Global authority can fill financial vacuum

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Even if the US’s massive financial rescue operation succeeds, it should be followed by something even more far-reaching – the establishment of a Global Monetary Authority to oversee markets that have become borderless.

Washington recognises that the crisis has become global. Hank Paulson, Treasury secretary, has said that foreign banks operating in the US will be eligible for federal assistance and he is urging other nations to fashion their own bail-out programmes. Central banks have also been synchronising injections of funds into markets. These should be steps to a more comprehensive international response designed not just to extinguish the current fires, but to rebuild and maintain the capital markets for the longer term.

The current global institutional apparatus is woefully incapable of overseeing the financial system that is evolving. The International Monetary Fund is irrelevant to this crisis, the Group of Seven leading industrial countries lacks legitimacy in a world where China, Brazil and others are big players, and the Bank for International Settlement has no operational role. The US Federal Reserve is too besieged to act as a global central bank.

That vacuum at the centre is dangerous for everyone. The US’s dependence on massive inflows of foreign capital, roughly $3bn (£2bn, €1.6bn) a day, will surely increase now as Uncle Sam acquires $1,000bn in new obligations from current bail-outs. For years to come, Wall Street and Washington will be unable to manage without strong co-operation from other markets.

Beyond that, the international dimensions of finance are mind-boggling. Global assets have increased from $12,000bn in 1980 to nearly $200,000bn in 2007, far outstripping the growth of gross domestic product or the expansion of trade. An increasing amount of this capital now resides in Asia and the Gulf, not the US or Europe. A US company such as AIG sold more of its credit default swaps and insurance policies outside the US than within it. UBS employs 30,000 Americans, is listed on the New York Stock Exchange and owns Paine Webber. The capital markets will evolve in the context in which emerging market economies will be growing twice as fast as the rich nations and will, by mid-century, probably account for almost two-thirds of global GDP.

Globalisation will now also create a clash of philosophies. Most governments and investors outside the US never shared the American system of cowboy capitalism. Now they have good reason to demand that some fundamental changes be made in the way the US manages its financial institutions. This can happen with a conscious, negotiated modification in the US financial model, or it could result from foreign investors shifting their funds elsewhere.

All of these considerations point to the eventual need for a new Global Monetary Authority. It would set the tone for capital markets in a way that would not be viscerally opposed to a strong public oversight function with rules for intervention, and would return to capital formation the goal of economic growth and development rather than trading for its own sake.

A GMA would be a reinsurer or discounter for certain obligations held by central banks. It would scrutinise the regulatory activities of national authorities with more teeth than the IMF has and oversee the implementation of a limited number of global regulations. It would monitor global risks and establish an effective early warning system with more clout to sound alarms than the BIS has.
It would act as “bankruptcy court” for financial reorganisations of global companies above a certain size. The biggest global financial companies would have to register with the GMA and be subject to its monitoring, or be blacklisted. That includes commercial companies and banks, but also sovereign wealth funds, gigantic hedge funds and private equity firms.

The GMA’s board would have to include central bankers not just from the US, UK, the eurozone and Japan, but also China, Saudi Arabia and Brazil. It would be financed by mandatory contributions from every capable country and from insurance-type premiums from global financial companies – publicly listed, government owned, and privately held alike.

In terms of US and international politics, a Global Monetary Authority is probably an idea whose time has not yet come. That may change as today’s crisis evolves.

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