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What's next after the London G-20?

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The G-20 meeting in London was a remarkable success in global governance, from several different perspectives. The world's leaders managed to agree on a set of detailed measures to combat the global slowdown and improve financial regulation. They proved that they were capable of responding to widespread public anger and disenchantment with the absence of any effective governance in the financial sector. They also indicated that these matters can be agreed upon within a global forum, between developing and developed countries, avoiding a North/South cleavage. Moreover, they agreed to upgrade the global institutional structure of finance, to ensure that these words will be followed up by deeds, a tricky issue at international level. Hence it is likely that the G-20 will become the dominant institution for global economic governance.

It is worth recalling that the G-20 is a recent creation in the panoply of international institutions. It was launched in 1999 as a forum for discussion primarily among finance ministers and central bankers, and until the crisis hit, had a more limited agenda. The proposal to discuss the crisis in this forum was initiated by the EU, more in particular by Nicolas Sarkozy who called for the launch of a "new Bretton-Woods" during his tenure at the helm of the French Presidency, While it would be entirely unworkable to tackle this issue in a UN context, the G-20 seemed a more appropriate framework, bringing together North and South. Developing countries are the victims of the current crisis, which in their eyes originated entirely in the Western world. Dealing with these matters in the G-7 (created in 1975), on the other hand, would reactivate the North-South tensions of the1970s, and it would not contribute to a comprehensive solution.

The final declaration also largely met expectations on the macroeconomic and financial fronts, but it implies an enormous workload with tight deadlines for the international institutions, regulators and supervisors. Policy-makers managed to meet the objectives set by the G-20 meeting in Washington in November, coming forward with very concrete and sensible action items in the different fields, but they will be tough to implement.

At the centre of the proposals for financial oversight is the enhanced role of the Financial Stability Board (FSB), with a strengthened membership and mandate, as a successor to the Financial Stability Forum (FSF). It includes all the G20 countries and other FSF members such as international financial institutions, central banks (e.g. the ECB), Spain, and the European Commission. Leaders probably wanted to indicate with the name change that the FSB will play a greater role in financial oversight. The inclusion of the European Commission is overdue, given the rule-making powers of this institution, and it will allow for a better coordination between the international and national level, at least in the EU.

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But the mandate to the FSB is huge, for an institution with a tiny secretariat. The FSB will have a dual task, including macro- and micro-prudential supervision. It is expected to:

- Provide early warning of macroeconomic and financial risks and reshape the regulatory systems to help authorities identify these signs; and

- Ensure that all systemically important financial institutions, instruments and markets are adequately supervised, thereby preventing regulatory arbitrage. This includes, amongst others, hedge funds, credit derivatives markets and offshore financial centres. The Basel II framework for banks has not been abandoned, but rather will be supplemented "once the recovery is assured" by capital buffers and a closer definition of capital.

These tasks will be exercised in cooperation respectively with the Bank for International Settlements (BIS) and the International Monetary Fund (IMF), with further deadlines set for autumn 2009.

Two further action items stand out from the G-20:

- the introduction of sustainable compensation schemes in the financial sector; and
- action against tax havens.

Both items have been prominent in the news in recent months, but they will be difficult to implement and enforce. They seem more designed to get the general public on board than to effect real change in these areas. Supervisors will be requested to ensure that compensation schemes are consistent with a firm's long-term goals. They could intervene with extra capital requirements in case the compensation packages are out of line. However, even within the EU, coordinated approaches on pay matters are hard, as pay packages differ widely, depending on local conditions such as the cost of living, taxation and national habits.

On tax havens, the G-20 boasted that "the era of banking secrecy is over". It called on all jurisdictions to follow international standards on prudential and tax matters. To enforce these, the G-20 conclusions list a toolbox of countermeasures, including disclosure and taxation of payments from tax havens and even economic sanctions. However, OFCs were not the culprit of this crisis, but rather an easy scapegoat for what went wrong at home. Whether they effectively manage to enforce these measures remains to be seen, but this is probably the first time such stringent action has been taken against tax havens.

But where does the G-20 leave the markets and independent standard-setters? Is it not an illusion to believe that regulators can control everything? Will the new structures, more in particular the FSB, be sufficiently strong to resist the conventional wisdom, and sound alarm bells if new bubbles develop? The failure of the self-corrective tools of many financial institutions should be no reason to do-away with self-regulation all-together. On the contrary, self-regulated organisations should take this opportunity to strengthen their enforcement mechanisms. New opportunities also emerge for consultants to develop audits for risk management or corporate governance, for example.

Will the G-20 deliver? Given the enormous praise that has been heaped upon the global leaders at the summit, they should certainly feel some pressure to do so. But the G-20 remains a limited group of nations, which raises a problem of representativeness and commitment. This is probably why the next G-20 summit is scheduled to take place in New York in September, after the annual UN meeting. In the meantime, G-20 leaders can work on the ambitious agenda they have set for themselves, and secure the backing of the rest of the world in one way or another. Global governance is on its way.