

Governance of Global Financial Markets: The Law, the Economics, the Politics

Emilios Avgouleas

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Many contemporary research monographs in law are modest affairs in which an author explores and analyses a smallish, discrete topic in 180 or so pages. Consistent with the passionate man he is, Emilios Avgouleas has in this book pursued a grand aspiration. He has attempted to explore and analyse the governance of global financial markets and do so in a truly interdisciplinary way, drawing on insights from economics, finance, political science and international relations as well as law. He has sought to do so without taking any shortcuts. He has started at the beginning and continued to the end. In a project that is audacious in scope; he has succeeded.

This is a book in three parts. Each part contains much more of value than most slim monographs in this field, and given the total book is almost 500 pages set in a pleasing but small font, each part is as long as most modern monographs. Cambridge is an admirable publishing house in many ways, but older people do read these books — please have a care for our eyes!

Part I considers financial markets and crises. It commences with the functions of financial systems and markets, and then proceeds to examine in great detail the causes of the global financial crisis. Professor Avgouleas has even wisely used the Australian-coined acronym, GFC, to describe the collapse of 2008 that many Americans refer to as the Great Recession. To analyse its causes he begins by explaining, in clear accessible language, derivatives, securitization, credit default swaps, collateralized debt obligations, and the other significant financial transactions of the modern era. He also explores the contributions to the crisis of neo-liberalism, of the global movement towards deregulation of markets, and of the effect of the Washington Consensus policies on development. He assesses the cornerstone dogmas of modern finance, such as the Efficient Capital Markets Hypothesis, and explores the contribution of bankers' remuneration. This is the sense in

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which he starts at the very beginning. Having thus comprehensively laid the groundwork, he then uses all these concepts to explain the GFC.

To provide a comprehensive analysis of the development of financial markets over the past three decades, the principal financial transaction types, their underpinning philosophies and theories and of the causes of the GFC in some 150 pages of pellucidly simple language, is an intellectual feat of no mean proportions. It is easy to describe complexity in turgid, lengthy prose and the global financial system has grown very complex. To do so simply and clearly without dumbing anything down is an achievement of another order of magnitude all together and suggests a very deep understanding of the topic. Part I and the final chapter are my favorite parts of the book. Part I for its clarity and readability. The final chapter for the deeply innovative thinking — but I am getting ahead of myself.

In Part II, the author goes even further back in time, to the formation of the present international financial architecture at the end of the WWII, and analyses the evolution of the system of international financial governance from Bretton Woods until today. He does so by breaking the time frame into three periods: from 1945 to 1997, from 1998 to 2008, and since the GFC. A traditional treatment would commence with the evolution from 1945 until the floating of the US dollar in the early 1970s, and then separately analyse the 1970s and early 1980s as its own period of development. So I was initially skeptical of this treatment, but when one reads the analysis, it makes sense. Not all authors place as much weight on 1997 and the responses to the Asian crisis in their analysis of the development of the international architecture as this author. But other authors could learn from this treatment, as it was the regulatory responses to the Asian crisis that saw rapid growth in the global soft law initiatives in financial regulation and its coordination.

I have only one point of disagreement with the text of this book. This is quite remarkable. I virtually always find many more substantial issues with which I disagree in most histories of the international financial system in recent decades. This is unsurprising as trying to write accurately about anything as complex as the international financial architecture is bound to result in errors or, at least, in ways of viewing developments which are at odds with how I perceive them. Professor Avgouleas' treatment of the history and development of the financial architecture is brilliant and exceptionally accurate — which, of course, is really just a coded way of saying I agree with it, for whatever that is worth.

My point of disagreement comes on page 205 when, in analyzing the emergence of the G-20 leaders' summit as a response to the GFC, he explains that the G-20 consists of the G-7 nations and “the biggest emerging economies: Argentina, Australia, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa and Turkey”. First Australia is not an emerging nation. For good or ill, we have emerged. Although of course in a 500-page text, this is a pedantic quibble. More substantively, this sentence suggests that the G-20 was formed by adding in the next 12 largest economies to the G-7 (plus the EU to make 20). But this is not what happened. The G-20 began life as a Finance Ministers' summit in 1999, as Professor Avgouleas suggests, and was upgraded to a Leaders' summit so as to be able to respond to the challenges of the GFC. However, in 1999 the 19 largest economies were not those assembled in the G-20. In 1999 the economy of Spain was larger than India's or Korea's, and Switzerland, Sweden, and Belgium

all had larger economies than Turkey or Russia.¹ Likewise, in 2008 when upgraded to a leaders' summit, three of the 19 largest economies in the world were not represented in the G-20 grouping.² To the extent these economies are European, such as Spain or the Netherlands or Poland, the seat of the EU on the G-20 provides some representation, but nations such as Saudi Arabia and South Africa have always been in the grouping for reasons other than economic size.

Part III analyses the post-GFC financial reforms in the US and EU and the new Basel III capital adequacy framework. Dodd-Frank and the EU reforms are considered in considerable detail. Particular attention is paid to the new resolution regimes in the US and EU as the books' earlier analysis identifies, rightly, the absence of effective cross-border resolution regimes as a major exacerbating factor in the GFC.

And then we come to the truly innovative part of this book — the final chapter, Chapter Eight. This is where the author spreads his intellectual wings and envisages an extensively revised and expanded regulatory structure for the global financial system. He is right to do so. The present basic financial architecture was assembled in 1944 upon the premise that international trade should be strongly promoted but finance would remain essentially national. This began to change in the 1970s and since then finance has become ever more international to the point today that it is one of the, if not the, most globalized sector of any economy. So essentially today we seek to regulate a truly global market with national regulators who seek to cooperate through organizations such as the Basle Committee, the Bank for International Settlements, the Financial Stability Board, and others. A global financial system with national regulation is a mismatch guaranteed to result in crises.

Chapter Eight presents Professor Avgouleas' vision of such a global regulatory regime. He sees it resting on four pillars: a macro-prudential regulator, a micro-prudential regulator, a somewhat clumsily named "Global Financial Policy, Regulation and Knowledge Organization" and a global resolution authority. The four pillars make sense as does his allocation of roles to existing organisations, and the creation of a new organization for the global resolution role. The four pillar organizations would be of equal status and would be accountable to a newly created Governing Council. The Governing Council would have 25 members: the G-20 members, the EU, the United Nations, the World Bank and "the three most important national economies" not in the G-20. The 20 members of the G20 plus six additional members adds to 25 as the G-20 comprises 19 nations plus the EU, and the EU doesn't get two seats on the Council.

Doubtless this composition of the Council makes sense viewed from Edinburgh, where Professor Avgouleas holds the Chair in International Banking Law and Finance. However, viewed from Australia it is difficult to justify a seat for the EU. If the EU is there to represent the European nations that do not have a direct

¹ The World Bank, *GDP (Current US\$)* (1999) online: <http://data.worldbank.org/indicator/NY.GDP.MKTP.CD/countries?order=wbapi_data_value_1999%20wbapi_data_value&sort=desc&page=2&display=default>.

² The World Bank, *GDP (Current US\$)* (2008) online: <http://data.worldbank.org/indicator/NY.GDP.MKTP.CD/countries?order=wbapi_data_value_2008%20wbapi_data_value&sort=desc&display=default>.

seat, why are there no regional representatives to represent other otherwise unrepresented nations? Rather than the three next most important economies, in my submission the Council would be better served with, in addition to the EU, regional representatives for Northern Africa (above the Sahara), Southern Africa, South Asia (possibly SAARC, the South Asian Association for Regional Cooperation), East Asia (possibly ASEAN, the Association of South East Asian Nations), and Latin America (possibly UNASUR, the Union of South American Nations). This would make it a far more representative body than the one proposed and thus one with more credibility and innate authority.

The first of the pillars deals with macro-prudential regulation, which seeks to manage systemic risk. The author gives this role of global systemic risk regulator to the International Monetary Fund and charges it with managing the systemic risk of national, regional and international banking systems and their shadow banking sectors. This is a big and important task. If it keeps the IMF so busy it precludes it from causing problems by dictating general economic policies to developing countries in crisis, as it presently does, this might be an unforeseen positive of this initiative.³

The micro-prudential authority would be comprised of the Financial Stability Board plus the Bank for International Settlements (BIS) minus its research division. It would be charged with dealing with Global Systemically Important Financial Institutions (the G-SIFIs) and the global derivatives and securities markets.

The OECD and the research division of the BIS would comprise the Global Policy, Regulation and Knowledge Organisation, surely sufficiently named as something like the Global Financial Policy Organisation. Its role would embrace overseeing the transnational regulatory networks, which include IOSCO and the Basel Committee on Banking Supervision with more authority than the Financial Stability Board, which currently discharges this role, and overseeing the private sector bodies such as the International Swap and Derivatives Association and the International Accounting Standards Boards, in the exercise of their rule making functions. This organization would also serve as a global knowledge bank for matters related to financial stability and risk.

The fourth pillar is the Global Resolution Authority, charged with the resolution of failed cross-border financial groups. This is a critically needed organization and a major undertaking as a new treaty is required to put in place a new global financial resolution scheme for banks and other financial institutions that, when applicable, would supersede relevant national schemes.

Different minds would take different views of the first three of the author's pillars, although I certainly broadly agree with the need for them. But few informed commentators would disagree with the need for his fourth pillar and the need for a uniform global resolution scheme that applies internationally.

Four pillars is a concept with particular resonance in Australia banking circles,

³ See the discussion of the impact of IMF policies in Ross Buckley, "Improve Living Standards in Poor Countries: Reform the International Monetary Fund" (2010) 24 *Emory International Law Review* 119-146; Ross Buckley, "IMF Policies and Health in Sub-Saharan Africa", chapter in Adrian Kay & Owain David Williams, eds., *Global Health Governance: Crisis, Institutions and Political Economy* (London: Palgrave Macmillan, 2008).

where I've always thought its principal attraction is that four pillars tend to hold things up well. For instance, if you were to build a carport near your house, you'd probably use four pillars to support the roof. There's much more to this author's four pillars than a good carport however. Chapter Eight is a substantial contribution to global thinking and a real challenge to those of us working in this field, to think bigger and more fundamentally than most of us have in the years since the GFC. Certainly far too much of the thinking underpinning the regulatory reforms since the crisis has been an extension of the thinking that delivered us the crisis — people are still thinking within the same box. Professor Avgouleas has stepped out of this box, and dared to think larger thoughts, and propose more fundamental reforms, that actually seek to address the seminal change from a system of national financial systems to one truly globalized financial system.

As the author rightly identifies, we cannot go back to national financial systems. If that option is not on the table, and it isn't, then we better start regulating properly our truly international system. The worst of all worlds would be to have a crisis even larger than the GFC that causes nations to retreat behind barricades of permanent capital controls. With a fuse burning in the Eurozone that could ignite a far larger crisis than the GFC, nothing could be more urgent than the G-20 resolving to make at least some of the ideas in this book a reality.

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