VOICES FROM THE PAST: THE INTERNATIONAL POLITICS OF FINANCIAL STABILITY

Louis W. Pauly
Director of the Centre
for International Studies at the
Munk School of Global Affairs

"In the wake of the 2008 financial crisis, it is time for some serious fishing."

In the wake of the financial crisis of 2008, many are hoping that the newly expanded G20 and its newly refurbished Financial Stability Board will foster cooperative policies and resilient markets. I wonder if my late friend Jacques Polak would have considered this hope realistic.

Polak lived almost long enough to celebrate his 96th birthday this spring. One of the most distinguished macroeconomists of his generation, his career began in the League of Nations in 1937. In 1947, he joined the International Monetary Fund, where he worked in one prominent capacity or another until 2007. During my sojourn on the Fund's staff in the late 1980s, Polak and his equally distinguished legal counterpart, Sir Joseph Gold, had a profound impact on my own practical education in monetary and financial affairs.

The post-war history of the Fund and the UN system of which it remains a part is continuous with the history of the League of Nations. The League's economic and financial files, for example, were passed on to the UN; and certain officials, like Polak and his friend, the late, great Canadian, Louis Rasminsky, began their careers in the League, then, after the war, took their experience with them directly into the nascent IMF. With good reason, Polak in particular felt that the League had been too "political," or unprofessional, that it had not subordinated narrow national interests to common global interests. The League, in his view, lacked clear authority. Its consensus decision-making practice made it too cautious, and it could not rise above petty concerns. When emergencies arose, it found itself on the sidelines, without resources and without legitimacy. Its small economic staff was ineffective and, in the end, powerless.

The Fund, on the other hand, was different. Polak and Gold both insisted so. It had a constitutional charter, authority delegated by ratified treaty, a clear mandate, the financial resources to fulfil that mandate, and, most importantly, a highly qualified, knowledgeable, technocratic, legally independent, and politically neutral staff. Together with a management team that was accountable to, but also empowered by, member states, and in the absence of the binding constraint on decisions posed by a unanimity principle, Polak and Gold believed that the staff could and did act as system regulators within an important, if bounded, policy arena.

The 1944 Bretton Woods Agreement and its amendment in 1976 did represent signal evolutionary steps toward a more integrated world. At base, they formally obligated member states of the Fund to account to one another on the external consequences of their main economic policies, consequences now increasingly transmitted through more open financial markets.

Polak and Gold were clearly correct that the key to making this novel and necessarily compromised form of accountability substantive and as effective as possible was the Fund staff. Only these permanent staffers or their equivalents could make operational the idea of meaningful accountability, given the continuing fact that national governments and their delegates ultimately remained politically responsible to their citizens alone. In the long run, only a neutral international staff could be the legitimate institutional memory, keep the files, record promises, and compile follow-up data. Without them, commitments were too easy to make in a global setting and even easier to forget back home.

In precisely this context, we can discern the main flaw of the multilateral process now focused on the Financial Stability Board (FSB), which the G20 created in April 2009 as a strengthened successor to the Financial Stability Forum. Working in collaboration with the IMF and other international financial institutions, the FSB is intended to address vulnerabilities affecting financial systems in the interest of global financial stability. Without disrespecting the honourable work of the qualified people now associated with it, the small, impermanent, and very loosely mandated staff of the FSB suggests a historical reversion. It is only too easy to imagine it being created by and within the early League, only to be practically washed away by the financial tsunami of 1931. A plenary body agreeing on policies by consensus, a chair dealing with the politics associated with the quest for unanimity, a secretary general with limited powers, a very small secretariat, and the expectation of voluntary policy implementation by national authorities. This was the essence of the League's economic and financial machinery, and the current structure of the FSB matches it almost completely.

Admittedly, plans for the FSB do represent a step beyond the G7, G8, and G20 processes out of which it has developed. As useful as they may sometimes be, the Gs have had no secretariat. Indeed, at the University of Toronto we can be very proud of the fact that the globally recognized substitute for that function — the archive, the institutional memory, and the constructively critical reviewer of promises made at international meetings — has for many years now been the G7, G8, and G20 research programs carried out by Professor John Kirton and generations of his students at the Munk School. Is it time for governments seriously to build on the base they have created?

In fact, governments leading the charge toward financial globalization have long preferred to deal with market-stability policies in very restricted fora. They have been very leery of empowering the international civil service actually required to hold them accountable to one another. The transformation of the Financial Stability Forum into the FSB, with a very small and impermanent staff, may be a modestly positive development, given the complicated technical issues involved. But if its work allows member states to render even more obscure the intimate connection between financial regulation and supervision and the international effects of core macroeconomic policies, systemic financial risk will increase.

Rasminsky once said to me, "At the League, we were expected to catch fish, but we had no bait." We do not need to relearn our history lessons the hard way. In the wake of the crisis of 2008, it is time for some serious fishing. The big fish goes beyond the scope of anything the FSB has yet proposed; it is a deep and binding arrangement for fiscal and monetary burden-sharing adequate to sustain integrating financial markets. If we really cannot imagine the bait that will help us catch it, now that the urgency of the financial crisis is dissipating, then we should abandon the dream of resilient global markets. This may eventually mean facing once again the much broader sorts of insecurities all too familiar to the founders of the League and the UN. If we are not that brave and we do not believe that under crisis conditions national leaders will discern the common good, then it is far preferable to return seriously to the hard work of building or adapting an actual governing organization at the system level — with staff. We may then discover that, indeed, Polak, Gold, and Rasminsky simply were ahead of their time.