasonable to assume that relevance plays a part we can base conclusions on relevant observations, this allows us to gain inferences of importance, while ruling out the possibility of quantifying the relationship.

2.3 A CRITIQUE OF CLUB STANDARDS SUBSEQUENT TO THE GFC

As Drezner has shown, the pre-crisis IFA was determined by the G7, who worked though their various standard setting clubs towards their regulatory goals. However with the GFC the traditional avenues of regulation where subsumed by the realisation of the need for a more systemic approach to regulation. Macroprudential regulation came to the fore; to complement the pre-existing microprudential regulation. At the behest of the G20 the FSB has developed this definition of macroprudential regulation:

"*(i)Its objective: to limit systemic risk – the risk of widespread disruptions to the provision of financial services that have serious negative consequences for the economy at large.*

(ii) Its scope: the focus is on the financial system as a whole (including the interactions between the financial and real sectors) as opposed to individual components (that take the rest of the system as given).

(iii) Its instruments and associated governance: it uses primarily prudential tools calibrated to target the sources of systemic risk. Any non-prudential tools that are part of the framework need to clearly target systemic risk.'[38]

They expand upon this further;

''Macroprudential policy also interacts closely with other spheres of public policy because:

Other policies have an impact on systemic risk. For example, the stance of monetary policy can affect risk-taking incentives. Similarly, fiscal policy and public debt levels can be an important source of vulnerability for the financial sector.

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[37] This is a least true of the crisis situation we are concerned with, as GDP, liquidity and the current account balance are all directly affected by the crisis.

[38] FSB, IMF and BIS, Macroprudential Policy Tools and Frameworks (Oct 2011), 4.

Macroprudential policy interventions, in turn, have macroeconomic effects. For example, raising capital requirements in a credit boom may to some extent dampen aggregate demand and, hence, influence the macroeconomic policy environment.'[39]

It is these linkages from traditional prudential regulation to the much broader policy agenda that has caused the change in the governance of the IFA. Each state that is concerned with systemic risk is now forced to consider the effects of domestic actions, of all the other significant powers in a manner that deals with many more policy areas.

The effect this has had is that there are now issues which require international attention which are outside the remit of the traditional clubs of the IFA such as the BCBS.[40] A new club that could deal with these linkages was needed, one that had the power to enact the required change.[41] The relative strengths of the emerging powers in economic areas now seen as determinants of systemic risk, means that the change from the G8 to the G20 as the primary international forum within the IFA is perfectly logical.[42] The objections that Drezner raised to the G20 being seen as an influential club within the IFA have all been refuted during the crisis.

Drezner claimed that the G20 did not meet regularly enough. Before 2008 there was no G20 summits, since then there have been 6, two a year during the height of the crisis. The G8 remained at one a year throughout this period. There were 10 meetings of the G20 finance ministers from 1999 - 2007, from 2008- 2011 there have been 15. Secondly, Drezner pointed out that the G20 has no secretariat or working groups. While the dedicated staff for the G20 does remain small, since 2008 there have been a number of working groups established; Trade finance and Energy experts groups, Study group on commodities and the Sherpa's meetings have expanded to cover; employment, corruption, tourism, multilateral trade, development and food security. Thirdly, Drezner claimed the G20 was powerless over the FSF. This has patently changed as it was the G20 which brought about the change of the FSF to the FSB with its expanded membership.[43]

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[39] FSB, IMF and BIS, Macroprudential Policy Tools and Frameworks (Oct 2011), 5.

[40] In response to this broader policy scope, the G20 through the IMF and FSB has attempted to identify the avenues through which systemic risk is conveyed internationally. Capital flows from the core advanced economies act as their source of spill over, and real economy supply and demand issues are the main avenue of conveyance from emerging economies. Capital flows and trade flows having been identified as the avenues of spill over, have provided the target area for policy action aimed at addressing the international conveyance of systemic risk and the build-up of global imbalances. This focus on capital flows and trade flows shall be revisited in chapter 4. IMF, Capital flows (2011), IMF, Implications from the analysis of the systemic five July (2011)

[41]Important to the logic of a club organisation is that it will only expand its membership as much as is absolutely necessary. This is clearly manifested in this statement by the US treasury department in 2000 "expansion of membership in the BIS should be judicious and deliberate". US-treasury-Deparment (June 2000), 42.

[42] The economic areas referred to are primarily related to trade and national debt levels, tables 3.1 to 3.7 and figures 3.1 to 3.17 have the relevant data.

[43] Financial Stability Board (2009)

The cost-benefit scenario of the broader macroprudential reform agenda is different to that highlighted by Drezner and underlines the inclusion of conflicts of interest within the new club structure. The benefit of developing international coordination to prevent the destructive effects of capital flows for the emerging markets is something which has been apparent to them since the crises of the 1990s, but which is only now on the agenda.[44] The advanced economies however have been reluctant to accept these spill-overs because of the potential cost to their financial sectors with limited benefit, as their currencies and financial markets are strong enough to withstand financial turbulence originating internationally. However the cost benefit scenarios are reversed when it comes to the other side of the coin, trade imbalances. The benefits to the advanced economies long term growth prospects is something which drags them to the negotiation table as the compliance of the emerging markets is required as the only rational alternative to all out protectionism. Obviously reducing their current account surplus includes a considerable cost for the emerging markets, and so the negotiation table is set.

To see what this means for the political cleavage let us go back to Drezner's original proposition. For Drezner there was only one dimension to the cleavage; more or less regulation. The GFC changed financial regulation away from an exclusive focus on microprudential standards towards a more systemic approach, consequently changing the range of national jurisdictions required in their implementation. As a result the primary cleavage around more or less regulation remained central, in areas such as capital adequacy levels, liquidity ratios and OTC derivative central counterparty monitoring. But there where now new issues on the agenda, on which there was far less established mechanisms for intervention. Questions about the form of the "tool kit" required to effectively intervene to prevent systemic risk had far less solutions, and there remains considerable debate over the best form of these mechanisms.[45] Another factor complicated the possibility of finding an early consensus on the form of these intervention mechanisms; the fact that the issues covered touched closely on the development concerns of the emerging powers. Capital flows in particular are something which the emerging markets have been very vocal about since the crises of the 1990s, and trade is the key component of export driven development.[46] This is clearly seen in the degree to which development issues have been included in the G20 agenda, especially since the Seoul summit. The result is that the second dimension of the political cleavage about the form of the macroprudential tool kit is defined by a far more controversial negotiation process, one which contains a number of conflicts of interest. Drezner's cleavage of more or less regulation remains but has been alleviated by a number of factors: first, the repeated emphasis placed on the country specific circumstances determining the form of best practice standards. Secondly, the stress placed by

[44] The value that the emerging markets attach to protecting their economies from volatile capital flows is substantial. Clearly seen in the large buffers that the emerging markets had built up previous to the GFC (e.g. foreign currency reserves), these buffers do carry significant costs and are only the second best option after proper international coordination which includes the advanced economies.

[45] The FSB's reports to the G20 on the macroprudential tool kit invariably start with the declaration that they are still at an early stage and that there is definitely no one size fits all solution. FSB, IMF and BIS, Macroprudential Policy Tools and Frameworks (Oct 2011), 2. FSB, IMF and BIS, Macroprudential policy tools and frameworks (Feb 2011), 2.

[46] Lamberte (2000), 8.

the G20 on the need for a lagged time frame for the emerging markets implementation. Thirdly, the levels of human-capital development aid that have been made available to the emerging markets by the G20.[47]

Essentially what this means is that there has been a move away from the pure club dynamics of Drezner, which was the only political cleavage existing between those in the club (and their closely associated nations) and those outside the club. Now there is a second political cleavage which is far more multi-faceted and issue specific, and exists within the club. What the next section will show is that this has changed the forms of power which are determinants within the IFA. Relational power has now become an important factor in addition to Drezner's structural power approach. As was mentioned before, this may spell the beginning of the end of the club system, but for the time being at least the G20 does operate along the same club framework as the G8.

2.4 MEMBERSHIP AND NEGOTIATION POWER

This section shall identify the parts of the IFA which are defined by economic power by first establishing the two forms of power which are relevant. These shall be structural power and relational power. The second method of investigation that this section shall use will be based on the extensive framework outlined by Bayne and Woolcock (2011) for analysing a specific regimes economic diplomacy. This will entail the thorough examination of all the various dimensions outline by Bayne and Woolcock in order to narrow down the area of investigation to those where power is the determining feature.

What Drezner did was to portray how power defined the structure of the IFA. The membership of the club that controlled the creation and promulgation of regulatory standards was based on the economic power of each state. The GFC has expanded that membership, but the G20 still operates under the same club framework that the G7 did, for the time being at least. For this new club it is still economic power that holds the key explanatory potential. The GFC also brought a number of issues involving conflicting interests within the club, and this has added a second form of power to the structural power highlighted by Drezner. As a consequence Economic power is crucial in the two ways, structural and relational:

Defining the structure of the IFA (e.g. the club structure and the membership of the club)

And

Issue specific instances where conflicting interests require negotiating power in order to be resolved.

Macroprudential linkages to macroeconomic policy are the source of the conflicting interests within the G20. The two areas in which these linkages manifest themselves can be broadly described as capital flows and global imbalances. These issues have been dealt with by the G20, as the only international forum with a comprehensive enough mandate to deal with them. The result is that the G20 is not just the steering committee

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[47] FSB, IMF and BIS, Macroprudential Policy Tools and Frameworks (Oct 2011), 1-2. G20, Seoul development consensus for shared growth: Annexes (2010), 5-6.

for the club's within the IFA, but because of the crisis, the premier forum has become a club itself. It is in this club alone, that negotiations are expected to be defined by relational power.

Bayne and Woolcock's book "The new economic diplomacy" gives a comprehensive analytical framework for understanding international economic diplomacy. This framework aides' the examination of the relative importance placed on different theoretical approaches and different conceptions of power at different places and times within international economic diplomacy. This will help to isolate the areas where either structural or relational power takes precedence.

Bayne and Woolcock isolate three systemic factors that drive the international system. Firstly, relative economic power along the lines of realist theories. Secondly, the independent force of international regimes and organisations. Because we are dealing with the G20 which is a relatively new forum, particularly the summits, it does not have established habits, also the lack of organisational structure (secretariat, specific voting rules) rule out the importance of structural influence. In a more general sense the IFA regime does influence the system, but as Drezner has described at great length, the club structure is one which increases the importance of relative economic power. And finally, markets. The markets can often imposes themselves and resist restrictions to such an extent that they determine the trajectory of a system. As well as this, markets are sometimes portrayed as the most effective force for driving international economics. This adds normative arguments to the proposals to deregulate. As the GFC was a consequence of the markets failing to self regulate, the market forces and the arguments to deregulate have not been considered practically viable. The possibility of the markets finding the solutions to the crisis has not been relied on internationally.[48] Only economic power has remained crucially significant within the IFA.

In addition to this Bayne and Woolcock describe two domestic factors which do not take the state as a unitary actor. The first examines the interests and bargaining that cumulate domestically and are then channelled through the state, as their agent. Second, Bayne and Woolcock describe an interesting two level game, which sees the negotiator as sitting at two tables, one international and one domestic. Through issue linkage and bargaining the negotiator aims at the highest possible welfare (based mainly on a rationalist approach to international relations). Both of these domestic factors are mitigated by the international nature of the crisis. It is the systemic volatility of the global financial markets that has been the key concern of the G20. This requires a focus on the international spill overs of the crisis, which is what the broader linkages to macroprudential regulation are trying to capture. As such the driving force of this particular instance of international coordination has its origins outside the realm of domestic interests. The importance of domestic interests is increased in the area of specific trade negotiations, these are something which macroprudential linkages do touch on but unfortunately this paper is ill-equipped to deal with them.

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[48] The failure of Basel two and the need for better regulation is in its self a testament to the loss of power of the market in determining the international system.

A further dimension which Bayne and Woolcock depict also highlights the importance of state power. International negotiation is depicted as consisting of a number of phases in a long iterative process. These are; preparation, framing, agenda setting, negotiation, ratification and enforcement. While the iterative nature of the process does raise the connections between each embedded phase; within each there is still a relevant theory which grasps the determining dynamics of that phase. The ongoing process within the G20 is a combination of agenda setting and broad negotiation. By the admission of the authors the relevant theoretical approach here is power centric theories.

Finally Bayne and Woolcock add the dimension of multi-level governance. This ties in directly with the depiction of club standards within the IFA developed by Drezner, although they refer to it as plurilateralism. Bayne and Woolcock leave the interaction between the different levels unexplored, but their references to forum shopping underline the potential for what Drezner depicted.

In addition to these dimensions of diplomacy they add three tensions affecting diplomats. These tensions are drawn from the experience of a number of the contributing authors, who have practical experience within the field and further highlight the relevance of the negotiating power of states within the G20 and the issues being dealt with. The first tension is between economics and political ideals. The GFC has firmly pushed the ball out of the economic court and into the realm of political priorities. This is to say that the priorities within the G20, as a consequence of the crisis, are political rather than economic. This is a very delicate difference in this situation, it hinges on the perceived need for regulation and the complete failure of mainstream economics in providing solutions based on the previously exalted power of the free market to self regulate. What we have is a market failure and the need for political intervention, it is with these political imperatives that power becomes a determining factor. The second tension is between domestic and international pressures, in essence this can be described as interdependence or globalisation. This is the tension which is most at play within the G20 by the very nature of the crisis. What this tension does is increase the relevance of the state but according to Bayne and Woolcock it also decreases the uniformity of a particular government. State preferences are important but issue/department specific and can often be isolated from the other concerns of a government within international diplomacy. The third tension is between the state and non-state actors. This could be private interests such a corporations or social interests such as NGO's. Here again the crisis reinforced the pre-eminence of the state as the main crisis resolution institution. In fact the state is the only institutional level capable of dealing with the crisis. NGO's have mainly focused on debt relief in the European periphery countries, but even this has been very minor. The G20 has not experienced anything close to the degree of negative attention from NGO's as the G7/8 did. Private interests are certainly still relevant within the IFA but not as policy leaders on systemic issues. This is closely related to the earlier paragraph on transgovenmental networks and regulatory capture.

To summarise the conclusions that can be draw by using the framework of Bayne and Woolcock. Firstly the driving systemic force in the IFA is economic power. Secondly, within the G20 and during the period of the crisis that state can be taken as a unitary actor. Third, that the particular period and circumstances which this paper seeks to examine are determined by power concerns, within the overall iterative process. Fourth, Bayne and Woolcock's dimension examining the multiple levels of international governance supports Drezner's conclusion that there is a club structure. Finally an examination of the possible tensions that affect the negotiation stances of diplomats' shows that politically based state preferences will be of primary concern and issue specific.

Within the theoretical framework which has just been outlined the question remains whether the assumption that Drezner and the majority of academic's make about market size being the best indicator for relative power, holds true during a crisis. This thesis focuses on the GFC and the G20 but the question is relevant to all economic diplomacy. In circumstances within economic diplomacy which are defined by a realist conception of power what is the best indicator of that power? It has been speculated that in specific circumstances other economic variables hold independent explanatory power.[49] So the purpose of this paper is to first identify which parts of the IFA are primarily defined by economic power and then to assess whether other indicators provide a better measure of that power.

One final question remains: what are the alternative measurements of economic power to market size? The indicators chosen are liquidity and the current account. This is based around the role these two factors play in a crisis and their relation to each other. Fundamental to this connection is the difference between illiquidity and insolvency;

"A liquidity crisis occurs when a country that is both willing and able to service its debts over the long run finds itself temporarily unable to roll over its debts"

"Insolvency is when a country is perceived to be unwilling or unable to pay over the long run".[50]

The key difference here is long run growth prospects. Assessing long run growth is often very difficult, even the most advanced macroeconomic models leave a significant degree of uncertainty and as a result the financial sector is never certain if a country is facing a liquidity crisis or an insolvency crisis. The benefit of facing a liquidity crisis over an insolvency crisis is that with the right management a liquidity crisis should be manageable without undue harm to the national economy. Due to this, politicians will invariable try to persuade the world and the global financial system that they are facing a liquidity crisis in order to stave off the liquidity crisis if they are in one or in order to minimize the negative effects of the insolvency crisis.[51] The question then arises as to how they can re-establish confidence in their long run growth prospects.[52] The

[49] "The relative size of economies usually provides a measure of economic power, although sector and policy specific factors are important also" Bayne and Woolcock (2011), 18.

[50]Rogoff, The IMF strickes back (2003), 60.

[51] Referring primarily to speculative attacks and increased borrowing costs.

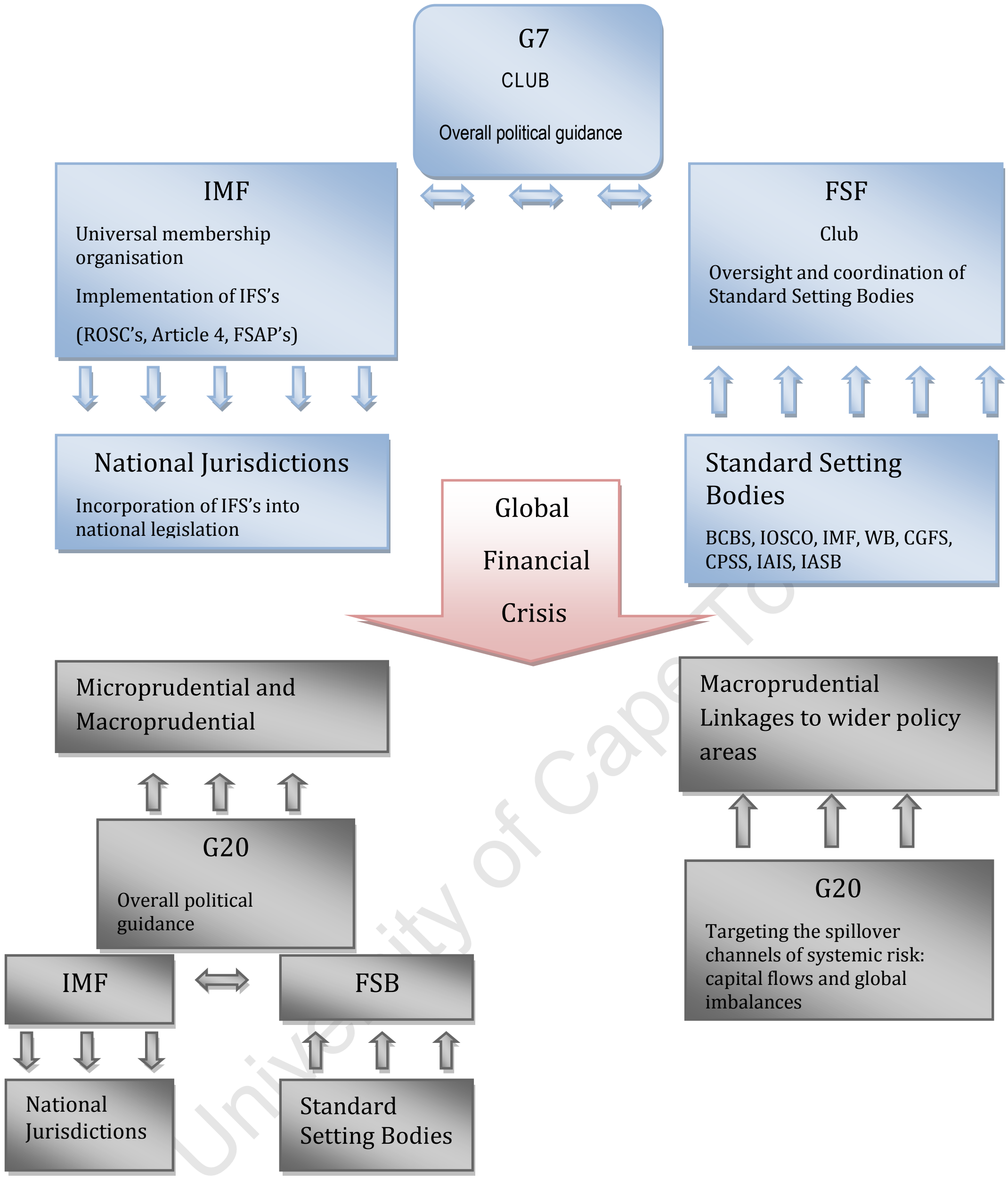
[52] The term confidence here is related to the economic term of rational expectations and means the distance that actual expectations are from the rational expectation: rational expectations + error.

answer to this question invariably includes increasing foreign exports, and this is especially true of countries which have a badly negative current account and have had so for a number of years.[53] The importance of the trade balance is increased by both the need for long run growth and the need for confidence. With this importance the stark gap between developing and developed world current accounts becomes apparent.

The structure of the IFA and the changes that have taken place because of the GFC are outlined in figure 2.1 below. This summarises the work done in this chapter and provides a useful visual aid in isolating the instances where economic power is crucial, in the structure of the IFA and within the G20 on specific issues.

[53] G20, Report on global credit market distruptions (2008), October, 27.

Figure 2.1: Club structure subsequent to the crisis



CHAPTER THREE: INDICATORS OF ECONOMIC POWER

3.1 INTRODUCTION

It is the objective of this chapter to establish the different groupings of states within the G20 based on their possession of the different indicators of economic power. What shall be shown is that the question of whether or not liquidity and the current account provide a better measure of economic power than markets size applies to two clearly identifiable groups. The emerging economies with the addition of Japan and Korea represent the alternative indicators; liquidity and the current account, whereas the advanced economies represent the traditional measurement of market size. While this is the general picture there are specific trends within this which are very relevant, particularly the growth trajectory of the BRIC countries.[54] This chapter provides the primary statistical data which isolates these groupings and allows the further analysis of economic power in chapter four.

3.2 MARKET SIZE

This section refers directly to table 3.1 in Annex 1: Market Size. It is clear that the advanced economies are by far the stronger in terms of market size, being almost double that of the emerging in 2006. That said we can see a growth trend in favour of the emerging economies. This demonstrates the important problem which we shall have to deal with when considering the outputs of power, to differentiate between the strong position that the emerging states have in liquidity and current account as opposed to their weak but strengthening position in market size. Ruling out the effect of the growth in market size will be a considerable difficulty but one which hopefully, shall be reduced when we go on to consider the size of the financial markets. We shall see that the emerging economies position in this area is not as strong and not improving at the same rate. This relies on the theoretical logic outlined as implicit in the practice of Drezner and others in isolating economic power as an independent form of power. That forms of power are likely to manifest themselves in those issues areas which are most relevant. In the case of the crisis the financial markets size is more relevant than the overall market size however this is more relevant for relational forms of power where the specific negotiation power of an official is directly influenced by the particular economic factor involved in the issue.[55]

3.2.1 FINANCIAL MARKET SIZE

This section refers to table 3.2 in Annex 1: Market Size. Unfortunately the data on financial market size from both the IMF and the BIS is broken down on a national scale only for the countries of significant market size. The result is that the emerging market economies get lumped in together. While this does confirm that the relevence of the emerging financial markets is negligible it does prevent us from establishing the pattern for the

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[54] Although the BRIC grouping has recently been expanded to include South Africa as well this paper refers only to the original four members, as many other publications still do.

[55] This can be seen in the inclusion of small countries like Switzerland, Netherlands and Singapore in some of the IFA institutions before the crisis.

emerging economies of interest. The EU and the USA alone account for 3/5ths of the world value in 2010. As was suggested above the difference between the advanced economies and the emerging is even more stark in the area of finance than of GDP. Given the data in tables 3.1-3.6 and the public communique's by the BIS, it is appropriate to assume that while the overall emerging markets group did suffer because of the crisis, that the BRIC countries where considerably less effected.This is the only assumption that can reliably be made about the aggregate data on the emerging economies. Even taking the possition that the main G20 emerging economies finacial sectors actually grew over this period the case is still one of an incredable discrepancy between advanced and emerging. Table 3.7 also shows that only France and Japan out of all the advanced countries, avoided negative growth between 2007 and 2008. While Japan has shown considerable liquidity, the story of France is one of delayed effects. The significance of the recession is also clear from this table, in the US between 2007 and 2008 4,603.9 billion dollars was lost, for the whole world it was 15,288 billion US dollars.

3.3 Liquidity

The concept of liquidity is not easily defined and less easily still, identified. The definition of official liquidity used by the BIS is "the funding that is unconditionally available to settle claims through monetary authorities". Barry Eichengreen gives an equally good summation of the concept: "the capacity [of the state] to issue and, more importantly, redeem safe assets that can be bought and sold at predictable prices".[56] There are certain pre-requisites to this definition of liquidity but as certain economic protocols become more and more firmly established (for instance the recognized need for steady inflation) these are fulfilled by the constrained hand of the sovereign. As a result of this the avenues open for a states short term financing becomes more specifically identifiable by economic modelling. Those emerging countries who do still retain a certain amount of wriggle room in other policy areas are fast heading towards the established position that the mechanisms for short term finance must be based on the state's economic capacity.[57] One further point needs highlighting; as was mentioned in chapter two, confidence is the crucial component of all of these factors and how they interrelate. A sovereign's liquidity is not like that of a firms in that it isn't quantifiable through numerical accounting alone, the accounting position is important, but how people from within and without view that can sometimes be the crucial factor. The indicators for liquidity are: the foreign currency reserves of the nation, the size of the national debt and the cost of borrowing on the international financial markets.[58]

[56] Eichengreen, Implications of the euro areas crisis for international monetary reform (2012)

[57] A good example of this is China which is far from being a model free market economy, the Chinese Government still retain a number of avenues of financing through their ownership of most of the domestic banking system. Yet still we see in the public announcements made in the last couple of years that China is well aware of the dangers of high inflation and is trying to combat it. Therefore it is very unlikely that they would start printing money to pay their debts and must, like the other countries, use other economic tools covered by this conception of liquidity.

[58] This third indicator is explicitly mentioned by the BIS and is widely considered the most appropriate and useful tool for maintaining liquidity during periods of financial stress. Committee on the Global Financial System (2011)

3.3.1 *FOREIGN CURRENCY RESERVES*

This section refers directly to table 3.3 to be found in Annex 2: liquidity.[59] In 2007 the average foreign currency reserves (FCR) of the advanced countries was 165,580.456 million dollars. However if we remove Japan and Korea then the figures are much more stark; 39,931.158 million. This is with an average GDP of 3,359,203 and 3,534,710 billion respectively. Compared with 138,929.888 million average FCR for the emerging countries who have an average GDP of 1,019,652 billion. The emerging nations are less than 1/3rd of the GDP of the advanced nations with FRC's that are 83% of the size of the advanced economies, but 3.5 times the amount of FCR of the advanced economies minus Korea and Japan. There are a number of countries that do stand out, Japan, Korea, China, Russia, India and Mexico. Russia and Mexico have enjoyed quite dramatic growth (indicating strong exports) and China, India, Korea and Japan have grown at a stable rate. Most countries reserves remained at the same nominal level but one or two did experience a slight drop namely France and Britain. While the need for international reserves to facilitate international financial exchanges is diminished for those countries whose currencies are internationally accepted currencies (i.e. the euro, dollar, yen and pound), this is a substantially more changeable that was thought before the crisis. The fall of the euro and even the dollar to some small extent and the rise of the renminbi shows that no currency is beyond doubt and raises the potential need for foreign reserves for all. Bearing this in mind the position of the emerging markets and the East Asian economies seem like the two strongest blocks, and as they overlap considerably it is clear that this indicator of liquidity isolates the advanced western economies of the G20 as the weakest participants.

3.3.2 *NATIONAL DEBT*

This section refers to table 3.4 in Annex 2: Liquidity. In order to maintain as balanced an analysis as possible one or two points must be kept in mind. Firstly it is generally considered that more advanced economies can handle larger debt. That said the very reason why numerous European countries and even the US faced downgrading by the ratings agencies was partly due to the realisation that this had been over played. Italy springs to the mind when thinking of this problem. In fact the original pre-crisis position that advanced countries could handle more debt relied more heavily on a sense of confidence than the economist who promoted it. Here again we see confidence in the economy being the crucial factor in deciding what are acceptable , in this case, levels of debt.

A second concern is that not every country's debt is composed in the same way; some countries have much greater domestic ownership of national debt. Issues apart from economic considerations become quite important here, the prime examples being social values. Japan is the best example of this; even though its national debt is monstrous we shall see later that its bond yields (borrowing costs) are quite low. This is generally attributed to the fact that Japanese citizens hold a very large amount of their government's debt at low prices. Only 6.9% of Japans national debt was held by non residents in 2010. There are three other

[59] The groupings of advanced and emerging economies are taken from the IMF WEO database and are consistent throughout this paper.

countries which exhibited the same feature; China (HK) 1.9 %, India 6.8% and Brazil 4.7%. This is compared with a G20 average of 30.4% and the USA of 22%.[60]

Table 3.4 shows a clear pattern attributable to the crisis, while the emerging economies show quite stable levels of debt through out, there is a considerable rise in the debt levels of the advanced economies from the beginning of the crisis to 2011/2012. The UK doubles its national debt, the USA's rises by 2/3rd's; in fact the only advanced country exempt from this rise is Korea. The overall position is clear; the emerging economies are in a much stronger position with regard to their national debt than the advanced. This is particularly true of the BRIC countries all of which have very low debt levels and of whom, China, India and Brazil all have strong domestic ownership of debt.

3.3.3 Cost of Borrowing

This indicator serves two purposes; firstly it provides us with information on the ability of the state to finance itself, as such the cost of borrowing is a crucial determinant of our understanding of liquidity. Secondly the cost of borrowing gives the most accurate reading of the confidence that markets have, and as such the likelihood that there liquidity will be put to the test. The specific indicator chosen for this is the yield rates on government ten year bonds. This is a commonly used indicator for assessing market sentiment of economies risk levels. Normally the yield rate is considered to represent predominantly the inflation risk but as we can see from table 3.5 on inflation which, the crisis has increased the relevance of credit risk in the overall yield value. In short the yield value gives a comprehensive picture of an important part of government borrowing. A note of caution is that countries have numerous economic tools at their disposal for financing themselves, government bonds are just a very prominent one. Here again the data suffers from some vacancies, Argentina is missing due to its recent default which negates the usefulness of any information on its bonds. Saudi Arabia is also missing for the same reasons as before. Information on Turkey was not available from the IMF but investigation of the Turkish treasury archives provided sufficient information.

Figures 3.1-3.17: Graphed yields on ten year government treasury bonds [61]

[60]This is non-resident holding of general government debt, 2010 (percent of total). Fiscal affairs department (2011)

Australia, Korea and Canada all show similar patterns representing high levels of confidence and an advantageous borrowing position. All three show reduced yields in 2009 when the crisis forced investors into what they deemed to be safer assets and all three yields began reducing as it became apparent that they were out of the recession 'woods' and inflation expectation stabilized. The expected inflation levels for all three suggest that their borrowing cost are very good and don't entail significant credit risks. The risk spreads for all three are within reasonable limits and also portray strong market confidence.

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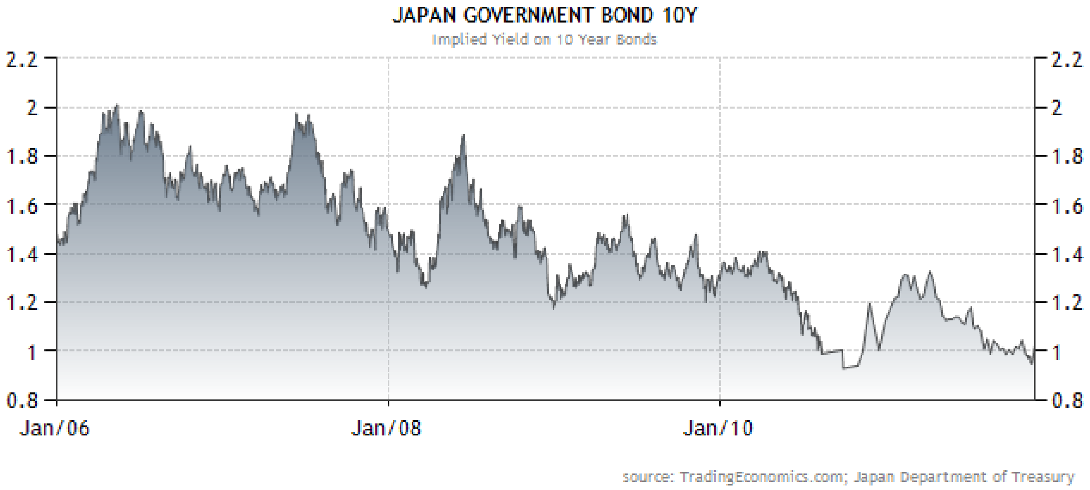
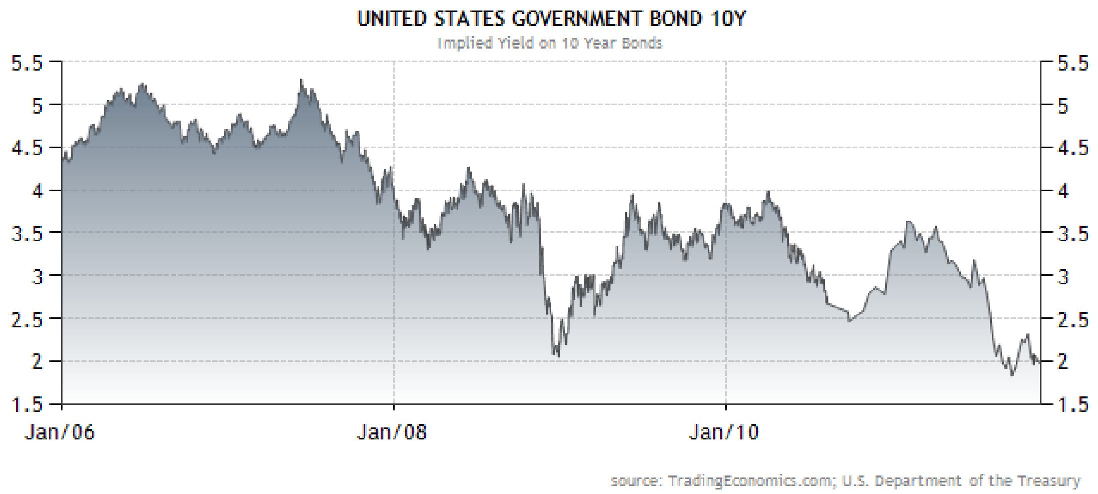
61 Data accessed 15th December 2011 from http://www.tradingeconomics.com/

The high points of the yield graphs in early 2008 show the lack of certainty due to the crisis. The period from 2010 to 2012 also highlights the effects of uncertainty on France and Germany's borrowing, this time as a consequence of the euro zone crisis. The trends also suggest a slight lack of market confidence, although the sources of this originate from outside these countries boarders. However overall these are strong borrowing rates making Germany and France's access to international liquidity quite cheap and reliable.

Not much needs to be said about Italy's position, as evident in 2011 have clearly demonstrated the lack of confidence that the financial markets had in Italy and the complementary rise in its yield rate is startling. It is particularly startling when Italy's low inflation levels are considered, this yield rate represents very low levels of confidence.



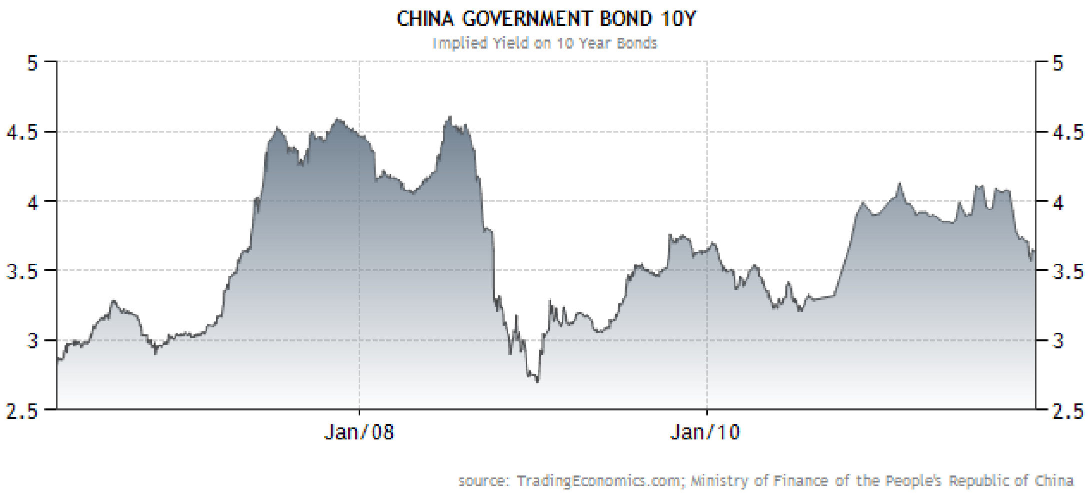
Even though Japan's inflation is regularly in the negative this is still a very strong borrowing rate, and links back to what was said earlier about the high levels of domestic ownership adding demand side factors such as national pride which affect the price.



Both the US and the UK show similar trends, in both cases representing good market confidence. The lower inflation rate for the US does suggest that even the holy grail of bonds, the ten year US Treasury bond, is not beyond the taints of credit risk.

The advanced economies as a group show very strong borrowing positions, with Australia, South Korea, Japan and the USA showing similar trends in their yields reactions to the events of the crisis. The euro zone countries show a grater lack of confidence than there advanced economy counter parts; this is particularly acute for Italy.

The spike in Brazil's bond yield in 2009 is clearly a response to the growing concerns and uncertainty of the GFC, however in general Brazil's yield rate is strong, shows little inclusion of credit risk and has stable and increasing confidence levels.



There are two elements to the Chinese government bonds. Firstly there does seem to be excessive volatility, indicating some confidence issues, although that said in 2009 the yield rate went down considerably much the same as the advanced economy safe haven bonds. Second, given the quite high inflation rate the bond yield shows a very strong borrowing position for the Chinese Government.[62]

The peak and trough of the yield rates around 2009 show both high levels of uncertainty and then a strong return of confidence, perhaps overshooting the mark given the later rise in yield rates. The earlier years of the crisis represent a good borrowing position but the fact that the yield is rising in 2011 when projections for inflation are dropping does suggest a deteriorating situation for India.

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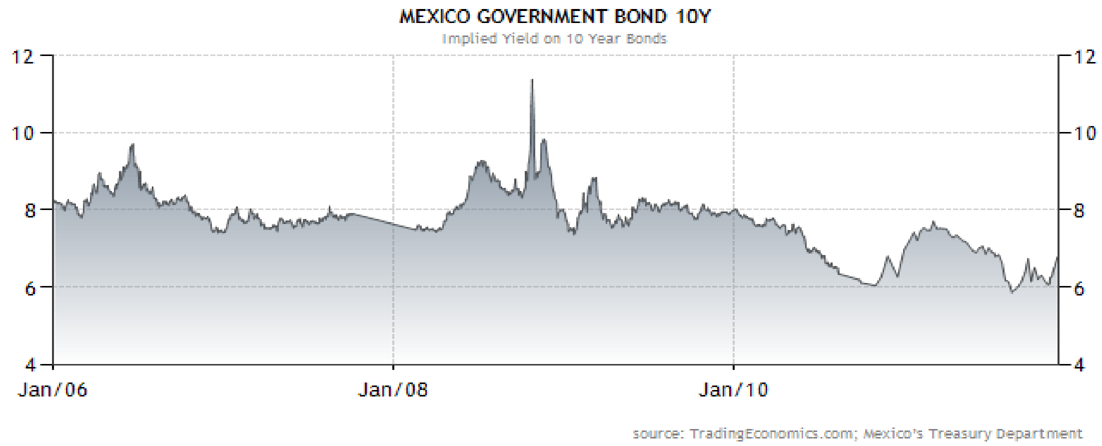
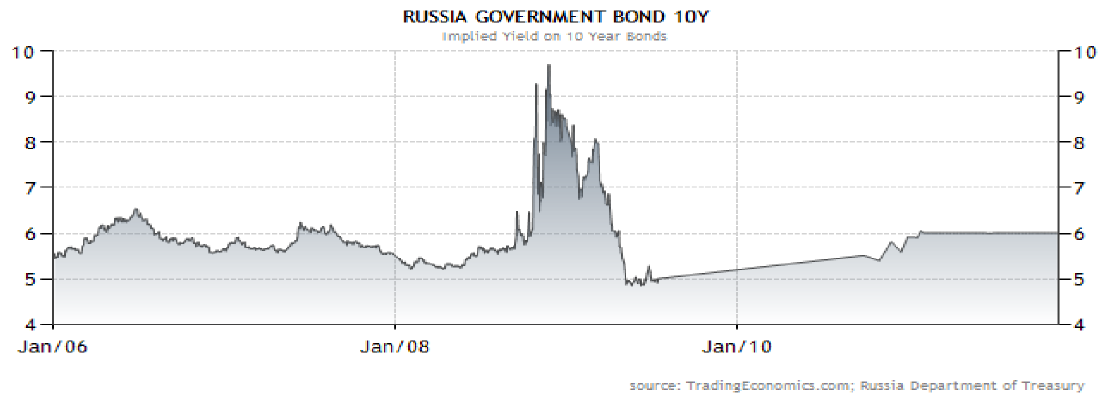
[62] This may change when and if the Chinese Private sector savings rate decreases, this rate has played a part in maintaining the low borrowing rates for China.

The spike of 12 percentage points, as a result of the crisis, sends a clear signal, markets do not expect Indonesia to do well in the bad times, even when the crisis is not of their making. The movement of the yield rate around the inflation rate is considerable, in the early years of the crisis (2006/7) the rate was far in excess of both current and expected inflation, however as the crisis has worn on this gap has narrowed, indicating a lower credit risk addition. In general this is quite a weak borrowing position.



Mexico exhibits a similar reaction to the crisis around 2009 as the majority of the other emerging markets, signalling a lack of confidence. While being reasonably steady and showing a consistent pattern this yield rate still remain substantially above inflation and as such represents quite a weak borrowing position.



Russian yield rates have the same reaction to the crisis but where Russia's position differs from that of Mexico is that Russia has a considerably higher inflation rate and as a result the consistent level of Russia's yield represents a very strong borrowing position.

South Africa position might be in part a consequence of its very erratic inflation rate. The dip of the rate around 2009 does indicate that it has the markets confidence in general, so whether it is the history of unpredictable inflation or credit risk which makes the later years of the rate so much higher than the merely covering the inflation risk alone is difficult to tell. Whatever the source of this differential the outcome is the same, a weak borrowing position.

Table 3.5: Yields on Turkish ten year treasury bonds[63]

	Average Yield on Turkish 10 year sovereign bonds (%)					
	2006	2007	2008	2009	2010	2011
Turkey	6.085	5.977[1]	6.3	7.6	4.727	1.870[2]

Source: Turkish Government Treasury.[64]

Here again is an emerging market that has a strongly negative reaction to the uncertainty of the GFC in 2009, but overall the very high inflation rate of Turkey means that this is actually a very strong borrowing rate and it increases in strength in later years.

The summary with regard to liquidity; in the first two indicators we can see a pattern in which the emerging economies on average are in a stronger position that the advanced. Within this there are two states which

[63] In 2007 Turkey did not actually issue any 10 year bonds, the figure here is the yield on the 9 year bonds it issued and as such is likely to represent a slightly lower yield compared to a 10 year. 2011 was the first time in two decades that turkey issued bonds in Japanese yen as opposed to dollar or euro sales.

[64] Turkish Dep of the Treasury (2011)

consistently buck the trend, Japan and Korea, so there is something of a South East Asian grouping separate to the emerging / advanced divide. Bond yields are more complicated; the advanced economies have been and remain in strong positions for international borrowing. That said the European countries do have some indicators of a significant lack of confidence or at least unresolved uncertainty, which is damaging their prospects. The position of the emerging economies is more varied; some show strong borrowing positions others weak. One dominant trend is the reaction to the epicentre of the crisis in 2009, the yields of most emerging markets demonstrated a lack of market confidence unrelated to their own domestic position but what appears to have been just a general flight of capital. Combining the three indicators leaves a clear pattern, that while the advanced economies are starting from a higher base level of liquidity given their low borrowing costs that this has been changing and continues to change in favour of the emerging markets some of whom not only have a favourable trend but also comparative strength against their advanced counterparts. The countries which showed the consistently strongest positions where: China, Brazil, Korea, and Russia and to a lesser degree, India. What is noticeable about this group is that four of these are the BRIC countries and none of them are from Western Europe or North America.

3.4 Current Account Balance

This section refers directly to table 3.7 in Annex 3: The Current Account. The dollar value has been included on the same table as the percentage value because even though the percentage gives a very good picture of the individual position this is an indicator which by its very nature is heavily interdependent and as such the overall size has an important effect. There is a similar pattern emerging here as in the section on liquidity. The emerging economies are in a much stronger position although that has decreased slightly as the crisis has worn on. This is not surprising as in economic terms the crisis acts as an automatic readjustment of imbalances. The adjustments in the current accounts of the debtor and creditor countries within the G20 are an important policy issue within those issues linked to a macroprudential concerns with systemic risk. What is clear from table 3.6 is that the policy positions of those within the G20 are clearly divided between advanced and emerging. For the main period of the crisis these imbalances don't seem to adjust to the levels that would be considered sustainable. Throughout 2010 and 2011 the IMF and many of the advanced economies within the G20 repeatedly brought this up as a top agenda priority and the dynamics around this conflict of interests is something that sheds a lot of light on the uses and successes' of power within the negotiation process. This is something which is dealt with in detail in the next chapter. The purpose of this section is to illustrate the different groupings along current account lines, which show a similar pattern to liquidity. The same countries stand out again on this table; China and Russia both show very strong positions and among the advanced; Japan, Germany and to a lesser extent Korea. The position of the US and the UK is once again remarkably weak for global leaders. Overall the emerging markets are in a dramatically better position than the advanced. In terms of sheer scale of deficit countries the US alone accounts for 800 billion dollars of the global deficit in 2007, this is not a cumulative sum this is the US's deficit amassed in 2007 alone. While many of the advanced economies and some of the emerging do have deficits with significance compared to their GDP, none compare with the US's in their implications for driving global imbalances. The opposing surpluses to this enormous deficit have a number of ring leaders; first is China with the single largest current account surplus and a key trading partner of the US. Germany and Japan also both run surpluses of roughly equal scale and in third place are the energy exporters; Russia and Saudi Arabia.

3.5 Chapter Summary

It is clear from the tables in this section that the position of the emerging markets is considerably better in terms of liquidity and current account than that of the advanced economies. It is also clear that the advanced economies still far outweigh the emerging with regards to market size. Finally it is also clear that the market size position of the emerging markets has gotten better. Putting these trends together leaves this paper with a clear picture: that as the original research question suggested, the relative position of the emerging economies is very much dependent on what indicators of power are considered. We can see from this chapter a variety of possible groups emerging in which the members share similar characteristics, be that in their current account or national debt. As we move on to the next chapter we shall be analysing the use of power, to assess whether there has been any change in the negotiating power within the G20. How the findings in chapter four correlate with the findings in this chapter will provide us some with tentative evidence as to the relative importance of the various indicators of power in a time of crisis.

CHAPTER FOUR: INTERNATIONAL FINANCIAL POWER IN THE G20: AN ANALYSIS

4.1 INTRODUCTION

Having distinguished the different groups of countries possessing the various sources of power in the previous chapter, this chapter shall investigate whether there has been any noticeable effect within the G20 which might correlate with the different groupings. There are two avenues of investigation: membership of the club and negotiating power within the club. Naturally these two have different implications for the paper; from the section on membership, structural power within the IFA should be identifiable. In the second section the individual issues will allow for a more specific and detailed analysis of the relational power within G20 negotiations. Most of the second section will deal with the most salient topic, global imbalances. This covers a number of issues specifically dealt with by the G20; exchange rate regimes (ERR), international safety nets and capital volatility. The other part of the second section shall look at some points on trade related commodity futures markets.

4.2 GOVERNANCE REFORM

Very quickly after the gravity of the crisis became apparent it also became clear that the pre-crisis IFA was not capable of warding off the looming threat of a second great depression. The G7 at the heart of the pre-crisis IFA, turned to an institution which had been born from the Asian crisis. In 2010 the Toronto Summit declaration began with this sentence;

"In *Toronto, we held our first Summit of the G-20 in its new capacity as the premier forum for our international economic cooperation.*"[65]

It is this change in the membership of the oversight club of the IFA that this section addresses, with the objective of determining the relative importance of liquidity and the current account vis a vis markets size. The first part of this section deals with the timing and character of these changes and their correlation to the groups outlined in chapter three. Given the club structure of the IFA the changes of governance reform penetrate out from the G20 as a direct result of the calls by the G20 leaders for reform of these other institutions.[66] Beside the change from the G7 to the G20 this section will also deal with the membership expansion of the; IMF, BCBS, FSB and IOSCO, as the principle standard setting bodies.

[65] G20, Toronto summit decloration 26-27th June (2010), 1.

[66] These organisations themselves cited the G20 call for reform as there impetus for expanding their membership and re-addressing their governance structure. Financial Stability Board (2009), 2. Basel Committee on Banking Suppervision (2009), 1. Strauss-Kahn (2008), 1. Interestingly the IOSCO reform of their Technical committee pre-dated the call from the G20 by two months, citing similar reasons for the expansion. IOSCO(2009), 1.

4.2.1 *FROM THE G7 TO THE G20: EXPANDING THE CLUB*

A brief explanation of the manner in which the data in this section is presented is required. There are a number of boxes throughout this section which represent comparisons between different club memberships and their relation to world rankings in the various indicators. The use of world rankings is so as to bring out the relative importance that each indicator may have had in explaining the changes. The interdependent nature of the rankings is the best method of capturing the overall significance of an indicator and the use of a comparison between the average and the optimal average is very useful in depicting the trend / direction of the change i.e. higher or lower significance. The optimal average represents the group of the same size as the actual group, whose membership correlates perfectly with the indicator being examined.

The first expansion of the G7 was to include Russia in 1997. This early expansion does not seem to correlate with any of the economic indicators, even the traditional explanation of market size. In 1997 Russia's share of global GDP based on purchasing power parity was only 2.662% as compared with China's 6.311% or India's 3.437%. And as Russia was about to go through a major financial crisis in 1998, in which it executed the largest default in history, we can safely surmise that it did not have a strong liquidity position and according to the IMF its current account was negative.[67] Even to Gordon Smith, a man with experience as the Canadian Sherpa to the G7/8 and a leading academic on the G20, the addition of Russia before other emerging economies seems "anomalous". He postulates political inclusion reasons being the deciding force.[68] This is best explained by the extraordinary circumstances of the end of the Cold War.

The next stage in the expansion of the club was the period around the development of the Heiligendamm process in 2007.[69] The countries included in this process, apart from the G8, were; China, Brazil, South Africa, Mexico and India. This serves as an excellent example of a non-crisis period, in which it is market size, the traditional explanation, which seems to correlate best with the results.[70] In a ranking of this groupings' GDP in 2007, China comes 2nd, India 4th, Russia 7th and Mexico 11th, all of them having established G7 members lower than them. This was generally agreed to be an adjustment of the club to accommodate the realities of the global economy based on market size.[71] This stage provides a good counter point from which to examine the difference in a crisis period. That the Heiligendamm process exemplifies a case where market size determined policy is not the same as to suggest that the G8 + 5 was the new club forum of governance for the IFA. China, India, Brazil and Mexico are all substantial global economies and in recognition of that they were brought into the Heiligendamm process. But the manner of this participation does bear mentioning. Firstly, previous to the

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[67] IMF, World Economic Outlook Database(2011)

[68] Smith (2011), 4.

[69] Even though this was only finally agreed in 2007, it cannot be considered as part of the crisis period as the Heiligendamm process was based on developments that stretched back the Gleneagles G8 summit in 2005.

[70] With the possible exception of South Africa who's place within the Heiligendamm process is probably accreditable to its international standing as a legitimate representative of LED countries.

[71] Smith (2011), 6.

crisis these countries participation was narrowly focused on four specific and relatively minor issue areas.[72] Secondly, according to Gordon Smith who was present, these invited guests did not say much.[73] There is a somewhat similar story for the inclusion of Russia, while it was a full member of the G8 it was still the G7 that remained the dominant club within international finance.[74] We could say that these countries had their foot in the door but they were by no means members of the club when it came to international finance. That came with the crisis and the move to the G20, which signified a considerable change from the pre-crisis situation.

Box 4.1: The Heiligendamm process

Heiligendamm process: the importance of GDP

Unit of measurement: Percentage of world GDP based on PPP, World Rankings

Source: IMF World Economic Outlook 2011 database

1) Average ranking of the group (Sum of rank values/number of countries)
2) Difference between average and optimal average (optimal average is the average of a group covering every consecutive top rank)

G7: (1st, 3rd, 5th, 7th, 8th ,10th ,14th)

1) 48/7 = 6.85
2) -2.85

G8: (1st, 3rd, 5th, 6th (Russia),7th ,8th ,10th ,14th)

1) 54/8 = 6.75
2) -2.25

G8 +5 (Heiligendamm process)((1st,2nd (China), 3rd,4th (India), 5th ,6th ,7th ,8th ,9th (Brazil),10th ,11th (Mexico), 14th, 25th (South Africa))

1) 105/ 13 = 8.07
2) -1.07

Without SA

1) 80/12 = 6.66
2) -0.16

[72] "Promoting and protecting innovation; enhancing freedom of investment by means of an open investment climate including strengthening the principles of corporate social responsibility; defining joint responsibilities for development focusing specifically on Africa; and joint access to know-how to improve energy efficiency and technology cooperation with the aim of contributing to reducing CO2 emissions." See Heiligendamm Process declaration at www.g8.de/Content/EN/Artikel/__g8-summit/2007-06-08-heiligendammprozess__en.html.

[73] Smith (2011), 7.

[74] The G7 finance ministers met three times a year to the G8's one, the G8 was primarily focused on foreign affairs ministerial meetings.

The last group requiring a brief explanation is the guest's. These can be divided in two; guest organisations and guest countries. With regard to guest organisations; there was initially a great deal of celebration about the regional outreach of the G20 in including organisations such as the AU and NEPAD. However this has not been maintained and the guests in the later summits consisted of the major organisations from the IFA and the outreach program has neglected the concerns of more regionally legitimate involvement. The International organisations will be considered as peripheral actors, not influencing the core power disputes. Spain and the Netherlands through the French presidency of the EU managed to get a seat at the first summit. Spain was the only one to hang on to this privilege and has attained the status of "permanent guest", the only one. What this means for the analysis is that while Spain was not a full participant of the change it shall be considered, but the figures will be given separately. To some extent Spain acts as a typical case study, because it has managed to become a member based entirely on present circumstances and not on other issues which may have been present in the late 1990s when the original G20 membership was formed. The implications of this are that Spain's inclusion represents a useful weathervane of the significance attached to the various indicators in 2008 and that its results are indicative of the overall pattern. Boxes 4.2 to 4.5 will go through the data for market size, liquidity and the current account.

Box 4.2: Market Size

GDP: Market Size

Unit of measurement: Percentage of world GDP based on PPP, World Rankings

Source: IMF World Economic Outlook 2011 database

1) Average ranking of the group (Sum of rank values/number of countries)
2) Difference between average and optimal average (optimal average is the average of a group covering every consecutive top rank)

G7 (1st, 3rd, 5th, 7th, 8th, 10th, 14th)

1) (G7) 48/7 = 6.85
2) (G7) -2.85

G20 (1st, 3rd, 5th, 6th (Russia), 7th, 8th, 10th, 14th)(2nd, 4th, 9th, 11th, 13th, 15th, 16th, 17th, 22nd, 23rd, 25th)

1) (G20): 211/19 = 11.1
2) (G20) -1.1

G20 with Spain (1st, 3rd, 5th, 6th (Russia), 7th, 8th, 10th, 14th)(2nd, 4th, 9th, 11th, 12th (Spain), 13th, 15th, 16th, 17th, 22nd, 23rd, 25th)

1) (G20): 223/20 = 11.15
2) (G20) -0.65

A comparison of the results for the difference between the optimal and actual average depicts a clear trend towards a group whose membership highly correlates with market size. The fact that Spain has been included in this expansion of the club even though it was not in the original G20 grouping is indicative of the importance that markets size played in determining the membership, as we can see that its inclusion substantially alters the correlation with GDP. There is, then a clear trend in which international financial matters have moved to a club which better represents the interests of countries determined by market size. Given the low values of the Difference from Optimal Average (DOA) it is almost certain that market size played a decisive role in who is in the club. A preferable unit of measurement would be based around the size of financial markets, unfortunately that data is not available. This provides strong support for the traditional use of market size as the measurement of economic power in financial governance; next this paper shall examine the alternative measurements.

Box 4.3: Liquidity (Gross national debt)

Liquidity

Unit of measurement: Gross national debt, percentage of GDP

Source: IMF World Economic Outlook 2011 database

1) Average ranking of the group (Sum of rank values/number of countries)
2) Difference between average and optimal average (optimal average is the average of a group covering every consecutive top rank)

G7 (110th, 135th, 138th, 140th, 142nd, 160th, 171st)

1) (G7) 996/7 = 142.28
2) (G7) -138.28

G20 (110th, 135th, 138th, 140th, 142nd, 160th, 171st) (18th, 21st, 31st, 57th, 64th, 75th, 90th, 98th, 119th, 132nd, 145th)

1) (G20) 1858/19 = 97.78
2) (G20) -87.78

G20 plus Spain (110th, 135th, 138th, 140th, 142nd, 160th, 171st) (18th, 21st, 31st, 57th, 64th, 75th, 90th, 91st (Spain), 98th, 119th, 132nd, 145th)

1) (G20)1949/20 = 97.45
2) (G20) -86.95

Box 4.4 Liquidity (foreign currency reserves)[75]

Unit of measurement: foreign currency reserves, as percentage of GDP based on PPP valued at 2001 US dollar.

Source: IMF World Economic Outlook 2011 database, International Reserves Template, own calculations.

1) Average ranking of the group (Sum of rank values/number of countries)
2) Difference between average and optimal average (optimal average is the average of a group covering every consecutive top rank)

G7 (4th, 49th, 53rd, 55th, 56th, 59th, 64th)

1) (G7) 340/7 = 48.57
2) (G7) -44.57

G20 (4th, 49th, 53rd, 55th, 56th, 59th, 64th) (9th, 17th, 29th, 35th, 36th, 38th, 42nd, 43rd, 46th, 47th, 52nd)

1) (G20) 734/18 = 40.77
2) (G20) -31.27

G20 plus Spain (4th, 49th, 53rd, 55th, 56th, 59th, 64th) (9th, 17th, 29th, 35th, 36th, 38th, 42nd, 43rd, 46th, 47th, 52nd, 60th)

1) (G20) 794/19 = 41.79
2) (G20) -31.79

The data on liquidity does show some promising trends. First on national debt; there is a noticeable difference between the G7 countries and the other members of the G20. Spain being near the median of the new members does not affect this trend towards less indebted countries. The low rankings do indicate that while the importance of debt levels (liquidity) may be increasing during the crisis, that it still does not have as significant a position as GDP. The trend in reserves is similar, although it starts from a much better ranking. Here again Spain is near the mean and does not change the finding significantly. A numerical comparison of the government bond yields is impossible but if we look at the section in chapter three we can see that this trend in government debt and currency reserves would most likely be reversed in the case of borrowing rates. However the strong performance of some of the new members would likely as not make this trend less steep than those in government debt and currency reserves.

[75] Saudi Arabia is missing, which is a pity because based on its current account it would probably rank quite highly.

Box 4.5: Current account

Current account

Unit of measurement: billions of US dollars.

Source: IMF World Economic Outlook 2011 database

1) Average ranking of the group (Sum of rank values/number of countries)
2) Difference between average and optimal average (optimal average is the average of a group covering every consecutive top rank)

G7 (2nd, 3rd, 177th, 179th, 181st, 183rd)

1) (G7) 758/7 = 108.2
2) (G7) -104.2

G20 (2nd, 3rd, (Russia) 33rd, 177th, 179th, 181st, 183rd) (1st, 4th, 31st, 37th, 57th, 169th, 170th, 172nd, 173rd, 176th, 178th)

1) (G20) 1931/19 = 101.63
2) (G20) -91.63

G20 with Spain (2nd, 3rd, (Russia) 33rd, 177th, 179th, 181st, 183rd) (1st, 4th, 31st, 37th, 57th, 169th, 170th, 172nd, 173rd, 176th, 178th, 182nd (Spain))

1) (G20) 2113/20 = 105.65
2) (G20) -95.15

Unit of measurement: percentage of GDP

G7 (34th, 41st, 58th, 65th, 67th, 74th, 83rd)

1) (G7) 422/7 = 60.28
2) (G7) -56.28

G20 (34th, 35th (Russia), 41st, 58th, 65th, 67th, 74th, 83rd) (8th, 23rd, 52nd, 56th, 59th, 63rd, 66th, 71st, 81st, 91st, 100th,)

1) (G20) 1127/19 = 59.31
2) (G20) -49.31

G20 with Spain (8th, 23rd, 52nd, 56th, 59th, 63rd, 66th, 71st, 81st, 91st, 100th, 119th (Spain) (34th, 35th (Russia), 41st, 58th, 65th, 67th, 74th, 83rd)

1) (G20)1246/20 = 62.3
2) (G20) -51.8

To take the first measurement of the current account, US dollars. It is clear from the very low overall rankings of all groups that this does not seem to be a significant determining factor. As to what direction it is going in as a result of the crisis the results are quite contradictory to the hypothesis. Looking at the DOA for the G7 and the G20, the situation does improve slightly in favour of the current account but if we consider the new members we can see that this improvement must be as a result of a small number of high ranks, and that as a group the new members don't show a strong relationship with a positive current account. The situation deteriorates when Spain is added. The high values for the average rankings mean that it is foolish to infer causal relationships based on such small changes in the values between the G7and the G20, with or without Spain. Using the unit of measurement as percentage of GDP shows a stronger version of the same pattern. The higher significance of the current account in percentage of GDP terms compared with gross values shows that the current account does have some moderate significance in the form which is most relevant to this paper. In chapter two the connection between liquidity and the current account was explained as being connected by confidence and long run growth prospects. In this case the more relevant measurement of the current account is compared to domestic GDP as this gives the states own position. However even if we use percentage of GDP the significance of the current account does not compare with that of GDP, and the inclusion of Spain still diminishes the gradient of any pattern of increasing significance.

Here is a short summary of this papers expectations (based on the hypothesis) and findings on membership;

- The expected outcome was that GDP would decrease in significance as an indicator of economic power during the time of crisis.
- The implied results of this section depict the importance of GDP. There is even a crisis trend towards an increased correlation between membership of the club (economic power) and GDP, this is not steep but given the already high ranking, it is significant. Spain's position further highlights the importance of GDP.
- The expected outcome for the current account was that it would increase in significance during the time of crisis.
- The implied results for the current account as an indicator of economic power don't show it to be useful. Low overall rankings indicating a low original significance, however there is a marginal trend towards a better correlation between the current account and economic power. Spain's position undermines the importance of the current account. Added to the rest of the results there seems to be no evidence that in this section that the current account provides a better indicator of economic power.
- The expected outcome for liquidity was that it would increase in significance during the time of crisis.
- The implied results do show a definite trend towards countries with stronger liquidity indicators. Although like the current account, liquidity is starting from a weak original position. Spain does not possess any strong outlier properties and thus its effect is negligible. While the trend towards grater liquidity in the process of expansion of the club does show some positive results for the hypothesis, compared with the strength of the correlation between GDP and membership, liquidity possesses week explanatory power.

4.2.2 MEMBERSHIP OF THE BCBS, FSB AND IOSCO

Table 4.1 shows the changes that have taken place in the membership of these three organisations during the early years of the GFC.

Table 4.1: Membership of; BCBS, FSB and IOSCO[76]

	Old members	New members	
BCBS	France ,Germany ,Italy, United Kingdom , Japan, Luxembourg, United States, Belgium, Netherlands, Spain ,Sweden ,Switzerland	March 2009	June2009
		Australia, Brazil, China, India, Mexico, Korea, Russia	Argentina, Hong Kong, Indonesia, Turkey, Singapore, South Africa, Saudi Arabia
FSB/FSF	Australia, France, Germany, Italy, United States, United Kingdom, Japan, Netherlands, Singapore, Hong Kong	Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Spain, South Korea, South Africa, Saudi Arabia, Turkey	
IOSCO	Australia, Japan, USA, Canada, UK, France ,Germany, Italy Netherlands, Switzerland, Spain, Hong Kong, Mexico	Brazil, China, India	

The participation of the old members who are not part of the G20 can be explained by their large financial market size. Luxembourg is something of a conundrum; it is an associate member of the G10 and was brought in on that platform. However, our primary concern is with the test period; the global crisis, so let us consider those changes. Broadly speaking we can see the changes reflect those that took place between the G7 and the G20. Russia's inclusion in the new members group but not for the IOSCO technical committee does support the early comments about its membership of the G8 being anomalous. The earlier inclusion of Spain is also supported by this table as it seems to have made its self an integral part of the G20. The glaring difference between this table and the section on the G20 is the more prominent role of some of the emerging economies. Brazil, China and India take the spotlight, but Russia, Mexico and Korea all show strong signs of a preferred position.[77] It is the inclusion of Korea in the earlier expansion of the BCBS that gives us our only indication of the significance of liquidity and the current account independent of market size, Korea being comparatively much stronger in those two sources of power. It still remains difficult to distinguish the significance of the various sources of power from this table alone, but the graph on the number of seats given to the various members of the FSB does provide some insight. This is a comparison between market size and the number of

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[76] This is based on the membership of the technical committee which has control over all of the core competencies covered by IOSCO (Multinational Disclosure and Accounting; Regulation of Secondary Markets; Regulation of Market Intermediaries; Enforcement and the Exchange of Information; Investment Management; Credit Rating Agencies).

[77] Australia was an old member of two of the organisations and seems to have been playing catch up in the BCBS.

seats in the FSB. Apart from the USA outlier this is as clear a correlation as you will find. It would seem that GDP is and remains an excellent measure of economic power, subsuming any independent importance of liquidity and the current account.

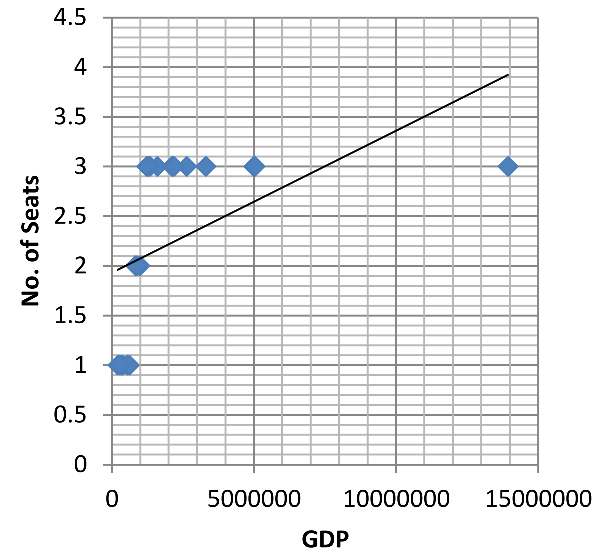

Figure 4.1: No. of Seats in the FSB

An analysis of the chairpersons of the different organisations re-affirms the importance of market size relative to liquidity and the current account and also clearly supports the earlier premise that financial markets size is a more important source of economic power in matters relating to financial markets than GDP. The case of Netherlands is the clearest evidence for this; it is clear that the Netherlands holds a very important position in the specific organisations related to international finance and yet it was unable to secure a permanent seat at the G20. It seems reasonable to speculate that the G20 in 2008 was an organisation that while having a substantial amount of financial matters on its agenda did however have a broader mandate, a mandate that better related to overall market size than just specific financial economic power.

Table 4.2: Chairpersons of BCBS, FSB and IOSCO

	Chairperson's
BCBS (GHOS)[1]	Mervin King (Governor of the Bank of England) 2011- Jean-Claude Trichet (Governor of the ECB) 2003- 2011
BCBS	Stefan Ingves, Governor of Sveriges Riksbank (Swedish) 1st july 2011- Mr Nout Wellink 1st (Governor of the Netherlands central bank) july 2006 - 2011
FSB/FSF	Mark Carney, Governor of the Bank of Canada (2011 -) Mario Draghi, Governor of the Banca d'Italia (2009 - 2011)
IOSCO	Mr. Masamichi Kono, (Japan) 2011- Hans Hoogervorst (Netherlands) 2010 - 2011 Kathleen Casey (USA) 2008 - 2009 Michel Prada (France) 2006- 2007

4.2.3 The IMF

The IMF remains a crucial and dominant organisation within the IFA, and one which has been openly and vehemently criticised by the emerging economies grouping within the G20, particularly the East Asian countries.[78] If there is a single target for this grouping's projects for reform it is likely to be here. There are three areas around which reform negotiations centre; voting weights, positions on the executive board and the appointment of the managing director.

Table 4.3: IMF voting shares

Country	Voting Shares pre- 2006 (% of total)	Voting Shares as of 2008 reform (% of total)	Voting Shares as of 2010 reform (% of total)	Change between 2006 and 2010
Advanced				
Australia	1.494	1.312	1.332	- .162 (+)
Canada	2.928	2.554	2.214	- .714 (+)
France	4.929	4.286	4.024	- .905
Germany	5.968	5.803	5.308	- .66
Italy	3.242	3.154	3.016	- .226
Japan	6.108	6.225	6.138	+ .03
Korea, Republic of	0.760	1.364	1.731	+ .971
United Kingdom	4.929	4.286	4.024	- .905
United States	17.023	16.727	16.479	- .544
Emerging				
Argentina	0.981	0.869	0.661	- .32
Brazil	1.402	1.714	2.218	+ .816
China P.R.: mainland	2.928	3.806	6.071	+ 3.143
India	1.916	2.337	2.629	+ .713
Indonesia	0.964	0.854	0.951	- .013 (+)
Mexico	1.196	1.467	1.796	+ .6
Russian Federation	2.734	2.386	2.587	- .147 (+)
Saudi Arabia	3.210	2.799	2.010	- 1.2 (+)
South Africa	0.867	0.770	0.634	- .233
Turkey	0.453	0.607	0.953	+ .3

Source: IMF finance department: Quota and voting share reforms

The expected change between 2006 and 2011 has been added in to that column when the sign of the actual values differs from the expected. The expectations are based on the data on liquidity and the current account from chapter three and if these two indicators became more important in the event of a crisis (the hypothesis). Voting shares correspond to a wide range of economic and political power balances but the change that has taken place as a result of the crisis is the perfect place to look for any correlations with specific sources of power. The changes that have taken place do follow quite closely the expectations based on liquidity and the current account, even the values of the change are in line with expectations. The major exceptions to this are;

[78] Kawai, Reform of the international financial architecture: An Asian perspective (2010), 207.

Russia, Saudi Arabia and Canada. Indonesia and Australia are off but not by a huge amount. Russia once again is a slight anomaly, the expectations for Saudi Arabia are not based on the same amount of data and so perhaps the flaw lies in the unavailable data and Canada may be explained by market size factors. Market size may again possess better explanatory power than liquidity and the current account.

Table 4.4 Change in GDP between 2006 and 2010[79]

Gross domestic product based on purchasing-power-parity (PPP) share of world total (%)	
Country	Change between 2006 and 2010
Advanced	
Australia	-.008
Canada	-.158
France	-.334
Germany	-.385
Italy	-.405
Japan	-.816
Korea, Republic of	.036
United Kingdom	-.399
United States	-2.206
Emerging	
Argentina	.104
Brazil	0.166
China P.R.: mainland	3.465
India	0.989
Indonesia	0.141
Mexico	0.184
Russian Federation	-0.079
Saudi Arabia	-0.012
South Africa	-0.012
Turkey	-0.038

Table 4.4 shows the change in GDP during the same period as the IMF voting reforms. Taken on the direction of the change alone market size has only two cases that don't fit the changes in the voting shares; Japan and Turkey. It is apparent that market size once again provides a better correlation than liquidity and the current account.

Previous to the 2010 reforms of the IMF, the US, UK, France, Japan and Germany all had permanent seats on the executive committee. Subsequent to these reforms this will no longer be the case, representing a definite victory in favour of the new members of the G20 and the emerging world in general. Is it possible to distinguish the relative significance of the various causes of this? No, it is impossible to say to what extent liquidity and the current account, market size, legitimacy claims or any variety of the global social recalculations that have taken place. This is particularly true of this issue, as it is an all or nothing change in a very prominent place.

There are two versions to the nomination of the IMF managing director debate; the official line which claims;

"*Today we build on our earlier commitment to open, transparent and merit-based selection processes for the heads and senior leadership of all the IFIs. We will strengthen the selection processes in the lead up to the Seoul Summit in the context of broader reform.*" [80]

The other version sees the appointment of Christine Lagarde in

[79] Data is taken from table 3.1

[80] G20, Toronto summit decloration 26-27th (June 2010), 6.

2011, after this statement by the G20, as a continuation of the tradition of a European being the managing director. Clearly if there had been any sincerity behind the official statement then they would have taken the first opportunity to legitimize the position of the IMF. In this regard at least, we can be almost certain that legitimacy issues were not at the centre of the reform. The fact that the 2010 reforms of the voting power will not come into effect until 2013 might hold the key to understanding why there hasn't yet been any significant change here, meaning that the voting power to enforce the desired change has not been implemented yet. This concludes the section on the membership of the club. This section link's back to the structural dimension of power indentified in chapter two. It's clear that with regard to structural power at least, market size retains the key explanatory power even during the time of crisis. The next section shall investigate the relational aspects of power playing out in specific negotiation issues within the G20 during the crisis.

4.3 NEGOTIATING POWER WITHIN THE CLUB

4.3.1 CAPITAL FLOWS AND GLOBAL IMBALANCES

This section will examine the policy positions surrounding; capital controls, exchange rate regimes and the new IMF lending facilities. It is these particular agenda issues which have proven the most controversial and show the highest degree of state v's state antagonism.[81]

Global imbalances is a term which covers a variety of issues which were at the root of the crisis. Global imbalances could consist of any economic interactions between states. Put another way global imbalances can occur in either the current account or the capital account. It is deemed to be imbalanced when these interactions are unsustainable, not at an equilibrium position. The use of the term global imbalances during the GFC primarily refers to the unsustainable current account deficits of the advanced economies and the various capital control measures of the emerging markets.[82] The theoretical essence of a free market is to find the equilibrium position, therefore *if* what we have under the WTO is as close as we currently can get to free trade then the solution does not lie with the current account but rather the distortions caused by the interventions in the capital account.[83] While this may be a narrow economic approach we can safely assume that it is still the mainstream position of the dominant form of neoclassical economics. So in order to understand global imbalances we have to start with capital flows and why these are, at times, curtailed.

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[81] The potentially relevant issues relating to capital flows and global imbalances that aren't being dealt with because they are not issues upon which power conflicts are likely to result are briefly explained here. Currency swap agreements and bond markets issues have both been uncontroversial, and shall not be dealt with in detail. The currency swap arrangements do remove a great deal of the threat of currency mismatch and hence the need for buffers, while the bond markets remain small and are unlikely to have any effect on policy making. Chin (2010) gives an explanation of the role currency swap arrangements played in protecting Korea during the GFC. Reserve currencies are also an issue which won't be dealt with, as reserve currencies are market determined. In recognition of the fact that they are market determined, the G20 statements on the subject have been remarkably bland and propose nothing new, focusing mainly on the possible role of the SDR. Truman (2011), 4.

[82] This is intended as a clarification of terminology, not an exhaustive explanation of the complex relationships at play during the crisis.

[83] This is obviously a big if, and is only there to aid explanation, the last section shall deal with trade issues.

Chronologically an explanation should start with the financial crises in the 1990s, where some developing countries with sound economic fundamentals experienced a dramatic reversal of capital flows. With their currencies not being international reserve currencies like the Euro and the Dollar they suffered a double mismatch; maturity mismatch in their domestic banking sector and a currency mismatch on their international borrowing. When the flows reversed their banking sectors could not withstand the shock independently, but the conditionality attached to assistance from the IMF was seen by many as only exacerbating their economic recessions.[84] As a result many developing nations resolved to build buffers to protect themselves from capital volatility and these came in the form of; foreign currency reserves, exchange rate controls, other capital controls, regional currency swap arrangements and deepening the market for currency and GDP indexed bonds regionally.

In response to the allegations that capital account restrictions by the emerging economies are preventing the re balancing of the global economy many academics and developing world policy makers have pointed the finger at push factors originating in advanced economies, particularly the US. Successive rounds of quantitative easing in the US have increased the risk appetite of private investors while low growth and low interest rates in the advanced economies has pushed the search for returns almost entirely into the emerging markets.[85] Unlike in the pre-crisis situation where the transitional economies of Eastern Europe received a sizable share of the capital outflows there are now less alternatives to the emerging and developing economies. The pressure that this puts on exchange rates and consequently, trade, is a very important part of the dispute on Exchange Rate Regimes (ERR). During all this it is important to remember that a number of the emerging market economies are currently in the upswing of their business cycle and that cooling down their economies is the important economic priority for them. It is on some of these issues that we have seen the key conflicts and negotiation struggles within the G20.

4.3.1.1 Capital controls

Capital controls can come in a wide variety of forms, some more successful at achieving their goals than others. There is not a set menu of alternatives, but some of the more commonly used include; quantity restrictions on inflows, interventions on the foreign exchange markets, maturity controls, additional reserve or liquidity requirements, controls on trading (geographic or original buyer) and specific taxes.[86] In essence capital controls are the opposite of having an open/liberalised capital account. There is a disagreement between economic schools of thought at the root of this debate. It revolves around the understanding of the business cycle. Some believe that the boom-bust cycle in all its destructive glory is an inherent part of the

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[84] Eichengreen, From the Asian crisis to the global credit crisis: reforming the international financial architecture redux (2009), 11. Walter, Governing Finance: East Asia's Adoption of International Standards (2008)

[85] In fact even the G20 has officially recognized the role of push factors from the monetary policy of reserve currency issuing nations, to what extent this was sincerely agreed upon and at whose instigation it was added we can but speculate. G20, G20 coherant conclusions for the management of capital flows drawing on country experiences (Nov 2011), 3.

[86] For an extensive analysis of this issue see Kawai and Lamberte, Managing capital flows: the search for a framwork (2010).

international financial system to a greater extent than a normal business cycle.[87] To put it another way, some believe the cyclical swings of the financial business cycle to be more extreme than those seen in other markets. Encouraged by the GFC, this is an idea which is begging to take root in the advanced economies and the dominant economic perspectives. As a consequence of this boom-bust cycle, the emphasis of both international and domestic policy makers is to enforce counter cyclical macro prudential regulation. This being one of the catch phrases of the G20 and the analysts during the GFC goes to show the degree of consensus that has recently emerged on this issue. However this does not count as some power based victory, rather it can be seen as a feather in the cap of those who turned out to be right, the emerging economy proponents. As an issue, it seems to revolve more around economic principles than a conflict of interest in a narrow power based sense.[88]

While it does seem that this issue does not clearly reflect power moves by those within the G20 it is worth a brief explanation, because it provides a better understanding of the other related issues and also because although it is difficult to distinguish there is a dimension of power implicit here. In order to redress the global imbalances at the root of the crisis it is perceived as necessary to reassure the economies vulnerable to capital flows that they do not need their buffers, and this could be done through appropriate regulation. In this way the regulation on capital controls and the move to ease concerns over financial volatility can be seen as part of an overall bargaining position. As well as this it must be remembered that any regulation that will increase the cost of capital is likely to receive stiff opposition for private interests within the main financial centres. This is something which was recognized by the head of the Asian development bank, Masahiro Kawai, when in early 2010 he noted that the counter cyclical measures put forward by José Antonio Ocampo to protect the emerging markets were unlikely to ever be agreed on within international financial governance because of the vested interests in the advanced economies.[89] In late 2010 early 2011 the BCBS put out Basel three, it had in it measures aimed at addressing each issue highlighted by Ocampo.[90] So moves have been made within the G20 which bear a significant cost for the financial centres in the advanced economies, but how much cost and how much benefit is accrued from them is dependent on the outcome of the broader negotiations and the reactions of the emerging economies.

One of the main areas of contention lies in the sequencing of liberalisation of the capital controls and other mechanisms used for building these buffers. Getting the correct sequencing is an idea which is generally agreed upon as the only effective rout to liberalising previously closed economies. But as with the debate about ERR many in the west are suspicious that the emerging economies will drag out the sequencing of events in order to

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[87] Kawai and Lamberte, Managing capital flows: the search for a framwork (2010), 387. Ocampo and Griffith-Jones June (2007), 1.

[88] This can be seen in the fact that all of the advanced economies have held this position at numerous different times throughout their history and then changed their position during the boom periods. This is something recognized by Kenneth Rogoff when he named his book "*This time will be different......*".Rogoff and Rienhart, This time is different: eight centuries of financial folly (2009)

[89] Ocampo publish a very impressive paper in 2003 and with Jones in 2007 outlining what he saw as the flaws in the IFA when it came to capital flows. Almost every single prediction he made came true not long after, his only mistake was to believe that some of the flaws he saw would only affect the developing world. Ocampo and Griffith-Jones (June 2007)

[90] See annex four for a summery table of Basel three.

gain competitive advantage. The relevance of this for the economic power variables cannot be discerned independently and must be considered within the wider picture of global imbalances. What can be said is that such a conclusive reversal in favour of the emerging markets and East Asian groups within the G20 suggests that if consensus on ERR and financial safety nets fails or goes in their favour, then it would seem that these groups are accumulating an impressive and growing list of benefits from the G20 process.

As for the difference between market size, liquidity and the current account if we look at those countries for whom capital controls are relevant, a similar grouping as before emerges.[91] Those countries for whom capital controls are relevant are; Argentina, Australia, Brazil, China, India, Indonesia, Korea, Mexico, South Africa and Turkey. Of those the only countries not engaging in capital controls are Australia, Mexico and South Africa. The difference between those who are and those who aren't does not seem to follow any identifiable pattern with our indicators. To speculate; those not engaging are the ones with closer ideological ties with the dominant economic consensus on capital account liberalisation. This would tie in with the general impression of this issue, a theory rather than power based dispute which given that the IMF and the G20 are now willing to officially accept the possibility of capital controls as a viable policy option in some cases, it would seem that the victory belongs to the ideas of the emerging markets in general and South East Asia in particular.[92]

4.3.1.2 Exchange rate regimes

In order to understand the other dividing lines in the debate over exchange rate regimes within the G20 it is necessary to consider two eventualities. First, EER's allow a country to manipulate its exchange rate and this could be used to competitively devaluate the currency to gain a trade advantage. Second, consider a primary purpose of ERR's, to protect countries from volatile capital flows, something which many in the developing world are susceptible to. This volatility is being increased by the domestic activities of some of the advance economies, primarily the USA.[93] As a result of these capital outflows, other nation's currencies are appreciating rapidly, adversely affecting their real economies, as well as fuelling the potential downside risks of their boom cycles. So the debate over EER's does not only depend on the actions of the emerging nations who have them but also on those who fuel capital volatility.

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[91] Relevant meaning those economies whose financial markets are small enough to be vulnerable to changes in flows, whose international borrowing is not denominated in their own currency and who are experiencing a capital inflow. For a list of those countries currently experiencing capital inflows see annex five.

[92] IMF, Recent experiances in managing capital flows - cross cutting themes and possible policy framwork (2011) G20, G20 coherant conclusions for the management of capital flows drawing on country experiences (Nov 2011), 1.

[93] In volume these programs have been enormous, far surpassing the additional resources being made available to the IMF and regional banks. The combined amount for the USA is just under three trillion dollars. Harding, et al. (2010)

Table 4.5 Exchange rate regimes		
INDEPENDENTLY FLOATING	*MANAGED FLOAT*	*CONVENTIONAL PEGGED*
Argentina, Australia, Brazil, Canada, France, Germany, India, Japan, Korea, Mexico, South Africa, United Kingdom, United States	China, Russia, Indonesia	Saudi Arabia

Table 4.5 shows the exchange rate regimes of the G20. An independently floating regime does not rule out state intervention, a number of these countries explicitly reserve the right to intervene if volatility is high, and all of them have intervened regardless of independently floating or not. Importantly both Korea and Japan have recently acted unilaterally and forcefully on the forex markets.[94]Also, almost all the other South East Asian countries not mentioned have either a pegged or managed EER, heightening the role of the region in this issue. there have also been a range of different currency control measures implemented by Brazil, Argentina and Indonesia. However in the EER debate these are all peripheral political battles compared to the conflict between China and the US

The USA is the primary representative of those who fear the use of competitive devaluation, fuelled by its concerns that its current account deficit is unsustainably high and that this will have grave implications for its economy.[95] Although the relationship between America's trade deficit and the exchange rates of its trade partners is not as certain as some might suggest, there has none the less been a great deal of political attention paid to this topic.[96] This issue provides us with an example of the inability of the G20 to settle a very pressing issue from 2007 until 2012. Some argue that the situation devolved into outright bilateral hostility, with congress passing a bill on the 6th of October 2011 to punish China for not allowing its currency to appreciate quicker against the dollar.[97] An analysis of the G20 summit documents demonstrates the slow progress on this issue. Almost exactly the same words are used from 2009 to 2010 and the space dedicated to it has been minimal.[98] The tone of the Cannes declaration was definitely far sterner, explicit and covering more of the details but this was not mirrored in the annex of the action plan. Each country went through their individual

[94] Beattie, Yen moves takes G20 by surprise (2011) Chin (2010), 7. The Japanese position is slightly different from the rest of south East Asia as it is an international reserves currency and its rapid appreciation which spurred the intervention is likely to have a lot to do with the euro crisis and outflows from there to safe havens.

[95] While the US is the main actor here, its position is the default position for all advanced and emerging countries that have a floating exchange rate and who have not intervened. It is also more likely to be the position of a country with a large current account deficit. The Euro area does have more pressing currency concerns at the moment; hence it's less prominent role.

[96] There was a report by the congressional research service in 2009 which found that there was no indication that the appreciation of the currencies of Americas trading partners would in fact decrease its current account deficit. Martin (2009), 1.

[97] This was later undermined by a US federal court ruling in December of 2011. It ruled that the application of two tariffs simultaneously was wrong. This could be overrun by congress passing another bill. If anything this domestic s dispute between the legislator and the judiciary highlights the strength of the political will on this issue. Beattie, US-China economic tiff simmers (2012)

[98] Shaw and Vassallo (2011), 1. A further brake down is in annex three.

commitments and the time frames they aimed at for completion; not one of the countries gave a specific time frame for action on their currencies, even though the majority of the other issues have very specific time frames.[99]

The recent move by the Peoples Bank of China (PBoC) to expand the floating band of the renminbi against the dollar by 1 %, adds some finishing context to this analysis. The question that this raises is if this is a victory for the US or is it just another controlled step in China's self imposed march to liberalising its currency? Other developments are unavoidable at this point, that China's growth prospects have been revised downwards in the latest world economic outlook may be significant. However this was small compared to the drop in the current account surplus, the actual figures for 2011 where 2.8% of GDP compared with the expectations in 2011 of 5.159%.[100] Still a more detailed examination of the reasons for the drop in the current account shows a more complicated picture. While China has weakened its surplus compared to GDP this must be placed in the correct context, where China's overall surplus will actually grow as a percentage of worlds GDP in 2013.[101] So China's overall growth makes the trend in its surplus seem starker than might necessarily be warranted. Also of the contributing factors to the diminishing surplus between 46.5% and 85% of this change is due to changes in terms of trade and investment patterns.[102] So while the figures for china do show some signs of weakening economic activity, due to the source of the contributing factors this is not something which would be likely to disturb the self contained policy space of the Chinese government. Since the time of reasonable mutual concessions and bargaining between the US and China is long past on this issue, there is only one possible avenue through which it might have been possible for the economic power of the deficit countries to have influenced the Chinese government's decision to expand the floating band. Diminished foreign demand also played a significant part in the reduction of the Chinese surplus, it is not beyond the realm of possibility that the use of camouflaged protectionist policies served as an avenue for punishing the Chinese for the failure to reach a international consensus acceptable to the advanced economies. However this is unlikely for a number of reasons. Firstly, China joined the WTO in 2001 giving it recourse to the WTO's settlement mechanisms. Secondly, during this recessionary period in the deficit countries (particularly Europe, a key trading partner of China's) it would be expected that demand would drop and as the significance of the influence of this drop on the Chinese surplus is not outside of these expectations the recession is sufficient to explain the influence on the Chinese surplus. It seems unlikely that this move by the PBoC stems from international pressure and it is worth remembering that this policy move has been vehemently demanded by the US since the beginning of the crisis six years ago.[103]

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[99] G20, Action plan: Annex A(2011), 5.

[100] Ahuja, et al. (2012), 5.

[101] This is a rise from 0.2% of global GDP in 2012 to 0.6 over the medium term. Ahuja, et al. (2012), 20.
[102] Ahuja, et al.(2012), 11.

[103] Other analysis's have come to the same conclusion, that this move is more to do with China's own objectives than foreign pressure lex (2012). This is also supported by the continuing importance placed on countries with high current

The resemblance of the groupings on either side of this debate to the divide depicted in chapter three between those possessing liquidity and strong current accounts and those favouring market size, should not be surprising as there are close links between liquidity and the ability to intervene in the forex markets and the current account has links to the benefits to intervention. This connection between the group correlating with liquidity and the current account and the position of these countries in the EER debate fits in to what has been laid out in the above four paragraphs. To summarise; there is a conflict of interest within the G20 over the EER and this was not quickly resolved to the satisfaction of the advanced economies, this was because of their inability to move the key emerging markets from their original position. What is crucial here is that the economic power that allowed this negotiation position of the emerging markets does not necessarily correlate better with liquidity and the current account than market size, rather the strength of these countries in these two factors gave them a strong starting position in the negotiation process. **This means that while liquidity and the current account do not necessarily provide a better measure of economic negotiating power, they can in specific instances (particularly crucial during a crisis) provide a strong starting position, putting the onus on the other states to move them from their status quo.**

4.3.1.3 IMF LENDING FACILITIES

There have been two new lending facilities provided by the IMF at the request of the G20; the Flexible Credit Line (FCL) and the High Access Precautionary Arrangements (HAPA). It is the FCL that is of interest as it comes the closest to lender of last resorts where as the HAPA does not differ that substantially from its predecessors in the IMF. The FCL is novel in that it has ex-post conditionality and considerably increased resources.[104] From an "impartial" economics point of view the situation is unclear, with academics both celebrating and decrying the new facilities.[105] The economic logic behind the need for a lender of last resort is important as, if it is convincing enough it might serve as neutral area for consensus within the G20, thus largely removing power from the equation. However it is argued here that the FCL represents an attempt by the USA and the advanced economies to entice the emerging markets away from their requirement of high buffers against capital volatility. There are a number of reasons for this; firstly, those who talk positively of the FCL don't see it as a lender of last resorts but a stepping stone on the road to one. It is far too moderate a facility to have been based on economic reasoning alone and necessarily implies political reluctance to go the whole way from those with the greatest "say so" power within the IMF. Secondly, the reason why it is an attempt by the US is because even though Mexico, Poland and Columbia have all negotiated arrangements under it, the majority of other emerging markets who could have availed of it and required it, did not avail and in some cases openly refuted any implication that they would; this suggests that the emerging markets do not view the FCL as an acceptable

account surpluses making their exchange rates more flexible, by institutions such as the IMF. IMF, Consolidated multilateral spillover report (April 2012), 2.

104 In 2009 the G20 promised to triple the IMF resources to 750 billion dollars with the possibility of a further increases left open. G20, Plan for reform and recovery (April 2009), 1.

105 Decrying: Eichengreen, From the Asian crisis to the global credit crisis: reforming the international financial architecture redux (2009) and Truman (2011) , Celebrating: Knedlik and Jari (2011).

option.[106] What does this imply for the differences on global imbalances? If America and the other dominant shareholders within the IMF are willing to accept an increased burden in the form of the FCL then obviously they are aware of the importance of correcting the imbalances but also it means that the stick is insufficient to move the emerging economies and that a substantial carrot is required.[107] That the emerging economies have not responded in the desired fashion indicates that they were confident of their position and were reluctant to change it for what was on the table. What this means is that the emphasis is shifted back onto the ERR and reform of voting shares of the IMF and whether or not the emerging markets will "play ball".

To tie together these points on global imbalances and capital flows, there does seem to be a discernible divide within the G20. This divide seems to largely correlate with the differences found earlier. As to which side is gaining the greatest advantages from the multilateral process; liquidity and the current account play a crucial role. It is strong positions in these sources of power which have given their possessors the advantageous position at the begging of the crisis. Those countries which have a current account surplus and the liquidity to support it, do not need to change anything, the status quo is stable for them; however those with deficits urgently need to change the status quo. That puts the onus on the advanced economies. It would appear that the advanced economies have made a number of considerable concessions, probably based on a number of reasons but the relevance of their overall negotiation position (apropos global imbalances) could not have been far from their mind. That America in particular felt for a long time that China's progress on its exchange rate was too slow indicates that those for who the concessions where made were capable of holding out for more. The advanced economies use of carrot and stick has been insufficient to change the status quo to their preferred position.[108] Liquidity and the current account played a crucial role in establishing the original position of advantage but it would appear that once again it is market size that has done all the heavy lifting in the negotiations. This is evident because, the two leaders when it comes to the ERR are definitely China and Japan. China leading the main body of those traditionally averse to liberalisation and Japan leading those who would be within the mainstream of neo-classical liberalisation economics but who have modified their position based on expediency. The dominant markets size of these two economies within their region means that even if the other countries in the region wished to liberalise faster they would not be able to, as they would quickly become uncompetitive. Furthermore among those who use capital controls the leader seems to be Brazil, another major economy. Brazil has been the most innovative and vocal proponent with its new financial transaction tax exclusively on foreign inflows. So while the concessions that have been made are to the benefit of the emerging economies, a grouping which on the whole is stronger in liquidity and current account than in market size, the main contenders within the negotiations are still determined by market size.

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[106] Knedlik and Jari (2011), 232.

[107] The burden is due to the increased exposure of the lenders to the possibility of moral hazard on the part of the borrowers, something which the US has been very vocal on. The emphasis is also on the US because EU countries will be swayed towards greater FCL capabilities due to the possibility of their need of it. Although this position of Europe can't be overstated as it is very unlikely that any of those EU countries requiring it, can meet the conditionality of strong economic fundamentals. Truman (2011), 3.

[108] That said the USA has only recently been doing some military posturing in South East Asia so there is still the possibility that they may move these issues out of the realm of purely economic power. Dyer (2012).

4.3.2 TRADE AND COMMODITY FUTURES

One of the most pressing limitations of this paper is the close links between international trade and monetary policies. It is a distinct possibility that a measure that falls within the scope of financial regulation and the G20 may have "policy substitutes" in the area of trade and the WTO, and visa-versa. One hopeful sign is that in general it seems financial related interventions are more likely to be the substitute for trade policies and not the other way around.[109] The paper by Copelovitch and Pevehouse (2010) finds that manipulated ERR's are significantly more likely where preferential trade agreements have been negotiated.[110] Copelovitch and Pevehouse draw links between these findings and the ongoing controversy surrounding the Chinese exchange rate. While this does help place the emphasis back within the scope of the paper, there are two trade issues which were specifically dealt with in detail by the G20; agriculture and energy. Even with the wish to analyse all negotiation issues which are influenced by power, this paper is unable to cover those related to trade. Both agriculture and energy market liberalisation arguments are tied in with the wider arguments of trade liberalisation at the WTO, when and which instances are defined by power involves more linkages and more actors than covered by this paper, any comments made could only be speculation. What can be said is that based on the characteristics of the issues, the policy cleavages do not form the same groupings as we have seen throughout the study on financial issues.[111]

Where the issue of agriculture and other commodity trade does link to a relevant G20 issue is in Commodity Price Volatility (CPV), particularly the role of financial markets in effecting CPV. The role of commodity futures markets and their connection to the real price of commodities is something on which there has been and is wide debate on.[112] What makes the debate so central is that for emerging market economies CPV can be very destructive.[113] However implementation of regulation has been at the discretion of the advanced economies as the domestic controller's of the majority of commodity futures markets. With the crisis, the volatility and volume of the commodities markets has significantly increased.

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[109] For an extensive analysis of the open economy relationship between goods trade and capital flows see Jiandong Ju, Kang Shi and Shang-Jin Wei's "Are trade liberalizations the sources of global imbalances?" (2011)

[110] Copelovitch and Pevehouse (2010), 1.

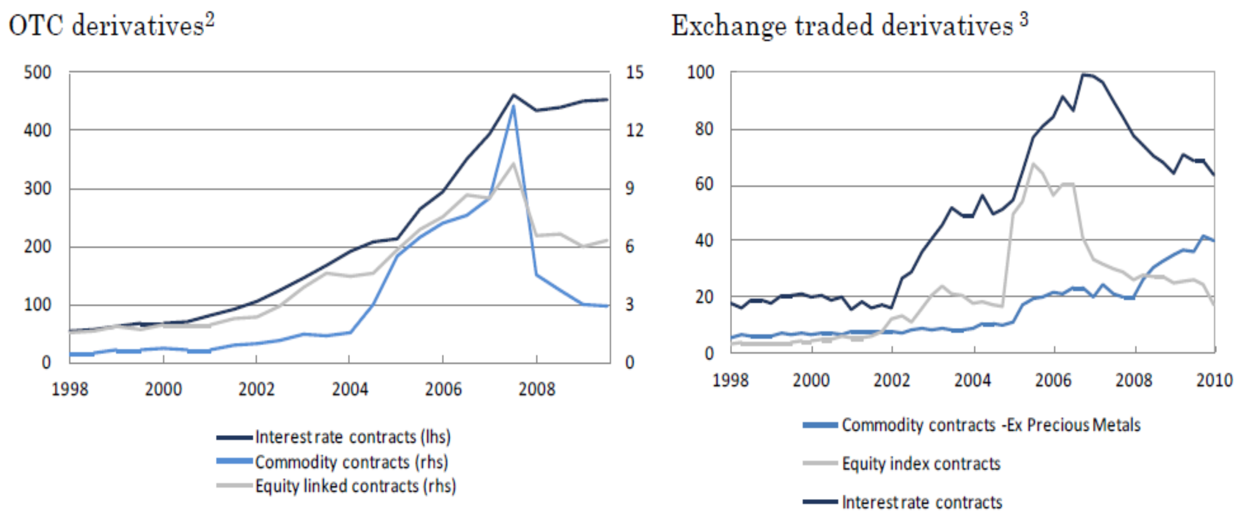
[111] Argentina, Canada, Germany, India, Indonesia, Italy, Korea, Mexico, Russia, Spain, Turkey and the United States are the 12 G20 countries which have made commitments to reduce energy related tariffs and subsidies. China did not commit and the other countries have no barriers to trade Energy experts group (2012) and it was claimed by Javier Blas that China, Brazil and the US are negotiation bedfellows when it came to watering down provisions by the G20 against bio fuel. Blas (2011).

[112] The G20 paper on commodity price volatility gives and extensive literature revive on the subject. The paper tentatively agrees with the existence of linkages between the markets and as a result the potential for prices not to based on economic fundamentals. G20 Study Group on Commodities (2011), 29.

[113] The reason's for this are many, see Kawamoto, et al. (2011).

Figure 4.2 commodities linked derivatives

Indicators of the volume of OTC and exchange traded derivatives linked to commodities[1]



[1] Commodities excluding precious metals. [2] Notional amounts outstanding, in trillions of US dollars. These are deflated by GSCI commodity, MSCI (All Country World) and Merrill Lynch Global one to three year Government bond indices respectively. Indices used to deflate OTC derivates rebased to 1998 = 100. [3] Number of contracts outstanding, in millions.

Source: BIS IBFS

The accommodative monetary policies in the advanced economies have also added to the debate about the possibility of price distortions stemming from financial speculation. Commodities futures have been targeted by these capital flows in what has been termed "the flight to simplicity".[114] There is some difficulty in distinguishing between the roles that power may have played as opposed to a knowledge based consensus. Since the financial crisis became apparent there emerged a general consensus that the opaque nature of the derivatives markets, particularly the OTC derivatives, added to uncertainty and the credit crunch. The IOSCO has been very pro-active in this regard, and it seems that the G20 reached consensus on the need for central counterparties without much difficulty, implementation has been quick and across all relevant G20 states.[115] It is likely then that as the most major regulation against commodity futures markets was forcing the derivatives trading though the central counterparties, that this could have been merely the uniform addition of commodities to the overall consensus on the need for derivative market transparency.[116] In fact the regulation on commodity futures has focused on increased transparency, while leaving any more controversial "oversight" controls for the future, based on "less data limitations".[117] In fact as IOSCO has expressly refuted the connection between financial markets and inappropriate pricing within the actual commodities markets, it would seem

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[114] Kawamoto, et al. (2011), 10.

[115] G20, Action plan: Annex A (2011)

[116] IOSCO did claim that commodities futures were an important part of this regulation , but in their report it was commodities that were subsumed by the overall derivatives and not the other way around. IOSCO Technical committee, Principles for the regulation and suppervision of the commodity derivitive markets (Sep 2011), 7.

[117] IOSCO Technical committee, Task force on commodities futures markets (Apr 2011), 9.

that the regulation on commodities futures has more to do with the general consensus on derivatives than any power or theory based conflict between the advanced and the emerging states.

This section on negotiating power was aimed at finding the relevant measure of economic power within a relational power context and it has provided two primary conclusions. Firstly, similar to the structural power investigated through membership, it would appear that market seize holds the highest potential as measurement of economic power. However the second conclusion is that within relational power dynamics the situation is more nuanced than that of structural power. When we are concerned with some crucial issues, specific to the circumstances of the GFC, it is clear that strength in liquidity and the current account translates into a stronger initial bargaining position, putting the onus on the negotiating opponents to change the status quo.

CHAPTER FIVE: CONCLUSION

As we try to move on from the GFC and its consequent recession those concerned with study of the IFA have the difficult task of trying to extrapolate from our experiences and predict the characteristics of the next global financial crisis. Undoubtedly this is a project that will draw on numerous fields and be best served through a diverse and comprehensive body of work. What this thesis has attempted to provide, is an understanding of the best measurement of economic power, as power is likely to remain an important part of any future work.

This thesis had one primary focus, namely: to identify the best measurement of economic power, but in the process of addressing this goal some interesting findings and implications became apparent. However let us start by addressing the primary focus toward which end this paper developed the hypothesis;

That, in a period of financial crisis, liquidity and the current account assumes significance as indicators of economic power within the IFA independent of market size.

The first imperative of this paper was to identify the relevant forms of power, as power its self is not an easily categorised and portioned out concept. This process encompassed three stages. Firstly, there was a close examination of Daniel Drezner's work. A comparison of it with the competing literature was sufficient to provide a basis for understanding the importance of power within the IFA's structure. It became apparent through this literary study that of all of the competing theoretical explanations for the structure of the IFA the one that held closest to the real world developments of the IFA was Drezners explanation of club standards. This understanding of the IFA hinged on state economic power as the determining feature of the IFA, although the exact manner in which that power was measured was to some extent, assumed. How power was measured was of crucial importance to Drezners work, as the club standards depended on a highly consolidated power, based in only a small number of countries. Indeed, measured by market size this certainly seemed to be the case of the pre-GFC IFA, but the question deserved asking, if market size remained the best measurement during a period of financial distress. The importance of these periods should not be underestimated; even though they are relatively brief they tend to have a disproportionate effect on the structure of the IFA as can be seen through this examination of the GFC and the studies on the crisis of the 1990s.

Secondly, it was found that the crisis intrinsically changed the dynamics within the club structure identified by Drezner. The changes that took place as a consequence where two-fold; change in the membership of the club organisations and the inclusion of relational power concerns within the G20. The structural power that had led Drezner to his conclusions on the pre-crisis IFA remained important but because of some of the developments of the crisis a new power dynamic had entered the regime. It was the connection between macroprudential regulation and the wider policy agenda that was identified as being the source of this new, relational, form of power conflict within the IFA. The reason for this stemmed from the development of the wider policy agenda related to macroprudential regulation. These macroprudential concerns brought onto the agenda issues of which some were nationally sensitive. These where not peripheral concerns either, they went to the heart of the GFC and its causes, for example: global imbalances. This made these issues unavoidable priorities for the governing body of the IFA. Resulting in both the expansion of the club, to include the new members upon who resolution of the global imbalances partly depended and the inclusion of issues which were of national importance and likely to cause a conflict of interests within the reform negotiation process. Therefore any study which wished to identify the best measurement of economic power within the IFA during a period of crisis would have to consider both forms of power, relational and structural.

Thirdly, before it was possible to examine structural and relational power there were two points which made the identification of power possible. The first premise was that, given the nature of a club, it would only expand only as much as was absolutely necessary. This was supported by both the theoretical conception of the club laid out by Drezner as well as the stated preferences of key players within the club. This premise locates power as a central concern in any change of membership. Second, the premise that the particular characteristics that confer power, confer it preferentially in policy areas with the closest links to it. This is particularly true in the specific iterative stage of the negotiation process, which the G20 meetings where identified as being at in chapter two. From this the scope of power within the IFA was moved from a indirect power to economic power and then on to financial power. Where this chain of relevance stops can be difficult to identify, how specific does the source of power have to be, and at what point is this specificity outweighed by the more general power spillovers from other sources? This weakness in exactly identifying the parameters of what sources of power count was alleviated initially by the particular circumstances being examined, as explained in chapter two. It was also alleviated by the broad study that this thesis conducted. Hopefully the broad statistical study on the structure of the IFA combined with the comprehensive qualitative study of the full range of specific agenda issues have provided sufficiently strong results for a conclusion to be drawn.

After the initial identification of forms and relevant indicators of power, this thesis went on to address the hypothesis along the two tracks of power; structural and relational. With regard to structural power the results of this paper provide a clear indication that market size remains the most effective measurement. Although there was a noticeable trend in the change from G7 to G20 that favoured more liquidity and stronger current accounts, this was not sufficiently isolated from the trend in GDP growth for it to be taken as independently significant. Given the low overall ranking for these two indicators it seems unlikely that any further statistical methods used to control for growth rates would provide a different picture. This conclusion was further compounded by the results that came from Spain. Because of its inclusion within the club after the formal membership had already been decided in the late 1990s, its participation can be more clearly associated with the effects of the crisis. As it is the crisis that this thesis is examining, the results from Spain act as a kind of weathervane for the relative importance of the three different indicators.

With regard to relational power the situation is more nuanced. While it does appear that the ability to pursue objectives internationally is still defined by market size, the strength of countries in the alternative indicators for economic power; liquidity and the current account, does determine the original position of countries at the negotiating table, either conferring an advantage or a disadvantage. However because both advantage or disadvantage is directly linked to areas where these indicators are the most relevant factor, this strength cannot be seen as an indicator of an overall economic power position. What can be said is that in every financial crisis these factors are likely to be crucial and so liquidity and the current account positions are and will continue to be good indicators of each countries stance in times of global financial turmoil, providing a useful tool for categorizing the primary negotiation position of states within the IFA. To sum up these findings in other words; the hypothesis was disproven.

5.1 FURTHER RESEARCH

One useful avenue of further research would be to ascertain the degree to which other forces, such as legitimacy concerns, are a determining feature of the G20, and the prospects that these infer for functionality and future change. This covers a number of possible avenues of research, but the most important considerations would be: the degree to which legitimacy begins to determine the governance of the IFA. Also, as the crisis begins to recede, the degree that market forces come back to the fore in influencing future regulation. While this is unlikely to be a serious concern in the near future, as Rogoff and Rienhart's 2009 book makes clear, the eventual degradation of regulation is inevitable. In essence these different avenues of research would all be useful in trying to identify the future trajectory of the IFA, which at this particular juncture in time seems uncertain. So the whole field is open and the body of work on this subject can only benefit from a multifaceted approach which examines multiple alternative scenarios.

Recently there has been more work done in comparing the various financial crises that the world has experienced, but as of yet this remains at quite a general stage. The scale of these crises warrants more attention and more issue specific comparisons focused on particular theoretical priorities or forces could, if built up over time; provide a useful database on financial crisis. Essentially the gaps in the literature need to be filled in.

A final avenue for further research that relates directly to this thesis would be an investigation into the importance of liquidity and the current account in international negotiations during the GFC, using Robert Putnam's two level game metaphor. This would provide a much clearer understanding of the influence of liquidity and the current account in the more nuanced relational power dynamics. It is the complexity of the interaction within this negotiation process that would benefit form this form of examination, as it allows for much more contextually specific circumstances.

5.2 FINAL COMMENTS

Finally, there are some interesting findings and implications that have come to light in the process of addressing the hypothesis. It appears that there is a high degree of regional coherence in South East Asia. Throughout chapters three and four there was a clear pattern of coordinated policy objectives and negotiation cohesion. Examples like the Chiang Mi initiative highlight the efforts of this region to determine its own path based on the independence given by economic strength. This may provide the basis for future international power-block policy positions. Either way this paper certainly highlights the increasing importance of this region for international relations.

The implications of the finding that market size still holds the greatest explanatory power for the IFA are that this ensures the continued dominance of the advanced economies for the time being. The growth of the emerging economies has been meteoric and continues to be the engine of global growth today. However this increase in market size has not been even across all sectors. In financial markets particularly, the emerging world remains behind and does not show the same promise of a rapid catch up phase. This holds considerable promise of future conflict, as the growth of financial markets in the advanced economies continues to be exponential and completely out of disproportion to their real economies. If the governance of the IFA does not accept that those upon whose economic growth the financial system depends must be the ones who determine the trajectory of future regulation then it seems likely that financial crisis will continue to escalate with a growing reluctance to assists on the side of the emerging powers. This is not a statement of a normative preference for a more egalitarian world order, rather it is a rational perspective that the job of steering the IFA should be given to those who exhibited a keen awareness of the dynamics at play. It is unfortunate that strength in liquidity and the current account which show this more accurate understanding of international finance will be less influential than historically accumulated bulk.

The inclusion of a political cleavage within the steering club of the IFA, as a consequence of the GFC, is likely to have some grave implications for the functionality of that club. The pre-crisis club exhibited far greater cohesion due to the externalization of the existing political cleavage to between those within and those outside the club, and yet was still unable to remain up to date with regulation. This raises concerns about how well the G20 will be able to provide functional responses once the urgency of the crisis recedes. For the time being however it would appear that power still plays the determining force, and as long as the governance of the IFA is determined by power, then a lack of cohesiveness in the governing body is likely to render it ineffective. That the club is likely to be ineffective and that market size continues as the determining measurement of economic power raises serious questions about the designing of this regime around economic power concerns, particularly as the externalities caused by ineffectual regulation are increasing substantially.

STATISTICAL ANNEXES

ANNEX ONE: MARKET SIZE

Table 3.1: GDP

	Gross domestic product based on purchasing-power-parity (PPP) share of world total (%)					
Country	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Advanced						
Australia	1.196	1.155	1.187	1.215	1.188	1.165
Canada	1.952	1.895	1.859	1.825	1.794	1.764
France	3.204	3.111	3.024	2.972	2.870	2.811
Germany	4.343	4.265	4.188	4.013	3.958	3.918
Italy	2.796	2.695	2.591	2.479	2.391	2.319
Japan	6.628	6.444	6.205	5.870	5.812	5.574
Korea, Republic of	1.935	1.932	1.925	1.949	1.971	1.973
United Kingdom	3.332	3.250	3.164	3.038	2.933	2.858
United States	21.735	21.039	20.426	19.902	19.529	19.105
European Union	22.686	22.254	21.816	21.088	20.438	20.023
Emerging						
Argentina	0.762	0.787	0.818	0.833	0.866	0.901
Brazil	2.763	2,784	2.852	2.861	2.929	2.928
China, P.R.: Hong Kong	0.436	0.441	0.439	0.437	0.440	0.449
China P.R.: mainland	10.140	10.999	11.743	12.948	13.605	14.351
India	4.466	4.666	4.827	5.203	5.455	5.668
Indonesia	1.248	1.260	1.302	1.374	1.389	1.424
Mexico	2.288	2.244	2.212	2.095	2.104	2.104
Russian Federation	3.078	3.173	3.253	3.028	2.999	3.014
Saudi Arabia	0.850	0.825	0.836	0.815	0.838	0.859
South Africa	0.719	0.721	0.727	0.722	0.707	0.704
Turkey	1.340	1.332	1.306	1.255	1.302	1.337
Total; Advanced	47.121	45.019	44.569	43.263	42.446	41.407
Total; Emerging	25.323	26.458	27.495	28.764	29.783	30.826
Total;G20	80.130	81.210	80.913	80.613	80.515	80.130

Source: IMF; Data source; World Economic Outlook . Accessed 28th Oct 2011 (Estimates start after 2009)

Table 3.2: Financial Market Size

	Bonds, Equities and Bank assets [1] (Billions of US $)				
Countries	2006	2007	2008	2009	2010
Australia	----	----	----	-----	-----
Canada	4,954.5	6,354.6	5,072.2	6,257.10	7,345.1
France	13,445.5	15,789.1	16,494.0	15,825.00	14,767.4
Germany	10,901.4	14,204.0	13,141.0	12,094.20	11,776.8
Italy	8,144.9	9,039.1	8,311.3	9,172.50	8,029.9
Japan	19,930.5	21,720.6	24,714.4	24,163.50	29,533.9
United Kingdom	16,304.6	18,748.9	18,180.1	18,217.00	20,503.2
United States	56,509.4	60,995.7	56,391.8	60,892.30	64,154.1
European Union[2]	72,913.5	86,098.5	83,2002.1	85,277.10	86,601.5
Emerging markets[3]	29,020.1	43,774.3	34,394.2	33,477.10	40,628.0
World Total	190,421.5	229,712.0	214,424.0	232,240.8	250,072.2

Source: referenced in IMF World Economic Outlook reports 2007-2011[118]

[118] Bank assets: Sum of Stock market capitalization, debt securities.

Domestic financial markets are one of the areas where it is possible and it makes sense to talk of the EU as a single entity, as the free movement of capital is one of the four founding economics freedoms around which the EC was based.

Emerging markets: as defined by the IMF this grouping consist of 150 countries and this particular figure also includes Korea, Hong Kong, Israel, Taiwan and Singapore. This covers all of the emerging economies in the G20 up to 2010. In 2010 the grouping was changed so that the emerging markets no longer includes Korea, Hong Kong, Singapore, Taiwan and Israel

ANNEX TWO: LIQUIDITY

Table 3.3: Official reserve assets

	Official Reserve Assets, Foreign Currency Reserves (in Convertible Foreign Currencies) (millions US $)					
Country	2006	2007	2008	2009	2010	2011
Advanced						
Australia	52514.625	23903.702	28708.939	32640.214	32396.565	34427.570
Canada	33198.000	39314.000	41537.000	42602.000	44888.000	50961.000
France	40287.030	43587.409	30382.203	27728.669	36211.020	32212.950
Germany	37718.880	40768.337	38557.049	36928.340	37356.143	38235.265
Italy	24413.367	27318.682	35303.330	34521.232	35677.712	33977.785
Japan	874596.000	947987.000	#########	996552.000	#########	1141120.000
Korea, Republic of	238291.000	262719.000	201042.000	265697.000	287480.000	300260.500
United Kingdom	61176.261	58832.972	46443.898	42570.000	50273.000	56802.500
United States	40845.000	45793.000	42073.000	45752.491	47466.526	50180.020
Emerging						
Argentina	30319.040	44021.245	44177.745	42817.400	46317.883	42791.500
Brazil	84463.014	163526.244	190929.372	228644.139	276147.998	335102.110
China, [1]P.R.: Hong Kong	129883.000	146911.000	178130.000	244922.000	258103.000	311233.000
China P.R.: mainland						
India	...	266553.000	246603.000	258583.000	267814.000	278114.500
Indonesia	40696.560	54555.710	49163.960	60368.960	89751.118	108115.060
Mexico	75416.166	86288.707	93958.578	94089.305	114933.675	68184.690
Russian Federation	214747.788	386170.477	406205.243	398870.558	426029.438	453062.670
Saudi Arabia[2]						
South Africa	22747.000	29273.000	30270.000	32474.000	35427.000	40552.000
Turkey	60649.997	73069.610	70818.070	69016.920	79042.023	84345.295

Source: IMF; data source: International reserves template. Accessed 18th April 2012.[119]

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[119] http://elibrary-data.imf.org/ViewData Reserves held in convertible foreign currencies where used as they are the most liquid type of reserves.

Table 3.4: General government gross debt

General Government Gross Debt *(Percent of GDP)*											
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Advanced Economies											
Australia	9.9	9.6	11.7	16.9	20.5	22.8	23.8	23.0	21.6	20.0	18.2
Canada	70.3	66.5	71.1	83.3	84.0	84.1	84.2	82.3	79.7	76.4	73.0
France	63.9	64.2	68.3	79.0	82.4	86.9	89.4	90.8	90.8	89.7	87.7
Germany	67.9	65.0	66.4	74.1	84.0	82.6	81.9	81.0	79.1	77.1	75.0
Italy	106.6	103.6	106.3	116.1	119.0	121.1	121.4	120.1	118.4	116.3	114.1
Japan	191.3	187.7	195.0	216.3	220.0	233.1	238.4	242.9	245.9	249.9	253.4
Korea	31.1	30.7	30.1	33.8	33.4	32.0	30.0	28.0	26.0	24.0	22.2
United Kingdom	43.1	43.9	52.0	68.3	75.5	80.8	84.8	85.9	85.1	83.1	80.4
United States	61.1	62.3	71.6	85.2	94.4	100.0	105.0	108.9	111.4	113.2	115.4
Emerging Economies											
Argentina	76.5	67.1	58.5	58.7	49.1	43.3	41.5	40.4	39.5	38.0	37.3
Brazil	66.7	65.2	63.6	68.1	66.8	65.0	64.0	62.5	60.9	59.0	57.2
Hong Kong SAR[1]	31.9	30.8	30.4	34.0	33.2	31.6	30.5	29.7	29.1	28.6	28.0
China	16.2	19.6	17.0	17.7	33.8	26.9	22.2	18.4	15.5	13.0	10.9
India	78.5	75.4	74.7	74.2	67.3	64.9	64.2	63.2	62.6	62.2	61.7
Indonesia	40.4	36.9	33.2	28.6	27.4	25.2	24.0	22.7	21.4	20.2	19.0
Mexico	38.4	37.8	43.1	44.7	42.9	42.9	43.6	43.5	43.4	43.3	43.2
Russia	9.0	8.5	7.9	11.0	11.7	11.7	12.1	12.6	14.5	16.8	19.5
Saudi Arabia	27.3	18.5	13.2	15.9	9.9	7.1	6.1	5.1	4.3	3.6	3.0
South Africa	32.6	28.3	27.3	31.5	34.8	36.9	38.5	39.5	39.6	38.6	36.3
Turkey	46.1	39.4	39.5	46.1	42.2	40.3	38.1	36.3	35.1	34.2	33.2
G-20 Average[1]	61.0	60.6	63.7	71.9	77.8	79.1	80.1	80.6	80.5	80.4	80.3
Advanced G-20	78.6	78.1	84.7	97.8	104.4	109.5	112.9	115.1	116.1	116.7	117.2
Emerging G-20	36.6	36.3	34.6	35.9	40.7	36.9	34.7	32.7	31.2	30.0	29.0

Sources: IMF: Data Source –Fiscal Monitor[120]

[120] (Fiscal Affairs Department 2011) For all of the aggregates data is weighted by GDP valued at PPP as share of the group GDP in 2009

Table 3.6: Inflation

	Inflation, average consumer prices										
Country	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Advanced											
Australia	3.538	2.332	4.353	1.82	2.845	3.536	3.321	3.469	3.045	2.864	2.582
Canada	2.018	2.131	2.385	0.292	1.777	2.905	2.068	1.997	1.987	2.012	2.003
France	1.912	1.607	3.159	0.103	1.736	2.146	1.35	1.66	1.767	1.828	1.949
Germany	1.784	2.276	2.754	0.234	1.15	2.236	1.3	1.6	1.9	2	2
Italy	2.217	2.038	3.5	0.764	1.639	2.613	1.644	1.7	1.8	1.9	2
Japan	0.299	0	1.39	-1.371	-0.72	-0.37	-0.48	0.041	0.345	0.639	0.84
Korea, Republic of	2.242	2.535	4.674	2.757	2.956	4.452	3.498	3	3	3	3
United Kingdom	2.3	2.346	3.629	2.12	3.339	4.513	2.439	2	2	2	2
United States	3.222	2.867	3.817	-0.327	1.646	2.987	1.209	0.903	1.118	1.378	1.658
Emerging											
Argentina	10.898	8.83	8.585	6.27	10.461	11.5	11.776	11	11.004	11.005	11.005
Brazil	4.196	3.638	5.672	4.899	5.037	6.589	5.151	4.152	4.503	4.531	4.531
China, [1]P.R.: Hong Kong	2.025	2.021	4.273	0.588	2.312	5.5	4.5	3.5	3	3	3
China P.R.: mainland	1.467	4.767	5.9	-0.683	3.325	5.498	3.3	3	3	3	3
India	6.268	6.373	8.349	10.882	11.989	10.551	8.587	7.071	5.366	4.992	4.085
Indonesia	13.104	6.034	9.777	4.814	5.133	5.695	6.471	5.441	5.303	4.747	4.482
Mexico	3.628	3.972	5.13	5.303	4.152	3.373	3.125	3.007	2.992	3.02	3.02
Russian Federation	9.679	9.007	14.108	11.654	6.854	8.876	7.282	6.936	6.637	6.5	6.5
Saudi Arabia	2.31	4.107	9.871	5.057	5.354	5.4	5.317	4.261	4.05	4	4
South Africa	4.688	7.09	11.536	7.125	4.271	5.926	4.998	5	4.925	4.825	4.7
Turkey	9.597	8.756	10.444	6.251	8.566	6.016	6.865	5.325	5.033	5	5

Source: International Monetary Fund, World Economic Outlook database, September 2011 (estimates start after 2010)

ANNEX THREE: THE CURRENT ACCOUNT

Table 3.7: Current account balance

Current account balance (Billions US Dollars, Percent of GDP)								
Country		2006	2007	2008	2009	2010	2011	2012
Advanced								
Australia	U.S. dollars	-41.614	-58.939	-47.303	-41.828	-33.089	-32.801	-73.455
Australia	Percent of GDP	-5.305	-6.18	-4.458	-4.231	-2.674	-2.176	-4.672
Canada	U.S. dollars	18.064	11.89	4.945	-39.573	-49.375	-58.626	-69.659
Canada	Percent of GDP	1.413	0.835	0.329	-2.959	-3.131	-3.334	-3.814
France	U.S. dollars	-12.995	-25.931	-49.632	-39.56	-44.657	-74.774	-72.17
France	Percent of GDP	-0.575	-1.002	-1.746	-1.503	-1.743	-2.663	-2.498
Germany	U.S. dollars	182.068	248.291	227.87	186.279	187.232	182.823	182.41
Germany	Percent of GDP	6.266	7.459	6.259	5.633	5.697	5.038	4.92
Italy	U.S. dollars	-48.137	-51.691	-67.7	-44.117	-67.646	-78.237	-68.104
Italy	Percent of GDP	-2.581	-2.439	-2.934	-2.084	-3.292	-3.484	-2.977
Japan	U.S. dollars	170.437	210.967	157.079	141.751	195.856	147.03	172.544
Japan	Percent of GDP	3.907	4.819	3.219	2.816	3.588	2.511	2.817
Korea, Republic of	U.S. dollars	14.083	21.77	3.198	32.79	28.214	16.96	17.774
Korea, Republic of	Percent of GDP	1.48	2.075	0.343	3.931	2.781	1.457	1.394
United Kingdom	U.S. dollars	-82.797	-73.025	-44.063	-37.319	-71.532	-67.379	-59.844
United Kingdom	Percent of GDP	-3.383	-2.597	-1.645	-1.71	-3.179	-2.716	-2.298
United States	U.S. dollars	-800.621	-710.304	-677.134	-376.551	-470.898	-467.642	-329.347
United States	Percent of GDP	5.985	5.063	4.738	2.701	3.242	3.104	2.125

Emerging								
Argentina	U.S. dollars	6.923	6.195	5.023	6.468	2.792	-1.233	-4.401
Argentina	Percent of GDP	3.234	2.364	1.531	2.084	0.755	-0.283	-0.939
Brazil	U.S. dollars	13.643	1.551	28.192	24.302	47.365	58.408	66.58
Brazil	Percent of GDP	1.248	0.113	-1.703	-1.518	-2.266	-2.32	-2.544
P.R.: Hong Kong	U.S. dollars	22.936	25.544	29.474	17.063	13.933	13.386	14.717
P.R.: Hong Kong	Percent of GDP	12.076	12.335	13.086	8.583	6.207	5.421	5.488
China P.R.: mainland	U.S. dollars	232.8	353.9	412.4	261	305.3	360.536	431.55
China P.R.: mainland	Percent of GDP	8.581	10.128	9.124	5.23	5.194	5.159	5.573
India	U.S. dollars	-9.299	-8.077	-24.87	-35.766	-42.807	-40.274	-43.958
India	Percent of GDP	1.024	0.701	1.087	2.828	2.623	2.185	2.184
Indonesia	U.S. dollars	10.86	10.494	0.126	13.583	5.643	1.54	4.016
Indonesia	Percent of GDP	2.981	2.428	0.025	2.523	0.798	0.185	-0.429
Mexico	U.S. dollars	-4.487	-8.851	-16.339	-6.352	-5.626	-11.274	-10.864
Mexico	Percent of GDP	-0.471	-0.855	-1.494	-0.722	-0.544	-0.951	-0.875
Russian Federation	U.S. dollars	94.34	77.012	103.722	49.518	71.129	104.002	73.362
Russian Federation	Percent of GDP	9.53	5.925	6.245	4.052	4.807	5.518	3.465
Saudi Arabia	U.S. dollars	99.066	93.454	132.499	20.983	66.841	115.308	82.585
Saudi Arabia	Percent of GDP	27.778	24.261	27.781	5.563	14.908	20.58	14.191
South Africa	U.S. dollars	13.861	19.924	19.617	11.504	10.114	11.624	16.577
South Africa	Percent of GDP	-5.307	-6.971	-7.118	-4.051	-2.781	-2.754	-3.739
Turkey	U.S. dollars	-32.193	-38.311	-41.946	-14.297	-48.424	-78.28	-59.661
Turkey	Percent of GDP	-6.083	-5.902	-5.744	-2.327	-6.584	-10.258	-7.44

Average; **Advanced**	Percent of GDP	-0.52922	-0.23256	-0.59678	-0.312	-0.57722	-0.94122	-1.02811
Average; **Emerging**	Percent of GDP	4.776636	3.92045 5	3.667818	1.508091	1.624636	1.646545	0.960636
Total; **Advanced**	U.S. dollars	-601.512	-426.972	-492.74	-218.128	-325.895	-432.646	-299.851
Total; **Emerging**	U.S. dollars	420.728	492.987	552.28	277.294	311.302	393.679	396.157

Source: IMF: Data source; World economic outlook database, accessed 16th Dec 2011 (Estimates start after 2009 for Saudi Arabia, UK, Italy, Argentina, Mexico, for all others estimates start in 2010)

ANNEX FOUR

Basel Committee on Banking Supervision reforms - Basel III

Strengthens microprudential regulation and supervision, and adds a macroprudential overlay that includes capital buffers.

	Capital					Liquidity
	Pillar 1			Pillar 2	Pillar 3	
	Capital	Risk coverage	Containing leverage	Risk management and supervision	Market discipline	Global liquidity standard and supervisory monitoring
All Banks	**Quality and level of capital** Greater focus on common equity. The minimum will be raised to 4.5% of risk-weighted assets, after deductions. **Capital loss absorption at the point of non-viability** Contractual terms of capital instruments will include a clause that allows – at the discretion of the relevant authority – write-off or conversion to common shares if the bank is judged to be non-viable. This principle increases the contribution of the private sector to resolving future banking crises and thereby reduces moral hazard. **Capital conservation buffer** Comprising common equity of 2.5% of risk-weighted assets, bringing the total common equity standard to 7%. Constraint on a bank's discretionary distributions will be imposed when banks fall into the buffer range. **Countercyclical buffer** Imposed within a range of 0-2.5% comprising common equity, when authorities judge credit growth is resulting in an unacceptable build up of systematic risk.	**Securitisations** Strengthens the capital treatment for certain complex securitisations. Requires banks to conduct more rigorous credit analyses of externally rated securitisation exposures. **Trading book** Significantly higher capital for trading and derivatives activities, as well as complex securitisations held in the trading book. Introduction of a stressed value-at-risk framework to help mitigate procyclicality. A capital charge for incremental risk that estimates the default and migration risks of unsecuritised credit products and takes liquidity into account. **Counterparty credit risk** Substantial strengthening of the counterparty credit risk framework. Includes: more stringent requirements for measuring exposure; capital incentives for banks to use central counterparties for derivatives; and higher capital for inter-financial sector exposures. **Bank exposures to central counterparties (CCPs)** The Committee has proposed that trade exposures to a qualifying CCP will receive a 2% risk weight and default fund exposures to a qualifying CCP will be capitalised according to a risk-based method that consistently and simply estimates risk arising from such default fund.	**Leverage ratio** A non-risk-based leverage ratio that includes off-balance sheet exposures will serve as a backstop to the risk-based capital requirement. Also helps contain system wide build up of leverage.	**Supplemental Pillar 2 requirements.** Address firm-wide governance and risk management; capturing the risk of off-balance sheet exposures and securitisation activities; managing risk concentrations; providing incentives for banks to better manage risk and returns over the long term; sound compensation practices; valuation practices; stress testing; accounting standards for financial instruments; corporate governance; and supervisory colleges.	**Revised Pillar 3 disclosures requirements** The requirements introduced relate to securitisation exposures and sponsorship of off-balance sheet vehicles. Enhanced disclosures on the detail of the components of regulatory capital and their reconciliation to the reported accounts will be required, including a comprehensive explanation of how a bank calculates its regulatory capital ratios.	**Liquidity coverage ratio** The liquidity coverage ratio (LCR) will require banks to have sufficient high-quality liquid assets to withstand a 30-day stressed funding scenario that is specified by supervisors. **Net stable funding ratio** The net stable funding ratio (NSFR) is a longer-term structural ratio designed to address liquidity mismatches. It covers the entire balance sheet and provides incentives for banks to use stable sources of funding. **Principles for Sound Liquidity Risk Management and Supervision** The Committee's 2008 guidance *Principles for Sound Liquidity Risk Management and Supervision* takes account of lessons learned during the crisis and is based on a fundamental review of sound practices for managing liquidity risk in banking organisations. **Supervisory monitoring** The liquidity framework includes a common set of monitoring metrics to assist supervisors in identifying and analysing liquidity risk trends at both the bank and system-wide level.
SIFIs	In addition to meeting the Basel III requirements, global systemically important financial institutions (SIFIs) must have higher loss absorbency capacity to reflect the greater risks that they pose to the financial system. The Committee has developed a methodology that includes both quantitative indicators and qualitative elements to identify global systemically important banks (SIBs). The additional loss absorbency requirements are to be met with a progressive Common Equity Tier 1 (CET1) capital requirement ranging from 1% to 2.5%, depending on a bank's systemic importance. For banks facing the highest SIB surcharge, an additional loss absorbency of 1% could be applied as a disincentive to increase materially their global systemic importance in the future. A consultative document was published in cooperation with the Financial Stability Board, which is coordinating the overall set of measures to reduce the moral hazard posed by global SIFIs.					

Source: BCBS over view table of Basel three. BIS website accesses Dec 12th 2011; URL: http://www.bis.org/bcbs/basel3/b3summarytable.pdf

ANNEX FIVE

List of Gross Capital Inflows Episodes

Country	Duration	Country	Duration	Country	Duration
Argentina	1991Q4 - 00Q3	Guatemala	1990Q3 - 93Q1	Philippines	1990Q2 - 93Q1
Argentina	2006Q1 - 08Q2	Guatemala	1993Q3 - 94Q4	Philippines	1993Q3 - 97Q3
Argentina	2010Q1 - ongoing	Guatemala	1998Q3 - 04Q2	Philippines	2006Q3 - 07Q4
Armenia	1994Q2 - 95Q4	Guatemala	2005Q2 - 08Q4	Poland	1997Q1 - 01Q1
Armenia	1996Q2 - 01Q1	Hungary	1993Q1 - 95Q4	Poland	2003Q4 - 08Q3
Armenia	2002Q3 - 08Q4	Hungary	1996Q3 - 01Q4	Poland	2009Q2 - ongoing
Armenia	2009Q2 - ongoing	Hungary	2002Q2 - 09Q1	Romania	1991Q2 - 92Q3
Bosnia & Herzegovi	1998Q1 - 04Q1	India	2004Q4 - 08Q3	Romania	1993Q1 - 97Q4
Bosnia & Herzegovi	2004Q3 - 09Q3	India	2009Q2 - ongoing	Romania	1998Q2 - 99Q1
Brazil	1993Q3 - 97Q3	Indonesia	1995Q2 - 97Q3	Romania	2000Q2 - 08Q4
Brazil	1999Q2 - 02Q2	Indonesia	2009Q3 - ongoing	Romania	2009Q3 - ongoing
Brazil	2006Q3 - 08Q3	Israel	1994Q2 - 01Q2	Russia	1997Q2 - 98Q2
Brazil	2009Q2 - ongoing	Israel	2003Q4 - ongoing	Russia	2002Q4 - 08Q3
Bulgaria	1998Q4 - 08Q4	Jamaica	1990Q1 - 98Q4	Serbia	2007Q1 - ongoing
Chile	1991Q4 - 01Q1	Jamaica	2000Q1 - ongoing	South Africa	1995Q1 - 00Q3
Chile	2001Q3 - 08Q3	Jordan	1990Q3 - 91Q4	South Africa	2004Q1 - 08Q3
Chile	2009Q1 - ongoing	Jordan	1994Q3 - 95Q4	South Africa	2009Q2 - ongoing
China	1993Q1 - 98Q2	Jordan	1999Q1 - 02Q4	Sri Lanka	1990Q1 - 97Q4
China	2002Q3 - 08Q2	Jordan	2004Q2 - 07Q4	Thailand	1990Q1 - 97Q1
China	2009Q3 - ongoing	Jordan	2008Q2 - 09Q3	Thailand	2004Q3 - 08Q3
Colombia	1996Q1 - 99Q1	Kazakhstan	1995Q1 - 08Q4	Thailand	2009Q2 - ongoing
Colombia	1999Q4 - 02Q1	Korea	1994Q2 - 97Q3	Tunisia	1990Q1 - 94Q4
Colombia	2005Q3 - ongoing	Korea	2003Q2 - 08Q3	Tunisia	2001Q1 - 04Q4
Costa Rica	2004Q3 - 08Q4	Korea	2009Q2 - ongoing	Tunisia	2006Q1 - 08Q3
Costa Rica	2009Q3 - ongoing	Latvia	1993Q1 - 00Q4	Turkey	1995Q3 - 98Q2
Croatia	1996Q2 - 97Q4	Latvia	2001Q2 - 08Q3	Turkey	1999Q3 - 00Q3
Croatia	1998Q2 - 08Q4	Lebanon	2002Q1 - 04Q4	Turkey	2002Q4 - 08Q3
Czech Republic	1995Q1 - 97Q4	Lebanon	2005Q2 - ongoing	Turkey	2009Q3 - ongoing
Czech Republic	1998Q2 - 05Q4	Lithuania	1993Q2 - 01Q4	Ukraine	1994Q1 - 95Q2
Czech Republic	2006Q2 - 08Q3	Lithuania	2003Q3 - 08Q4	Ukraine	1997Q1 - 98Q2
Czech Republic	2009Q2 - ongoing	Malaysia	1991Q1 - 93Q4	Ukraine	2003Q2 - 08Q4
Dominican Republic	1998Q1 - 03Q4	Malaysia	1995Q1 - 98Q2	Ukraine	2009Q3 - ongoing
Dominican Republic	2005Q1 - 08Q4	Malaysia	2004Q1 - 05Q3	Uruguay	1994Q1 - 97Q4
Ecuador	1990Q1 - 92Q4	Malaysia	2009Q3 - ongoing	Uruguay	2000Q2 - 01Q1
Ecuador	1995Q2 - 96Q3	Mexico	1990Q1 - 94Q3	Uruguay	2006Q3 - ongoing
Ecuador	1997Q3 - 98Q4	Mexico	1995Q3 - 03Q2	Venezuela	1991Q1 - 94Q1
Egypt	2005Q1 - 08Q2	Mexico	2007Q1 - 08Q3	Venezuela	1996Q4 - 97Q3
El Salvador	1995Q1 - 00Q1	Mexico	2009Q3 - ongoing	Venezuela	1998Q1 - 00Q2
El Salvador	2000Q3 - 03Q4	Morocco	1990Q1 - 94Q4	Vietnam	1996Q1 - 00Q4
El Salvador	2006Q2 - 08Q4	Pakistan	2005Q4 - 08Q2	Vietnam	2002Q3 - ongoing
Estonia	1993Q1 - 99Q2	Peru	1993Q4 - 98Q3		
Estonia	2000Q2 - 08Q4	Peru	2006Q4 - 08Q3		
		Peru	2009Q3 - ongoing		

Source: (IMF, Recent Experiances in Managing Capital Flows - Cross Cutting Themes and Possible Policy Framwork 2011)

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