TOWARD A NEW DESIGN FOR INTERNATIONAL FINANCIAL REGULATION

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1. INTRODUCTION

In 1944, at the conclusion of World War II, the allied powers under the leadership of the United States and the United Kingdom agreed on a design for the redevelopment and reintegration of the world economy following three decades of crisis and conflict. That design, the Bretton Woods international economic system, was based on the premise of trade liberalization, closed domestic financial systems, and fixed exchange rates. Since that time, the world's economy has reintegrated and become globalized in many ways.

While international finance began to reemerge soon after World War II (initially in the form of the Euromarkets — the basis of today's global financial system), due to the Bretton Woods focus on fixed exchange rates and closed domestic financial systems, there were no corresponding efforts directed towards its regulation, leaving finance to domestic law. The first change occurred in the 1970s, when the collapse of Bankhaus Herstatt in Germany and Penn Central in the United States highlighted that not only was international finance of increasing importance, but also that there was significant interlinking between domestic financial intermediaries and systems that raised real cross-border risks. The result was a series of discussions among the major jurisdictions involved, hosted by the Bank for International Settlements ("BIS")

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in Basel, Switzerland, and later formalized as the Basel Committee on Banking Supervision, the Committee on the Global Financial System, and the Committee on Payment and Settlement Systems—all hosted today by the BIS.

As international finance has developed and globalized, it has faced a number of crises, including: the developing country debt crisis of the 1980s; the global stock market collapse of 1987; periodic collapses of international financial intermediaries such as Banco Ambrosiano, Bank of Credit and Commerce International, Barings, and Long Term Capital Management; and financial crises with international implications in Europe, Mexico, East Asia, Russia, Turkey, and Argentina, among others. Each of these events has resulted in international efforts to prevent similar situations through financial regulatory cooperation.

Today, following development over the past thirty-five years, international financial regulation focuses not only on the Bretton Woods institutions and the BIS, but also on an ever-increasing number of international financial organizations (such as the Basel Committee and the International Organization of Securities Commissions ("IOSCO") of varying levels of formality involved in the development, implementation, and monitoring of international financial standards.

In this Article, international financial regulation is understood as the normative intervention of a state in the economic activities of firms and individuals,[1] including rules and standards issued by international organizations and self-regulatory bodies disciplining financial services trade. Such regulation is designed to avoid or at least minimize risks inherent in business, particularly (1) insolvency risks encompassing the risks in loans of a bank (credit risk) and (2) investment or market risks, as well as (3) systemic risks causing social costs imposed on the economy by a contagious failure of a financial intermediary.[2] Therefore, financial regulation should support the safety and soundness of the financial system

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[1] *See generally* John William Anderson, Jr., *Regulatory and Supervisory Independence: Is There a Case for Independent Monetary Authorities in Brazil?*, 10 L. & BUS. REV. AM. 253 (2004) (discussing independent regulation of the financial sector).

[2] *See* JAN H. DALHUISEN, DALHUISEN ON INTERNATIONAL COMMERCIAL, FINANCIAL AND TRADE LAW 807 (2000) (outlining problems of capital flow in the European Union).

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(financial stability) while at the same time promoting economic growth through financial development.[3]

This Article argues that while this system of international financial standards is a significant development in response to the risks of financial globalization, it in fact merits a higher level of attention, design, and formalization. Section 2 discusses the development of international financial regulation since World War II, and Section 3 contains an overview of the current system of international financial cooperation and standards. From this basis, in Section 4 it is suggested that the current system deserves a thorough redesigning, focusing on financial globalization and the twin objectives of financial stability and financial development. Finally, Section 5 presents ideas for developing an appropriate design.

2. THE INTERNATIONAL FINANCIAL ARCHITECTURE AND GLOBALIZATION OF FINANCE

By the mid-1990s, both the theoretical understanding of finance and the actual nature of international and domestic financial systems had changed radically from those at the end of World War II. In order to give context to the discussion, this Section provides an overview of the Bretton Woods international economic system, followed by a short description of financial globalization and the series of financial crises over the past twenty-five years, leading to changes in the nature of the international financial architecture.

2.1. The Bretton Woods System and Globalization of Financial Markets

In August 1941, Franklin D. Roosevelt and Winston Churchill met on a battleship near Nova Scotia in the Atlantic Ocean and laid down their vision of a peaceful world order after World War II in the Atlantic Charter.[4] This document was essentially based on three pillars: peace, financial stability, and trade between equal nations. The first pillar discussed in 1944 under the auspices of the United States and the United Kingdom was to prevent international economic instability of the sort seen in the interwar period (1914-44) and to support economic development through

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[3] *See* Anderson, *supra* note 1, at 253 (discussing a new financial regulation system in Brazil).

[4] *See* Official Statement on Meeting Between the President and Prime Minister Churchill (Aug. 14, 1941), *in* 10 THE PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 314 (Samuel I. Rosenman ed., 1950).

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reintegration of domestic economies. The design encompassed three elements. First, its structure was formal and institutional, based on an interlinked set of international treaties and institutions. Second, it assumed closed national financial markets, with limited capital flows, but open markets for trade in goods. Third, relationships among closed national systems were structured through an international institutional framework.[5] Institutionally, the Bretton Woods system included three interlinked international organizations: the International Monetary Fund ("IMF"), the World Bank, and the International Trade Organization ("ITO").

However, the Bretton Woods system as designed never actually functioned: the ITO was still-born[6] (though ultimately reincarnated as the World Trade Organization ("WTO") in 1994 after fifty years in the limbo of the General Agreement on Tariffs and Trade ("GATT")). Likewise, the role of the World Bank was quickly usurped in many ways, first by the bilateral efforts of the United States through the Marshall Plan and related reconstruction initiatives, and later by the European Community with its aid programs for Southern and Eastern European countries, leaving the World Bank to focus on developing (often post-colonial) countries—the role it continues to play today. Nonetheless, the design for monetary relations, with the IMF at the center of a system of fixed exchange rates based on the U.S. dollar and its link to gold, did function—arguably quite well—until the early 1970s.

Since the end of the Bretton Woods international monetary system in 1973, financial markets have changed dramatically through a process of liberalization, internationalization, and globalization, undergirded by incredible technological changes. Fifty years after the creation of the Bretton Woods system, the deficiencies of the existing international institutions and arrangements (the "international financial architecture") in dealing with this changed nature came dramatically to light through the Mexican, East Asian, and other financial crises that followed. Since that time, the IMF, World Bank, and WTO gradually have been forced to come to grips with the increasingly globalized nature of

[5] *See generally* 1-2 PROCEEDINGS AND DOCUMENTS OF THE UNITED NATIONS MONETARY AND FINANCIAL CONFERENCE (1948) (documenting the proceedings of the conference held in Bretton Woods, New Hampshire, July 1-22, 1944).

[6] *See* JOHN H. JACKSON, THE JURISPRUDENCE OF GATT AND THE WTO 21-23 (2000) (outlining the relationship between the ITO and GATT).

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finance. Discussions both in these institutions and elsewhere have focused on whether there is a need to reform the existing international institutional arrangements—whether there is a need for a "new international financial architecture."[7]

2.2. Bretton Woods as Designed

The Bretton Woods system as designed was largely the result of the work of two economists and civil servants, one British, one American: John Maynard Keynes and Harry Dexter White. Both Keynes's and White's systems, as coherent designs, reflected the context of then-existing circumstances in a framework to support the future development of the international economy following the end of World War II. Incidentally, both were designed also to some extent to reinforce the economic positions of their respective countries; not surprisingly, Keynes's and White's governments adopted their positions (and Keynes and White played central roles in the negotiation process[8]). Perhaps because of the much stronger bargaining position of the United States, White's ideas were taken up to a greater extent than those of Keynes during the negotiations in Bretton Woods in 1944, and the newly created institutions were located in Washington, D.C.

The essential underlying theory of both designs and the final structure adopted was based, first, on a system of stable exchange rates. All negotiators involved felt that, while it was impossible to return to the gold standard as it existed prior to World War I, it was important to return to a parallel system, with money circulating on the basis of a fixed relationship to gold, rather than on the basis of pure paper currencies ("fiat money"). This design was intended to provide a stable base for finance, investment, and trade—the other central pillars of the structure—and to avoid the

[7] *See generally* Mario Giovanoli, *A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standard Setting, in* INTERNATIONAL MONETARY LAW: ISSUES FOR THE NEW MILLENNIUM 3 (Mario Giovanoli ed., 2000) (outlining legal standards for international financial markets); Joseph J. Norton, *"Qualified Self-Regulation" in the New International Financial Architecture*, J. INT'L BANKING REG., Jul. 2000, at 9 (discussing an evolving partnership between banking authorities and banking institutions); Rolf H. Weber, *Challenges for the New Financial Architecture*, 31 H.K. L.J. 241 (2001) (giving suggestions on how to use the "new financial architecture").

[8] Michael D. Bordo, *The Bretton Woods International Monetary System: A Historical Overview, in* A RETROSPECTIVE ON THE BRETTON WOODS SYSTEM: LESSONS FOR INTERNATIONAL MONETARY REFORM 3 (Michael D. Bordo & Barry Eichengreen eds., 1993).

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sorts of monetary instabilities seen during the period from 1914 to 44.[9] Capital movements would be largely controlled through domestic restrictions, with the IMF supporting the system by monitoring capital flows and facilitating orderly exchange readjustments when necessary.[10]

Underpinned by this international system of fixed exchange rates and limited capital mobility, both White's and Keynes's designs focused on the need to re-establish international trade linkages.[11] All the participants at Bretton Woods agreed there was a vital need to begin rebuilding these linkages as quickly as possible. The design was based around the ITO, which was intended to serve a formal role both in reducing trade barriers and in policing the agreements. However, due to U.S. and French political concerns, this institution was not established. Rather, trade relationships were addressed through a system of negotiations, formalized as the GATT. Despite not being of the same magnitude as the ITO system, the GATT over the next fifty years gradually and successfully reduced trade barriers around the world, especially among developed economies. In 1994, the WTO—an institution in many ways paralleling the ITO—was established, though by this time the system of fixed exchange rates with which it was meant to operate in tandem had long ceased to exist.

2.3. Bretton Woods in Practice: 1944-94

In practice, the Bretton Woods international economic system never came into existence as designed, as the ITO was not formed and the central role of the World Bank in post-war reconstruction was quickly displaced by bilateral efforts such as the Marshall Plan.

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[9] Under the Bretton Woods international monetary system, the U.S. dollar was fixed to gold at $32 per ounce. All other currencies were then fixed in value to the U.S. dollar.

[10] The result gave an important economic benefit to the Unites States: the U.S. dollar became the world's reserve currency (along with gold) and the backbone of international finance and trade, rather rapidly replacing the British pound sterling, which fulfilled similar roles in the pre-war period of globalization (1870-1914).

[11] By 1944, due to economic nationalism and the needs and results of war, the system of free trade which had existed in the 1870-1914 period had been completely destroyed.

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2.3.1. *Money and the IMF*

Nonetheless, the international monetary system, centered on the IMF, came to life. The system of fixed exchange rates in fact functioned rather well from 1945–73,[12] at which time the United States finally abandoned the fixed link between the U.S. dollar and gold, largely as a result of domestic financial pressures (fiscal and inflationary) resulting from the expenses of the Vietnam War, the Cold War, and domestic social spending. Despite the abandonment of the fundamental link to gold, many economies continued to maintain fixed relationships between their currencies and the U.S. dollar (though subject to periodic, often painful adjustments) and capital flows remained largely restricted during this period (with the exception of the development of the Euromarkets, laying the foundation of today's international global financial system). During this period, the role of the IMF mainly focused on the relationship between the developed economies and necessary (sometimes painful) exchange rate adjustments.[13]

During the 1970s, the IMF, having partially lost its role after the abandonment of the gold standard, sought to replicate this link through the creation of a new synthetic currency, the special drawing rights; however, this never really worked as intended. Nonetheless, the IMF continued to maintain a certain role in the process of exchange rate adjustment. Additionally, two amendments to the IMF Articles of Agreement reflected its new role in the international monetary system,[14] allowing the IMF to focus increasingly on lending designed to support economies dealing with periodic exchange crises, thereby operating with a developing system of conditions for support, the IMF "conditionality."

In the early 1990s, the IMF argued for a further amendment to

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[12] *But see* ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW 525–27 (2002) (discussing some instances in which nations did not adhere to the fixed exchange rate system).

[13] This was especially true as the economic importance of Germany and Japan increased and that of the United Kingdom decreased.

[14] The IMF Articles were adopted at the United Nations Monetary and Financial Conference, held in Bretton Woods, New Hampshire on Jul. 22, 1944, and entered into force Dec. 27, 1945. They have subsequently been amended three times: (1) Board of Governors Resolution No. 23-5, adopted May 31, 1968, and effective Jul. 28, 1969; (2) Board of Governors Resolution No. 31-4, adopted Apr. 30, 1976, and amended effective Nov. 11, 1992; and (3) Board of Governors Resolution No. 45-3, adopted Jun. 28, 1990, and effective Nov. 11, 1992.

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its Articles to formalize its role in encouraging and supporting capital liberalization, especially in developing, emerging, and transition economies. In addition, with the collapse of the Soviet Bloc, the IMF began to focus on its role in monetary aspects of the transition process. By 1994, the fiftieth anniversary of the Bretton Woods conference, the IMF largely felt that it understood its role and the mechanisms through which to achieve its goals—centered on the policy-focused ideas of the Washington Consensus.[15]

2.3.2. *Finance and the World Bank*

With the onset of the Cold War, the United States realized the need to build allies, if necessary on the foundations of former enemies, and initiated a number of bilateral programs to support reconstruction, of which the Marshall Plan for Western Europe is the most well-known. As a result, in a very short period following the World Bank's creation, its primary role and mission of had been transferred elsewhere.

Therefore, the World Bank was forced to search for a new role, almost from the beginning; its focus turned increasingly to the needs of developing countries around the world, rather than post-war reconstruction of developed countries. This role received a significant boost as the former colonial powers lost their empires, whether through emancipation, revolt, or abandonment. The World Bank sought to step in and assist these new countries in developing infrastructure and building their economies. During its initial decades, the World Bank focused on loans to governments for both specific projects and increasingly, through the 1970s, for general budgetary support. Lending was supplemented by the provision of grants to the least developed countries, generally

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[15] *See* Paul Krugman, *Dutch Tulips and Emerging Markets*, FOREIGN AFF., July-Aug. 1995, at 28 (discussing emerging free markets in the early 1990s). Krugman describes the so-called "Washington Consensus" regarding economic policies that developed in the early 1990s as: liberalizing trade, privatizing state enterprises, balancing the budget, and pegging the exchange rate. Having done these things, one will have laid the foundations for an economic takeoff; find a country that has done these things, and there one may confidently expect to realize high returns on investments. *Id.* at 29. *See generally* LATIN AMERICAN ADJUSTMENT: HOW MUCH HAS HAPPENED? (John Williamson ed., 1990) (discussing adjustments made with respect to Latin American countries' debts); WORLD BANK, WORLD DEVELOPMENT REPORT 1991: THE CHALLENGE OF DEVELOPMENT (1991); Stanley Fischer, *ABCDE: Past Ten Years, Next Ten Years, in* IMF ESSAYS FROM A TIME OF CRISIS: THE INTERNATIONAL FINANCIAL SYSTEM, STABILIZATION AND DEVELOPMENT 487 (Stanley Fischer ed., 2004).

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through the International Development Agency ("IDA") created in 1960.[16]

With the onset of the debt crisis in the early 1980s, the World Bank was faced with a challenge to its previous focus on state lending, as it became obvious that in many cases, resources lent for general purposes and even for specific projects had been squandered and in some cases even caused more harm than benefit. As a result, in addition to state lending and grants, the World Bank began to focus to a greater extent on providing private sector assistance through the International Finance Corporation ("IFC") and Multilateral Investment Guarantee Agency ("MIGA"), established in 1956 and 1988, respectively.[17] By the end of the 1980s, the World Bank Group included the World Bank, IFC, IDA, and MIGA, dealing with (respectively) state lending and technical assistance, private sector projects, grants to developing countries, and investment guarantees.[18] With the collapse of the Soviet Bloc, the World Bank, like the IMF, added the transition economies to its development assistance portfolio. Nonetheless, unlike the IMF, the World Bank was facing many questions about its role and future at the time of the fiftieth anniversary of the Bretton Woods conference in 1994, leading it to focus on the overall objective of poverty reduction.

2.3.3. *Trade, the GATT, and the WTO*

As noted above, international trade relationships were structured through a series of rounds of negotiations, formalized through the GATT (established in 1948). Even with a narrower focus than planned, the GATT was, in fact, quite effective in gradually reducing trade barriers, especially among developed countries. In 1994, the GATT members agreed to the establishment of the WTO (including the General Agreement on Trade in Services ("GATS")), reflecting this success and the general consensus supporting freer trade.[19] Therefore, by the fiftieth anniversary of

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[16] *See* IDA Home Page, http://www.worldbank.org/ida (last visited Dec. 12, 2007) (giving general information on the IDA).

[17] *See* IFC Home Page, http://www.ifc.org (last visited Dec. 12, 2007) (giving general information on the IFC); MIGA Home Page, http://www.miga.org (last visited Dec. 12, 2007) (giving general information on MIGA).

[18] In addition, it also serves as a host for the International Centre for Settlement of Investment Disputes ("ICSID"), founded in 1966. Along with MIGA, ICSID supports the development of international investment.

[19] *See* What Is The WTO?, http://www.wto.org/english/thewto_e/

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the Bretton Woods conference in 1994, the successor of the ITO finally had been established, to much fanfare and high expectations, through the formation of the WTO.

2.3.4. *Coordination and Linkage*

Because the ITO was never formed, the planned coordinating committee likewise was never formed. Perhaps as a result, the IMF and the World Bank often have been accused of failing to coordinate their activities despite the fact that they sit on opposite sides of the same street in central Washington, D.C. Only a few efforts have been made in this direction following problems arising in the context of the 1980s debt crisis (i.e., the creation of the "Interim" Committee to coordinate activities), but this remains a continuing concern.[20]

2.4. *Responses to the Mexican and East Asian Financial Crises*

The profile of international organizations such as the IMF and the World Bank makes them the usual starting point in any discussion of problems in the international financial system, and this was, in fact, the approach chosen following the Mexican crisis in 1995 and the East Asian financial crisis in 1997-98.[21] The increasing role of these institutions in development finance and the debt crisis of the 1980s, the fiftieth anniversary of the Bretton Woods system in 1994, and the United States' desire not to lead further international rescues made these institutions the focus of debate regarding sovereign liquidity and debt problems. Further, the role of the IMF reflected its desire to find a new leadership role in the period after the deterioration of the Bretton Woods system.[22]

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whatis_e/whatis_e.htm (last visited Dec. 12, 2007) (discussing the formation and structure of the WTO).

[20] *See* JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS (2002) (discussing problems with cooperation between the IMF and the World Bank); *see also* Allan H. Meltzer, *The Report of the International Financial Institution Advisory Commission: Comments on the Critics*, *in* THE IMF AND ITS CRITICS: REFORM OF GLOBAL FINANCIAL ARCHITECTURE 106 (David Vines & Christopher L. Gilbert eds., 2004) (discussing the Meltzer Commission's report to Congress and the need for greater reform of the international financial institutions).

[21] *See* Takashi Kiuchi, *The Asian Crisis and Its Implications*, *in* SHAPING A NEW INTERNATIONAL FINANCIAL SYSTEM 37 (Karl Kaiser et al. eds., 2000) (discussing the Asian financial crisis).

[22] *See* Zanny Minton-Beddoes, *Why the IMF Needs Reform*, FOREIGN AFF., May-June 1995, at 123 (suggesting that the IMF overreached its capacity, not because of the United States' influence on IMF policies, but rather because of its

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Regardless of the underlying motivation, the IMF's role was both significant and unusual (at least at that time) as it exceeded its lending limits to certain countries.[23]

3. CONTEMPORARY INTERNATIONAL FINANCIAL REGULATION

3.1. Discussions of the New International Financial Architecture

3.1.1. Initiative of the Group of Ten

Following the Mexican financial crisis, the Group of Seven Industrialized Countries ("G-7") at its Halifax summit in 1995 called on the Group of Ten ("G-10") and other countries to support the international monetary system to develop financing arrangements to help prevent and to deal with the onset of international financial crises in emerging economies.[24] Upon this invitation by the G-7 to the G-10, the Deputies of the G-10 established a Working Party to consider the issues arising with respect to the orderly resolution of sovereign liquidity crises, which was formally endorsed and released in May 1996.[25]

In its report, the G-10 affirmed that, given the need to contain moral hazard and the desirability of equitable burden-sharing, first, neither the debtor countries nor their private creditors should expect to be insulated from any adverse financial consequences of their financial decisions by the provision of large-scale official

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desire for new relevance in a world economy now characterized by instability and private power); *see also* Robert Chote, *Mexico 'Showed IMF Flaws,'* FIN. TIMES, Apr. 25, 1995, at 4 (discussing the IMF's flaws as shown by the Mexican financial crisis).

[23] *See* George Graham, *$50bn Mexico Aid Plan 'Averted a Global Crisis,'* FIN. TIMES, Feb. 3, 1995, at 16. (noting that the IMF's contribution to support Mexico has been estimated at almost one-fifth of the IMF's liquid resources and seven times Mexico's quota); *see also* Francois Gianviti, *The IMF and the Liberalization of Capital Markets*, 19 HOUS. J. INT'L L. 773, 777 (1997) (presenting methods of preventing liquidity crises); Editorial, *Perspective on a Panic*, FIN. TIMES, Feb. 11, 1995, at 8 (cautioning against overreaction to Mexico's financial troubles). *See generally* STEPHAN HAGGARD, THE POLITICAL ECONOMY OF THE ASIAN FINANCIAL CRISIS (2000) (giving a broad overview of the Asian financial crisis).

[24] *See generally* G-7, *Halifax Summit Communiqué*, June 16, 1995, *available at* http://www.g7.utoronto.ca/summit/1995halifax/communique/index.html (providing the general results and findings of the summit).

[25] *See* GROUP OF TEN, THE RESOLUTION OF SOVEREIGN LIQUIDITY CRISES: A REPORT TO THE MINISTERS AND GOVERNORS PREPARED UNDER THE AUSPICES OF THE DEPUTIES (1996), *available at* http://www.bis.org/publ/gten03.pdf (discussing how to resolve foreign financial crises).

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financing in the event of a crisis, and second, there should be no presumption that any type of debt would be exempt from payment suspensions or restructurings in any future sovereign liquidity crisis.[26] Importantly, the G-10 stated that the existing flexible, case-by-case practices and procedures, as developed over the years, were an appropriate starting point for considering how to respond to future sovereign liquidity crises, advised that improvements should continue to evolve to meet the needs of specific crises, and stressed that improvements should be led by private sector groups.[27] Further, they affirmed that the official community's primary role in the resolution of sovereign liquidity crises should remain centered on "the promotion of strong and effective adjustment by debtor countries in the context of IMF-supported programs,"[28] thereby indicating the continued importance of IMF conditionality and structural adjustment programs.

Overall, in the immediate aftermath of the Mexican crisis, the emphasis was very much on improving existing mechanisms, albeit with a new focus on the development of international standards.

3.1.2. Challenges of the Globalization of Finance

Following the Asian financial crisis, the discussions on the IMF's role in transparency and liquidity increased, with a new focus on whether there was a need to reform the existing international financial architecture.[29] These discussions first looked to the changed nature of international finance and the implications of these changes. Two specific areas received the greatest attention: crisis prevention and crisis resolution. Both of these issues largely arose due to the changed nature of the international financial system—the process of globalization.

A number of factors underlie the process of financial market globalization (or re-globalization), namely: the liberalization of money, finance and investment, and trade; the process of disintermediation (sometimes labeled as securitization); technological innovation; financial innovation; and privatization.

[26] *See id.* para 2.

[27] *Id.*

[28] *Id.*

[29] *See* Weber, *supra* note 7, at 250 (arguing that the international financial infrastructure needs to be improved to best benefit all participants).

The elements[30] that contributed to this process can be identified as the following: first, there has been a progressive and comprehensive liberalization of capital flows and financial systems from the original closed and fixed structure established under the Bretton Woods system, resulting in an international system today much more similar to that preceding World War I and that which existed at the end of World War II. Second, financial markets both internationally and domestically have undergone a process of disintermediation, as financial flows have moved from traditional banks to capital markets.[31] Third, technological innovation has increased the speed with which information is transferred around the world, reinforcing the interlinkage between formerly isolated financial systems and markets. Fourth, financial innovations have developed to meet the challenges of changing financial markets and their participants, with constant development of new intermediaries and products to deal with the increased volatility and flexibility inherent in international finance. Fifth, there has been a reduction in the role of centralized economic decisionmaking, as evidenced by the spread of privatization around the world since the early 1980s, supporting both the development of international markets as funding sources and the reduction of government influence and control over domestic markets.

By the beginning of the 1990s, these trends had fundamentally altered the financial landscape around the world, both internationally and domestically. As the decade progressed, a clear feature of international finance was the occurrence of a series of financial crises, often with international or global implications—exactly the sort of crises that the Bretton Woods system was designed to prevent. As these crises have occurred, increasing attention has been give to their causes, resolution, and possible prevention, often discussed in the context of a "new" international financial architecture.[32]

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[30] *See generally* DOUGLAS W. ARNER, FINANCIAL STABILITY, ECONOMIC GROWTH, AND THE ROLE OF LAW (2007) (examining the reasons for financial market globalization).

[31] This process has changed dramatically the risks and parties involved in both international and domestic finance.

[32] *See* BARRY EICHENGREEN, TOWARD A NEW INTERNATIONAL FINANCIAL ARCHITECTURE: A PRACTICAL POST-ASIA AGENDA 133 (1999) (discussing how economists understand crises).

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Today's financial markets exhibit a number of characteristics.[33] First, the character of the markets is largely global at the wholesale level, but at best international at the retail level (even in the context of the European Union). Second, the dominant international monetary system is one based on floating rates between major currencies, with many other currencies fixed to the major currencies through various systems. Third, capital flows are largely unrestricted. Fourth, the period so far has been characterized by significant financial crises. Fifth, international financial cooperation can be characterized, on the one hand, by the continued development of the existing international financial architecture, and on the other, by the creation of the WTO. Sixth, international financial institution innovations include the EU Single Market Financial Market project, the WTO, the Financial Stability Forum, and a proliferation of international financial organizations of various characters and forms. Seventh, major financial innovations and developments include the massive growth of derivatives instruments and markets (especially the over-the-counter-market), the ongoing process of transition from central planning and state ownership and control to regulated market economies, and technological developments, especially in communications and computing. Eighth, the dominant economic philosophy has been integration, with a continued role of the Washington Consensus, modified by a new focus on incentives and institutions. Ninth, regulatory developments include an increasing focus on risk-based regulation, especially in the context of discussions of capital adequacy regulation and a new focus on legal infrastructure. Finally, fragmentation continues among more than 200 different national jurisdictions, including different currencies, different supervisory authorities, different tax systems, different laws and regulations, and different courts.

What does this mean for the future of both individual countries and the international financial system? According to Michel Camdessus, speaking in 1998, seven areas of the "architecture of the international financial system" needed to be strengthened in the wake of the Asian financial crisis.[34] First, more effective

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[33] *See* ARNER, *supra* note 30, at 64 (discussing characteristics of today's financial markets).

[34] Michel Camdessus, Managing Dir., Int'l Monetary Fund, The Role of the IMF: Past, Present, and Future, Remarks at the Annual Meeting of the Bretton Woods Committee (Feb. 13, 1998), *available at* https://www.imf.org/external/np/speeches/1998/021398.htm (discussing recent and ongoing activities of the IMF).

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surveillance over countries' economic policies, coupled with fuller disclosure of all relevant economic and financial data, was needed, given that in each situation market responses were aggravated by a significant lack of proper information.[35] Second, regional surveillance efforts needed to be improved in order to encourage neighboring countries to put pressure on one another to prevent the sorts of contagion experienced following the Mexican and Asian crises. While little has yet developed in this respect outside of the context of the European Union, discussions continue in regional fora worldwide. Third, financial sector reform focusing on improved prudential regulation and supervision was necessary around the world; this reform was based on ongoing efforts to develop "best practices" through the activities of the various organizations and institutions in order to transfer lessons learned as broadly and quickly as possible. Fourth, more effective structures needed to be developed in regard to debt workouts, both on a national level through bankruptcy laws and at the international level through ongoing efforts such as those of the G-10.[36] Fifth, capital account liberalization should have continued but needed to be based on prudence and proper sequencing to increase the orderliness of and access to international capital markets. Sixth, worldwide efforts needed to be increased to promote good governance and to fight against corruption. Seventh, multilateral financial institutions needed to be strengthened, both in terms of resources and authority and in terms of equitable representation.[37]

3.1.3. *Domestic Responses*

According to Stanley Fischer, speaking in the autumn of 1997, in order to avoid crises, a country needs both sound macroeconomic policies and a strong financial system.[38] A sound

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[35] In this regard, the IMF developed the Special Data Dissemination Standard and the General Data Dissemination Standard, and promoted disclosure through its programs and policy advice.

[36] Crisis resolution and workout issues are beyond the scope of the present Article. For more detailed discussion, see ARNER, *supra* note 30, at 303-19.

[37] Michel Camdessus, Managing Dir., Int'l Monetary Fund, Reflections on the Crisis in Asia, Address to the Extraordinary Ministerial Meeting of the Group of 24 (Feb. 7, 1998), *available at* http://www.imf.org/external/np/speeches/1998/020798.htm (discussing possible solutions to the Asian financial crisis).

[38] Stanley Fischer, First Deputy Managing Dir., Int'l Monetary Fund, How to Avoid International Financial Crises and the Role of the International Monetary

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macroeconomic policy framework is one that promotes growth by keeping inflation low, the budget deficit small, and the current account sustainable. This has been the traditional focus of the IMF through the time of the Asian financial crisis.

The focus on the importance of the financial system, however, is a more recent development. The critical role of the strength of the financial system was becoming clear before the Mexican crisis; it was crystal clear in that crisis and its aftermath, and it was widely acknowledged in the wake of the Asian crisis.

3.1.4. *International Responses*

Following the Asian financial crisis, a number of actions were taken to address these issues and to build on the initiatives undertaken after the Mexican financial crisis, focusing on the IMF (transparency and liquidity), the World Bank (technical assistance), and international financial standards.

According to its commitments in Asia in the second half of 1997, the IMF acted to further enhance its role both in the provision of international liquidity and in encouraging transparency. With regard to additional liquidity, the IMF approved the Supplemental Reserve Facility and a general capital increase. In addition, the IMF initially continued to attempt to expand its mandate to include capital account liberalization, though this was largely abandoned by the end of 1998.

The focus of the World Bank and the regional development banks[39] (collectively, "multilateral development banks") is somewhat different from that of the IMF. In general terms, the IMF can be compared to the fire brigade while the World Bank is more of a construction agency.[40] While these institutions are

Fund, 15th Annual Cato Institute Monetary Conference (Oct. 14, 1997), *available at* http://www.imf.org/external/np/speeches/1997/101497.htm [hereinafter How to Avoid Crises] (discussing how the IMF works to prevent financial crises). *See also* Stanley Fischer, *The IMF and the Asian Crisis, in* IMF ESSAYS FROM A TIME OF CRISIS: THE INTERNATIONAL FINANCIAL SYSTEM, STABILIZATION, AND DEVELOPMENT 93 (2004) (citing "macroeconomic balance and a strong and well-supervised financial system" as prerequisites for liberalizing capital accounts to prevent crises).

[39] Multilateral regional development banks include the Inter-American Development Bank, African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, and Islamic Development Bank.

[40] Sven Sandström, Managing Dir. of the World Bank Group, The East Asia Crisis and the Role of the World Bank, Statement to the Bretton Woods

increasingly working together (especially the IMF and World Bank), a number of differences between them can be discerned. First, the multilateral development banks' focus is structural and sectoral, as compared to the IMF's traditional focus on macroeconomic aggregates. Second, the multilateral development banks focus more on long-term restructuring than on short-term adjustment. Third, the multilateral development banks focus not solely on economic and financial issues, but often on a broad array of development issues (especially poverty reduction).

Overall, the division of responsibilities among these various international institutions remained (and remains) somewhat tentative. Nonetheless, following the Mexican and Asian financial crises, the multilateral development banks increasingly focused on efforts to strengthen the domestic financial systems of their member countries, especially given that precipitous crises such as those in Mexico and Asia can quickly impact not only development but also the quality of the multilateral institutions' own respective loan portfolios. However, even if the initial changes were small (but useful) steps—focusing on strengthening the financial resources of the IMF and on increasing transparency of financial markets—in fact, as Fischer suggested, more was required.[41]

3.2. *Crisis Prevention and Financial Stability: Structure and Process*

In addition to liquidity and transparency issues, the third major area of concern focused on preventing financial crises through enhancing the quality of individual financial systems. The regulator is confronted with the general objective of mitigating increased volatility, susceptibility, and contagion, all of which can have a costly impact on an economy as a whole.[42] The causes of financial crises are manifold. For example, fragile financial systems, weak institutions, unsustainable macroeconomic policies, or insufficient market supervision can all lead to crisis. The main types of financial crises can be characterized as follows: first,

Committee, paras. 5-6, (Feb. 13, 1998), *available at* http://go.worldbank.org/QJMS1KWNI1 (discussing the World Bank's relationship to the IMF).

[41] *See* How to Avoid Crises, *supra* note 38.

[42] *See* Barry Eichengreen, *Financial Instability*, *in* GLOBAL CRISES, GLOBAL SOLUTIONS 251, 254 (Bjørn Lomborg ed., 2004) (describing potential costs of excessive volatility as decreased value of collateral, bank failures, cancelled investment projects, and an overall drop in output).

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capital account crises occur if balance sheets are highly mismatched.[43] Second, banking crises are the consequence of substantial capital withdrawals from depositors leading to liquidity shortages.[44] Finally, currency crises follow from imbalances in the foreign exchange markets due to excessive demand or supply[45] or a high exchange rate volatility.[46]

Following the Mexican financial crisis of 1994-95 and the United States-led international rescue operation that followed, leaders of the developed economies recognized the need to develop mechanisms to deal with the potentially systemic dangers of such crises.[47] In response to an initiative at the Lyon summit of the G-7 in June 1996, representatives of the G-10 countries and of emerging and transition economies jointly sought to develop a strategy for fostering financial stability through the analysis of experiences in previous crises and to elucidate basic standards and principles to guide individual economies in the development of stronger financial systems,[48] going far beyond the initial efforts

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[43] *See* Rudiger Dornbusch, *A Primer on Emerging Market Crises* 2 (Nat'l Bureau of Econ. Research, Working Paper No. W8236, June 2001), *available at* http://econ-www.mit.edu/faculty/dornbusch/download.php?ids=7 (calling balance sheet issues "fundamentally linked" to mismatches in regards to financial crises).

[44] *See* Ross H. McLeod, *Lessons from Indonesia's Crisis, in* CAPITAL FLOWS WITHOUT CRISIS? RECONCILING CAPITAL MOBILITY AND ECONOMIC STABILITY 199, 209–11 (Dipak Dasgupta, Marc Uzan & Dominic Wilson, eds. 2001) (detailing the specifics of Indonesia's banking crisis and the negative impact of large capital withdrawals made by depositors who had lost confidence in the banks).

[45] *See* Eduardo Levy-Yeyati, Maria Soledad Martinez Peria & Sergio L. Schmukler, *Market Discipline under Systematic Risk: Evidence from Bank Runs in Emerging Economies* 7–9 (World Bank Policy Research, Working Paper No. 3440, 2004), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=625318 (citing the devaluation of the Brazilian dollar as a major factor in the Argentinean currency crisis).

[46] *See* INT'L MONETARY FUND, EXCHANGE RATE VOLATILITY AND TRADE FLOWS: SOME NEW EVIDENCE 8 (2004) (*prepared by* Peter Clark, Natalia Tamirisa & Shang-Jin Wei), *available at* www.imf.org/external/np/res/exrate/2004/eng/051904.pdf (finding currency crises in emerging markets to be "notable cases of large exchange rate volatility"). Another differentiation is chosen by Frankel, who cites differing inflation crises, securities market crises, international crises, global recession, and illiberal economic policies. Jeffrey A. Frankel, *Responding to Financial Crises* (Harv. U. Kennedy Sch. of Gov't, Working Paper No. RWP07-010, Feb. 2007), *available at* http://ssrn.com/abstract=963133.

[47] *See* Douglas Arner, *The Mexican Peso Crisis: Implications for the Regulation of Financial Markets,* 2 NAFTA L. & BUS. REV. AM., Fall 1996, at 28, 38 (describing the international response to the Mexican peso crisis).

[48] *See* WORKING PARTY ON FIN. STABILITY IN EMERGING MARKET ECONOMIES, FINANCIAL STABILITY IN EMERGING MARKET ECONOMIES: A STRATEGY FOR THE

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published in May 1996.[49] The primary conclusion to emerge from this study was that a financial system that is robust is less susceptible to the risk of a crisis in the wake of real economic disturbances and is more resilient in the face of crises that do occur.

As noted, financial crises can have serious repercussions for economies in terms of heightened macroeconomic instability, reduced economic growth, and a less efficient allocation of savings and investment.[50] In its report, the G-10 focused on three central elements necessary to the development of a robust financial system: (1) creation of an institutional setting and financial infrastructure necessary for a sound credit culture and effective market functioning; (2) promotion of functioning of markets so that owners, directors, investors, and other actual and potential stakeholders exercise adequate discipline over financial intermediaries; and (3) creation of regulatory and supervisory arrangements that complement and support market discipline.[51] The World Bank and regional development banks were given a leading role in providing technical assistance to countries seeking to build robust financial systems.

3.2.1. *Financial Stability*

The focus since the Mexican financial crisis has therefore come to rest on the concept of "financial stability" as the primary target in preventing financial crises and reducing the severe risks of financial problems that do occur from time to time. Financial

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FORMULATION, ADOPTION AND IMPLEMENTATION OF SOUND PRINCIPLES AND PRACTICES TO STRENGTHEN FINANCIAL SYSTEMS (1997), *available at* http://www.bis.org/publ/gten02.pdf [hereinafter G-10 STRATEGY (1997)] (discussing how to maintain strong financial markets). This framework was developed further by the Group of 22 Systemically Significant Countries. WORKING GROUPS ON TRANSPARENCY AND ACCOUNTABILITY, STRENGTHENING FIN. INST., AND INT'L FIN. CRISES, SUMMARY OF REPORTS ON THE INTERNATIONAL FINANCIAL ARCHITECTURE 11 (1998), *available at* http://www.bis.org/publ/othp01a.pdf [hereinafter WORKING GROUPS] (discussing a method for strengthening financial markets).

[49] *See supra* notes 24–28 and accompanying text.

[50] *See* WORKING GROUPS, *supra* note 48, at 1 (discussing general effects of financial crises).

[51] *See* WORKING GROUP ON STRENGTHENING FINANCIAL SYSTEMS, REPORT OF THE WORKING GROUP ON STRENGTHENING FINANCIAL SYSTEMS 3–4 (1998), *available at* http://www.bis.org/publ/othp01c.pdf (discussing elements of a robust financial system).

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stability, however, is not a clearly defined term. In fact, financial stability is usually more clearly defined by what it is not than by what it is: financial stability is often described as the absence of a major financial crisis.[52] According to Garry Schinasi, discussing the term in literature and practice,[53] financial stability may be defined as the joint stability of the key financial intermediaries operating within the financial system and the stability of the constituent markets.[54] For financial intermediaries, this generally means that they are sound—i.e., that they have sufficient capital to absorb normal, and at times abnormal, losses, and sufficient liquidity to manage operations and volatility in normal periods of time. Market stability generally means the absence of the kind of volatility that could have severe real economic consequences (i.e., systemic risk).

Financial stability is therefore both the absence of financial crisis and the normal operation of financial intermediaries and markets. Marc Quintyn and Michael Taylor go one step further, suggesting that the financial sector plays a special and unique role in an economy, and that as a result, "the achievement of financial stability . . . is now generally considered a public good."[55] With financial stability as the agreed international objective, a system has been developed to assist countries in achieving this goal.

3.2.2. *Structure and Process*

The emerging international strategy for the development of financial stability can be described as a system of international

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[52] *See* Udaibir Das, Marc Quintyn & Kina Chenard, *Does Regulatory Governance Matter for Financial System Stability? An Empirical Analysis* 5-6 (Int'l Monetary Fund, Working Paper WP/04/89, May 2004) (discussing problems with defining financial stability). As a result "financial system soundness" is used instead of "financial stability."

[53] *See* Garry J. Schinasi, *Responsibility of Central Banks for Stability in Financial Markets* (Int'l Monetary Fund, Working Paper WP/03/121, June 2003) (discussing the controversy over defining financial stability). For further discussion concerning the definition of financial stability, see Andrew Crockett, *The Theory and Practice of Financial Stability*, GLOBAL ECON. INST. NEWSL. 6 (Centre for Econ. Policy Research, London, Eng.), Aug. 1997; David S. Bieri, *The Basel Process and Financial Stability* (Soc. Sci. Research Network, Working Paper, 2004), *available at* http://ssrn.com/abstract=616723.

[54] Schinasi, *supra* note 53, at 4 (providing a general, working definition of financial stability).

[55] Marc Quintyn & Michael W. Taylor, *Regulatory and Supervisory Independence and Financial Stability* 8 (Int'l Monetary Fund, Working Paper WP/02/46, Mar. 2002) (emphasis removed).

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financial standards. The system, as it has developed, has the following primary characteristics: (1) development of an international consensus on the key elements of a sound financial and regulatory system by representatives of the relevant economies; (2) formulation of sound principles and practices by international groupings of technocratic authorities with relevant expertise and experience, such as the Basel Committee, IOSCO, the International Accounting Standards Board, the International Association of Insurance Supervisors ("IAIS") and the Joint Forum on Financial Conglomerates; (3) use of market discipline and market access channels to provide incentives for the adoption of sound supervisory systems, better corporate governance, and other key elements of a robust financial system; and (4) promotion by multilateral institutions such as the IMF and the multilateral development banks of the adoption and implementation of sound principles and practices.[56] Importantly, however, the ultimate responsibility for policies to strengthen financial systems lies with the governments and financial authorities in the economies concerned.

This system of international financial standards developed in response to the financial crises in the 1990s. In a nutshell, it can be described as having four levels, incorporating both existing and new international institutions and organizations. At the first level, there is a structure and process which has mainly been established through political processes. At the second level, the process focuses on international standard-setting, largely of a technocratic nature. At the third level, there is the process of implementation of standards—in principle a domestic process, but with technical assistance through a variety of international, regional, and bilateral sources. At the fourth level, there is a process of monitoring the implementation of standards.[57]

3.3. International Financial Standards and Standard-Setting Organizations

International standards and their development are the central

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[56] *See* G-10 STRATEGY (1997), *supra* note 48, at 49 (discussing the new global stability strategy and the principles on which it should be based).

[57] This essential structure was affirmed by the G-7 Finance Ministers in the Communiqué from their Köln summit in 1999. *See* G-7 Finance Ministers, *Report of the G7 Finance Ministers to the Köln Economic Summit* (Jun. 18-20, 1999), *available at* http://www.g8.utoronto.ca/finance/fm061999.htm.

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element of the second level of the current system of international financial standards—the only truly new element of the international financial architecture to follow the series of financial crises over the past fifteen years. Given that a safe and efficient financial system is crucial for the functioning of any economy, the G-7 at their Lyon Summit in 1996 directed the international financial institutions and international financial organizations—especially the IMF, World Bank and Basel Committee—to develop standards for financial regulation to be implemented in developed, developing, emerging, and transition economies, as well as to develop solutions for domestic crises with international implications. As a result, a wide range of institutions and organizations have been producing standards in a number of areas.

The only new institution to emerge from discussions of the international financial architecture is the Financial Stability Forum ("FSF").[58] The FSF was established to serve the role of the coordinator in the system of international standards and to promote standards. At present, the FSF has agreed a list of twelve "key standard areas," which incorporate fifteen "key standards." In addition to coordination and standard-setting through the FSF, the established international financial institutions, such as the IMF, the World Bank, and the BIS, adhere to their mandate of standard-setting, as well as implementation and monitoring. In addition to the international financial institutions, other formal international organizations, such as the Organization for Economic Cooperation and Development ("OECD"), are of importance. However, the WTO is not formally included; this is a potential weakness in the existing framework. Finally, much standard-setting takes place through various international financial organizations of varying levels of formality.[59]

At the political level, the G-7[60] industrialized countries have

[58] *See* The Financial Stability Forum, http://www.fsforum.org (last visited Dec. 12, 2007) (describing the creation, purpose, and work of the Financial Stability Forum).

[59] *See* David Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*, 33 TEX. INT'L L.J. 281 (1998) (analyzing the regulatory cooperation of international financial organizations in order to illustrate the development of international rules).

[60] The G-7 includes Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States. The Group of Eight ("G-8") includes Russia in addition to the G-7 members. The European Union is also a member of both the G-7 and the G-8. For the best resource on the G-7 and G-8, see G8 Information Centre, http://www.g7.utoronto.ca/ (last visited Dec. 12, 2007).

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taken the lead in establishing an operating framework for the process. In addition, the G-10[61] initiated efforts to elaborate the details. Finally, other groups such as the Group of Twenty ("G-20")[62] are also involved in various aspects. Today, the process has largely been formalized.

3.3.1. Coordination

The FSF and the BIS currently serve the primary role in coordination of the process of standard-setting. As noted, the FSF was established under the auspices of a G-7 mandate in February 1999. Its purpose is threefold: (1) to promote international financial stability, (2) to improve the functioning of markets, and (3) to reduce systemic risk through enhanced information exchange and international cooperation in financial market supervision and surveillance.

The FSF includes five different types of members: national authorities,[63] international financial institutions,[64] other international organizations,[65] international financial organizations,[66] and committees of central bank experts.[67] In addition, the FSF has created a number of ad hoc working groups to develop recommendations on specific issues. These include: highly leveraged institutions, capital flows, offshore financial

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[61] The G-10 includes Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States. Therefore, it actually includes thirteen countries.

[62] The G-20 includes the finance ministers and central bank governors of 19 countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, and the United States. It also includes the European Union (Council President) and the European Central Bank ("ECB"), as well as (on an ex officio basis) the Managing Director of the IMF, the President of the World Bank, and the chairs of the International Monetary and Financial Committee and Development Committee of the IMF and World Bank.

[63] National authorities include the G-7, plus the ECB, plus five economies: Australia, Canada, France, Germany, Hong Kong, Italy, Japan, Netherlands, Singapore, Switzerland, the United Kingdom, the United States, and the ECB.

[64] International financial institution members include the BIS, the IMF, and the World Bank.

[65] International organization members include the OECD.

[66] International financial organization members include the Basel Committee on Banking Supervision, the IAIS, and IOSCO.

[67] Committees of central bank experts that are members include the Committee on the Global Financial System ("CGFS") and the Committee on Payment and Settlement Systems ("CPSS").

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centers, implementation of standards, incentives to foster implementation of standards, deposit insurance, and e-finance.

In addition to the FSF, the BIS plays an important role in coordination. It provides the secretariat for the FSF, as well as the Basel Committee, Committee on Payment and Settlement Systems, Committee on the Global Financial System, G-10, and IAIS.

3.3.2. *Key Standards for Sound Financial Systems*

The FSF has agreed upon twelve key standards areas,[68] including a total of fifteen standards, which are considered to be the quintessential minimum requirements for good practice.[69] They are grouped into three main categories encompassing several different aspects. The intention is that each set of key standards will be supported by a methodology for assessment and implementation and a variety of related principles, practices, and guidelines.

The first category, macroeconomic policy and data transparency, includes three key standard areas: (1) monetary and financial policy transparency, (2) fiscal policy transparency, and (3) data dissemination. The first two key standard areas include one key standard each, while the third includes two key standards. The second category, institutional and market infrastructure, includes six key standard areas: (1) insolvency, (2) corporate governance, (3) accounting, (4) auditing, (5) payment and settlement, and (6) market integrity. The second, third, and fourth areas include one key standard each. The fifth and sixth contain two key standards each. The first is still under discussion. The third category, financial regulation and supervision, includes three key standard areas: (1) banking supervision, (2) securities regulation, and (3) insurance supervision. Each area includes one key standard.

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[68] Some of the key standards are relevant for more than one policy area. For example, sections of the Code of Good Practices on Transparency in Monetary and Financial Policies have relevance for aspects of payment and settlement as well as for financial regulation and supervision.

[69] THE FINANCIAL STABILITY FORUM, 12 KEY STANDARDS FOR SOUND FINANCIAL SYSTEMS (2006), http://www.fsforum.org/compendium/key_standards_for_sound_financial_system.html (listing the twelve key standards areas that are essential to developing and maintaining a sound financial system).

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3.3.3. *Process of Standard-Setting*

As noted, standard-setting takes place through a range of different bodies. These can largely be grouped into international financial institutions,[70] other formal international organizations,[71] and international financial organizations. The international financial organizations include a range of different forms, including regulators,[72] central banks,[73] professional groups,[74] market associations,[75] expert groups,[76] and legal groups.[77]

To date, the exact process of selecting standard areas, designating standard areas and standards as "key," selecting appropriate standard-setting organizations, and developing standards themselves are all unclear despite the extended emphasis on transparency. Selection and designation seems to be something of a bottom-up process, with standard-setters selecting areas to address and promoting their respective standards to political institutions such as the G-7 and the international financial institutions for adoption and support. Nonetheless, a uniform process for standard-setting does appear to be developing. In addition, the more recent process has included an increasing amount of public consultation and input, which enhances the quality of and support for resulting standards.

Standard-setting now appears to follow a similar pattern, with the basic elements (for both initial development and revision) as

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[70] The international financial institutions include the IMF, the World Bank, and the BIS.

[71] At present, this includes the OECD. At present, the WTO is not officially represented.

[72] Regulators include the Basel Committee, IAIS, and IOSCO. The Financial Action Task Force can also be included in this category.

[73] Central banks operating in this arena include CPSS and CGFS.

[74] These include the International Accounting Standards Board ("IASB") and the International Federation of Accountants.

[75] Market associations include the International Swaps and Derivatives Association, the International Capital Markets Association, and the Loan Market Association.

[76] Expert groups include the Institute of International Finance, the Group of Thirty, the Institute for International Economics, and a plethora of domestic and academic research and policy institutes.

[77] Legal groups include the International Law Association, the International Bar Association, the U.N. Commission on International Trade Law ("UNCITRAL"), the International Institute for the Unification of Private Law ("UNIDROIT"), the Hague Conference on Private International Law, and the Council of Europe.

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follows: (1) networking and lobbying by potential standard-setters for mandates to develop standards in various areas; (2) support through the G-7, FSF, and/or other bodies for a standard development process to proceed; (3) an international process of awareness-building and discussion of issues; (4) multilateral technocratic cooperation in drafting; (5) support from the governing body of the standard-setting organization; (6) testing the use of standards in monitoring and implementation; (7) finalization of guidance and supporting materials; and (8) approval by the governing body of the standard-setting organization(s) and referral to other bodies such as the G-7 and/or FSF. Revisions (recently completed in some areas and on-going in others) appear to be following a similar path.

3.3.4. *Compendium of Standards*

The FSF has produced a "Compendium" of standards encompassing the fifteen key standards; in addition, the Compendium includes the various standards which the FSF has designated as significant for financial stability and domestic implementation.[78] The FSF Compendium is organized under three broad headings identical to those used in respect to the twelve key standard areas, namely (1) macroeconomic policy and data transparency, (2) institutional and market infrastructure, and (3) financial regulation and supervision.[79] These three broad headings are, in turn, subdivided further. As a result, the broad heading of macroeconomic policy and data transparency includes four subject areas: (1) monetary and financial policy transparency, (2) fiscal transparency, (3) data dissemination, and (4) data compilation. The broad heading of institutional and market infrastructure includes seven subject areas: (1) insolvency, (2) corporate governance, (3) accounting, (4) auditing, (5) payment and settlement, (6) market integrity, and (7) market functioning. The broad heading of financial regulation and supervision includes four subject areas: (1) banking supervision, (2) securities regulation, (3) insurance regulation, and (4) financial conglomerate supervision.

While the FSF Compendium is a useful web-based source, it

[78] *See* FINANCIAL STABILITY FORUM, *supra* note 69 (designating twelve key standards for sound financial systems which are "broadly accepted as representing minimum requirements for good practice").

[79] *See supra* Section 3.3.2.

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has not been updated on a regular basis, which limits its usefulness to some extent. In addition, as noted above, the exact process for inclusion is not transparent. Both of these issues are worth further consideration by the FSF if it wishes to increase its effectiveness and legitimacy.

3.4. Implementation and Monitoring

An important element of the standard-setting process involves monitoring the implementation of international standards around the world. Implementation is primarily a domestic process, but it is supported by a range of international assistance mechanisms. Monitoring mainly takes place at the international level through the international financial institutions, especially the IMF and the World Bank. Specifically, the IMF works through its annual Article IV consultations. The IMF and the World Bank collaborate through Reports on the Observance of Standards and Codes ("ROSCs") and Financial Sector Assessment Programs ("FSAPs"). The OECD and the Financial Action Task Force on Money Laundering ("FATF") also engage in monitoring, with the FATF playing an influential role in the context of money laundering and terrorism financing. At the regional level, regional development banks[80] encourage implementation through their respective projects and reviews. In addition, regional economic associations[81] may play a role; in cases such as the European Union, these associations may play a very important one. At the bilateral level, some countries (especially the United States) are keen to support the implementation of certain standards, such as those of the FATF. Finally, at the market level, the rating agencies have shown some interest in monitoring standards, though not as much as policymakers had initially hoped.

As mentioned above, implementation is largely a domestic process, but it is supported by technical assistance from a variety of sources. Individual state self-interest includes crisis prevention and support for economic growth through improved financial system efficiency and effectiveness. International interests include

[80] Chiefly, the African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, and Inter-American Development Bank are playing this role.

[81] This primarily pertains to the European Union, the Association of Southeast Asian Nations ("ASEAN"), Mercosur, the North American Free Trade Agreement ("NAFTA"), and the Southern African Development Community.

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prevention and reduction of contagion and support for economic growth. Market interests, while potentially the strongest incentive, have yet to become focused.

3.4.1. *The Standards and Codes Initiative of the IMF and the World Bank*

The most significant developments with respect to both implementation and monitoring have been achieved through the efforts of the IMF and World Bank standards and codes initiative. The IMF and World Bank standards and codes initiative operates through two interrelated aspects: ROSCs and FSAPs. The IMF and World Bank ROSCs and FSAPs are perhaps the most important developments enhancing the accountability and credibility of policy and reducing vulnerability since the series of financial crises in the 1990s.[82]

The standards and codes initiative does this through the following methods:[83] (1) encouraging the development of internationally recognized standards in areas endorsed by the Executive Boards of the IMF and the World Bank; (2) encouraging members to adopt and implement these standards, including technical assistance; and (3) assessing members' observance of selected standards and producing and publishing ROSCs.

To date, the IMF and the World Bank have endorsed a list of twelve areas of concern, divided into three categories:[84] (1) transparency standards: data transparency,[85] fiscal transparency,[86] and monetary and financial policy transparency;[87] (2) financial

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[82] INT'L MONETARY FUND, IMF EXECUTIVE BOARD REVIEWS INTERNATIONAL STANDARDS: STRENGTHENING SURVEILLANCE, DOMESTIC INSTITUTIONS, AND INTERNATIONAL MARKETS, IMF PUBLIC INFORMATION NOTICE NO. 03/43 (Apr. 3, 2003), http://www.imf.org/external/np/sec/pn/2003/pn0343.htm.

[83] INT'L MONETARY FUND & WORLD BANK, INTERNATIONAL STANDARDS: STRENGTHENING SURVEILLANCE, DOMESTIC INSTITUTIONS, AND INTERNATIONAL MARKETS 6 (2003), *available at* http://www.imf.org/external/np/pdr/sac/2003/030503.pdf.

[84] *Id.*

[85] Int'l Monetary Fund, General Data Dissemination System, http://dsbb.imf.org/Applications/web/getpage/?pagename=gddshome; Int'l Monetary Fund, Special Data Dissemination Standard, http://dsbb.imf.org/Applications/web/sddshome.

[86] INT'L MONETARY FUND, CODE OF GOOD PRACTICES ON FISCAL TRANSPARENCY (2007), *available at* http://www.imf.org/external/np/pp/2007/eng/051507c.pdf.

[87] INT'L MONETARY FUND, CODE OF GOOD PRACTICES ON TRANSPARENCY IN MONETARY AND FINANCIAL POLICIES: DECLARATION OF PRINCIPLES (1999), *available at*

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sector standards: banking supervision,[88] securities,[89] insurance,[90] payment and settlement systems,[91] and anti-money laundering and combating the financing of terrorism;[92] and (3) standards concerned with market integrity: corporate governance,[93] accounting,[94] auditing,[95] and insolvency and creditor rights.[96]

In March 2003, the IMF and the World Bank reviewed their experiences with 343 ROSCs produced for eighty-nine economies as of December 31, 2002, and reached a number of conclusions.[97] First, in relation to data and fiscal transparency, one of the most severe weaknesses of members was coverage and consistency of fiscal data, while another relates to quasi-fiscal and off-budget

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http://www.imf.org/ external/np/mae/mft/code/eng/code2e.pdf.

88 BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, CORE PRINCIPLES OF EFFECTIVE BANKING SUPERVISION (2006), *available at* http://www.bis.org/publ/bcbs129.pdf.

89 INT'L ORG. OF SEC. COMM'NS, OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION (2003), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf.

90 INT'L ASS'N. OF INS. SUPERVISORS, INSURANCE CORE PRINCIPLES AND METHODOLOGY (2003), *available at* http://www.iaisweb.org/view/element_href.cfm?src=1/94.pdf.

91 COMM. ON PAYMENT AND SETTLEMENT SYS., BANK FOR INT'L SETTLEMENTS, CORE PRINCIPLES FOR SYSTEMICALLY IMPORTANT PAYMENT SYSTEMS (2001), *available at* www.bis.org/publ/cpss43.pdf; TECHNICAL COMM. OF THE INT'L ORG. OF SEC. COMM'NS, BANK FOR INT'L SETTLEMENTS, RECOMMENDATIONS FOR SECURITIES SETTLEMENT SYSTEMS (2001), *available at* http://www.bis.org/publ/ cpss46.pdf.

92 FIN. ACTION TASK FORCE ON MONEY LAUNDERING, THE FORTY RECOMMENDATIONS (2003), *available at* http://www.fatf-gafi.org/dataoecd/7/40/34849567.pdf; FIN. ACTION TASK FORCE ON MONEY LAUNDERING, SPECIAL RECOMMENDATIONS ON TERRORIST FINANCING (2001), *available at* http://www.fatf-gafi.org/dataoecd/55/16/34266142.pdf.

93 ORG. FOR ECON. COOP. & DEV., OECD PRINCIPLES OF CORPORATE GOVERNANCE (2004), *available at* http://www.oecd.org/dataoecd/32/18/31557724.pdf.

94 INT'L ACCOUNTING STANDARDS BD., INTERNATIONAL FINANCIAL REPORTING STANDARDS (2007).

95 INT'L FED. OF ACCOUNTANTS, HANDBOOK OF INTERNATIONAL AUDITING, ASSURANCE, AND ETHICS PRONOUNCEMENTS (2007), *available at* http://www.ifac.org/Members/Downloads/2007_IAASB_Handbook.pdf.

96 U.N. COMM'N ON INT'L TRADE LAW, LEGISLATIVE GUIDE ON INSOLVENCY LAW (2005), *available at* http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf; WORLD BANK, PRINCIPLES AND GUIDELINES FOR EFFECTIVE INSOLVENCY AND CREDITOR RIGHTS SYSTEMS (2001), *available at* http://www.worldbank.org/ifa/ipg_eng.pdf. At present, the IMF, the World Bank, and UNCITRAL are cooperating to produce a single standard, but no agreement has yet been reached.

97 INT'L MONETARY FUND & WORLD BANK, *supra* note 83, at 9-11.

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activities, especially in transitioning and emerging economies. Second, in relation to banking, political influence over banking supervision is an important weakness in developing countries. Third, in insurance and securities, weaknesses often reflect inadequate regulatory and supervisory systems and institutional weaknesses. Fourth, in accounting and auditing, good financial reporting laws and standards are not sufficient without robust regulatory frameworks to ensure adequate monitoring and enforcement. Fifth, in corporate governance, there is often a discrepancy between laws on the books and actual practice, with especial weakness in relation to shareholders' rights and the ability of the securities regulator to enforce penalties. Sixth, in insolvency, weak implementation rather than inadequate law is the most common weakness.

As a result of the 2003 review, the IMF Executive Board requested that both members and the board receive reports on progress achieved that clearly identify staff views on institutional weaknesses and their significance, and with explicitly prioritized recommendations.[98] This is intended to enable both members and the IMF and the World Bank more clearly to prioritize follow-up actions and necessary support, as well as to increase the developmental role of the standards and codes initiative. In addition, the Financial Sector Reform and Strengthening Initiative ("FIRST") was established to provide systematic technical assistance follow-up of ROSC/FSAP efforts, as well as financial support.[99] Further, in May 2002, according to the IMF, the IMF and the World Bank launched a coordinated effort to support implementation and technical assistance follow-up.[100]

3.4.2. Reports on the Observance of Standards and Codes

The ROSCs review the extent of observance of specific international standards and codes selected by the World Bank and the IMF. As of January 2007, ROSCs involving 124 economies had

98 INT'L MONETARY FUND, *supra* note 82.

99 *See* FIRST Initiative, Strengthening Financial Sectors, http://www.firstinitiative.org (last visited Dec. 12, 2007) ("providing technical assistance (TA) to promote financial sector strengthening").

100 INT'L MONETARY FUND, INTERNATIONAL STANDARDS: BACKGROUND PAPER ON STRENGTHENING SURVEILLANCE, DOMESTIC INSTITUTIONS, AND INTERNATIONAL MARKETS 19 (2003), *available at* http://www.imf.org/external/np/pdr/sac/2003/030503s1.pdf.

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been published with the consent of the relevant members.[101] In terms of structure, ROSCs generally take the following form: (1) description of the member's practice, (2) an assessment against all areas of the standard, and (3) prioritized recommendations.[102]

3.4.3. Financial Sector Assessment Program

The FSAP is a joint World Bank-IMF initiative introduced in May 1999 to promote sound financial systems in member economies. Work is coordinated through the World Bank-IMF Financial Sector Liaison Committee.[103] A major objective of the FSAP is to help countries map a transition to a more diversified and competitive financial sector without creating vulnerabilities.[104] A well-functioning financial services sector is essential for sustained economic development and poverty reduction. The FSAP should strengthen the monitoring of financial systems in the context of the IMF's bilateral surveillance and the World Bank's financial sector development work, help countries enhance their resilience to crises and cross-border contagion, and foster growth

[101] These economies include: Albania, Algeria, Antigua and Barbuda, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahrain, Bangladesh, Barbados, Belarus, Belgium, Benin, Bolivia, Bosnia and Herzegovina, Botswana, Brazil, Bulgaria, Burkina Faso, Cameroon, Canada, Chad, Chile, Colombia, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Dominican Republic, Ecuador, Egypt, El Salvador, Equatorial Guinea, Estonia, Euro Area, Fiji, Finland, France, FYROM, Gabon, Gambia, Georgia, Germany, Ghana, Greece, Grenada, Guatemala, Honduras, Hong Kong SAR, Hungary, Iceland, India, Indonesia, Iran, Ireland, Israel, Italy, Jamaica, Japan, Jordan, Kazakhstan, Kenya, Kuwait, Kyrgyzstan, Latvia, Lebanon, Lithuania, Luxembourg, Madagascar, Malawi, Mali, Malta, Mauritania, Mauritius, Mexico, Moldova, Mongolia, Morocco, Mozambique, Namibia, Nepal, Netherlands, New Zealand, Nicaragua, Niger, Norway, Oman, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Poland, Portugal, Romania, Russia, Rwanda, Samoa, Saudi Arabia, Senegal, Serbia and Montenegro, Singapore, Slovakia, Slovenia, South Africa, South Korea, Spain, Sri Lanka, St. Kitts and Nevis, St. Vincent and the Grenadines, Sweden, Switzerland, Tajikistan, Tanzania, Thailand, Trinidad and Tobago, Tunisia, Turkey, Uganda, Ukraine, United Arab Emirates, the United Kingdom, the United States, Uruguay, and Zambia. *See* Int'l Monetary Fund, Reports on the Observance of Standards and Codes (ROSCs), http://www.imf.org/external/np/rosc/rosc.asp (last visited Dec. 12, 2007) (summarizing "the extent to which countries observe certain internationally recognized standards and codes"). Some ROSCs were also published as part of FSSAs.

[102] INT'L MONETARY FUND, *supra* note 100, at 6.

[103] INT'L MONETARY FUND & WORLD BANK, FINANCIAL SECTOR ASSESSMENT PROGRAM: REVIEW, LESSONS, AND ISSUES GOING FORWARD 5 (2003), *available at* http://www.imf.org/external/np/fsap/2003/review.pdf.

[104] *Id.* at 4.

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by promoting financial system soundness and financial sector diversity.[105] Assessments of financial systems undertaken under the FSAP identify the strengths, risks, and vulnerabilities in the financial system, and the two-way linkages between financial sector performance and the macroeconomy.[106]

The Executive Boards of the IMF and the World Bank reviewed the program in December 2000 and January 2001[107] and agreed on broad guidelines for continuation and further development.[108] Following a March 2003 review based on completed assessments in forty-five economies and work underway in twenty-five more and twenty-seven additional scheduled for 2004 or later,[109] the IMF Executive Board agreed that the FSAP was generally successful in a number of respects, including: (1) identifying financial sector vulnerabilities and strengths; (2) strengthening analysis of financial stability issues and development needs and priorities; (3) providing country authorities with appropriate policy recommendations; (4) enhancing data availability; (5) improving assessments of financial system strengths and vulnerabilities, including by markets; and (6) improving analysis of the potential impact of financial crises on macroeconomic conditions.[110]

In terms of structure, the FSAP includes several elements:[111] (1) systematic analysis of financial soundness indicators ("FSIs") and stress tests;[112] (2) assessment of standards and codes; and (3)

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[105] INT'L MONETARY FUND, IMF REVIEWS EXPERIENCE WITH THE FINANCIAL SECTOR ASSESSMENT PROGRAM AND REACHES CONCLUSIONS ON ISSUES GOING FORWARD, IMF PUBLIC INFORMATION NOTICE NO. 03/46 (Apr. 4, 2003), http://www.imf.org/external/np/sec/pn/2003/pn0346.htm.

[106] *Id.*

[107] *See* INT'L MONETARY FUND, IMF REVIEWS EXPERIENCE WITH THE FINANCIAL SECTOR ASSESSMENT PROGRAM (FSAP) AND REACHES CONCLUSIONS ON ISSUES GOING FORWARD, IMF PUBLIC INFORMATION NOTICE NO. 01/11 (Feb. 5, 2001), http://www.imf.org/external/np/sec/pn/2001/pn0111.htm (noting the Board's observances); INT'L MONETARY FUND & WORLD BANK, *supra* note 103 (utilizing the past FSAP reviews to suggest strategies and tools for moving forward with FSAP more thoroughly and effectively).

[108] INT'L MONETARY FUND & WORLD BANK, *supra* note 103, at 8.

[109] *Id.* at 11-12.

[110] INT'L MONETARY FUND, *supra* note 105.

[111] INT'L MONETARY FUND & WORLD BANK, *supra* note 103, at 18. See INT'L MONETARY FUND & WORLD BANK, ANALYTICAL TOOLS OF THE FSAP (2003), *available at* http://www.imf.org/external/np/fsap/2003/022403a.pdf, for a discussion on the tools used in assessing the effectiveness of the FSAP.

[112] *See* OWEN EVANS ET AL., INT'L MONETARY FUND, MACROPRUDENTIAL INDICATORS OF FINANCIAL SYSTEM SOUNDNESS, OCCASIONAL PAPER NO. 192 (April

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assessment of the broader financial stability framework, including systemic liquidity arrangements, governance and transparency, and financial safety nets and insolvency regimes. FSAPs are usually conducted over two separate missions.[113] Following completion, an FSAP team prepares an FSAP *aide-memoire* presenting their findings.[114] The IMF staff uses the FSAP *aide-memoire* to prepare a Financial Sector Stability Assessment ("FSSA"); the World Bank staff uses the FSAP *aide-memoire* to prepare a Financial Sector Assessment ("FSA"). FSSAs then may be issued as ROSCs with the permission of the relevant member.

In November 2001, the World Bank and IMF staff and external assessors from other institutions involved in the FSAP met in Paris to assess progress to date. They reached a number of conclusions with respect to areas requiring further effort, including: (1) assuring consistency in assessments, (2) need for more detailed guidance on assessing actual implementation, and (3) further work to measure linkages between financial sector standards and financial stability.[115]

3.4.4. *Ongoing Surveillance*

The FSAP is used to prepare FSSAs, which are included in biannual IMF Article IV surveillance activities. As of January 2007, FSSAs for seventy-five economies were published with the consent of the relevant IMF members.[116] In addition, while the IMF

2000), *available at* http://www.imf.org/external/pubs/ft/op/192/OP192.pdf (surveying current knowledge in the area of macroprudential indicators and suggesting their use for the effective monitoring of financial systems); MONETARY & EXCH. AFFAIRS DEP'T & STATISTICS DEP'T, INT'L MONETARY FUND, FINANCIAL SOUNDNESS INDICATORS: POLICY PAPER (2001), *available at* http://www.imf.org/external/np/mae/fsi/2001/eng/pp.pdf (discussing the need for a means to monitor risks and vulnerabilities in financial systems and the utilization of financial soundness indicators as a solution to that need).

[113] INT'L MONETARY FUND & WORLD BANK, *supra* note 103, at 25.

[114] These are not published. Prior to March 2003, FSAP teams prepared more lengthy FSAP reports.

[115] INT'L MONETARY FUND & WORLD BANK, *supra* note 111, at 23-25.

[116] See Int'l Monetary Fund, Financial Sector Assessment Program (FSAP), http://www.imf.org/external/np/fsap/fsap.asp (last visited Dec. 12, 2007) for a collection of the Financial System Stability Assessment country reports pertaining to the following economies: Albania, Algeria, Australia, Austria, Bahrain, Barbados, Belarus, Belgium, Bosnia and Herzegovina, Bulgaria, Chile, Colombia, Costa Rica, Croatia, Czech Republic, Denmark, Finland, France, FYROM, Gabon, Georgia, Germany, Ghana, Greece, Hong Kong SAR, Hungary, Iceland, Ireland, Israel, Italy, Jamaica, Japan, Kazakhstan, Kuwait, Kyrgyzstan, Latvia, Lithuania,

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historically has not been a major provider of technical assistance, the standards and codes initiative has significantly increased the IMF's activities in this area: it is now one of its priority areas for technical assistance.[117]

As noted earlier, the World Bank uses FSAP *aide-memoires* to prepare an FSA, which is used to support the Bank's development work (especially technical assistance), also in the context of its Country Assistance Strategies.

According to the Bank there are three reasons for its participation in the standards and codes initiative:[118] "First, that structural and institutional underpinnings of a market economy are an important complement to sound macroeconomic policies for both successful integration with the world economy and sound development."[119] Second, "implementation of standards can help countries establish these foundations, in turn contributing to national and global financial stability."[120] Third, "partnership with the IMF provides the basis for a comprehensive approach and broad-based effort for the implementation of standards."[121] Increasingly, the Bank is attempting to integrate ROSCs, FSAPs, and FSAs into its development work. However, given the decentralized nature of the Bank, this has not been as easy to achieve as in the context of the more centralized IMF structure.

Apart from the activities of the IMF and the World Bank, regional initiatives supporting implementation and monitoring involve the regional development banks, regional financial organizations, and regional economic arrangements; however, to date, these are more limited than those of the IMF and the World Bank. Bilateral initiatives addressing implementation and monitoring have come via two paths: (1) the bilateral aid agencies

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Luxembourg, Madagascar, Malta, Mauritius, Mexico, Moldova, Montenegro, Morocco, Mozambique, Namibia, Netherlands, New Zealand, Norway, Pakistan, Philippines, Poland, Portugal, Romania, Russia, Rwanda, Saudi Arabia, Senegal, Serbia, Singapore, Slovakia, Slovenia, South Korea, Spain, Sweden, Switzerland, Tanzania, Trinidad and Tobago, Tunisia, Turkey, Uganda, Ukraine, United Arab Emirates, the United Kingdom, and Uruguay, plus the Central African Economic and Monetary Community and the Eastern Caribbean Currency Union.

117 INT'L MONETARY FUND, *supra* note 100, at 17.

118 INT'L MONETARY FUND & WORLD BANK, ASSESSING THE IMPLEMENTATION OF STANDARDS: A REVIEW OF EXPERIENCE AND NEXT STEPS 26 (2001), *available at* http://www.imf.org/external/np/pdr/sac/2001/eng/review.pdf.

119 *Id.* at 26.

120 *Id.*

121 *Id.*

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(such as the U.S. Agency for International Development ("USAID")) and (2) bilateral monitoring by individual countries, such as the United States, in the context of money laundering. There has been hope that market initiatives would provide a key incentive for economies to implement international standards and also an additional form of monitoring. While the take-up has not been significant, there have been some important developments in this respect from rating agencies and investors. In addition, research is beginning to support the effectiveness of the implementation of standards in reducing financial costs.

3.5. Financial Liberalization and the WTO

In addition to the various organizations discussed above, foreign participation in domestic financial services is dealt with largely through bilateral, regional, and international negotiations, with the latter centered on the WTO—specifically, the Marrakesh Agreement Establishing the WTO ("WTO Agreement") entered into force on January 1, 1995, with its annexes, including the General Agreement on Tariffs and Trade 1994 ("GATT") and the General Agreement on Trade in Services ("GATS"). The main legal components affecting international trade in financial services include: (1) GATS,[122] (2) Annex on Financial Services, (3) Second Annex on Financial Services, (4) Understanding on Commitments in Financial Services, (5) Second Protocol to the GATS, (6) Fifth Protocol to the GATS, (7) Decisions, and (8) Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU").

These components contain a number of general obligations respecting trade and financial services contained in the various agreements, including most favored nation ("MFN") treatment,[123]

[122] According to the Results of the Uruguay Round of Multilateral Trade Negotiation, the GATS is composed of four parts: (1) the main text of the Agreement (the General Agreement on Trade in Services), (2) eight Annexes, (3) Schedules of specific commitments, (4) List of Article II Exemptions. The GATS Text refers to only the first part. General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 283, 33 I.L.M. 1125, 1168 (1994) [hereinafter GATS].

[123] GATS Article II (most favored nation treatment) is composed of three paragraphs, applicable to all services sectors. Paragraph 1 is the core rule identifying the MFN obligation with respect to trade in services. It requires that each member accord to services and service suppliers of any other member

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transparency,[124] and the effect of domestic regulation, discussed further in the following Section. The GATS covers all sectors of services,[125] including financial services. In addition, the Annex on Financial Services and the Second Annex on Financial Services, as part of the GATS, directly relate to financial services.[126] The Understanding on Commitments in Financial Services, as part of the Final Act, stipulates higher requirements for financial liberalization for those members that have adopted it. The so-called Financial Services Agreement and its scheduled commitments, in contrast to the financial services commitments undertaken in the Uruguay Round and in the 1995 interim agreement, are not temporary, but permanent until the WTO members conclude a new agreement through negotiations. The Fifth Protocol to the GATS entered into force on March 1, 1999, and at the same time, those schedules of specific commitments and lists of MFN exemptions annexed to the Fifth Protocol replaced those undertaken in the 1995 interim agreement or in the Uruguay Round. These commitments form the basis for future financial services negotiations.

The WTO provides the international framework for foreign participation in financial services. However, unlike other areas, commitments made by members in the area of financial services are exclusive rather than inclusive, as in the area of trade in goods, and therefore liberalization is at the discretion of individual WTO members and remains quite limited in most cases. The framework is therefore an important starting point in supporting foreign competition in financial services, but needs to be extended through further negotiations in order to provide greater benefits. It also should be explicitly incorporated into the system of international

treatment no less favorable than that it accords to like services and service suppliers of any other country. GATS art. II.

[124] The obligation of transparency provided by GATS Article III can be divided into three categories. The first is the obligation of publication of all relevant measures or international agreements pertaining to or affecting trade in services. The second is the obligation of notification to the WTO (the Council for Trade in Services) of any new laws (or any changes to existing laws) significantly affecting trade in services. The third is the obligation of responsiveness to requests by other WTO Members for information through the establishment of enquiry points. GATS art. III.

[125] *See* GATS art. I(3)(b) ("'[S]ervices' includes any service in any sector except services supplied in the exercise of governmental authority.").

[126] *See generally* WENDY DOBSON & PIERRE JACQUET, FINANCIAL SERVICES LIBERALIZATION IN THE WTO 76–77 (1998).

financial standards. At the same time, it needs to be carefully considered in the context of the relationship between financial liberalization and financial stability.

4. INTERNATIONAL FINANCIAL REGULATION: SYSTEM OR NON-SYSTEM?

The previous Sections reviewed the development and role of the international financial architecture, focusing on the impact of changes in the global financial system and the responses to the series of financial crises which underlay these changes, emphasizing the development of international financial standards. Based on the preceding Sections, it can be said that international financial regulation today is an accretion of institutions, organizations, international standards, and domestic laws and rules in many ways not designed to address the requirements of the continuing integration of domestic economies into an increasingly globalized financial system. While the original Bretton Woods design was for a coherent global economic governance structure, today's matrix of actors lacks any coherent overarching economic, institutional, or legal framework. Rather, international financial regulation has developed in reaction to the globalization of finance. In fact, today's "system" of international financial regulation is more of a non-system.

While the efforts with respect to a system of international financial standards are definitely a major step in the development of the international financial architecture, certain issues remain unaddressed. The existing framework focuses on financial stability, but it should also tackle financial development in the context of the on-going process of globalization. In addition to including certain other specific areas, in order to better address the needs of emerging, transition, and developing economies, both the standards themselves and the supporting framework for implementation and monitoring should incorporate development issues explicitly. This probably has the greatest relevance for the multilateral development banks. Furthermore, the system of standards should also include guidance on competition in the financial sector, both domestic and foreign (notwithstanding the fact that foreign competition is addressed by the WTO financial services framework), and should be integrated into the existing system.

On the basis of the preceding discussion, this Section asks

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whether the existing structures are appropriate to the changed needs of the international financial system. As noted above, the international financial architecture as it currently exists does not yet deal with the issue of crisis resolution.[127] In addition, the international financial architecture, as designed, does not integrate its various components in such a coherent manner as the Bretton Woods system. In looking forward, we suggest that the international financial architecture should focus on the issue of integration into the global financial markets and related sequencing.

4.1. *International Standards and Codes*

The system of international standards, as developed at the end of the twentieth century, is perhaps the only major development in the international financial architecture to result from the many discussions of whether there is a need for a "new international financial architecture." The system of international financial standards has many implications for individual economies, regional arrangements, and the international financial architecture. Nonetheless, several weaknesses remain in the existing system. A number of these have already been noted (e.g., enhancement of the role of the FSF, improvement of the quality of the FSF Compendium, and formalizing the standard selection and standard-setting process).

In 2005, the IMF and the World Bank released a comprehensive assessment of their experiences with international standards and codes.[128] This review concluded, first, that there were many benefits from the initiative, especially for member authorities; and second, that there was no strong reason to modify or expand coverage beyond the twelve existing areas but that certain

[127] This is an area which merits further attention but which is beyond the scope of this Article.

[128] INT'L MONETARY FUND & WORLD BANK, THE STANDARDS AND CODES INITIATIVE—IS IT EFFECTIVE? AND HOW CAN IT BE IMPROVED? (2005), *available at* http://www.imf.org/external/np/pp/eng/2005/070105a.pdf (*approved by* Mark Allen & Danny M. Leipziger) (discussing the role of the standards and codes initiative launched in 1999 in strengthening the international financial architecture). *See also* INT'L MONETARY FUND, POLICY DEV. & REVIEW DEP'T, THE STANDARDS AND CODES INITIATIVE—IS IT EFFECTIVE? AND HOW CAN IT BE IMPROVED?: BACKGROUND PAPER (2005) (*approved by* Mark Allen), *available at* http://www.imf.org/external/np/pp/eng/2005/070105b.pdf (providing background on the standards and codes initiative and reviewing its results).

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improvements could be made in other aspects. Specifically, the IMF and the World Bank proposed to: (1) focus efforts on helping members to strengthen institutions and use the initiative to inform other work (such as surveillance and development initiatives, and also areas beyond the specifically financial context); (2) encourage country participation; (3) adopt a flexible approach to updates, basically following a five-year cycle; (4) include a clear executive summary, a principle-by-principle summary of observance, and a prioritized list of main recommendations in each ROSC; and (5) collect information on observance of standards more systematically to facilitate prioritization of assessments, management of progress towards observance of standards, and cross-country analysis.[129]

Further, the IMF is to institute a process to identify areas of macroeconomic relevance and enhance mechanisms to reflect recommendations into technical assistance prioritization, while the World Bank is to implement a multi-step plan to enhance ROSC follow-up. In respect to the latter, the World Bank is to develop detailed follow-up action plans, including addressing technical assistance needs, assigning responsibility for assimilating recommendations into work programs, helping members identify and arrange necessary implementation assistance, and implementing a process for monitoring progress.[130]

In addition to the joint report, in 2006, the IMF released an evaluation of the FSAP by its Independent Evaluation Office ("IEO"),[131] and the World Bank released a similar evaluation by its Independent Evaluation Group ("IEG").[132] Overall, the IMF IEO concluded the FSAP was significant and effective in the context of the IMF's mandate, and made seven recommendations focusing on three themes: (1) "reconsidering incentives for participation, clarifying priorities, and strengthening the links with surveillance"; (2) "steps to maintain and strengthen further the quality of the FSAP and organizational changes within the IMF"; and (3) "the

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[129] *See* INT'L MONETARY FUND & WORLD BANK, *supra* note 128.

[130] *See id.* at 30 (discussing how to develop a detailed follow-up plan in selected countries to integrate the initiative into other Bank and Fund work).

[131] INT'L MONETARY FUND, INDEP. EVALUATION OFFICE, REPORT ON THE EVALUATION OF THE FINANCIAL SECTOR ASSESSMENT PROGRAM (2006), *available at* http://www.imf.org/external/np/ieo/2006/fsap/eng/pdf/report.pdf.

[132] WORLD BANK, INDEP. EVALUATION GROUP, FINANCIAL SECTOR ASSESSMENT PROGRAM: IEG REVIEW OF THE JOINT WORLD BANK AND IMF INITIATIVE (2006), *available at* http://siteresources.worldbank.org/EXTFINSEC/Resources/fsap_evaluation.pdf.

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working of the joint IMF-World Bank approach."[133] Recommendations included prioritizing and strengthening financial sector surveillance—including the FSAPs—mainstreaming FSAPs and follow-up work into regular IMF surveillance activities, maintaining the joint approach but giving the World Bank the lead in cases in which financial sector development issues predominate with the IMF leading where significant domestic or global financial stability issues exist, and establishing a clearer mechanism for follow-up technical assistance coordination involving the World Bank and other providers.[134] Significantly, these recommendations were supported in the context of the IMF's Medium-Term Strategy.[135]

Similar to the IMF's IEO, the World Bank's IEG reached the following conclusions. First, "[t]he quality of the diagnostics has been good," although uneven across sectors. Second, "[c]ountry authorities have found the [FSAP] useful." Third, "FSAP recommendations need to be better integrated into [World] Bank programs." Fourth, "[c]ountry selection needs to better reflect surveillance priorities and the likelihood of financial sector reform." Fifth, "[t]he scope of assessment must be more tailored to the specific needs of the country." Sixth, "[t]he program must do a better job of keeping the [Executive] Board informed in a timely manner," as well as coordinating with other partners.[136] Unfortunately, it is unclear at present whether or how these conclusions and recommendations will be implemented into World Bank work.

4.2. Integrating Development with Financial Stability

The financial sector can have both a positive and a negative impact on economic development. Since, as noted, financial crises around the world have had devastating effects on economic

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[133] INT'L MONETARY FUND, *supra* note 134, at 13.

[134] *Id.* at 13–14.

[135] *See* INT'L MONETARY FUND, POLICY DEV. & REVIEW DEP'T, STANDARDS AND CODES—IMPLEMENTING THE FUND'S MEDIUM-TERM STRATEGY AND THE RECOMMENDATIONS OF THE 2005 REVIEW OF THE INITIATIVE 2 (2006) (*approved by* Mark Allen), *available at* http://www.imf.org/external/np/pp/eng/2006/062906.pdf (discussing "the operational changes that are being made to the Fund's work on Standards and Codes, to implement the Fund's Medium-Term Strategy (MTS) and the recommendations of the 2005 IMF-World Bank review of the Standards and Codes Initiative").

[136] WORLD BANK, *supra* note 132, at xii.

growth in developed, emerging, transition, and developing economies, the system of international standards for sound financial systems should be a direct response to the destructiveness of financial crises. Furthermore, the financial sector supports economic growth through facilitating allocation of financial resources, with finance providing the support for the exploitation of technology and human capital. Therefore, the financial sector can have a very positive role to play both in economic growth and in facilitating economic development. Significant research has now been done on this general relationship and also on a number of specific elements across the financial sector. However, at present, the system of international financial standards, while beginning to do so, has not yet taken sufficient account of development needs and opportunities.[137]

In looking at development issues today, the consensus view is expressed through the Millennium Development Goals ("MDGs").[138] All the various international institutions have, to some extent, taken account of these goals in pursuing their respective mandates. In addition, these goals have begun to filter through to the system of international financial standards. Specifically, the IMF has already taken steps to incorporate many of the indicators in the Special Data Dissemination Standard and the General Data Dissemination System. Furthermore, due to their focus on poverty alleviation, the World Bank and the Asian Development Bank consider these issues across their various activities, including in the financial sector. The World Bank is also beginning to use the FSAP/ROSC process to highlight

[137] *See* INT'L MONETARY FUND, DEVELOPMENT ISSUES IN THE FSAP (2003), http://www.imf.org/external/np/fsap/2003/022403b.htm (discussing the infrastructure needed to support healthy financial sector development and the stability assessments that apply).

[138] *See* The World Bank Group, Millennium Development Goals, http://www.developmentgoals.org (last visited Dec. 12, 2007) (providing comprehensive information on the Millennium Development Goals, commonly accepted as a framework for measuring development progress and creating a global partnership for development). *See generally* United Nations Millennium Declaration, G.A. Res. 55/2, U.N. Doc. A/RES/55/2 (Sept. 18, 2000) (reaffirming the United Nations' commitment to supporting world peace and justice, upholding fundamental values, and facilitating globalization in a positive way); The Secretary-General, *Road Map Towards the Implementation of the United Nations Millennium Declaration: Report of the Secretary General*, U.N. Doc A/56/326 (Sept. 6, 2001) (assessing the goals and commitments made under the Millennium Declaration and offering suggestions and best practices for meeting them).

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developmental needs and to support its overall efforts in the financial sector.

This sort of activity needs to be increased. At present, neither the standards nor the evaluation process is designed with developmental issues in mind. As standards are revised, greater account should be taken of their use in development. Further, the evaluation process should be extended beyond assessment of financial stability to assessment of financial stability and development. This kind of assessment would logically be undertaken by the World Bank. However, it should also incorporate the various regional development banks and involve the bilateral aid agencies. If this were to take place, financial sector development assessments could play a major role in directing the efforts of individual economies and the multilateral and bilateral aid providers to greater effectiveness in the financial sector.

4.3. Financial Liberalization and Globalization

Following the financial crises of the 1990s, scholars started to link these crises to financial liberalization. In addition, there is an important link between financial liberalization, especially competition, and financial sector development and economic growth. It is important therefore to consider how countries should go about achieving the benefits of liberalization and competition while at the same time reducing risks of financial crisis.[139] Overall, the focus should be on the concept of sequencing, looking to the process of liberalization and the process of institutional strengthening and asking which order is best to secure financial development while at the same time minimizing financial crises.

Several studies explore the link between financial services liberalization and financial crises.[140] Research by the BIS and the

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[139] For a highly readable treatment on the benefits of financial globalization, see FREDERIC MISHKIN, THE NEXT GREAT GLOBALIZATION: HOW DISADVANTAGED NATIONS CAN HARNESS THEIR FINANCIAL SYSTEMS TO GET RICH (2006).

[140] *See* MORRIS GOLDSTEIN & PHILIP TURNER, BANKING CRISES IN EMERGING ECONOMIES: ORIGINS AND POLICY OPTIONS (Bank for Int'l Settlements, Economic Paper No. 46, 1996), *available at* http://www.bis.org/publ/econ46.pdf (exploring the factors responsible for banking problems in developing countries and some crisis prevention or reduction options available); *see also* William R. White, *What Have We Learned from Recent Financial Crises and Policy Responses?* (Bank for Int'l Settlements, Working Paper No. 84, 2000), *available at* http://www.bis.org/publ/work84.pdf (advocating for a focus on crisis prevention, crisis management, and crisis resolution in approaching recurring financial crises, noting that

IMF concludes that financial liberalization is a key leading indicator of financial crises in countries around the world over the past century. This is the case in developed countries (e.g., the United States and many European countries), in developing and emerging economies (e.g., Latin America and East Asia), and in transition countries (e.g., Russia). Analyses of financial crises during the 1990s suggest that weak domestic financial systems are a significant underlying cause of crisis when coupled with liberalization without appropriate prior and/or concurrent restructuring. Recent research indicates that financial liberalization is followed by more pronounced boom-bust cycles in the short run; however, financial liberalization leads to more stable markets in the long run.[141] While the literature is generally incomplete and inconclusive to date, there is some positive effect of capital account liberalization on growth, especially for developing countries,[142] though crises seem to be larger in emerging economies if the capital market opens first, rather than the domestic financial sector.[143] Further, equity market liberalization appears to decrease both output and consumption growth volatility, indicating that equity market liberalization is good for both global markets and individual markets.[144] Finally, insurance liberalization also correlates with financial instability: most life-insurance company failures occurred after financial deregulation, economic expansion, and a large price fluctuation.[145]

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incrementalist solutions seem to be the more appropriate treatment for such crises than an overhaul of the international financial system).

[141] *See* Graciela Laura Kaminsky & Sergio L. Schmukler, *Short-Run Pain, Long-Run Gain: The Effects of Financial Liberalization* (Int'l Monetary Fund, Working Paper No. WP/03/34, 2003), *available at* http://www.imf.org/external/pubs/ft/wp/2003/wp0334.pdf (analyzing the short-term and long-term effects of financial liberalization on capital markets).

[142] *See* Hali J. Edison et al., *Capital Account Liberalization and Economic Performance: Survey and Synthesis* (Nat'l Bureau of Econ. Research, Working Paper No. 9100, 2002), *available at* http://www.nber.org/papers/w9100.pdf (exploring the effects of capital account liberalization and stock market liberalization on economic growth).

[143] *See id.* at 24 (citing a study that found that "capital account openness detracts from growth for countries at lower levels of income").

[144] *See* Geert Bekaert et al., *Does Financial Liberalization Spur Growth?* (Nat'l Bureau of Econ. Research, Working Paper No. 8245, 2001), *available at* http://www.nber.org/papers/w8245.pdf (examining ways in which the liberalization process may contribute to economic growth).

[145] *See* Udaibir S. Das et al., *Insurance and Issues in Financial Soundness*, 17–20 (Int'l Monetary Fund, Working Paper No. WP/03/138, 2003), *available at* http://

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Graciela Kaminsky and Sergio Schmukler have provided the most comprehensive analysis of the issue.[146] Reviewing the literature, they suggest that there are two main categories of studies, one indicating that financial liberalization supports financial development,[147] and another indicating that financial crises are triggered by financial liberalization. Kaminsky and Schmukler, in analyzing the issues, focus on the definition of liberalization and the time periods involved.

In relation to liberalization, they look at a number of criteria to identify twenty-eight countries' financial systems as "fully liberalized," "partially liberalized," or "repressed" in each of three main areas over the period from 1973 to 1999: (1) capital account liberalization: regulations on offshore borrowing by domestic financial institutions, offshore borrowing by nonfinancial corporations, multiple exchange rate markets, and controls on capital outflows; (2) domestic financial liberalization: regulations on deposit interest rates, lending interest rates, allocation of credit, foreign currency deposits, and reserve requirements; (3) liberalization of stock markets: regulations on acquisition of shares in the domestic stock market by foreigners, repatriation of capital, and repatriation of interest and dividends.[148]

Their analysis produced a number of interesting results. First, at present, mature financial markets are on average less regulated than emerging economies, but there is a pattern of gradual liberalization across all regions and markets. Second, liberalization in developed economies has been uninterrupted while liberalization in emerging economies reversed following the 1980s debt crisis before resuming in the 1990s. Third, stock markets in developed economies were liberalized first, beginning in the 1970s, though the domestic financial sector and capital account tended to

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www.imf.org/external/pubs/ft/wp/2003/wp03138.pdf (discussing several recent insurance failures and the important factors that played a role in causing them).

[146] *See* Kaminsky & Schmukler, *supra* note 141.

[147] *See* Bekaert et al., *supra* note 144; Frederic S. Mishkin, *Financial Policies and the Prevention of Financial Crises in Emerging Market Countries* (Nat'l Bureau of Econ. Research, Working Paper No. 8087, 2001), *available at* http://www.nber.org/papers/w8087.pdf (explaining that financial liberalization produces investment opportunities and therefore spurs economic growth).

[148] Kaminsky & Schmukler, *supra* note 141, at 8–9 (explaining the criteria used to determine the status of the country's financial system and the meaning of each classification).

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be repressed until the 1980s, with liberalization of the domestic financial sector (by the mid-1980s) typically preceding liberalization of the capital account (at the beginning of the 1990s). Fourth, in emerging economies, reform waves occurred in the late 1970s and late 1980s, with the 1970s reforms focusing only on the capital account and domestic sector, with stock markets universalized, while in the second wave, domestic sector and stock market joint deregulation precedes capital account liberalization in the 1990s. Fifth, liberalization increases the effects of financial crises in the short run, especially in emerging economies, and decreases development in the long run. Sixth, financial crises in emerging economies are more likely to occur when the capital account is liberalized first. Seventh, institutional reforms tend to occur after initial liberalization, and partial liberalization supports further institutional reforms. Eighth, improvements in the legal system improve market stability. Kaminsky and Schmukler's study, however, "leaves unanswered the question of whether countries can deregulate financial systems without becoming vulnerable to [financial] crises."[149]

David Beim and Charles Calomiris use financial liberalization as the definition and objective of the move from a developing or transition economy to an emerging economy, arguing with the essential role of law in successful financial and economic development.[150] They define repression in terms of six aspects: (1) interest rate ceilings on bank deposits, (2) high bank reserve requirements, (3) government credit and direction of bank credit, (4) government ownership and micromanagement of banks, (5) restrictions on foreign bank and domestic non-bank entry, and (6) restrictions on capital flows.[151]

Likewise, Beim and Calomiris define liberalization in terms of six aspects: (1) elimination of interest rate controls, (2) lowering of bank reserve requirements, (3) reduction of government interference in banks' lending decisions, (4) privatization of nationalized banks, (5) introduction of foreign bank competition, and (6) facilitation and encouragement of capital inflows.[152] They conclude that while liberalization is destabilizing and can be

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[149] *Id.* at 37.

[150] DAVID O. BEIM & CHARLES W. CALOMIRIS, EMERGING FINANCIAL MARKETS (2001).

[151] *Id.* at 47.

[152] *Id.* at 119.

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related to financial crises, with proper institutional strengthening, liberalization can be beneficial.

A related question is the relationship between WTO financial services liberalization and financial crises. One aspect of WTO membership is financial services liberalization under the GATS. The potential danger inherent in financial liberalization under the WTO has also been pointed out, and the lack of linkage between the WTO framework and international financial standards has been noted, though, to date, not developed in significant detail.[153]

Nico Valckx has analyzed this issue and concludes: (1) commitments tend to relate to economic growth, current account balances, banking sector development, policy restrictiveness and peer group behavior; and (2) more liberal commitments may be associated with greater vulnerability to financial crisis in the short term, though this risk can be reduced by sound domestic policies and regulation.[154] Alexei Kireyev has taken the analysis further, focusing on the very limited nature of WTO financial services commitments as one small segment of wider financial liberalization, concluding that WTO-mandated liberalization, because of its limited focus on competition, has led to financial stability in the longer term.[155]

However, no explicit link has been developed between financial services liberalization under the GATS and the development of a robust financial system through implementation

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[153] *See* Joseph J. Norton, *"International Financial Law," An Increasingly Important Component of "International Economic Law": A Tribute to Professor John H. Jackson*, 20 MICH. J. INT'L L. 133, 147 (1999) (stating that study is needed on the effects of WTO liberalization of financial services and safety and soundness concerns).

[154] *See* Nico Valckx, *WTO Financial Services Commitments: Determinants and Impact on Financial Stability* (Int'l Monetary Fund, Working Paper No. WP/02/214, 2002), *available at* http://www.imf.org/external/pubs/ft/wp/2002/wp02214.pdf (providing an analysis of the relationship between WTO financial services, liberalization, and financial crises).

[155] *See* Alexei Kireyev, *Liberalization of Trade in Financial Services and Financial Sector Stability (Analytical Approach)* (Int'l Monetary Fund, Working Paper No. WP/02/138, 2002), *available at* http://www.imf.org/external/pubs/ft/wp/2002/wp02138.pdf (stating that the coordination of WTO-driven liberalization of financial sectors with preexisting international agreements will best facilitate financial stability); *see also* Alexei Kireyev, *Liberalization of Trade in Financial Services and Financial Sector Stability (Empirical Approach)* (Int'l Monetary Fund, Working Paper No. WP/02/139, 2002), *available at* http://www.imf.org/external/pubs/ft/wp/2002/wp02139.pdf (exploring the economic links between WTO liberalization efforts and financial sector stability, specifically as they relate to exchange rate and banking sector stability).

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of international financial standards. As noted earlier, the key appears to be the appropriate sequencing; the Beim and Calomiris framework seems to provide an appropriate ordering (though it does not expressly do so), supporting the view that WTO financial services liberalization (which only takes place as steps 5 and 6) should be beneficial, so long as it is done as part of a broader process of reform. It is worth noting that China appears to be following this trajectory.

Beim and Calomiris do suggest a sequence for privatization: (1) create legal structures for property rights, corporations, and contracts (building legal foundations); (2) restructure state-owned enterprises in corporate form (corporatization); (3) introduce competition (by allowing market entry, both domestic and foreign); (4) eliminate government barriers to price setting; (5) introduce modern accounting and auditing; and (6) determine and apply privatization process.[156] While they have not linked this to financial development and transition, a logical step would be the following sequence: (1) privatize industry according to the steps listed above, and (2) liberalize the financial sector according to those steps. Finally, one should have an emerging economy with a financial system to support growth and reduce the likelihood and impact of financial crises.

In addition to the process of liberalization in individual economies, a related question refers to the role of international organizations in encouraging and supporting the process of liberalization and institution building. These questions become especially important when one considers the role of the IMF and World Bank vis-à-vis the WTO. In fact, the IMF, the WTO and other interested actors have begun to specifically address the question of the relationship of their various mandates and roles in the financial sector. As one example, following the fourth WTO Ministerial Conference in Doha in November 2001, the membership of the WTO forced it to look into issues of trade, debt, and finance.[157] As a result of this decision, a working group

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[156] BEIM & CALOMIRIS, *supra* note 150, at 105-06.

[157] *See* World Trade Organization, Ministerial Declaration of 14 November 2001, WT/MIN(01)/DEC/1, 41 I.L.M. 746, para. 36 (2002).

> We agree to an examination, in a Working Group under the auspices of the General Council, of the relationship between trade, debt and finance, and of any possible recommendations on steps that might be taken within the mandate and competence of the WTO to enhance the capacity of the multilateral trading system to contribute to a durable solution to

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involving, inter alia, the IMF, the OECD, the United Nations, and the World Bank was established to look into (1) financing of trade, (2) trade and debt, and (3) coherence.[158] Individual reports were produced on each of the themes, with only that on trade and debt publicly available,[159] and initial findings were reported to the WTO General Council. Further results are expected in the near future. In addition to the WTO working group, the IMF focused on these issues.[160]

5. TOWARD A NEW DESIGN FOR INTERNATIONAL FINANCIAL REGULATION

Based on the suggestions for aspects of international financial regulation that could be improved, focusing on international standards and the twin objectives of financial stability and development in the context of financial globalization, the final Section provides a number of issues for consideration in a possible design for international financial regulation. Furthermore, it is argued that the system should be designed to address the realities of the global financial system and the increasing integration of domestic economies; in this context, the overall objective is to support financial stability and financial development. The Bretton Woods system was designed to support global trade but not global finance. As a result, we cannot simply return to the old system but must look towards the requirements of today's reality. In doing so, we first turn to the most successful international arrangement to address these issues: the European Union.

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the problem of external indebtedness of developing and least-developed countries, and to strengthen the coherence of international trade and financial policies, with a view to safeguarding the multilateral trading system from the effects of financial and monetary instability.

[158] *See* World Trade Organization, Working Group on Trade, Debt and Finance, *Report to the General Council*, WT/WGTDF/2 (Jul. 11, 2003) (stating that the group would focus on these issues as part of its three-part Work Plan).

[159] World Trade Organization, Working Group on Trade, Debt and Finance, *Improving the Availability of Trade Financing: Report of Preliminary Work*, WT/WGTDF/W/23 (Mar. 25, 2004).

[160] In relation to trade finance, see INT'L MONETARY FUND, POLICY DEV. & REVIEW DEP'T, TRADE FINANCE IN FINANCIAL CRISES: ASSESSMENT OF KEY ISSUES (2003) (*approved by* Mark Allen), *available at* https://www.internationalmonetaryfund.com/external/np/pdr/cr/2003/eng/120903.pdf (showing a relationship between financial crises and loss of trade via loss of trade finance).

5.1. Lessons from Europe?

On a regional level, efforts such as those of the European Union, the North American Free Trade Agreement ("NAFTA"), Mercosur, and the Association of Southeast Asian Nations ("ASEAN") now have an increasing significance for those countries wishing to become involved with these various sorts of regional efforts. For EU aspirants especially, the regional model has been of major significance given the nature of the accession process. As a result of its successes, the European Union is increasingly serving as a model for other regional integration exercises. These sorts of regional factors cannot be ignored in the process of domestic law reform. Further, European financial market rules provide an excellent second level of detail to international financial standards, because European directives and similar instruments have been carefully developed in order to deal with issues across a variety of institutional structures.

The experiences of the European Union demonstrate how, in one context, liberalization and regulation have been formally related. The EU experience shows that regional integration can play a role in promoting the adoption of sound principles and practices in economies and in supporting their implementation. The fundamental principle of mutual recognition and a system of a single license ensure that these directives provide a set of minimum norms while at the same time avoiding the creation of obstacles to competition among financial intermediaries.

5.1.1. Creation of the Internal Market and Single Market for Financial Services

A study of capital markets by the European Economic Community in 1966 addressed impediments to the effective functioning of national markets and their availability to foreign borrowers. The Segré Report found that national markets in Europe discriminated in favor of domestic borrowers primarily through regulations governing the investment of funds of savings banks and insurance companies.[161] In addition, few European

[161] *See* EUR. ECON. CMTY. COMM'N, THE DEVELOPMENT OF A EUROPEAN CAPITAL MARKET 79-80 (1966) (providing potential explanations for the trends seen in the movement of capital between Member States and non-member countries); *see also* CHARLES P. KINDLEBERGER, A FINANCIAL HISTORY OF WESTERN EUROPE 450 (2d ed. 1993) (stating that "national markets in Europe discriminated in favor of domestic borrowers, especially national governments").

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securities were listed on exchanges outside the domicile of the issuing company. As a result of practical governmental needs (combined with the forces of harmonization, access deregulation, and prudential re-regulation inherent in the process of market liberalization developed in the context of the "Maastricht" objective of free movement of capital), national financial regulation in Europe has developed significantly in recent years.[162]

The EU framework for financial services provides minimum standards for banks and other financial intermediaries, securities regulation, accounting and auditing, company law, and regulation of institutional investors, all based on the premise of universal banking and an open internal market. Since its purpose is to ensure the harmonization of the laws of the Member States to common minimum standards—insofar as this is necessary for the achievement of a single market—and to fill gaps relating to cross-border activities, it builds on the existing national systems of laws, rather than trying to replace them with a complete, new system.[163]

The EU legislative framework for financial markets seems to be grounded in a concept that can be thought of as a search for equivalence among disparate regulatory and legal systems, while taking into account the continuing reality of separate and distinct national legal and regulatory regimes as the basis of any overall EU initiatives.[164] Initially, efforts focused on harmonization of rules across Member States; however, this proved impossible in many areas. In the 1980s, the key principles were outlined in the European Commission's 1985 White Paper[165] and enshrined in the 1986 Single European Act,[166] which implemented the common internal market on the basis of mutual recognition that is based on common minimum standards applicable in all Member States

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[162] *See* Manning Gilbert Warren III, *Global Harmonization of Securities Laws: The Achievements of the European Communities*, 31 HARV. INT'L L. J. 185 (1990) (discussing the effects of harmonization, deregulation, and re-regulation on the development of national financial regulation in Europe).

[163] The purpose of this section is not to evaluate the specific provisions of the EU framework; however, a general appreciation of the key elements of the EU framework is necessary to understand the development of European financial market regulation and the way in which it integrates liberalization and regulation.

[164] *See generally* DAMIAN CHALMERS, CHRISTOS HADJIEMMANUIL, GIORGIO MONTI & ADAM TOMKINS, EUROPEAN UNION LAW: TEXT AND MATERIALS (2006).

[165] *See Commission White Paper on Completing the Internal Market*, COM (1985) 310 final (Jun. 14, 1985) (detailing the movement toward a unified European internal market).

[166] *See generally* Single European Act, Feb. 17, 1986, 1987 O.J. (L 169) 1.

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through European Directives and implemented through domestic legislation.[167] According to this methodology, all Member States agree to recognize the validity of one another's laws, regulations, and standards, thereby facilitating free trade in goods and services without the need for prior harmonization, while limiting the scope for competition among rules by mandating Member State conformity with a "floor" of essential, minimum European requirements. As such, financial services regulation in the European Union seeks to avoid the problem of competitive deregulation and regulatory arbitrage that may undermine the legitimacy and efficiency of financial markets.[168]

5.1.2. *Attempts to Improve the Single Market for Financial Services*

The single market is rooted in basic tenets of the Treaty of Rome respecting the free movement of capital, establishment, and services, and is manifested in the various single "passport" directives.[169] Under the concept of the "single" passport, an EU firm authorized in one Member State (its "home state") and wishing to operate in other Member States ("host states") will generally be able to choose to supply services through branches or on a cross-border basis without having a permanent physical presence in the host state.[170] The intended benefit of the passport is that it should "increase competition by opening markets to a wider range of participants and by allowing firms to choose the most cost-effective means of supplying services to a particular market."[171] The passport directives in the financial services area

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[167] *See id.*

[168] *See* Warren, *supra* note 162, at 186–87 (analyzing the efforts of the European Communities to overcome the obstacles created by regulatory disharmony among states).

[169] The passport directives in the financial services area include: (1) the First, Second and Third Banking Coordination Directives ("1BCD," "2BCD," and "3 BCD") (banking); (2) the Investment Services Directive ("ISD") (investment firms and securities markets), which has been repealed by the Directive on Markets in Financial Instruments ("MiFID"); (3) the UCITS Directive (collective investment schemes); (4) the First, Second and Third Life Assurance Directives (life assurance); (5) the First, Second and Third Non-Life Insurance Directives (non-life insurance); and (6) the proposed First Pension Funds Directive (pension funds).

[170] *See* Innes Fraser & Paul Mortimer-Lee, *The EC Single Market in Financial Services*, 33 BANK OF ENG. Q. BULL. 92 (Feb. 1993).

[171] *See Statistical Annex*, 33 BANK OF ENG. Q. BULL. 169, stat. annex (Feb. 1993) [hereinafter *Statistical Annex*].

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have a number of common aspects: each defines its scope in terms of the type of intermediary and the activities that it will carry out (though perhaps with reference to particular instruments); each requires firms to be authorized and sets out the conditions a firm must satisfy for initial and continuing authorization; each frames the division of responsibility between the home state and the host state in various areas;[172] and each addresses the issue of relations with non-EU Member States.[173]

In order to overcome the fragmentation of national markets, which were characteristic of the 1990s and made subsequent consolidation and integration of financial services markets difficult, the EU Commission decided in October 1998 to develop an Action Plan through two Forum Groups.[174] Based on these preparations the EU Commission issued the Financial Services Action Plan in May 1999 encompassing forty-two specific measures (later amended by five subsequent measures).[175] The objective was to fully integrate financial services markets by harmonizing the relevant rules; the progress would have to be reported to the newly established Financial Services Policy Group.[176] In the following six years, the EU Commission introduced a large number of new or at least substantially revised directives in finance matters. In 2005 it summarized its plans for future activities in the White Paper on Financial Services Policy;

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172 As a general rule, the home state will have responsibility for the prudential supervision of a firm and all its branches as well as the "fitness and properness" of its managers and major shareholders, while the host state will be responsible for the conduct of a firm's business with its customers in the host state. Fraser & Mortimer-Lee, *supra* note 170, at 93.

173 *See Statistical Annex*, *supra* note 171.

174 *See* Press Release, European Union Commission, Financial Services: Commission Proposes Framework for Action (Oct. 28, 1998), *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=IP/98/941&format=HTML&aged=1&language=EN&guiLanguage=en (exploring some aspects in achieving and maintaining the Single Market in financial services).

175 *See Communication of the Commission on Financial Services: Implementing the Framework for Financial Markets: Action Plan*, COM (1999) 232 final (May 11, 1999) (outlining objectives which would guide financial policies in coming years, setting priorities and time-frames for achieving these objectives, and recognizing factors that may contribute to their achievement).

176 *See* Howard Davies, FMG Lecture, Creating a Single Financial Market in Europe: What do We Mean? (Feb. 3, 2004) (transcript available at http://www.lse.ac.uk/collections/LSEPublicLecturesAndEvents/pdf/20040203Davies.pdf) (evaluating the progress of the Commission towards creating a single financial market under the FSAP).

the key word appears to be the realization of a "dynamic consolidation" of legal rules.[177]

Furthermore, an expert group chaired by Alexandre Lamfalussy, having studied the securities markets from July 2000 to February 2001, came to the conclusion that the structure of the EU legislative process should be improved.[178] The expert group proposed the introduction of a four-step model leading to a distinction of theoretical rulemaking and practical implementation as well as to improved monitoring and enforcement.[179] In a nutshell, the European Union can serve as an example of a quite successful integration of different national markets achieved by introducing harmonized regulations.

5.1.3. *The Accession Process and the Economic and Monetary Union*

The EU requirements relating to financial services have strongly influenced those countries in the region seeking EU membership.[180] The accession process involves Agreements with the European Union[181] which oblige applicants to take on board the *acquis communautaire*. A primary obligation of an accession state is the approximation of existing and future state legislation in the financial services sector to that of the European Union.

As an aid to this process of incorporation of the *acquis*, in April 1995 the European Commission issued a White Paper identifying the key measures required to be undertaken in each sector of the

177 *Commission White Paper on Financial Services Policy 2005-2010*, at 4, COM (2005) 629 final (May 12, 2005).

178 *See Comm. Of Wise Men, Final Report of the Committee of Wise Men on the Regulation of European Securities Markets* (Feb. 15, 2001), *available at* http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf (providing the conclusions from the studies of Lamfalussy's expert group).

179 *See* Press Release, European Union, Commission Welcomes Parliament's Agreement on Lamfalussy Proposals for Reform (Feb. 5, 2002), *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=IP/02/195&format=HTML&aged=1&language=EN&guiLanguage=en (describing the four-level approach and its reception by the European Parliament).

180 These countries are Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, and Slovenia.

181 For details, see Christos D. Hadjiemmanuil, *Central Bankers' "Club" Law and Transitional Economies: Banking Reform and the Reception of the Basle Standards of Prudential Supervision in Eastern Europe and the Former Soviet Union*, *in* EMERGING FINANCIAL MARKETS AND THE ROLE OF INTERNATIONAL FINANCIAL ORGANIZATIONS 179 (Joseph J. Norton & Mads Andenas eds., 1996).

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internal market. The White Paper proposed a sequence under which the accession candidates should seek to approximate their domestic legislation to that of the European Union, including that European rules in the financial services area should be adopted in two stages: the first involved the introduction of the basic principles for the establishment of financial intermediaries, and the second (although some elements are also important for the first stage) aimed to strengthen prudential supervision of financial firms in order to bring them up to international standards. This second stage of the Commission framework for the accession candidates focused on the various European provisions for free movement of capital and services in the financial sphere. The EU accession process thus provides a possible model for sequencing financial reform and liberalization, as well as for integrating liberalization and regulation.

On January 1, 1999, the individual currencies of the eleven EU Member States that met the relevant criteria and accepted the relevant obligations of the Maastricht Treaty (Austria, Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain) became permanently fixed in exchange rate and ceased to exist, thereby creating a single European currency, the "euro," and the European Economic and Monetary Union ("EMU"). From January 1, 2002, the twelve (Greece had also joined the EMU) and, since 2007, thirteen (Slovenia became the first former Soviet Bloc country to adopt the euro) different sets of notes and coins were quickly replaced by a single physical currency. While significant differences still exist in European financial markets, with the introduction of the Euro, information has begun to become comparable. This shift is beginning to produce, when combined with the painfully developed financial regulatory framework discussed in the previous sections, the development of a unified European financial market for the first time.

While the ultimate result is yet to be seen, substantial movements have already taken place with the significant and continuing development of domestic financial markets in the European Union. Further, new initiatives are coming rapidly, seeking to benefit from new opportunities and to place competitors at an advantage in the European markets that are, in all likelihood, to arrive in short order. Although numerous impediments to such developments remain (most notably in the area of taxation), activity is set to continue increasing at a rapid pace, putting

pressure on the barriers that remain. One example is the establishment of financial services committees to review aspects of EU financial markets and to develop proposals to remove remaining barriers to the creation of a single European financial market. Other issues are related to the need to differentiate between wholesale and retail financial services.[182]

It is this "real world" experience of the countries of the European Union and its moves to develop a single regional financial market that indicate the real advantages of the multilateral path that may lie ahead in the globalization of financial markets. The development of European financial markets, and other countries' nervousness respecting the same, has provided an impetus to international organizations, such as the IOSCO and the International Accounting Standards Board ("IASB") (and their previously recalcitrant members, such as the United States). Cally Jordan and Giovanni Majnoni suggest that two lessons can be drawn from the European experience with financial integration: first, the principle of minimum harmonization together with mutual recognition underlines the potential for leaving integration to market forces once national legal and regulatory frameworks share common minimum standards. Second, in a financially integrated world, size matters both for regulated entities and for the regulators and the same set of rules may not be efficient and equitable for both large and small players.[183] While the EU experience is definitely instructive to both the international financial architecture and other regional arrangements, the reality is that the EU process will not be politically acceptable in most other environments due to its impact on sovereignty.

5.2. Improving the International Financial Architecture

Sections 2 and 3 discussed the basic components of the international financial architecture as designed under Bretton Woods, as it operated in practice, and the major changes that have taken place since the fiftieth anniversary of the IMF and World Bank in 1994. While some of these changes are significant (e.g., the

182 Cally Jordan & Giovanni Majnoni, *Financial Regulatory Harmonization and the Globalization of Finance* 9 (World Bank, Policy Research Working Paper No. 2919, 2002), *available at* http://papers.ssrn/com/sol3/papers.cfm?abstract_id =636281.

183 *See id.* at 9-10 (summarizing the two lessons).

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system of international standards for financial stability), the discussions about whether there is a need for a new international financial architecture to deal with the changed nature of the international financial and economic system have not produced any real results (except for the development of international standards for financial stability and the creation of the WTO in 1994, which predated discussions of the "new international financial architecture" and was essentially an independent development, stemming originally from the Bretton Woods idea of the ITO).[184]

5.2.1. *Towards Regulatory Convergence*

By detailing the supporting institutional components necessary for financial stability, over time, a (non-)system without a coherent structure, and not designed to meet clear overriding objectives, in the manner of Bretton Woods or the single market financial project of the European Union has emerged. Further, the system fundamentally fails to address the risks inherent in the liberalization process under the WTO/GATS/financial services process.

Jordan and Majnoni discuss the ongoing process of financial regulatory convergence and the role of international financial standards and codes.[185] They suggest three issues inherent in the current process: complementarity, coordination, and fair representation.[186] Problems of complementarity arise from inconsistency of implementation and interpretation across jurisdictions and the voluntary nature of compliance.[187] The latter, to some extent, is being addressed by development of the IMF and World Bank international standards initiatives (e.g., FSAP/ROSC). The former, while also being addressed by the FSAP and ROSC processes, requires further research and analysis to develop proper approaches for individual countries with wide differences. This is an area in which regional financial arrangements may have an important role to play.

Coordination problems arise from the proliferation of

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[184] *See* Giovanoli, *supra* note 7; Norton, *supra* note 7; Weber, *supra* note 7 (all discussing aspects of the "new international financial architecture").

[185] *See generally* Jordan & Majnoni, *supra* note 182.

[186] *See id.* at 15–16 (expounding upon the three issues).

[187] *See id.* at 15–17 (describing the difficulty of transforming ideas into international laws).

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standards and standard setters.[188] While these have been addressed to some extent through the creation of the FSF, a key issue that remains is the existence of a relationship between compliance and financial stability—an issue only just beginning to be addressed empirically. A second issue relates to problems of reaching consensus—for example, in relation to accounting standards. These matters are likely to remain, unless the architecture of the international financial system is addressed in a more coherent manner. Issues of fair representation arise from both the limited nature of the membership of many standard setters and from the focused nature of their membership—that is, lack of consideration of issues outside of the groups' immediate competence.[189] As a result, the standards to date are not coherent in any overall fashion—lacking a true "macro-prudential" approach to financial regulation.[190] This issue has been raised especially in relation to the role of the G-7, with various recommendations for reform. Like issues of coordination, these topics should be addressed in a more coherent manner.

5.2.2. *International Institutions, Financial Stability, and Financial Development*

At the political level (represented by the various "Group of . . ." or "G" organizations, such as the G-7, G-10, and G-20), the clearest need is to improve the representativeness of the most influential grouping, the G-7/G-8, by bringing in the major emerging economies. In this context, the logical additions would be China, Brazil, India, and South Africa. Significantly, the creation of the G-20 largely reflects this objective. Importantly, the G-20 is beginning to take a more active leadership role in financial sector issues (reflecting its financially focused composition). With luck, future chairs of the G-20 will continue this trend, possibly with the eventual result of the G-20 largely supplanting the G-7 and G-10 in international financial matters. Further, the G-20 parallels the wider membership of the FSF, providing a natural political parallel to the technocratic role of the FSF while at the same time making up a majority of the voting quotas of the IMF and the World Bank

[188] *See id.* at 20 ("[T]he proliferation of international standards and codes may exemplify the lack of coordination that often precludes 'first best' approaches to market regulation.").

[189] *See id.* at 22–24 (identifying the two aspects of fair representation).

[190] *Id.* at 23–24.

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(and thereby ensuring implementation of G-20 decisions in both the technocratic standard-setting level and the multilateral institution implementation and monitoring level).

In relation to the international financial institutions (the IMF, the World Bank, and regional development banks) as well as related international institutions (such as the WTO and UN agencies), there is a need to improve coordination and focus, with clear objectives and responsibilities. In this regard, it would make sense to bring the WTO (at least as far as its responsibilities for GATS/financial services) into the G-20 and FSF membership. The following Sections look to other components of the system of international standards, of which the IMF, the World Bank, and multilateral development banks are the most significant, with possible suggestions on enhancing their respective roles.

5.3.3. The International Monetary Fund

In 2005, the IMF published its Medium-Term Strategy, a document considering the future direction of the IMF in light of economic globalization.[191] The IMF concluded that the emergence of new economic powers (e.g., China and India), integrated financial markets, unprecedented capital flows, and new ideas to promote economic development required an updated interpretation of the IMF's mandate as the steward of international financial cooperation and stability. From this basis, the IMF's strategic direction includes the following four main aspects: (1) making surveillance more effective, focusing on globalization, addressing regional aspects, and focusing assessments of standards and codes on "macro-criticality"; (2) adapting "to new challenges and needs in different member countries," with differentiated roles in more advanced and less advanced members; (3) improving internal institutional aspects of the IMF, such as capacity building, organization, and budgeting; and (4) addressing IMF governance issues, especially in relation to quotas.[192]

In relation to differential roles that depend on the level of development of members, several aspects are noteworthy. In emerging economies, the focus will be on: (1) crisis prevention, (2)

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[191] *See generally* INT'L MONETARY FUND, THE MANAGING DIRECTOR'S REPORT ON IMPLEMENTING THE FUND'S MEDIUM-TERM STRATEGY (2006), *available at* http://wwwimf.org/external/np/pp/eng/2006/040506.pdf (synthesizing discussions about the "strategic direction of the Fund").

[192] *Id.* at 4.

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crisis resolution, and (3) financing arrangements. In developing economies, the IMF will focus on macroeconomic stability, emphasizing the MDGs, and focused financing instruments, leaving coordination and harmonization to other agencies. In addition, the IMF will expand its work on managing capital account liberalization, focusing on sequencing, and on building capacity and making institutional reforms.[193]

In 2006, the IMF released a report from Rodrigo Rato bringing up plans for the IMF's medium-term development, addressing concrete proposals in relation to each area of the Medium-Term Strategy.[194] In addition, the IMF is currently discussing ways in which to improve its representation of economic power through changes to quota and related voting structures. Overall, the IMF should focus on financial stability (as well as monetary stability), leaving financial development issues to the World Bank and regional development banks. Significantly, the IMF appears to be gradually arriving at the same conclusion.[195]

5.2.4. *The World Bank*

In 2006, the World Bank IEG released a major synthesis of evaluations of the World Bank's financial sector work from 1993-2005.[196] The report is a synthesis of three underlying evaluations addressing lending,[197] technical assistance,[198] and the FSAP.[199] In addition, findings from a similar report addressing pensions are

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[193] *See generally id.*

[194] *See generally id.*

[195] *See id.* at 12, 15 (noting, as one of its strategies, a "division of labor with World Bank").

[196] WORLD BANK INDEP. EVALUATION GROUP, WORLD BANK ASSISTANCE TO THE FINANCIAL SECTOR: A SYNTHESIS OF IEG EVALUATIONS (2006), *available at* http://siteresources.worldbank.org/EXTFINSEC/Resources/financial_sector_synthesis.pdf.

[197] *See generally* WORLD BANK INDEP. EVALUATION GROUP, WORLD BANK LENDING FOR LINES OF CREDIT: AN IEG EVALUATION (2006), *available at* http://siteresources.worldbank.org/EXTFINSEC/Resources/lines_of_credit.pdf (evaluating lines of credit financed by the World Bank).

[198] *See generally* WORLD BANK INDEP. EVALUATION GROUP, IEG REVIEW OF WORLD BANK ASSISTANCE FOR FINANCIAL SECTOR REFORM (2006), *available at* http://www.worldbank.org/ieg/financial_sector (tracking the effects of technical assistance loans).

[199] WORLD BANK INDEP. EVALUATION GROUP, *supra* note 132 (assessing the effectiveness of the Financial Sector Assessment Program).

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included where relevant.[200] Overall, the IEG concluded that the World Bank's assistance to the financial sector has contributed to the development of the financial sectors, that the FSAP advanced dialogues with governments and provided useful advice and recommendations, and that lending helped to bring about positive changes in governance, regulatory framework, market structure, and efficiency.[201] Nevertheless, financial sectors would remain shallow, with narrow access to credit in many, if not most, of the countries supported by the World Bank, and there would be room for improvement in the quality and impact of assistance.

In respect to improvements, the report made a number of useful suggestions: first, the World Bank should focus more on the non-banking sector (leaving the banking sector to the IMF) and on identifying constraints to credit access through a range of activities, including lending and diagnostic work such as investment climate surveys, poverty assessments, and other economic work that could include assessments of access to various types of finance.[202] In other words, the World Bank should focus on financial sector development. Second, internal World Bank guidelines for dealing with financial crises, with triggers for actions and clear lines of responsibility (following an unimplemented conclusion following the Mexican financial crisis) should be prepared.[203] Given the decentralized nature of the World Bank's organization and work, this would ensure that it would be better prepared to deal with emergency situations in a more effective manner. Third, the overall coherence of the World Bank work in the financial sector should be improved, with the Financial Sector Network (an internal cross-department virtual group) ensuring that: (1) country strategies incorporate, where relevant, a coherent strategy for the financial sector that draws on the FSAP or other relevant

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200 *See generally* WORLD BANK INDEP. EVALUATION GROUP, PENSION REFORM AND THE DEVELOPMENT OF PENSION SYSTEMS: AN EVALUATION OF WORLD BANK ASSISTANCE (2006), *available at* http://www.worldbank.org/ieg/pensions/documents/pensions_evaluation.pdf (analyzing the World Bank's assistance to support pension reform).

201 *See generally* WORLD BANK INDEP. EVALUATION GROUP, *supra* note 196 (highlighting common themes found in three evaluations that "reviewed major components of the Bank's assistance during more than a decade to the financial sectors of client countries").

202 *Id.* at viii (discussing the joint Bank-IMF Financial Sector Assessment Program).

203 *See id.* (pointing out inadequacies in past crisis support tactics).

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diagnostic work, (2) the sector strategy carries through to lending and non-lending, and (3) quality control exists for lending and non-lending assistance to the financial sector.[204] In other words, the World Bank should have a more organized approach to its financial development work, based on the FSAP/ROSC framework.

Overall, these conclusions appear to be convincing: the World Bank should take the leading role in relation to financial development, working closely with the IMF in the context of the FSAP/ROSC, but taking an expanded, development-focused role. At the same time, however, the World Bank at present is suffering from a lack of direction generally, but especially in regard to its financial sector work. To some extent, this is being alleviated by the IFC (the World Bank's private sector development arm) increasingly taking on financial sector assistance efforts while leaving research to the World Bank.

5.2.5. Regional Development Banks and UN Agencies

The regional development banks and UN agencies such as the United Nation Committee on Trade and Development ("UNCTAD") and the United Nations Development Program ("UNDP") have been less involved to date in the FSAP/ROSC process but have played and continue to play a significant role in supporting financial development and economic growth. In this context, their efforts should be more closely coordinated with those of the World Bank, with a general focus on financial development based on the FSAP/ROSC framework.

5.3. Integrating the International Financial Architecture

The manifold comments made in this Article regarding the development of an improved international financial architecture allow the summarizing suggestion that the liberalization framework (provided at an international level through the WTO) should be more explicitly linked to the financial stability framework, though at present it is not. The international level could, in fact, take a lesson from the EU Single Financial Market project having liberalized the financial services markets simultaneously with the strengthening of the financial stability

[204] *See id.* at ix (emphasizing the importance of the Financial Sector Network).

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parameters, which may, in turn, provide a model for other regional efforts, as well as for the international financial architecture.

As noted, the international financial architecture today is not appropriately integrated to meet the needs of the international financial system. This is most explicit in the context of the relationship between the WTO, the IMF, and the World Bank. In this context, the three organizations would benefit from the creation of a joint committee to deal with issues of common concern (modeled on the original Bretton Woods design and currently operating in the form of the joint IMF-World Bank International Financial and Monetary Committee and Development Committee). Even at this stage, there are lingering unresolved issues concerning the relationship of the IMF and the World Bank; the area where this is clearest today appears to be in the context of financial liberalization and integration.

A further aspect to be taken into account in the context of the objective to realize adequate international financial architecture concerns appropriately timed action: proper sequencing of regulation, privatization, and competition appears to be crucial for achieving the gains for liberalized trade in financial services.[205] Often this sequencing is a balancing task between regulatory objectives (transparency, prudential safeguards, and supervision) and macroeconomic policies (monetary and fiscal framework). The respective balancing "test" makes it necessary to outweigh the different parameters influencing the financial system.

As one aspect of accession to or membership in the WTO and the implementation of the GATS and its annexes respecting financial services, members make numerous commitments with respect to financial services liberalization, addressing, inter alia, banking, securities and insurance activities, and intermediaries. Significantly, financial liberalization without appropriate regard for sequencing and adequate prudential safeguards has been a substantial precursor to financial crises in economies (developed, emerging, developing, and transition) around the world over the past century—and a dominant factor in the last fifteen years. A further central conclusion to emerge from analysis of recent crises is the fundamental role played by institutions, especially legal

[205] *See generally* Aaditya Mattoo, *Developing Countries in the New Round of GATS Negotiations: Towards a Pro-Active Role*, *in* DEVELOPING COUNTRIES AND THE WTO: A PRO-ACTIVE AGENDA 75, 75-93 (Bernard Hoeckman & Will Martin eds., 2001).

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institutions, financial regulation, and legal infrastructure, in reducing the risks inherent in financial liberalization.

Therefore, a goal of the international financial architecture should focus on the increased integration of developing, emerging, and transition economies into the international financial system. However, this integration is not without its dangers and must be based on coherent sequencing of liberalization preceded as a necessary first stage by the development of an effectively functioning financial system in each country.

5.4. Conclusion

This Article has looked at issues of financial stability and development which merit further attention. First, it has suggested that the international standards framework should be expanded and modified to explicitly incorporate development goals in addition to stability. While financial stability is a central goal, financial development should merit the same attention. The experiences of the European Union provide a useful example and possible model, not only for the international financial architecture but also for other regional financial arrangements as they seek to achieve the twin goals of financial stability and development across a given region. Second, in looking at the international standards framework, issues of competition and financial liberalization and their role in both financial stability and development should also be covered. Third, beyond the standards initiative, the international financial architecture deserves further attention—if not a full Bretton Woods-style review, then at least to take into account the WTO and related financial services frameworks and to address financial crisis resolution in a more coherent manner, and address interactions with global climate change mechanisms.

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