

Has Global Finance Finally Been Tamed?

Barry Desker and Pradumna B Rana

Last July, Argentina defaulted for the second time in 13 years after failing to reach a deal with a group of so-called “holdout” creditors. Unlike the December 2001 default which had reverberated around the world and created panic everywhere, the adverse impacts this time around have been more muted and are being felt mainly at home. Has global finance finally been tamed? No, a lot has been done to reform the global financial architecture, but yet more remains to be done.

Financial crises of the past three decades have underscored the dangers of unfettered finance and led to major reforms. Global financial architecture has emerged firmly as the fourth pillar of the rules-based international economic architecture established at Bretton Woods, complementing the monetary, trade, and development architectures. Mirroring the efforts to promote global financial safety nets for crisis prevention and crisis management, reforms of the global financial architecture have been multi-pronged: multilateral, regional, and national.

Multilateral efforts

A key multilateral level effort in the post-Global Financial Crisis (GFC) period has been the upgrading of two institutions established in response to the Asian financial crisis (AFC). The dominant powers moved quickly to (i) create the G20 Summit by upgrading the G20 finance ministers and central bankers forum which had started since 1999 and (ii) upgrade the Financial Stability Forum (FSF) to the Financial Stability Board (FSB) with the responsibility for financial sector oversight.

The establishment of the G20 was a historic event as important emerging countries were for the first time included in the core of global economic governance. But the G20 continues to suffer from issues related to “input” legitimacy – its exclusive nature and lack of broader representation – and “output” legitimacy – its ability to strengthen international cooperation and come up with effective solutions. Its agenda is also over-crowded and it does not have a permanent secretariat. The G20 which had made substantial progress in promoting global policy coordination at its first three summits – that is, until the Pittsburgh summit – is now a relatively weak institution. For example, its pledge to transfer six percent of quota and voting power and two chairs at the IMF Board to large emerging markets has been held up by the US

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Congress despite pleas from the G20 itself, the IMF Managing Director, and academics.

Under the oversight of the FSB, various standard setting bodies, most notably the Basel Committee on Banking Supervision, have developed standards and codes and best practices to strengthen financial regulation and supervision, and risk management practices. Some of these were diluted somewhat in response to opposition from the industry.

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G20 Finance Ministers and Bank Governors Meeting, April 2014. Courtesy of Flickr account of IMF and used under a creative commons license.

Expert Talk: Reforming the Global Financial Architecture

Over the years, calls to reform the global financial architecture have gained significant traction. The most recent global financial crisis has led to diminished confidence on the ability of the existing financial architecture to ensure the stability of the world financial and monetary system. The situation has been further complicated by the minimal progress made in introducing governance reforms to the International Monetary Fund, as well as other institutions. In this context, countries have adopted various strategies to protect against external threats and minimize the impact of contagion in the event of a financial crisis outside their territories. This has led to the rise in number of alternative policy mechanisms adopted by countries. Such mechanisms include a slew of bilateral swap agreements and creation of new institutions, such as the China-backed New Development Bank, to deal with the uncertainty.

Multilateral Matters invited three distinguished analysts to share their views on these issues. More than 50 years after the establishment of the Bretton Woods institutions, is it time to establish a new Bretton Woods system? How can governance of the global financial system be improved? What measures are needed to provide greater stability in the global financial system?

Dr. Kui-Wai Li

Associate Professor, Department of Economics and Finance, City University of Hong Kong

The financial sector has changed for the worse since most G7 countries adopted a low interest rate regime for decades. This practice was meant to stimulate investments, but unintentionally, also speculative activities. This has led to the rise of many financial derivatives that are not backed by physical assets. As a result, money has lost its function as a store of value. The Quantitative Easing policy is more of a political instrument to rescue banks and prevent financial collapse. Economic growth could only take place when there are sufficient high-return investments. It is time for the G7 countries to revise the interest rate upwards, so as to bring the monetary economy back on track. ■

Dr. Cyn-Young Park

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The absence of a global mechanism to manage the international monetary system exposed serious problems during the recent financial crises. The new global monetary system needs to address four interrelated issues: (i) sustained high global imbalances which could pose a threat to global economic and financial stability; (ii) the use of a single national currency – the US dollar – as an international reserve currency which not only creates tension between national and global monetary policy making for the US, the so-called Triffin dilemma, but also continues to be a source of instability by allowing lower financing costs for the US and hence leading to an enormous build-up of debt; (c) inadequate mechanism for global policy coordination to build a collective response during the crisis; and (d) large and volatile capital flows which can be a source of macroeconomic and financial instability. The reform of the global monetary and financial system needs to address these four important issues and must take place in a more flexible and multipolar fashion. Without tighter coordination between traditional and emerging powers, it will be hard to find lasting solutions to dealing with the reality of globalized finance.

Global financial governance must change to reflect the new realities of the global financial system characterized by increasing financial globalization, growing economic linkages, and more systemic spillovers. The reform should focus on realigning the global economic order with increasingly collective responsibilities. Stronger regional and global cooperation can help this process by building an effective multilateral framework that leads to an orderly workout of global imbalances and addresses the collective challenges of a new multipolar, more flexible globalization. There is a need to create a global mechanism for both originators and recipients of capital flows to coordinate macro-financial policies to ease macroeconomic and financial stresses of large capital flows. Financial deepening of emerging market economies can also broaden the choice of global reserve assets and help mitigate the impact of large capital flows. Building vibrant local currency bond markets is one important initiative in Asia to better channel Asia's vast resources and reduce over-reliance on US debt securities for savings—in turn helping unwind global imbalances. ■

Dr. Hyoung-Kyu Chey

Associate Professor of International Political Economy
National Graduate Institute for Policy Studies- Japan

One of the most crucial lessons from the 2008/09 crisis is that countries which do not issue reserve currencies can become innocent 'bystander' victims of crises. This is due to sudden stops and reversal of capital flows in these countries despite having strong economic fundamentals and sound policies in place (including 'massive' build-up of foreign reserves). Currently, almost all of the burdens for coping with such instability fall on the bystander victim countries themselves. In order to make the global financial system more stable, and also more fair, a system should be established wherein the countries in which the instability originates assume or at least share some of the responsibilities for it. ■

MRP Roundtable on “Impact of the Sino-Japanese Competitive Relationship on ASEAN as a Region and Institution”

On 24 September 2014, the Multilateralism and Regionalism Programme of RSIS held a roundtable on the “Impact of the Sino-Japanese Competitive Relationship on ASEAN as a Region and Institution.” About 30 participants, including experts from the Philippines, Thailand, Indonesia, Myanmar and Vietnam gathered at the Grand Copthorne Waterfront Hotel Singapore for the full-day event. Four main themes were covered: major power competition and the impact on Southeast Asia, maritime security, institutional building, and the way forward for ASEAN.

Participants agreed that Sino-Japanese competition had affected ASEAN states in a range of spheres ranging from the political-security to the economic. As such, ASEAN countries have utilized a variety of strategies to ensure that their interests remained protected and that Sino-Japanese competition does not result in regional conflict. Maritime security, including territorial disputes, remained a key area where Southeast Asia faces the biggest security challenge. In this area, it was agreed that ASEAN needed to be united if it wanted to avoid taking sides with either China or Japan. On institutional building, it was noted that the regional security architecture was largely premised upon ASEAN being in the driving seat. This however, could not be taken for granted; ASEAN has to continue to work hard to ensure it remained relevant to regional security.

Lastly, it was also noted that given the myriad interests of ASEAN countries, there was a need to also strengthen the ASEAN Secretariat to play a more effective role in coordinating ASEAN’s responses in engaging the major powers. Participants also agreed that the Sino-Japanese rivalry was not a zero-sum game and that ASEAN could also benefit from their enhanced engagement in the region, provided it displayed creativity and ingenuity in its policies. ■



Participants of the roundtable discussion

Professor T.V. Paul Discusses Role of International Institutions in Shaping Great Power Behaviour at RSIS Seminar



Prof T.V. Paul (Left) with Dr Khong Yuen Foong (Right)

The use of non-military instruments in influencing state behaviour has garnered significant interest in the recent decades but studies tend to focus on how second-tier states respond to so-called “soft balancing” tactics when engaging with great powers. Professor T.V. Paul, Ngee Ann Kongsi Professor of International Relations at RSIS and James McGill Professor of International Relations at McGill University, argued that attention should also be given to the role of international institutions and economic sanctions in the current context of new emerging great powers and an increasingly globalised international order. He discussed the findings of his ongoing study on

this topic at the RSIS Seminar on “Restraining Great Powers through Institutions” held 4 August 2014 at the RSIS Seminar Room 5.

Paul gave an overview of the theoretical debates on the role of institutions in constraining great powers. While liberals and constructivists give due importance to institutions, their analyses disregard the perspective of great powers. Realists on the other hand are dismissive of institutions and hold that wars cannot be prevented by institutions and the instruments they have at their disposal. Paul’s ongoing study addresses the debate by making a historical survey of international institutions such as the Concert of Europe, the League of Nations and the United Nations. The findings will look at the conditions wherein institutions are more likely to succeed than military means and the implications given today’s increasingly multipolar world and ongoing tensions involving rising powers.

Attendees shared their views on Paul’s study and raised questions concerning soft balancing through economic instruments (e.g. BRICS bank and mega-regional trade agreements) and the implications of his findings for ASEAN and China, among others. The discussion also touched on the true value of international institutions in an era where great powers are already economically and strategically interdependent. ■

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Regional and country efforts

Regional efforts are most notable in Europe where EU-wide supervisory agencies have been set up for banks, securities market, and the insurance industry. More recently, the euro-zone countries have agreed to establish a banking union. The European Central Bank is to supervise large Euro-zone banks. A single-resolution mechanism has been established to close down or restructure euro-zone banks if they run into trouble. Binding rules for imposing losses on shareholders and creditors have been agreed. An EU-wide deposit guarantee fund is also to be established by collecting taxes from banks.

In Asia, calls have been made for the establishment of an Asian Financial Stability Board by involving financial regulators, and central bank and finance ministry officials. This Board will promote capital market rules and regulations and maintain financial stability throughout the region through early warning systems. It would also ensure that the Asian context and situation is adequately understood in financial sector policies and regulatory reforms.

Countries all over the world have implemented policies to strengthen their financial regulations. In addition to the steps taken in Europe (discussed above), in July 2011 the US approved the Dodd-Frank Wall Street Reform and Consumer Protection Act. The major components of this Act are the establishment of a bureau in the Fed to tackle abusive mis-selling of mortgages and other products and

the introduction of the Volker Rule to prevent deposit-taking banks from proprietary trading.

Emerging markets all over the world have also taken steps to strengthen their financial sector and financial markets and these are regularly monitored by the IMF and the FSB. The health and robustness of the financial sectors in these countries have, therefore, improved significantly.

Remaining agenda

Despite a raft of policies that have been implemented, a lot more remains to be done. There are many remaining gaps such as, to mention a few, ending the “too-big-to-fail problem”, collusion in fixing LIBOR and foreign exchange rates, establishing crisis resolution mechanisms, and reforming credit rating agencies, hedge funds, and shadow banks. Also many of the agreements that have been reached at the multilateral and regional levels have yet to be legislated at the national level and implemented. Similarly announced national efforts have to be expedited. There is also a need to promote complementarity between multilateral, regional, and national efforts so that they can reinforce each other in a seamless manner. There is, therefore, no room for complacency. Who knows when the next crisis might hit!

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Seminar Series on International Political Economy Issues launched, Michael Plummer Discusses ASEAN Centrality and Mega-regionalism in Inaugural Lecture

RSIS recently launched the Seminar Series on IPE issues. The convenor of the platform, Assistant Professor Kaewkamol Pitakdumrongkit describes the new seminar series as an interdisciplinary forum to examine and discuss pressing and upcoming issues in the IPE field. Experts from around the world are invited in these talks where the public and students are exposed to different IPE issues beyond their classroom experience. About six IPE Seminars are slated to be convened for the duration of this academic year.

The inaugural lecture was delivered by Michael Plummer, Director, School of Advanced and International Studies-Europe, and Eni Chair in International Economics, Johns Hopkins University last 22 August 2014. He spoke on the topic “ASEAN Centrality and Mega-Regionalism in the Asia-Pacific Region”. Plummer expounded on the importance of ASEAN Centrality in the context of the growing popularity of mega-regionalism in the evolving Asia Pacific trade architecture. He argued that ASEAN centrality benefits ASEAN through deeper integration within ASEAN. This then makes ASEAN an attractive region for production networks. Partner countries also stand to benefit as a strong ASEAN provide a counterbalance to other powers in the region underpinning ASEAN’s role as a middle power. Plummer suggested that moving forward, ASEAN should continue to participate in mega-regionals noting that participation in these arrangements generally result to positive economic welfare gains. ■



Dr Michael Plummer delivering his lecture

Former Singapore WTO Ambassador Discusses Contemporary Developments in the International Trading System

Mr See Chak Mun, former Singapore ambassador to the World Trade Organization (WTO) and former senior advisor to the Ministry of Foreign Affairs Singapore, gave a lecture on contemporary developments in the international trading system last 5 August 2014. His talk is part of the RSIS Seminar Series on the Practice of Diplomacy and International Affairs.

Mr See gave an overview of the General Agreement on Tariffs and Trade (GATT) and the WTO and how GATT was eventually transformed into an organization that acts as the guardian of the current multilateral trading system. He discussed the deadlock in the Doha Development Agenda (DDA) trade negotiations and how this has led to a situation where more countries are turning to bilateral and regional trade cooperation agreements instead of the WTO track. These developments undermine WTO's central role in the multilateral trade liberalization process including its rule-setting and enforcement mandate. In addition, the WTO is faced with various external challenges beyond its control including (i) the emergence of supply chain trade, (ii) growth in trade in services, and (iii) trade and climate change issues among others.

To address these challenges, WTO would need to review and expand the WTO agenda and find new approaches to move the DDA such as by simplifying modalities for market access negotiations and adopt plurilateral approaches to trade negotiations. ■



Ambassador See Chak Mun during his presentation

China's Supply Chain Grand Strategy

On 26 September 2014, Dr Parag Khana, adjunct professor at the Lee Kuan Yew School of Public Policy (LKYSPP) delivered a lecture on China's Supply Chain Grand Strategy as part of the Seminar Series on IPE Issues.

Dr Khana prefaced his lecture by describing the complexity of the current geopolitical and economic landscape as one where there is no single hegemon at the center. From a unipolar world order, the world has moved to a multi-polar, multi-regional geopolitical architecture. Another important trend to note is the increasing priority for many countries to fund physical infrastructure. This emphasis to bridge the infrastructure supply deficit underscores the growing importance attached by countries to compete economically in the era of supply chain trade. China is no different from other countries in this regard.

Dr Khana argued that for China, its grand strategy is premised on building and operating extensive supply chains for raw material inflow and goods outflow. This can be seen in China's "five finger strategy" of railways, roads and pipelines, connecting China to its neighboring countries west of its border and eventually leading to Europe. Moving forward, China would have to adjust its strategy to suit the fluid dynamics of the global order. This is true especially as the dividends for China's supply chain strategy trickle down beyond the realm of geopolitical and economic considerations. ■

Selected Publications

- [Assessing the Progress of AEC Projects: A New Approach](#)
Kaewkamol Pitakdumrongkit and Maria Theresa Anna Robles, RSIS Working Paper No 280. 5 Sept 2014.
- [Building Silk Roads for the 21st Century](#)
Pradumna Rana, East Asia Forum. 16 Aug 2014.
- [China's Proposal for Trans-Himalayan Connectivity: Consider Four Economic Corridors](#)
Pradumna Rana, RSIS Commentary 154.1 Aug 2014.
- [US-Led vs China-led Economic Architecture: Case for a New Bretton Woods?](#)
Pradumna Rana. RSIS Commentary 147. 24 Jul 2014.

Upcoming Event

- RSIS-Economic Growth Center Conference on ASEAN's Long-term Economic Potential and Vision 20-21 November 2014
Hotel Jen Singapore (by invitation only)

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The Centre for Multilateralism Studies (CMS) is a research entity within the S. Rajaratnam School of International Studies at Nanyang Technological University, Singapore. The CMS team conducts cutting-edge research, teaching/training and networking on cooperative multilateralism in the Asia Pacific region. The Centre aims to contribute to international academic and public discourses on regional architecture and order in the Asia Pacific. It aspires to be an international knowledge hub for multilateral cooperation and regional integration.

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