# THE SUBTLE ART OF COMPROMISE AND THE INTERNATIONAL FINANCIAL ARCHITECTURE: CAN THE CURRENT FRAMEWORK SUSTAIN THE POLITICS OF GLOBALIZATION?

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A. INTRODUCTION
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## A. INTRODUCTION

Ever since the Bretton Woods conference, which took place in New Hampshire in July 1944 and revolutionarily sought to establish a solid framework for economic and monetary relationships between countries around the world, politics has played a major role in determining the nature of the international financial architecture. Building on the practical experience developed throughout the New Deal years in America, and on the idea of welfare state that emerged in Britain during the early 1900s, prominent economists, such as Harry Dexter White and John Maynard Keynes, approached the conference with enthusiasm and with the utmost desire to include borderless international development as a fundamental pillar of the common postwar plans.[1] Thus, recent scholarship has indicated how the Bretton Woods negotiations should be applauded for their pioneering incorporation of international development goals into a liberal multilateral financial architecture, and for their considerable acceleration of the dialogue between the rich "Northern" countries and the poorer "Southern" ones.[2] In the decades following Bretton Woods and leading to the 21st century, however, this dialogue did not retain a position of priority in the agenda of the international financial architecture, due to the menace of the Cold War, to the domestic economic troubles suffered by advanced countries, and to the resurgence of "neoliberal" values in the Anglo-American alliance, which rejected both, more generally, governmental interventionism and, more specifically, ambitious concerted schemes such as the New International Economic Order (NIEO).[3] The status quo shifted again only with the rise of China, India, Brazil, Mexico, Indonesia and South Africa as simply unignorable economic powerhouses, with the Global Financial Crisis of 2007-2008, which highlighted the intricate linkages permeating the global economy, and with the ensuing creation of the Group of 20 (G20) as the "premier forum for international economic cooperation," in which Southern countries finally exert significant influence on decision-making.[4]

Analogously, in his analysis of the numerous failures of global financial governance, and thus of the international financial institutions and transnational regulatory networks operating at its basis, Professor Emilios Avgouleas has identified three key historical segments, each reconcilable with a particular worldwide policy that was never comprehensively implemented: firstly, in the Bretton Woods phase (1947-1997), there was

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[1] Eric Helleiner, *Forgotten Foundations of Bretton Woods: International Development and the Making of the Postwar Order* (Cornell University Press, 2014), 9-13.
[2] Helleiner, *Forgotten Foundations*, 1-4.
[3] Helleiner, *Forgotten Foundations*, 260-276.
[4] Helleiner, *Forgotten Foundations*, 276-277.

a focus on moving from fixed to floating exchange rates; secondly, in the post-Asian Crisis period (1998-2008), loose regulatory structures and free-market tendencies gave way to a tighter framework, called New International Financial Architecture (NIFA); and thirdly, in the aftermath of the Global Financial Crisis (2009-present), the causes and consequences of this unprecedentedly seismic event were recognized and tackled with shared reforms.[5] Nevertheless, in light of the lack of success underpinning this evolutionary tale, it has been argued that, even if standard-setters, such as the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO), come up with the policies required to fight financial crises, and even if monitoring institutions, such as the International Monetary Fund (IMF) and the World Bank, fulfil their surveillance duties appropriately, effective financial regimes leading to cross-border stability might still prove difficult to achieve, due to the political disagreements inherent to the fundamental agenda-setting body (i.e. the G20).[6]

Therefore, in this essay, progressively expanding on the brief historical accounts given above, it shall be argued that the most serious limitation of the international financial architecture has always been its dubious ability to cope with the everchanging political and diplomatic dimensions of the interconnected economic systems of our contemporaneity. In fact, somewhat paradoxically, the international financial architecture is simultaneously strengthened by the "increasing need for countries to cooperate, given the continuous integration of the global economy," and endangered by the "continuous diminution in the willingness of the international community to surrender sovereignty" to international bodies seemingly dominated by technocratic elites.[7] Concomitantly, another important characteristic of the international financial architecture (i.e. the widespread reliance on soft law by transnational standard-setting and monitoring organizations) will not be viewed as a shortcoming, but rather as the epitome of an aptitude to retain the flexibility needed to address unique and unpredictable challenges, to give audience to a multitude of stakeholders, and to reach unavoidable compromises. This feature will demonstrate how the international financial architecture attempts to guarantee efficient solutions and undisrupted service, notwithstanding the heated political debates that constantly threaten and undermine its very existence.

## B. SOFT LAW, MONITORING AND STANDARD SETTING

As mentioned at the end of the introductory section, soft law is the main legal instrument through which the international financial architecture is authorized to propagate its policies across the world, in accordance with the boundaries set by the international treaties signed and ratified by individual countries. One of the considerations naturally stemming from this statement concerns the extent of the powers that are vested in international financial institutions by virtue of international treaties. As argued by Professor Chris Brummer, from Georgetown University, setting standards in international financial regulation, as well as ensuring that there are no gaps in the entire architecture, "is often fraught with misaligned and even antagonistic interests," resulting from individual governments wishing to retain some flexibility in the tailoring of solutions according to their

[5] Emilios Avgouleas, *Governance of Global Financial Markets* (Cambridge University Press, 2012), 157-159.
[6] Avgouleas, *Governance*, 205-206 and 211-212.
[7] Sean Hagan, 'The IMF and the Evolution of International Monetary and Financial Law,' in Margaret McGuinness and David Stewart (eds), *Research Handbook on Law and Diplomacy* (Elgar Publishing, 2022), 123

own policy preferences and to the conditions of their domestic markets.[8] The cross-border rules producible, monitorable and enforceable by, for instance, the BCBS, the IOSCO, the IASB (International Accounting Standards Board), the IAIS (International Association of Insurance Supervisors), the IMF, and the World Bank, are constrained by compromises between national financial authorities, each seeking to negotiate harshly, to promote its own national beliefs, and to take advantage of any potential disparity in bargaining power.[9] Thus, it is arguable that the majority of the problems faced by the aforementioned regulating and monitoring institutions are directly caused by the lack of political agreement, coordination and commitment that pervades the agenda-setters (i.e. the G20 and the Financial Stability Board (FSB)). If individual countries were more politically predisposed to follow the guidance of the international financial architecture, it would not matter whether this guidance came in the form of soft law, or in the form of hard law, upon an official devolution of powers by means of signing additional international treaties.

Despite the significant constraints deriving from international politics and diplomacy, and namely from the questionable impact of both the G20 and the FSB, it has been pointed out that soft law is still capable of achieving satisfactory results thanks to the often-misunderstood role played by the IMF.[10] In fact, the IMF is created through a constitutive treaty that is “the centerpiece of international monetary law” and, in accordance with that treaty, it does not only fulfil a function of multilateral financial surveillance, but also of indirect enforcement, because, in case a signatory member were not to conform to the rules of the international financial architecture, that member would potentially cease to benefit from the IMF’s discretionary power to become a lender of last resort.[11] It flows logically that, if a signatory member anticipates that, in the future, they may need financial assistance in the form of conditional lending from the IMF, that member will be more likely to adjust its financial policies *ex ante* consistently with the cross-border rules that the IMF is officially mandated to surveil.[12]

Another valuable example of how soft law distinctly and substantially influences the worldwide economy is the relationship between the BCBS and participants in the banking market, in both the public and private spheres. The BCBS does not possess any formal supranational authority, it does not possess any legal status at all, and its proposals or decisions do not have any legal force, until they are “separately implemented, whether by hard or soft law, in each separate state” that contributes with member organizations to the activities and the consultations of the committee.[13] Nevertheless, even though the BCBS regulations are informal and must be observed only in a voluntary and self-imposed manner, it is remarkable how often and extensively they are implemented, and that is because of the distinction between implementation (a “factual concept” deriving from considerations of competition in the realm of international business) and enforcement (a “legal concept” deriving from the ability of the competent state authority to impose compliance).[14] It has been argued that the BCBS regulations and, more generally, international financial soft law are “well suited to the changing needs and rapidly evolving structures that characterize the workings of financial markets” and that the “softness” of

[8] Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (Cambridge University Press, 2015), 270-271.
[9] Brummer, *Soft Law,* 273.
[10] Adam Feibelman, ‘Law in the Global Order: The IMF and Financial Regulation,’ (2017) 49 New York University Journal of International Law and Politics, 688-689.
[11] Feibelman, ‘Law in the Global Order,’ 744-745.
[12] Feibelman, ‘Law in the Global Order,’ 729-730.
[13] Charles Goodhart, *The Basel Committee on Banking Supervision: A History of the Early Years, 1974-1997* (Cambridge University Press, 2012), 542-543 and 546.
[14] Goodhart, *The Basel Committee*, 557-558.

these rules can become "as compelling as hard law," thanks to the ideas of honor and rigor that permeate the public sector, and thanks to the perception of resilience and strength that private actors in the banking and finance industry wish to instill in potential customers.[15]

However, continuing to examine the case of the BCBS, and more particularly of its third capital accord (commonly known as Basel 3), it becomes clear how political interest is still capable of exerting formal influence on the production of international financial soft law, in light of the establishment by the G20 of the FSB in 2009, and of the BCBS being subject to the approval and directional guidance of the FSB.[16] Looking at both the BCBS's original proposal and the content of the finalized Basel 3 regulatory scheme, it has been argued that regulatory capture by the private sector (i.e. the most pervasive problem for the first and second capital accords) has decreased in scope, whilst a "tilting of power in favor of emerging markets and publicly accountable authorities has occurred."[17] This interpretation is due to the fact that Group 2 banks (i.e. the more regional ones, with lower overall capital), in comparison to Group 1 banks (i.e. the well diversified, internationally active, and capital-heavy ones), appear less affected by the new definitions of capital ratio (CET1) and by the altered risk metrics for banks' assets, and by the fact that Group 2 banks are more prevalent in countries from the global South.[18] Thus, once again, remembering that the soft law produced by the BCBS has the opportunity to be implemented almost universally and in reasonably strict accordance with its final content, the problem lies with how diverging political sentiments influence this content and how, in turn, this content diverges from the original, data-driven and risk-averse intentions of the BCBS. This leads to a rather oxymoronic situation, whereby, in the "uploading stage," elected officials delegate the making of international financial soft law to standard-setters like the BCBS, which "mobilize extensively and, to a large extent, successfully," but, in the "downloading stage," those same elected officials seek to alter the content of this soft law, in order to avoid "negative distributional implications for domestic constituencies."[19]

Of course, at this stage, it is important to highlight that international financial soft law, besides having merits in terms of pragmatic rule-making and flexible implementation in accordance with the peculiarities of individual jurisdictions, is also transparently defective in many other respects, including the possibilities of inconsistent translation into domestic rules and regulatory arbitrage, which might "induce states to race to the bottom" and "lay the ground for the next financial crisis."[20] One commentator even suggested that the most important aspects of international financial cooperation "either lack any legal dimension, or involve traditional hard-law international organizations," thus implying that soft law does not accomplish any useful objective, including the most obvious (i.e. harmonization of standards), which could be handled equally successfully by "purely private industry organizations."[21] Furthermore, academics have indicated that international financial regulatory cooperation and the ensuing "hardening process" of soft

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[15] Goodhart, *The Basel Committee*, 553-555 and 559.
[16] Elias Bengtsson, 'The Political Economy of Banking Regulation: Does the Basel 3 Accord Imply a Change?,' (2013) 46 Sociologus, 306-307.
[17] Bengtsson, 'The Political Economy,' 326-327.
[18] Bengtsson, 'The Political Economy,' 319-322.
[19] Lucia Quaglia, 'The Politics of State Compliance with International "Soft Law" in Finance,' (2019) 32 Governance (Oxford), 45 and 57.
[20] Bin Gu and Tong Liu, 'Enforcing International Financial Regulatory Reforms,' (2014) 17 Journal of International Economic Law, 139.
[21] Matthew Turk, 'Reframing International Financial Regulation after the Global Financial Crisis: Rational States and Interdependence, Not Regulatory Networks and Soft Law,' (2014) 36 Michigan Journal of International Law, 124-126.

law are accelerated during times of crises, but drastically wane in their aftermath, thus producing dangerous and shortsighted tendencies, such as unilateralism, deliberate discrepancies across national borders, and the overall fragmentation of global financial markets.[22]

However, one could question the adequacy and the accuracy of forming a direct conduit between these complications, each severely contributing to a potential increase in cross-border systemic risk, and the constituent elements of the transnational regulatory networks, including its signature reliance on soft law mechanisms.[23] Indeed, the way in which soft law is utilized by the international financial architecture has been argued to facilitate worldwide regulatory cooperation, to converge norms, consequently improving the experience of both lenders and borrowers within the global financial markets, and to reflect the needs of a globalized economy, where "expertise, speed, cost, flexibility, adaptability and public participation" are not marginal considerations to make.[24] Through the soft law mechanisms embraced by transnational regulatory networks, national regulators and legislatures have a chance to interact with each other, learn from each other, and "gradually bridge substantive differences, laying foundations for the ultimate creation" of binding international treaties.[25]

Closing this section, therefore, it is proposed that reliance on soft law, in itself, is not necessarily the cause of the failures of financial regulation over the past decades. Rather, it is the underwhelmingly meagre content of this soft law that constitutes a danger for the stability of the global financial markets, and this is determined chiefly by the political discordance among the public parties that dictate the workings of international regulatory and monitoring organizations.

## C. POLITICAL DISCORDANCE AND AGENDA SETTING

Referring again to the introductory section, and to the historical context of international financial regulation, it is crucial to stress the importance of the change in the power dynamics of international politics that has gradually taken place since the end of the Cold War (i.e. when globalizing tendencies resurfaced). In the late 1990s, especially, with a period of financial crises (beginning with the 1997 Asian Financial Crisis) spreading quickly and extensively, it was recognized that emerging market countries "were not adequately included in the core of global economic policymaking and governance," especially as they came to represent a higher and higher percentage of the world's economic output.[26] Thus, in 1999, the G20 was established, mimicking certain principles and objectives that had been originally envisioned at Bretton Woods (i.e. promoting constructive discussion between industrial and emerging market countries, considering each party equally important in its contribution, supporting worldwide growth and development, strengthening the international financial architecture, and implementing and monitoring common standards and structures).[27] After the Global Financial Crisis, the G20 (together with its sister institution, the FSB) emerged as the principal coordinating body for the achievement of international financial cooperation, dictating the agenda to be

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[22] Gu and Liu, 'Enforcing,' 172-173.
[23] Xun Li, 'How Effective Are the Transnational Regulatory Networks?: A Perspective of International Financial Regulation,' (2021) 18 Manchester Journal of International Economic Law, 392.
[24] Li, 'How Effective,' 412-417.
[25] Li, 'How Effective,' 423.
[26] Emilios Avgouleas, 'Rationales and Designs to Implement an Institutional Big Bank in the Governance of Global Finance,' (2012) 36 Seattle University Law Review, 335-336.
[27] Avgouleas, 'Rationales,' 335-336.

implemented through transnational regulatory networks and to be monitored by the IMF and by the World Bank, but it is arguable that the extreme diversity of its composition makes it too fluid "to play a leadership role in the field of financial stability on a permanent basis."[28]

Nowadays, in fact, the G20 comprises Anglo-American countries (i.e. Australia, Canada, South Africa, United Kingdom and United States), European countries (i.e. France, Germany, Italy), the European Union, the African Union, Latin American countries (i.e. Argentina, Brazil, Mexico), Asian countries (i.e. China, India, Indonesia, South Korea, Japan), Middle Eastern countries (i.e. Saudi Arabia, Turkey) and Russia. Each of these members has its own defining political machineries, economic interests, and financial practices, which leads to conflicting perspectives on the agenda to be agreed at the G20 and FSB levels, to the unwillingness to give rise to formal international financial institutions, and to thinning policies that are ultimately targeted for development at the level of transnational regulatory networks.[29] Additionally, as appropriately pointed out by Daniel Drezner, from Tufts University, even though emerging market countries have obtained better representation in the G20 and in the IMF after the Global Financial Crisis, we have been witnessing a growing "counter-hegemonic order," in opposition to the historic system of global economic governance dominated by the West.[30] China, in particular, with its Asian Infrastructure Investment Bank (AIIB), Cross-Border Interbank Payments System (CIPS), and Belt and Road Initiative (BRI), as well as through its *de facto* leadership of the BRICS intergovernmental organization, is signaling itself as a new domineering party within the world economy, capable of guaranteeing fresh diplomatic and financial alternatives to countries that wish to rationally revise, or even fully delegitimize, the current US-fashioned status quo.[31] Thus, a question arises pertaining to the future of the international financial architecture as the world has known it for the past 25 years, considering political disruptors both in counter-hegemonic countries and in the US itself (i.e. Donald Trump, who may or may not secure a second presidential term).

Continuing to analyze the case of China, authors from Australian universities have interestingly explained that this growing superpower is challenging the international financial architecture in three main respects: firstly, it challenges the global system's capacity to absorb a substantial increase in the supply of savings; secondly, it challenges the adequacy of global financial safety nets and their ability to incorporate China, monitor meaningful and rapid changes in capital flow, and increase general financial integration; and thirdly, it challenges the framework for investment and development finance, for which there is an "immense unmet demand."[32] In turn, to tackle these challenges, to account for the changes in the global economic order, and to reform effectively the international financial architecture, China has two options, which are not necessarily mutually exclusive: firstly, China needs to improve its international diplomacy, in order to work with the established powers and to overhaul the established institutions, as it has already happened with the G20 and with the IMF, which now feature better representation of emerging nations; and secondly, it needs to build new institutions that are tailored to "fill

[28] Avgouleas, 'Rationales,' 345-346.
[29] Robert Ahdieh, 'Coordination and Conflict: The Persistent Relevance of Networks in International Financial Regulation,' (2015) 78 Law and Contemporary Problems, 77 and 100-101.
[30] Daniel Drezner, 'Counter-Hegemonic Strategies in the Global Economy,' (2019) 28 Security Studies, 505.
[31] Drezner, 'Counter-Hegemonic Strategies,' 508-510.
[32] Peter Drysdale, Adam Triggs, and Jiao Wang, 'China's New Role in the International Financial Architecture,' (2017) 12 Asian Economic Policy Review, 258-259.

important gaps in the existing architecture," even though not singlehandedly, not illiberally, and not through the lens of potentially achieving even greater global influence for itself.[33]

Academics from the University of Oxford seem to be in agreement with the first of these two proposals: in fact, they argue in favor of strengthening the voice of developing countries not only in agenda-setting institutions, but also in standard-setting ones, so that there can be a greater focus on the effects that worldwide policies may have on different jurisdictions and on the goal of those jurisdictions to become more and more involved in the dynamics of the global financial markets.[34] Furthermore, they criticize the current international financial architecture for focusing too much on the promotion of financial stability from the univocal perspective of highly industrialized countries, exemplified by the concerted efforts of the FSB, the BCBS and the IMF to bring to an end the wave of crises that has developed since the late 1990s, whilst forgetting the more ethically relevant pursuit of inclusion and (eventually) equality across the entire financial spectrum, including countries that have historically sit at its "periphery."[35] These ideas resonate with both the Bretton Woods original purpose for the international financial architecture (i.e. widespread development) and the increasingly globalized and diversified source of financial resources that permeates the world. In other words, they are at once fiercely principled and intelligently forward-looking.

In completing this third section, it is fundamental to remark that the G20 was created "at a time when the global financial system was on a precipice," when there was a "very real prospect of another Great Depression," and when "macroeconomic cooperation" was centered around crisis response and the provision of large-scale fiscal stimuli.[36] In that moment, the creation of a global financial safety net was an urgent and common prerogative of every country in the world, which meant that agreement on the agenda-setting level was easy to reach.[37] On the contrary, the ambitious and more longterm frameworks that set out to reform international financial institutions and to reduce global economic imbalances, which were also constructed in the years following the Global Financial Crisis, have been thoroughly unsuccessful, because of the difficulties to find political agreement during "peace time."[38] In fact, "by its nature, the G20 is a body whose impact depends on what each of its members brings to the table" and, if the G20 is weak due to the weakness of the political will of the countries that underpin it, the whole of the international financial architecture will suffer the effects of this weakness, because the G20 is tasked with agenda-setting and, thus, sits on top of the entire international financial hierarchy.[39]

## D. CONCLUSION

In this essay, it has been submitted that the most cumbersome shortcoming of the current international financial architecture is the lack of political agreement at the agenda-setting level, which produces, in turn, pervasive negative effects on both standard-setting transnational networks and monitoring organizations established through international legal treaties (i.e. the IMF and the World Bank). At the same time, it has been highlighted

[33] Drysdale, Triggs and Wang, 'China's New Role,' 269-271.
[34] Emily Jones E, and Peter Knaack, 'Global Financial Regulation: Shortcomings and Reform Options,' (2019) 10 Global Policy 193.
[35] Jones and Knaack, 'Global Financial Regulation,' 194-195.
[36] Adam Triggs, 'Macroeconomic Policy Cooperation and the G20,' (2018) 41 The World Economy, 1309.
[37] Triggs, 'Macroeconomic,' 1335-1336.
[38] Triggs, 'Macroeconomic,' 1337.
[39] Triggs, 'Macroeconomic,' 1337.

that the reliance on soft law mechanisms by international financial bodies does not represent a shortcoming *per se*, but that the failures concerning the development, implementation and enforcement of policies promoting financial stability and progress are again related to the asymmetry in political goals that affects each individual country. Thus, ultimately, it is proposed that countries, whether belonging to the original hegemonic order, led by the US, or to the new emerging challengers, led by China, set aside their political differences, in order to commit to a truly globalized version of financial regulation, which would induce collaboration, growth and successfulness in both the public and private sectors. For this to happen, excellent diplomacy, an authentic inclination to compromise, and adamant trust in the strategic plans delineated by financial experts are essential. After all, the world ought not to wait for the next great crisis, in order to address the macroscopic flaws that still lie at the basis of its irretrievably interconnected financial systems.[40]

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[40] Emilios Avgouleas E, and David Donald, *The Political Economy of Financial Regulation* (Cambridge University Press, 2019), 1-2 and 4-5.