“Carlo Monticelli provides a unique insider’s perspective that combines the insights of a seasoned economist with the personal reflections of a concerned global citizen. A rewarding and enjoyable read for anyone interested in the causes and lessons of the global financial crisis!”

Masood Ahmed, President, Center for Global Development

“The author is an insider. When reading him on how the Europeans missed all opportunities by just looking inward, you oscillate between hilarity and despair.”

Agnès Bénassy-Quéré, Professor, Paris School of Economics, University Paris 1 Panthéon-Sorbonne

“There is no going back to the old multilateralism. Based on first-hand experience and sharp analysis, this book provides the economic and political-economy arguments to understand why this is the case, wrapped in a captivating narrative accessible to the non-specialist. Don’t miss it!”

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“Emerging market countries now play a more relevant role in the G20 and all the IFIs. With analytical rigour and an engaging style, this book analyzes the events and underlying reasons that brought about this radical change in global governance. Highly recommended.”

Sri Mulyani Indrawati, Finance Minister of Indonesia

“This book gives an inside story of how international financial architecture is created and reformed as advanced and large emerging market countries play power games.”

Takatoshi Ito, Professor of International and Public Affairs, Columbia University

“Combining an insider view with a multidisciplinary approach, this book offers fresh insights on why and how global economic governance has changed. A must read.”

Nouriel Roubini, Professor of Economics, Stern Business School, New York University

“Over the last decade, the international economic and financial landscape has changed much more than you think. This is the surprisingly convincing leitmotiv of this book. As a former official who has been involved in all the big issues from the inside, I did not expect Carlo Monticelli to be so candid and, in many ways,
so radical. The book is loaded with a myriad of facts and yet the reader will not
get lost because the powerful underlying analysis constantly brings all the pieces
into a coherent lot. It makes you think hard but the style is so smooth and
engaging that you do it with intense pleasure.”

Charles Wyplosz, Professor of Economics, The Graduate Institute, Geneva
The architecture of global economic and financial governance has undergone a deep and pervasive reform in the last ten years, radically transforming international institutions and groups, such as the International Monetary Fund, the G7, and the G20. This book investigates the new, unsettled order which is now prevailing, driven by the change in the balance of power between advanced economies and key emerging market economies.

Bringing together multiple strands of analysis, traditionally kept separate, Reforming Global Economic Governance: An Unsettled Order particularly explores the role of Europe within this changing world. The book documents and examines a broad range of events, building on methods from economics and other disciplines, as well as on the insights from the author’s personal involvement. This innovative approach allows the reader to ascertain the defining features of the reform: the increasing fragmentation of governance; the interconnectedness of its different elements; and the strong concern for inclusiveness. Furthermore, it presents analyses highlighting the controversial nature of the new order which underpins the current policy debate on international economic relations, including the resurgence of nationalism and trade conflicts. Through these explorations, this engaging book has direct relevance for the future prospects of international economic affairs.

Offering a comprehensive view of these issues, this accessible text will appeal to scholars, insiders, and the general reader. Its detailed and thorough analyses will also be of great use to those studying economics, international political economy, and international relations.

Carlo Monticelli is Vice Governor of the Council of Europe Development Bank. His career has straddled both private and public sectors, with positions including Deputy Director in the Research Department of the Bank of Italy; Head of European Economics, Deutsche Bank, London; and Head of International Financial Relations of the Italian Treasury. In this capacity he represented Italy in key international fora such as the G7, the G20, and the Economic and Financial Committee of the European Union.
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To Francesca and Silvia
The brain is wider than the sky:
let your soul stand ajar,
as forever is composed of nows.
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ABBREVIATIONS

AfDB  African Development Bank
AIIB  Asian Infrastructure Investment Bank
AsDB  Asian Development Bank
BCBS  Basel Committee on Banking Supervision
BRIC  Brazil, Russia, India and China
BRICS Brazil, Russia, India, China and South Africa
CEB   Council of Europe Development Bank
CRA   Contingency Reserve Arrangement
EC    European Community
ECB   European Central Bank
Ecofi Economic and Financial Affairs Council
EIB   European Investment Bank
EU    European Union
FSB   Financial Stability Board
FSF   Financial Stability Forum
GAB   General Agreement to Borrow
GDP   Gross Domestic Product
IADB  Inter-American Development Bank
IBRD  International Bank for Reconstruction and Development
ICT   Information and Communication Technology
IDA   International Development Agency
IEO   Independent Evaluation Office
IFC   International Finance Corporation
IFIs  International Financial Institutions
IMF   International Monetary Fund
IMFC  International Monetary and Financial Committee
LDCs  Less-developed countries
Abbreviations

MDBs  Multilateral Development Banks
MDGs  Millennium Development Goals
NAB   New Agreement to Borrow
NDB   New Development Bank
NGOs  Non-Governmental Organizations
ODA   Official Development Aid
OECD  Organization for Economic Cooperation and Development
OTC   Over-the-counter
PPP   Purchase Power Parity
SDGs  Sustainable Development Goals
SDRs  Special Drawing Rights
SIFIs Systemically Important Financial Institutions
SSBs  Standard Setting Bodies
ToRs  Terms of Reference
UN    United Nations
WB    World Bank
WTO   World Trade Organization
ACKNOWLEDGMENTS

On occasion, during the 2008 and the European sovereign crises, as an official of the Italian Treasury attending international meetings, I had the distinct feeling of being a fortuitous eyewitness to economic history in the making. The ensuing urge to report “my testimony” was tempered by the awareness that memoirs have a pernicious inclination to be exaggerated and self-righteous – or simply boring, unless one is a literature-Nobel-prize-winner prime minister. But the insights that the experience had offered me I thought should not be lost. A pungent mixture of amazement and concern provided the stimulus to embark on the long and arduous journey of research, building on methods from both economics and international political economy, which resulted in this book. The effort to use a style as accessible and enjoyable to the non-specialist as possible, while preserving rigour and precision, made the enterprise even more challenging.

Another motivation to write about the momentous transformation in global economic governance was to lubricate the communication between the academic and the policy-making communities – this time having an official respecting the constraints posed by academic standards. Many fora provide opportunities for the two groups to interact and explicitly exchange views on the burning policy choices of the moment – think of the Bellagio Group gatherings, the seminars and conferences organized back-to-back to G7, G20, and informal Ecofin meetings, to name but a few. Yet, fruitful communication has plenty of room for improvement. In fact, during the most recent crises, discounting respectful politeness, policy proposals elaborated in academic circles typically gained minimal, if any, traction in the policy debate in striking contradiction with the intellectual calibre of the proponents – a circumstance that would warrant a rigorous scientific investigation.

It is a pleasure to express my gratitude for direct help and encouragement for this work to Svein Andresen, Catherine Avraam, Richard Baldwin, Lorenzo Bini
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Finally, in the acknowledgements it is customary for authors to confess that the completion of their project took much longer and required a much more strenuous effort than original envisaged; admit an intellectual debt to a much wider group of people than those they name for their direct help in the preparation of the manuscript; and finally apologize to their family for their guilty absence and foul mood. With no originality but with genuine truthfulness, I dress old words new and wholeheartedly underwrite all of the above.

At end of this long journey, it is a pleasure to thank, deeply and devoutly, my wife for her unflagging support, encouragement, intellectual stimulus, and palpable interest for issues distant from her academic domain.

Paris, November 2018
INTRODUCTION AND OVERVIEW

The world as we know it has come to an end: a new, unsettled order prevails in global economic and financial affairs. It took a crisis to act as a catalyst and precipitate the change in regime. But the transformation had fundamental causes; the financial turmoil that erupted in 2008 cannot be blamed or praised as the origin of the new order.

In contrast to the last major reform in global economic governance associated with the Bretton Woods conference, the demise of the old regime was not marked by the setting up of a new, well-structured financial architecture with the consensus of the major countries. Rather, it came as a radical and pervasive change in the balance of power between the “old” players, led by the G7 club of advanced economies, and the key emerging market economies. This shift in power overwhelmed all international economic and financial relations: it radically modified the functions and modus operandi of the most important international groups, the G7 and the G20; it deeply altered the equilibrium among shareholders in the formal and informal control of existing international financial institutions; and it led to the creation of several new organizations: an institution to promote cooperation in financial regulation, two multilateral development banks, and various regional financial arrangements.

The diffused and unsettled character of the reform in global economic governance requires a special analytical effort to detect its multifaceted consequences, recognize its relevance, and grasp its coherent nature, while acknowledging its inadequacies. This is precisely the task set for this book, which requires an eclectic approach: bringing together different strands of analysis traditionally kept separate; documenting and examining a broad range of events and institutional changes; building on methods from economics, international political economy, and political science. Further insights come from the author’s direct involvement in all the major international economic fora as an official of the Italian Treasury.
The analyses conducted in this book reveal the unsettled and controversial essence of the new order which, deliberately or unknowingly, underpins the current policy debate on international economic relations, including the resurgence of nationalism and trade conflicts. A proper evaluation of these tensions and the available policy options must rest on an understanding of the reform in global governance, considering its features in detail together with the dissatisfaction and mutual recriminations they give rise to. For this reason, the findings of this research, which examines how these features came about during the crisis, have a direct relevance for the future prospects of international economic affairs that goes beyond the historical interest of the events that changed the global order for good.

Despite its focus on policy issues, this book offers a contribution to positive analysis, based on an eclectic but rigorous method, rather than taking a normative perspective on the “right way” to address the challenges facing international economic relations or venturing scenarios about the future of the global economy. Only the final chapter partly deviates from this principle. Following an historical and institutional analysis of Europe’s external representation, Chapter 6 advocates a stronger role for Europe in global economic governance, argues that this would be beneficial both to Europe and to the world as a whole, and puts forward a concrete and expedient strategy to pursue this objective.

A radical reform

That global economic governance has undergone a radical transformation with the emergence of a new and unsettled, yet consistent and pervasive, global order is the first major finding established in this book.

To the officials directly involved in international economic and financial relations, this conclusion is self-evident – an analytical confirmation of the change in the balance of power between major countries they daily experience in their formal and informal meetings at international groups and institutions. Yet, it stands in stark contrast to the assessment of several distinguished scholars of international relations: the absence of a novel international financial architecture and the resilience of the system, which did not collapse in spite of severity of the crisis, motivate their conclusion that no real change in governance occurred.

True, continuity has been a remarkable feature of the functioning of global governance since the 2008 crisis. In addition to aspects of a cosmetic nature – such as the ecumenical choreography of the annual meetings of the International Monetary Fund – there are three substantive elements of continuity also evidenced in the present analysis: the persistence of the US dollar as the pivot currency of the international system; the endurance of the international standards regime in financial regulation; and the survival of the orthodox approach to macroeconomic policies outlined in the “Augmented Washington Consensus”.

Yet, these important elements of continuity do not warrant the misleading conclusion that no fundamental change has taken place. Crucial transformations have occurred too, causing a regime break: the international supremacy of the US in
economic affairs has been repeatedly and successfully defied – suffice it to recall the US opposition to the emblematic establishment of a new, Chinese-led multilateral development bank. The voting power and the informal clout within international financial institutions have dramatically shifted in favour of the key emerging market countries, whose concerns are now as important as those of the G7 in defining the viable policy space. The proliferation of regional financing arrangements, despite their inadequacies, has questioned the G7-led monopoly of the International Monetary Fund in the provision of emergency financing during crises.

Most conspicuously, the G20 has replaced the G7 as the key decision-making forum on global economic and financial matters. Its effectiveness in this function is arguably inferior to the achievements of the G7 in its heyday, as shown by its inability, which emerged soon after the acute phase of the 2008 crisis, to marshal consensus on many of the crucial issues facing the global economy. The drift of the G20 towards irresolution – which contrasts with the enthusiasm for its achievements expressed by some scholars – ultimately derives from its members’ marked heterogeneity in economic, political, and social systems, especially when compared to the relative cohesion of G7 countries. But this profound divergence on many fundamental aspects across systemically important economies is a fact which global economic governance has to come to terms with. Certainly it cannot be addressed with the return to a G7-based governance, more or less openly advanced in some quarters: since the early 1990s this group has lost more than a third of its share in the world economy, and its position is set to decline even further.

Despite its shortcomings and mixed track record, the G20 is the forum where, since the 2008 Washington summit, all the key international decisions have been formally made or informally negotiated and politically agreed. The G20 has become the ultimate setting to seek the key countries’ consensus over the issues regarding macroeconomic policy coordination as well as the other institutions and processes that are part and parcel of the day-to-day functioning of global economic governance.

The central role of the G20, with the influence it gives to emerging market countries, is the most emblematic aspect of the new order and crowns all the other transformations, including those described earlier. The ascendancy of the G20 in the reform of global governance can be seen as the conspicuous indication that “this time it’s real”, to quote the title of one of the many analyses contending the end of the pax Americana, the unipolar governance structure hinging on the accepted supremacy of the US.

This overhaul in the balance of power that has materially changed global economic governance has not yet been accepted in principle and absorbed in practice by the US and the other advanced countries, which still resent it and try to resist it. For their part, emerging economies consider the transfer of power in their favour as insufficient and continue to question the legitimacy and representativeness of international financial institutions. The new global regime remains unsettled and incomplete, fuelling frustrations and mutual recriminations. These
impulses underpin the resurgence of nationalism and trade disputes, which threaten the liberal order and the global economic integration it allowed.

**Key features of the new order**

Against the backdrop of the persistent tensions between advanced and emerging market countries, the limited capacity of the G20 to mediate and reach compromises with the outright endorsement of all its members has led to a proliferation of new regional arrangements and institutions in the economic and financial sphere, such as the Asian Infrastructure Investment Bank and the Contingency Reserve Arrangement. Even more emblematically, the G20 leaders’ summits have to coexist with the continuation of yearly summits of the G7 and with the high-profile annual meetings of the leaders of the BRICS – the club comprising Brazil, Russia, India, China, and South Africa, established in 1999 as the antagonist of the G7.\(^5\) The resulting _fragmentation_ of many aspects of global governance is the _first feature_ of the new order that is worth highlighting. Although some authors see fragmentation as a proof of the continuing absence of effective governance,\(^6\) most consider it as an inevitable component of a multipolar system, although with different gradations of optimism for the benefits it can bring to the effectiveness of global governance.\(^7\)

The analyses in this book elucidate the functional links between fragmentation and the unsettled nature of the reform in global governance, establishing that fragmentation is not the result of the intention to relinquish the pursuit of a cohesive institutional architecture. Among the several facts that support this conclusion, one might recall emerging economies’ struggle to increase their influence in the Bretton Woods institutions and the attention they pay to the issue of congruity of frameworks across international institutions and arrangements, as illustrated by the co-financing operations between the Asian Infrastructure Investment Bank and the World Bank, and by the explicit reliance of many regional financing arrangements on the surveillance framework of the International Monetary Fund.

In the absence of an off-the-shelf model of global institutional architecture adequate to the economic and financial multipolarity that has emerged since the 2008 crisis, the quest for a satisficing, rather than optimal, governance design has been actively pursued through a trial-and-error process. This process has given plenty of room to serendipity in establishing new arrangements and defining their characteristics. _Fortuna is always imperatrix mundi_, but more so at this particular juncture. Yet, the more marked role for happenstance has been compatible with an overall consistency because of the _purposeful experimentation_, which is the _second remarkable feature_ of the reform in global governance. Driven by the twofold objective of defying the status quo and searching for a satisficing order, emerging market countries have directly established or pushed to put in place a host of new arrangements which share a common characteristic: their potential to become, as originally set up or duly adapted, the building blocks of a more accomplished and multipolar global architecture.
Clear examples of this approach are the foundation of the New Development Bank, with the explicit ambition to elaborate an alternative paradigm for development; the démarches to become members of the rule-making bodies which set the international standards of financial regulation; China’s success in having its currency inserted in the basket of the unit of account of the International Monetary Fund – the Special Drawing Right – and its advocacy for the latter to perform a more relevant function in the international monetary system. Moreover, such initiatives have been complemented by the emerging economies’ resolute efforts to develop the human capital necessary for an efficacious participation in international processes and institutions, as indicated by the conspicuous rebalancing in the nationality of both international organizations’ staff and senior international appointments.

In addition to the pursuit of this dual objective, another powerful factor contributed to the internal consistency of the reform: the interconnectedness of the different elements that shape global economic governance, which has acted as a centripetal force balancing fragmentation. Interconnectedness, which is the third noteworthy feature of the reform, originates from several concurrent factors: the greater awareness of the importance of the interdependence between different domains of global governance that became apparent during the crisis; the function of the G20 as the hub for many interacting international groups; and the wider access to global networks, as well as the closer interactions between them, brought about by the direct involvement of new actors and stakeholders in international relations.

This interconnectedness is ultimately a reflection of the increased interconnectedness of the global economic and financial system, which has reached an intensity unconceivable just a few years ago, driven by two major factors: i) the radical transformation in global value chains and trade patterns, made possible by the revolution in information and communication technology; and ii) the impressive deepening of global financial integration, in turn due to new technologies and to “swollen finance” – that is, the phenomenal expansion of the stock of financial assets both in absolute terms and in relation to global production.

Nations are now more interdependent than ever. Thus, the disastrous scenario in which the outbreak of a global political crisis would precipitate the end of multilateralism and the “balkanization” of global trade and finance into regional blocs, would have even more disruptive effects than those of “the end of globalization”, as the period following the Great Depression was dubbed. And such a catastrophic outlook cannot be regarded as totally implausible, given the widespread and multifaceted backlash against globalization in spite of the fact that it enabled generalized improvements in welfare and an emancipation from poverty and disease like in no other epoch in history.

The dissatisfaction with globalization has been an important element of the public debate on economic developments for many years, at least since the unexpectedly violent demonstrations at the World Trade Organization summit in Seattle in November 1999 – an outcry of radical dissent against the liberal
order that initiated the series of street protests that have ever since accompanied G8 summits (and G20 summits too, as soon as their relevance was perceived by the “antagonist” demonstrators). But the critique of globalization has not been confined to political radicalism. With different ideological and analytical underpinnings, it has also entered mainstream academic and policy discussions, leading to widespread calls for reform and political action to ensure that the economic benefits from globalization are more evenly distributed.

The backlash against globalization and the relative debate, which is too articulated to be outlined here, are the fundamental motivations of the fourth notable feature of the reform in global governance: the concern for inclusiveness in economic growth. This is a sensitive and divisive issue, since the notion of inclusive growth is given different interpretations both across the political spectrum and among different countries. Yet, it is an inescapable element of the reshaping of global governance, because inclusiveness, both within countries and across nations, is by now recognized as an essential element for the sustainability of growth and the long-term viability of international arrangements. The goal of inclusive growth has even become an integral part of the orthodoxy of the major international organizations.

Before moving to the overview of the material covered in the various chapters of this book, there is one final element that has to be mentioned because of its pervasive impact on national politics and international relations: the social media revolution. The study of the implications for social interactions and political processes of the enormous increase in the accessibility of information is in itself a specific topic of investigation that has been garnering growing scholarly attention. In particular, the analysis of the consequences of the social media revolution for the reform of global economic governance stands as a compelling area for future research. Here one cannot fail to highlight that the 2008 financial turmoil was the first global crisis ever to be managed with a direct public feedback on the policy response taking place in real time.

These events have illustrated how strong the impact of social media can be on international interactions in the economic and financial field, and have shown that it unfolds through two main channels. The first one is the increased “impatience” of policy makers: the real-time scrutiny and feedback to which they are subject constrain their attitude in international relations. Politicians have to show (or they perceive they have to show) that their country “won”, or directly benefitted from, every single piece of international negotiation. Conversely, international cooperation thrives on the repeated nature of commercial, financial, and political interactions that offer scope for compromises across issues and over time.

The second channel of influence originates from the much more diffused and unverified production of information. This innovation has been both hailed as a powerful instrument of empowerment and material democracy – the Arab Spring in 2012 is the example cited most often – and blamed as an insidious threat to a genuine public debate because of the frequent diffusion of fake news, in some cases with the deliberate plan to interfere directly with the political process – as
some argue was the case in the election of President Trump. With an informed and articulated analysis of this phenomenon still in the making, one can only flag the issue of the growing importance of public perceptions, not always based on true facts, in setting constraints on the politically viable outcomes of international relations, to the likely detriment of mutually beneficial international cooperation.

The ascent of the G20

The analysis starts with the symbolic event that marks the beginning of the reform in global economic governance: the unannounced participation of President Bush, on 11 October 2008, in the G20 meeting of finance ministers and central bank governors. That extraordinary session was convened because the crisis was so intense and systemic that it could only be credibly addressed with the direct involvement of the major emerging economies, even though they still had little influence over international institutions. Their direct engagement in the global policy response changed this for good and put an end to the G7-based global governance, paving the way for a new, multipolar order.

After a brief review of the achievements of the G7 order, Chapter 1 examines its progressive failings, in particular its inability to exert peer pressure on its own members and to prevent the inappropriate macroeconomic policies and the inadequate supervision of the financial sector that caused the 2008 crisis. The waning grip of the G7 on world economic affairs, however, had an even more fundamental reason: the drastic reduction in its relative economic weight. Since the late 1990s, the G7 countries have lost a third of their share of world GDP, which returned below 50 per cent, as it was at the end of the 19th century.

The gains of this epochal shift in economic power mostly accrued to a relatively small number of countries, with three – China, India, and Brazil – benefitting from about two-thirds of the fall in the G7 share of the world economy. The loss in effectiveness of the G7-based system of global governance was thus accompanied by a progressive decline in its legitimacy. The inadequacy of the G7 became apparent just when effective international cooperation became all the more crucial because of deeper economic and financial interdependence.

The explosion of the crisis provided the key emerging market economies with the opportunity to demand a more important role in global governance to which they had long been aspiring. Due to a series of serendipitous events, chronicled and analysed in detail, the G20 was the setting where this demand was most forcefully expressed. It became the group around which the reform in global governance was centred with a marked shift in power towards emerging economies. To perform this function, the G20 had to transform its format, with the upgrade at the leaders’ level, the creation of several specialized working parties preparing its deliberations, and pervasive changes in its modus operandi.

Chapter 2 assesses the role of the G20 in the reform of global economic governance and its performance, which has been extremely varied in the span of only a decade. Under the pressure of the raging crisis, the G20 successfully
marshalled the consensus to implement ambitious and coordinated policy measures that avoided a global collapse. It also managed to agree on launching the revamp of the key areas of economic governance: i) the coordination of macro-economic policies; ii) the international financial architecture, with a rehabilitation of the function of international financial institutions and a revival of the debate on the role of the SDR; and iii) the international standards underpinning the regulation and supervision of the financial sector.

With the recovery in economic activity and the stabilization of financial conditions, the traditional difficulties in international macroeconomic cooperation, such as the dispute about the burden sharing of the adjustment of outstanding imbalances, powerfully resurfaced and stifled the effectiveness of the G20. This happened despite the major improvements that had been implemented in the coordination process, such as the explicit and consensual definition of the objectives of the exercise. No widely agreed, structural reform in the international financial architecture took off either. Advanced countries defended the status quo and emerging countries opted for a piece-meal approach: fighting for a rebalance of power in old institutions, creating two novel multilateral development banks, and establishing new regional financing arrangements.

The inquiry of Chapter 2 also covers the BRICS group, the club created by the major emerging economies to boost the public profile and the efficacy of their common demand for a more influential role in global governance. In spite of the achievements on this score and the great visibility of its yearly summits, as soon as the BRICS ventured beyond this agenda, its cohesion practically vanished, strained by its members’ differences over strategic objectives and overarching political values. For these reasons, in contrast with the more optimistic assessments of some authors, this analysis concludes that the BRICS group is unlikely to remain as a central element in the new international architecture.

The mix of G20 successes and failures is testimony to the unsettled order emerging from the reform of global governance, characterized by significant elements of continuity with the G7-based regime, which coexist with a drastic power shift in favour of emerging economies, the establishment of new institutions, and the fragmentation of many international arrangements. The uneven performance of the G20, however, should not be mistaken for an indication that other institutions are more relevant or effective, since it is the forum where all the key international decisions were, and still are, formally made or informally initiated and negotiated. Although its wide membership has often proven an obstacle to its decision-making capacity, the flexibility of its working methods is an important asset for its leading role in the reform of global governance.

**Vying for control of the International Monetary Fund**

Chapter 3 addresses another key element of the reform in global governance, the international financial institutions, and provides new insights into the two-way interaction with their shareholders. These institutions have been, at the same time,
instruments to pursue the objectives of their key members, pro-active agencies capable of enormous influence over their masters’ policies, and the terrain for large countries’ disputes to exert their control. Among them, the International Monetary Fund has always had a special relevance because of its role as international lender of last resort.

The decision of the G20 to give international financial institutions major responsibilities in the policy response to the 2008 crisis revived their prominence in the mechanics of global governance, after many years when their function and legitimacy had been bitterly criticized. In April 2009 the G20 London summit deliberated on a massive increase of the Institutions’ resources, including the tripling of the lending capacity of the International Monetary Fund. The G20 could only agree to this increase on the condition of a significant shift in voting power in favour of emerging economies. The ensuing struggle to gain more influence within the Fund became one of the defining elements of the transformation in global economic governance emerging economies championed in the G20.

This struggle involved protracted and harsh negotiations – whose technical aspects are presented in a way accessible to outsiders – that took place in different fora but remained always under the constant supervision of the G20. The resulting agreement, which provided for a substantive shift in voting power in favour of emerging market countries, took nearly five years to enter into force: the embroilment in US domestic politics delayed its ratification by the US Congress, necessary because of the US veto power over the Fund’s major decisions. This episode further questioned the political appropriateness and the economic benefits of centring global economic governance on the hegemonic role of the US, providing renewed momentum to the shift towards a more multipolar system.

The transfer in power in favour of emerging economies went beyond the increase in their voting rights: it also involved a significant boost in their clout on day-to-day decision making, acquired through greater recognition in the informal contacts that shape the Fund’s decisions. Although insufficiently appreciated because of the confidentiality of the Fund’s deliberations, this influence is one of the qualifying elements of the reform in global governance.

In spite of these radical changes in the power balance within the Fund, substantive continuity in the paradigm underpinning its policies has prevailed. Under the influence of emerging economies, new elements – such as a more benevolent attitude towards some form of capital controls – have been incorporated in the Fund’s framework, revealing its adaptive nature as well as its widespread acceptance as an element of the new order.

The key role of multilateral development banks

Chapter 4 is devoted to the role of multilateral development banks in global governance – a role which has been traditionally neglected despite their importance in determining the mainstream approach to development as well as the
policy frameworks of countless countries. As the analysis shows, views on development have greatly evolved over time, sparking controversies that are still open, most notably about the priority of investment in infrastructures over interventions to alleviate poverty immediately. Development banks, and the World Bank in particular, have led this debate, shaping the definition of the international community’s development goals – most notably those adopted by the United Nations at two special summits in 2000 and 2015.

Chapter 4 starts with an in-depth analysis of the development banks’ business model – an innovation introduced with the establishment of the World Bank and perfected over the years – which proved very successful by virtue of its capacity to offer a flexible and efficient use of their members’ financial resources. Building on its operational achievements, unrivalled in scope and geographical diversity, the World Bank has established its intellectual leadership by defending the mainstream view of development, while actively contributing to adapt it in response to the concerns of an ever wider range of stakeholders.

Regional development banks, such as the African Development Bank, were established in the wake of the World Bank, in some cases with the unconcealed objective of elaborating an alternative model of development. Although they did not succeed in this goal, they proved effective catalysts of economic integration at the regional level and useful mediators between local governments and the World Bank regarding regional policy objectives and investment priorities. This function partly sheltered regional banks from the malaise that affected the World Bank before the 2008 crisis, with mounting doubts about the effectiveness of its policies, a weakening leadership, and a flagging lending activity.

This situation drastically changed with the G20 decision to use development banks as a key instrument of the response to the crisis, supporting global demand by financing investment. To this end, multilateral banks received a huge boost to their capital on the condition that they reformed to enhance emerging market economies’ voting power and influence. Chapter 4 also probes into the economic and political reasons why this aspect of global governance reform was far less controversial within the G20 and was approved by the US Congress far more easily, although it was as important as the reform of the Fund.

Conscious of the effectiveness of the multilateral banks’ business model, emerging economies were eager to deploy financial and political capital in a bold move of defiance towards the prevailing order: founding two new institutions to challenge advanced economies’ monopoly in this instrument of global governance, and to prepare useful building blocks for the new international financial architecture. The setting up of two new institutions rather than one reflects the pursuit of a twofold goal: challenging the mainstream view of development through a novel global institution, aptly named New Development Bank, and defying Japan’s economic leadership in Asia, usually taken as an integral part of the post-war order.

China swayed the setting of this agenda, directing it towards its commercial and geopolitical priorities, much to the irritation of the other emerging
economies, which went along nonetheless: the foundation of new institutions was too important a step towards a more multipolar governance. Negotiations with China were harsh and led to various concessions on its part both on various aspects of the two new banks and on the resources to establish a new financial arrangement providing support to the BRICS in the event of a crisis.

Like all the others, this regional financing arrangement has limited resources and insufficient analytical capacity, and has to be taken as yet another expression of emerging markets’ challenge to the existing financial architecture. In spite of their limitations, for a period, regional arrangements were considered within the G20 as elements of a global financial safety net to be established by encompassing them and the International Monetary Fund within a single operational framework. No real progress has been achieved in this direction. Thus, without a substantive increase in their resources, which is unlikely, regional arrangements cannot become relevant building blocks of the new financial architecture.

The importance of multilateral development banks for global governance received further corroboration by yet another sizeable increase in resources which, after insistent pressures by the banks, shareholders eventually started to grant in 2018. Emerging economies’ success in advancing their formal power and informal influence in this crucial facet of global governance, both through their stronger clout over the “old” Banks and through the establishment of two new institutions, is one of the most significant aspect of the reform.

The persistence of the international standards regime and the dollar

Emerging market countries were definitely less successful in acquiring influence in the other new institution which was established after the crisis: the Financial Stability Board, whose function in the reform of global governance is analysed in Chapter 5.

Given the blatant flaws in the regulation and supervision of the financial sector which were exposed by the crisis, the urgent repair and the re-regulation of the financial sector were key elements of the policy response. They featured prominently in the agenda of the G20 with a persistence and an attention to technical details that have no historical precedent for international relations at the leaders’ level. The focal point of this action was the establishment of the Financial Stability Board, with the mandate of strengthening and ameliorating the international standards regime, which Chapter 5 analyses both in its economic function and in its political economy aspects.

The Board was tasked by the G20 with the ambitious objective of spearheading “sweeping reforms” on a very wide range of issues. Such a broad scope led to the dispersal of international negotiations in many processes, each involving different institutions, stakeholders, and political-economy dynamics. Chapter 5 evaluates the attainments achieved by these efforts in the most important areas, namely: capital adequacy, too big to fail, transparency and integrity, excessive risk taking, shadow
banking, and over-the-counter derivatives. It concludes that the results were mixed and uneven, in many cases unsatisfactory, with continuity and incremental revisions as the most recurrent features. Various factors account for the mixed results, most of which were specific to the particular issue. Two common causes, however, stand out for this unconvincing performance: the dispersal of the reform momentum in so many threads of work and the financial industry’s persistent ability to capture regulators, thanks to its unmatched technical skills and its key role in finding viable solutions to international regulatory disputes.

International financial regulation was an important concern for emerging economies, given that the pre-crisis international standards regime was firmly entrenched in the power relations of the G7-based system: standards largely drew on US rules and practices, while emerging market economies were members of neither the standard-setting bodies nor of the predecessor of the Financial Stability Board. The latter instead provided for the participation of all G20 countries, meeting emerging market countries’ demands in line with their objective of power rebalancing in global governance.

The Financial Stability Board was not the treaty-based, international institution that some advocate. International financial regulation has continued to be based on soft law, mainly because, even after the crisis, each country has continued to defend its own financial industry’s interests in the negotiations for the scope and method of international regulatory cooperation. Yet, the Board has become an important element in the reform of global governance, as the unavoidable hub for the key international negotiations in its field, promoting international consistency of regulatory and supervisory policies in a system of ever-growing financial interconnectedness.

Despite their participation in the Board and all the standard-setting bodies, emerging market economies have gained little clout on the shaping of financial regulation. They have maintained a rule-taking attitude, which stands in sharp contrast to the influence they have acquired in all the other aspects of global economic governance. In addition to the resistance of advanced countries, other factors account for this puzzling finding. First, emerging countries are reluctant to invest political capital in international regulatory disputes. Second, they do not have sufficient technical expertise and human capital to be effective in the negotiations. Finally, and so-far unnoticed as an explanation for advanced countries’ command over financial regulation, the dollar has continued to be the pivot of the international monetary system. The dollar’s role is a key factor in the shaping of financial regulation through two main channels: the support it provides to the supremacy of US banks in global finance, and the priority assigned by all large international banks, irrespective of their nationality, to have direct access to the Federal Reserve’s dollar facilities, requiring them to be chartered in the US and hence subject to US regulation.

The crisis, which originated in the US and was fuelled by its macroeconomic imbalances, was initially expected to lead to a substantive depreciation of the dollar. On the contrary, the dollar was taken once again as a safe haven and thus
it appreciated, confirming its role as the key reserve currency. Although many structural imbalances suggest that a diminution of the dollar is prospectively inevitable, this has not yet happened and it is unlikely to occur soon. The demise of a pivot currency takes a very long time, as the historical experience of sterling has shown. Moreover, the two potential alternatives are not yet ready: the renminbi is not backed by deep and resilient financial markets, and China’s capital account and financial industry have not been liberalized, while the euro lacks the support of adequate institutional background and political cohesion.

**Europe and global governance**

Finally, Chapter 6 addresses the reasons why Europe has exerted such a small influence in the reform of global governance. The continent has obtained remarkable achievements in economic, financial, and political integration, which have been enshrined in a succession of ever more ambitious Treaties and the introduction of the euro. In spite of these successes, which have brought about the longest uninterrupted period of peace and prosperity in history, European countries have remained very jealous of their prerogatives regarding the relations with third countries.

As a result, European external representation has always been weak, confused, divided, and derivative with respect to national positions, even when strategic objectives were obviously coincident, as in the International Monetary Fund or in the G7. “Who do I call when I want to call Europe?” Henry Kissinger supposedly quipped in the 1970s. After several revisions of the European Treaty, he would now have a well-defined answer, even though not as clear as he desired: the correct addressee of the call depends on the subject matter, because the process to determine Europe’s external position and external representation remains complex and topic-dependent.

The complexity of the process to define a common European position and the reluctance to defend it with conviction is not only the result of bureaucratic impediments. It reflects the widespread idea that European and national external interests differ, which is based on three misconceptions that stand to be corrected: i) in contrast with the ambition, rekindled by a new powerful wave of nationalism, to continue playing a significant global role as an individual country, no European nation has the economic weight to maintain world relevance on its own; ii) despite the belief that differences across Europe are so deep that they cannot possibly be encompassed in a common European position, they are dwarfed in comparison with the divergences with extra-European countries; and iii) contrary to the idea that national economic interests are overwhelmingly different, contrasts across European countries in extra-EU economic matters are not of any strategic significance.

Intricate procedures for the definition of a single European external position, a lukewarm response to championing it, and defensiveness in safeguarding national prerogatives have resulted in an ungainly and ineffectual European stance. Such discouraging ineffectiveness is in blatant contradiction with the
high number of European representatives and the large size of European voting power in international financial institutions and groups.

The reform in global governance initiated by the crisis highlighted the inadequacy of the European position: at that crucial juncture, Europe missed the chance to influence the events in line with its economic size and potential geopolitical power. It was so absorbed by its internal disputes over the management of the sovereign crisis as to be unable to join forces and defend its own interests in the rebalancing of power within the G20 and in the negotiations over the reform of the International Monetary Fund. Moreover, Europe badly mismanaged its relationships with the Fund during its involvement in the European crisis.

Europe’s declining influence in the reform of global governance is not inevitable. The most compelling and expedient strategy to this end is to arrange a more effective representation in international fora and institutions by systematically following, at the European level, the same approach that countries adopt in international financial institutions when they are jointly represented by the same executive director. This approach requires no change in domestic or international legislation, only political goodwill. And it is no utopian proposal, as the recent decision to form a euro-area constituency in the Asian Infrastructure Investment Bank has shown. Flexible in its implementation and highly symbolic in the message of European unity it conveys (think of a euro-area executive director at the International Monetary Fund!), this arrangement could be an important step for a more effective role of Europe in the reform of global governance.

A more united Europe, capable of exerting significant influence over global economic and financial architecture would benefit not only Europe itself but the whole world too. A more prominent Europe would help the diffusion of the features of its social model, such as consumer protection, that could contribute to mitigating the costs associated with globalization, thus helping to preserve an open multilateral system. Moreover, a stronger Europe could contribute to the resilience and stability of the global economy, reducing the risks associated with a governance based on a US-China bipolar system. Finally, a more united Europe could underpin the function of the euro as an international reserve currency, which could facilitate the ordinate correction of the huge outstanding imbalances that pose a disquieting threat to global financial stability.

Europe and global governance

“Never let a good crisis go to waste” was the precept often repeated in international official circles to provide impetus to the reform efforts initiated by the Washington G20 summit in November 2008: crises offer opportunities for radical changes that are not otherwise possible. Ten years on, the deep and pervasive reform in global economic governance, which this book has documented and analysed, suggests that the crisis was not wasted, at least in this domain.
The reform has attained a radical change, which was long due, in the balance of power between advanced and emerging economies, associated with a remarkable enhancement of its legitimacy and considerable progress towards multipolarity. The reform has led to the establishment of new international financial institutions and arrangements, as well as to profound and pervasive innovations in the modus operandi of pre-existing formal and informal institutions. These transformations have provided the international community with a new array of institutional and operational tools which have greatly increased the potential flexibility and effectiveness of internationally coordinated policy actions.

Yet, in spite of these innovations and attainments, the global order remains unsettled in its architecture and institutional arrangements. Moreover, it is shaken by lacerating tensions fuelled by the resurgence of nationalism and protectionism, which are in turn rooted in the wide dissatisfaction with globalization, the alarming implications of the increase in inequality, both within and across nations, the growing threats to global commons, with climate change at the top of the list. Other factors too add to the risks of an outbreak of disruptive instability: longstanding global imbalances persist, and worrying fragilities in the financial sector have resurfaced, originating from a return of traditional excesses that the post-crisis regulatory reform proved unable to prevent as well as from the very high levels of private and public debt.

Against this backdrop, risks loom large of another episode of severe financial instability or, even worse, of an international crisis precipitating the end of multilateralism and the fragmentation of trade and finance into regional blocs. History has time and again shown humankind’s inability to avoid repeating past mistakes – so that these adverse scenarios cannot be shrugged off relying on the guidance offered by past crises. Yet, the analysis of this book has shown that, even if still unsettled, the reform in global governance has strengthened the world’s resilience through the increased flexibility and effectiveness of international policy action which the new tools can provide if there is sufficient policy agreement.

Challenges might appear insurmountable, but the tools to address them are available. Solutions lie in the international community’s own hands – which, indeed, are our own hands.

Notes
1 The System Worked and the Status Quo Crisis are the self-explanatory titles of the books by, respectively, Drezner (2014b) and Helleiner (2014a).
3 For example, Kirton (2013), Cooper and Thakur (2013), and Hajnal (2014). The fervour about the G20 as the lynchpin of a revamped international architecture has even extended to the elaboration of academic proposals to change its composition with the addition of seats assigned to geographical constituencies in order to improve its representativeness and legitimacy, as in Vestergaard and Wade (2012).
4 Layne (2012).
5 To be precise, South Africa became a member of the BRICS and started to participate in the annual summits only in 2011, while G8 summits have been replaced by the
return to the G7 format only since 2014 – see Chapter 4 for a full discussion. It is interesting to notice that, in the period between 2009 and 2013, Russia brazenly participated in a whole assortment of leaders’ summits: G8, BRICS, and G20.

6 For example, Bremmer and Roubini (2011), and Temin and Vines (2013).
7 For example, Helleiner (2016a) talks of “cooperative decentralization” (p. 1), Larionova (2016) proposes the “governing in alliance model” (p. 70), and Acharya (2016) sees “creative fragmentation […] as the reflection of […] broader forces in world politics” (p. 454). On the other hand, Plesch and Weiss (2015) lament that “a variegated institutional sprawl […] can only result in […] a ‘good-enough global governance’, […] which however […] ain’t good-enough” (p. 198), while Weder and Zettelmeyer (2017) argue that to ensure “coherent governance in a multipolar system […] requires (at a minimum) consistency between the frameworks of the International Monetary Fund and those of the new sources of financing” (p. 3) – a condition that cannot be taken for granted.
8 Baldwin (2016).
11 The symbolic status of the Seattle events is also acknowledged by (some of) the protesters themselves in their “short history of anticapitalist alterglobalization”, available at https://antig7.org/en/node/57.
12 The reader is referred to Stiglitz (2017) for a recent (and opinionated) review of the debate on globalization.
13 Boughton et al. (2017), Buti and Tomasi (2018), and Snower (2018) are among the recent papers that focus on this.
14 Loungani (2017) documents in detail how inclusiveness became a component of the orthodoxy of the International Monetary Fund. Promoting Inclusive Growth (De Mello and Dutz, 2012) was jointly published by the Organization for Economic Cooperation and Development and the World Bank.
15 See, for example, Sunstein (2017) and the literature quoted there.
16 The importance of patience, or rate of time preference in game-theoretic jargon, for international cooperation is discussed in Chapter 1. China’s attitude in international negotiations reveals more patience and a longer time horizon than all other major countries.
17 For example, Stuenkel (2015, 2016) and Nayyar (2016).
18 For example, Kono (2017), who however insists on the need to retain sufficient flexibility at the national level.
19 The video available at www.youtube.com/watch?v=1yeA_kHHLow shows Rahm Emanuel, President Obama’s chief of staff, uttering this phrase. Other attributions are also available, including to Winston Churchill.
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