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An Institutional Perspective on International Financial Governance: How Much Has Happened Since the Crisis?

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Abstract: This article studies some institutional trends in international financial regulation after the great crisis of 2008. It supports the idea that the largest financial corporations are working to create several components for an international self-regulation. Private firms make up the architecture of this complicated global mechanism, which is backed up by governments. Meanwhile, this built-up mechanism is based on several assumptions about the origins of the great financial crisis and on the capabilities of governments to reach the objectives they are expected to achieve. This article concludes that a new financial crisis will develop, and the "too-big-to-fail" financial corporations are already preparing strategies on resolution regimes.

Keywords: financial crisis, global governance, international financial regulation

JEL Classification Codes: F55, F65, G38

The great crisis that began between 2007 and 2008 changed the financial markets. Even though the structured finance model went bankrupt and the profitability of business around credit securitization became fragile, the business of financial markets continues to be supported by structured finance. Almost a decade after the outbreak of the crisis, financial markets are fragile, and it is difficult to see stable perspectives in the near future. Successive episodes of financial crises have emerged, including financial instruments, currencies, or commodities. All of them are linked more to credit behavior and less to the conditions of each country or the demand for goods. Such is the case of the crises in Greece, Spain, Portugal, the food crisis, and the energy crisis.

The financial crisis of 2008 has been global, extensive, and heterogeneous. It has also been characteristically opaque, leaving many governments with very limited abilities to contain it. The roads taken for its management — mainly by private corporations — have resulted in new instruments and institution. The latter are

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created in the framework of central banks and domestic supervision authorities, but also through the Bank for International Settlements (BIP) and the International Monetary Fund (IMF). Yet, the main financial actors and managers in the crisis have been the same global banks. Indeed, these global financial corporations were the largest contributors to the crisis. However, they are also the main participants in the creation of new rules and institutional frameworks for their (own) rescue in another crisis in the future. The return to profitable business has been piecemeal — based on segments, regions, and markets. It is taking new dimensions in conglomerates and markets. Financialization has built up strong and deeply efficient networks for transferring profits and losses that are useful for concentrating income. It has also been effective in controlling losses. The Great Recession has exposed the enormous difficulties that state and/or private management systems face as they work with limited information in very opaque market operations and in conditions of shadow banking's portfolios, where the opacity of global banks and all financial institutions dominates, in spite of the rating agencies.

Using this framework, we track the path of financial markets by reviewing several main trends: (i) special agreements on financial information disclosure; (ii) weakening of government regulations due to private bargaining and supervision agreements; (iii) revision of lender-of-last-resort mechanisms and central banks functions; (iv) global coordination of national treasuries for the redistribution of regional assets, firms, and operations; (v) new constraints on shadow banking; and (vi) growing speculation on land and infrastructure.

We argue that, by analyzing the above path, we could uncover useful knowledge about what the financial crisis left behind. We also posit that the same trends which led to the Great Recession are continuing.

Are We Aiming for Just Market Governance?

Since the 1970s, state regulation of markets and financial firms has been consistently weakened, opening the door to new competition, but mostly to deal-making and collusions between corporations. For example, since the 1980s, loan contracts between banks and developing countries have clauses mandating that all dispute resolutions would take place in New York courts. One recent outcome, resulting from this regulation, was the vultures' funds — led by Paul Singer — imposing their decisions over Argentina's bonds sovereignty.

Consecutive financial crises entail cyclical commitments for private firms to improve institutions and market rules. But as soon as the main pressure from a crisis eases, commitments to negotiate new agreements get diluted. The 2008 crisis appears to be the result of market regulations, but it is the deregulation that preceded it (Correa 1998). The last mechanism of financial concertation for regulation and supervision was developed by the G20. For example, in 2009, the Financial Stability Board (FSB) was created (Kirton 2013). The FSB was preceded by the 1999 G7's Financial Stability Forum that was formed in the wake of the big East Asia's credit crunch (Porter 2000).

Among the first obstacles identified by governments and state authorities while trying to stop the crisis were precisely the lack and quality of information. Added to this was the international admixture of laws on bankruptcy and resolution, fundamental concepts and methodologies for assessing the health of banks, and the conditions of liquidity and risks in the markets. These are the lines where the FSB has advanced the most.

The FSB has worked hard on data collection and analysis, as well as on the construction of regulation proposals, bringing together the major financial actors in the global market. These actors must accept the regulations. In the lobbying process for global-national regulations, states have lost much of their sovereignity. At the same time, the most important government positions are occupied by former executives of financial conglomerates. In addition, the crisis has opened space for relaxing both regulation and the commitment to new rules.

Financial institutions that are the main target of this new regulation mechanism include global, systemically important banks (G-SIBs) and insurance companies (G-SIIs). But reforms in shadow banking, over-the-counter (OTC) derivatives, and "too-big-to-fail" policies have not really moved forward (FSB 2016). Even if the direction of regulation reforms is positive, it either moves very slowly or not at all. The FSB Report (FSB 2016, 1) highlights this trend: "Implementation progress remains steady but uneven across the four core areas of the reform program ... [S]ome major advanced economies have not addressed deviations in their rules from the Basel framework."

Proposals to end the "too-big-to-fail" problem have taken the approach of building resolution regimes for the global systemically important banks and insurance companies. Even if the resolution regimes were completed, they would still have to be tested. Another global crisis would result in a credit crunch and liquidity demands on treasuries. Right now "substantial work remains [to be done in order to] to build effective resolution regimes and to operationalize resolution plans for cross-border firms" (FSB 2016, 1). The same can be said of both the OTC market and shadow banking.

All these processes have been consulted and agreed upon by the largest global financial actors. For example, the documents for "Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities" were accepted by several well-known financial actors, such as Axa Investment Management, BlackRock, Deutsche Bank, Fidelity, State Street, and Vanguard.

International agreements are another type of financial regulation designed by financial actors. The United Nations Conference on Trade and Development (UNCTAD 2015) reports over 2,600 international treaties being signed between 1990 and 2007, many of which have clauses that create a "spaghetti bowl" of interconnected agreements. This interconnection places the support for the local liquidity demands on domestic treasuries. In the case of extraordinary liquidity requirements of headquarter banks, these interconnections support central banks. They are restructuring the role of central banks, not only because the latter were incapable of funding the demand liquidity, but also because national treasuries would support funding subsidiaries to major global banks.

Almost all international treaties signed after NAFTA (1992) include an investor-state dispute settlement (ISDS) clause in their contracts with governments, which allows investors to sue governments for redress of losses. These treaties commit signatory governments and their budgets (and contributors) to private contracts that a nation's citizenry did not sign.

How Much Has Happened?

The great crisis of 2008 emerged precisely from the heart of the global financial world. However, the deep interconnection of markets, built to decentralize risks and concentrate profitability, spread the crisis globally. As the prices of raw materials and energy grew quickly, international prices began to rise, too. Very early trends of slow growth and even stagnation were present, and high levels of speculation in these products as underlying assets of different securities led to a huge drop in prices of the most important exports of developing economies. The great crisis depressed economies worldwide, following a path of slow growth and stagnation (BIS 2015; IMF 2016). Austerity policies have prevented any possible exit that implies a market expansion through the increase in consumption and investment.

Some figures that illustrate this global stagnation include the global per capita product, which rose from $5,100 to $5,900 (in constant 2005 prices) between 2007 and 2014. Foreign direct investment reached $3 trillion in 2007, falling to $ 1.6 trillion in 2014. World merchandise exports amounted to $16 trillion both in 2007 and in 2015. The total global employed population barely increased by 200,000 people from 2007 to 2015, as the working population declined in relation to the total population. Domestic credit to the private sector in the same period rose from 129 to 137 percent of GDP (World Bank 2016). In the post-crisis years, there has been a trend toward global stagnation of real wages, especially in developed economies as well as in Latin America (ILO 2014).

These trends — as well as governments' reactions to them — have created very different business modalities in each of the states where they have been implemented. For example, in its 2016 list, *Forbes* features public companies from 63 countries that, together, amassed $35 trillion in revenue, $2.4 trillion in profit, $162 trillion in assets, and have a combined market value of $44 trillion (*Forbes* 2016a). More than three hundred sites, or 15 percent of the two thousand listed companies, are global banks and financial institutions. Among the largest banks, nine are from China; four from the US; Canada, Japan, and Australia each have two banks; and the United Kingdom, Spain, Switzerland, France, and the Netherlands have one bank each. Germany does not have a bank ranked in the top twenty-five. Commerzbank, the highest-ranking German bank, occupies 62nd place and Deutsche Bank takes 76th place among banks (*Forbes* 2016b).

These deep economic interrelations among the largest companies have been documented by Stefania Vitali, James Glattfelder, and Stefano Battiston (2011). These authors study 47,000 publically listed companies, based on 2007 data:

> We find that, despite its small size, the core holds collectively a large fraction of the total network control. In detail, nearly 4/10 of the control over the economic value of TNCs in the world is held, via a complicated network of ownership relations, by a group of 147 TNCs in the core, which have almost full control over itself. The top holders within the core can thus be thought of as an economic "super-entity" in the global network of corporations. A relevant additional fact at this point is that 3/4 of the core are financial intermediaries. (Vitali, Glattfelder and Battiston 2011, 6)

The largest global financial actors have changed positions in the ten-year post-crisis period. The most notable change was seen in Chinese banks. The assets of Chinese financial institutions grew from four to almost forty trillion dollars between 2002 and 2014. But it has also been the case of Brazil, whose assets also increased from 0.4 to 4.8 trillion dollars. Australia's financial institutions' assets grew from 1.3 to 5.6 trillion dollars, as well as those of Canada's — from 2.4 to 5.9 trillion dollars.

In the same sense, institutional investors have changed, too. Investment funds with remarkable growth were located in Luxemburg, Canada, and the United States (note that the OECD does not present data from China and the United Kingdom). At the same time, the assets of insurance corporations and pension funds have not seen the same spectacular growth after falling in 2008–2009 (OECD 2015).

Bank return on equity has not come back to its pre-crisis level in Europe and North America, although it has happened for Asia-Pacific banks (IMF 2016). Moreover, shadow banking continues to grow in the UK, but not as much in the US and in the Euro-area countries. The IMF (2016) reports that shadow banking represents 180 percent of banking assets in the US. In the UK, shadow banking is equivalent to 350 percent of GDP, and in the Euro-area and the US — almost 200 percent of GDP. The shadow banking's lending constitutes more than 50 percent of private credit, accounting for almost 30 percent in the Euro-area.

One of the most remarkable post-crisis financial processes has been the tremendous growth of agricultural property prices. These have increased further than the prices of commodities and, in recent years, even further than gold prices. These price increase was especially notable in Central Europe and Latin America (Savills World Research 2016).

Conclusion

The 2008 crisis — as well as the post-crisis processes — revealed the high level of addiction of financial markets to securitization growth. The return to profit by financial markets is going hand in hand with emerging new developments, including: financial instruments; privatization of state-owned assets; large agriculture and mineral land sales as underlying assets of financial instruments; and new borrowers in the process of deepening banking services. This explains the renewed interest of financial and non-financial corporations in developing economies. As financial profits fell in the few years after the financial crisis, the profitability of all economic sectors remains lower and even the most dynamic markets are not enough to support strong economic growth in many countries. Austerity policies continue to be the determining factor in maintaining economic stagnation.

The utopia of creating formulas for international government — one that is able to resolve differences in markets and competition, as well as provide rules for general compliance — causes corporations to be driven by advancing economic transformations. While it may be possible to curb some of the most pernicious effects of financial crises by selling organized corporations too big to be rescued, it does not mean that many other issues of global competition are not still falling short of governance and stability. In turn, this has generated concentration, marginalization, poverty, and increasing expropriation of people's livelihood by putting their very survival at stake in many nation-states across the globe.

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