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FINANCIAL REGULATION IN FINANCING FOR DEVELOPMENT AT THE UN

Barry Herman[1], October 20, 2014

Whenever an international economic or financial issue gains significant political importance, one or more Member States of the United Nations brings it to the General Assembly for political discussion and possible action. The General Assembly is not a forum of financial experts but of political ones and thus the discussions of emergent financial crises typically lead to resolutions expressing political concern and often offer broad normative guidance to the authorities responsible for financial policies. The UN also serves as a forum that brings together representatives of Governments, relevant international institutions and other stakeholders to discuss financial issues in their broader context, especially regarding their impact on the international imperative to promote the development of the developing countries. This note recalls that tradition as the international community prepares for the third International Conference on Financing for Development (FfD) in Addis Ababa in July 2015.

The UN concern with global financial volatility can be traced back at least to the 1990s, beginning with the "Tequila crisis" in which instability in the Mexican peso in 1994 caused an economic shock in other countries, especially in Argentina. On the heels of that crisis, observers called for strengthened regulation of banks and delaying the opening of domestic capital markets to short-term international flows until financial institution regulation and supervision were made adequate.[2] Reflecting such sentiments, in December 1995 the UN General Assembly adopted a resolution that, inter alia, expressed support for the April 1995 communiqué of the Interim Committee of the International Monetary Fund (IMF) on strengthening surveillance of all countries (e.g., including members of the Group of 7) "with regard to potential sources of destabilization of capital markets" (as monetary policy changes in the United States had triggered the Mexican crisis) and improving timely provision of relevant data (as on Mexican central bank reserves, whose deterioration was made public with delays). This initiative was in response to recognition that "a significant number of developing countries have become more vulnerable, in the course of liberalizing their external economic and financial regimes, to the volatile fluctuations of private capital flows in international financial markets" (resolution 50/91). The following year, the Assembly adopted a similar resolution which also welcomed the agreement to start a series

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[2] See Frederic Mishkin, "Lessons of the Tequila Crisis," *Journal of Banking and Finance*, vol. 23 (1999), pp. 1521-33.

of annual discussions in the Economic and Social Council (ECOSOC) with the Bretton Woods institutions that began in 1997. That turned out to be timely, as the Asian financial crisis broke out soon after the first meeting.[3]

Those meetings also became a relevant forum in which to discuss an expansion of the scope of the work of the IMF and the World Bank into areas of oversight that went beyond traditional surveillance, namely assessment of country implementation of a broad set of internationally agreed standards and codes. Certain of the standards, such as the Special Data Dissemination Standard, were developed in the IMF following the Tequila crisis, while others were developed independently in specialized forums, such as the Core Principles for Effective Banking Supervision, developed in the Basel Committee on Banking Supervision in 1997. In 1999, the newly created Financial Stability Forum identified 12 key sets of standards whose implementation the IMF and World Bank would monitor through its program on standards and codes.[4]

The ECOSOC discussions continue to this day, with participation as well of the World Trade Organization and the United Nations Conference on Trade and Development, as mandated by the Monterrey Consensus on Financing for Development in 2002.[5] The essential point here is that Member States agreed in Monterrey that the UN should serve as a forum to bring the relevant policy making institutions together with representatives of Member States who serve at the UN and at other institutions, along with speakers from affiliated civil society and business sector organizations. This cemented a longstanding practice in ECOSOC to invite a wide range of stakeholders to contribute to discussion of important issues, but it also extended the practice by adopting special provisions for operating in a similar way when the General Assembly convokes meetings on Financing for Development.

These discussions are unique. Nothing remotely like them takes place outside UN bodies (excepting trade-related discussions among the membership of the World Trade Organization). Discussions within the Group of 7 or the Group of 20 are obviously among a highly limited number of Governments and are not public. Discussions of the IMF and World Bank Executive Boards are among elected representatives of the membership, but are also confidential, although IMF and increasingly the World Bank Board discussions are summarized for the public. Discussions in the intergovernmental bodies of the Organization for Economic Cooperation and Development and the financial regulatory committees are also among their membership, albeit with participation of outside observer States and organizations sometimes encouraged. For regular multi-stakeholder discussions in a universal body, there are only United Nations forums.

It is also noteworthy that the Monterrey Consensus not only cemented commitment

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[3] The early period of UN consideration of international financial instability is traced in Mahfuzur Rahman, *World Economic Issues at the United Nations: Half a Century of Debate* (Boston, Dordrecht and London: Kluwer Academic Publishers, 2002), chapter 13.

[4] See Benu Schneider, ed., *The Road to International Financial Stability: Are Key Financial Standards the Answer?* (Basingstoke and New York: Palgrave Macmillan, 2003).

[5] United Nations, *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7), chapter I, resolution 1, annex.

to how issues would be discussed but also explicitly included "systemic issues" in its agenda, including appropriate regulation of financial institutions and markets. This was not automatically embraced by all Member States when proposed by developing country members, but the logic was inescapable. The Asian and Russian financial crises and the shock to global finance from the threatened collapse of Long Term Capital Management, a US hedge fund, made indisputably clear that development was vulnerable to global financial sector instabilities.

Indeed, the "systemic issues" section of the Monterrey Consensus included not only a call for "strong coordination of macroeconomic policies among leading industrial countries" and according high priority to "the identification and prevention of potential crises and to strengthen the underpinnings of international financial stability", but also to "ensure the effective and equitable participation of developing countries in the formulation [and implementation on a voluntary and progressive basis] of financial standards and codes...as a contribution to reducing vulnerability to financial crises and contagion". The Consensus also called on the "Bank for International Settlements, Basel Committees and Financial Stability Forum" to continue enhancing their outreach to developing and transition economy countries and to review their membership "to allow for adequate participation", as well as calling on IMF and the World Bank to continue to enhance the participation of these countries in their decision making.

While membership in the standard-setting bodies for financial regulation and the Financial Stability Board do not include a full variety of developing country voices, the forums do undertake systematic outreach and consultation efforts in their respective fields. It is a compromise, but others will need to assess whether it suffices and what kind of improved scope for participation is technically—let alone, politically—feasible. It is important to note, however, that the regulatory bodies regularly publish their proposed regulatory reforms for comment and take responses into account in drafting their final texts. While apparently a disproportionate share of the comments are submitted by representatives of the institutions to be regulated, seeking to soften them, the mechanism for consultation seems a valid one. It does not necessary follow that it is enough. Proposals for strengthening it might be conceived.

The open and political venue of the United Nations thus offers a possibility for broad interactions with international regulatory authorities. Moreover, unlike the usual practice at the UN where foreign ministry staff represent their countries, participants from national central banks and regulatory authorities have participated in the preparatory discussions for the Monterrey conference and at the conference itself. So too did Andrew Crockett, the Chairman of the Financial Stability Forum, who also was the General Manager of the Bank for International Settlements. This practice has been renewed by Rupert Thorne, the Deputy Secretary-General of the successor and enlarged Financial Stability Board (FSB), who has participated in recent meetings on Financing for Development.

In conclusion, the deliberations hosted by the United Nations on Financing for Development offer both a precedent and a continuing practice of broad consideration of the adequacy and effectiveness of international standards of financial regulation. The question that needs to be debated at this moment, as preparations begin in earnest for the Addis Ababa FfD conference, is what content to propose for consideration "on the road to Addis". Some potential questions that might be discussed could include:

1. Should the international community devise global guidelines to help shape financial regulations, such as privileging simplicity over complexity and requiring prior approval for marketing complex financial instruments?[6]

2. Should the "Ruggie principles" on business and human rights be taken into regulatory obligations on the model that the "Thun Group of Banks" has applied to itself?[7]

3. Should monetary authorities avoid introducing non-traditional instruments of monetary policy when they embody systemic risks?[8]

4. Should the opposition of huge financial institutions to policies to effectively remove their "too big to fail" status be more creatively fought?[9]

There are many such possible questions and some should be ripe for bringing to the FfD preparatory process.

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[6] See Saule Omarova, "License to deal: Mandatory approval of complex financial products," (available at http://ssrn.com/abstract=1996755).

[7] See Thun Group of Banks, "UN Guiding Principles on Business and Human Rights: Discussion Paper for Banks on Implications of Principles 16–21," October 2013 (available at http://business-humanrights.org/sites/default/files/media/documents/thun-group-discussion-paper-final-2-oct-2013.pdf).

[8] See Sheila Bair, "The Federal Reserve's risky reverse repo scheme," *Wall Street Journal*, July 24, 2014.

[9] See Mayra Rodriguez Valladares, "The brilliant solution to TBTF no one is talking about," *American Banker*, March 27, 2014 (while the FSB has recently elaborated in more detail how Governments should address the insolvency of financial institutions that are "too big to fail", it does not seem to have a strategy to reduce the number of such financial firms).