The G-7, the Financial Stability Forum, the G-20, and the Politics of International Financial Regulation

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In 1999, in the wake of the two previous years of international financial turmoil in East Asia and elsewhere, two new intergovernmental institutions were created by the G-7 to assist in regulating global finance. The first, the Financial Stability Forum, brought together representatives from G-7 countries and from existing international institutions concerned with international financial regulation. The second, the Group of 20, brought together finance ministers and central bank governors from the G-7 and from twelve non-G-7 emerging market countries, along with high-level representatives from EU, the IMF and the World Bank. This was accompanied by much discussion and further changes in existing institutions as part of the focus on reform of the international financial architecture.

The relatively rapid creation of two new international institutions, under any circumstances, but especially in an issue area which is thought to be notoriously difficult to regulate, offers interesting opportunities to apply or reconsider existing theories of international institutions. The severe practical consequences of the crisis to which these institutions are designed to respond further contributes to the importance of analysing them.

At first glance it appears that these developments can be fairly easily explained by theories that emphasize the self-interested use of power politics by states. Faced with a systemic crisis, the great powers, working together in the G-7, quickly put together institutions which they solidly controlled to respond to that crisis and thereby preserve the advantages they get from their dominant position in the system.

The developments also seem to fit well with approaches which emphasize the mutually supportive roles of states and powerful market actors, as conceptualized for instance in Cox's *nébuleuse* (Cox, 2000), a transnational process bringing together finance officials, international financial institutions, and other participants in various financially-dominated discourses, to strengthen the degree to which states are forced to adjust to the needs of the global economy. Financial crisis threatens not only wealthy holders of financial assets, but capital more generally, as the stability of international markets as a whole is at risk. Thus it is not surprising that powerful states would organize a response to such a threat.

Finally, liberal approaches which emphasize bargaining among rationalistic actors would see these developments as the result of the desire of the states involved in them to work together to prevent international financial crisis, a task in the interest of all participants.

Despite the apparent ease with which these developments can be explained as a reflection of the interests of powerful state and economic actors or an outcome of rationalistic bargaining there are anomalies that raise questions. Why did the G-7 feel a need to institutionalize the participation of non-G-7 countries? Why was the apparently weaker and less formal G-20 developed rather than relying on the IMF with its proven record of obtaining compliance of developing countries through practices of conditionality? Why were two institutions, the FSF and the G-20, formed in quick succession, despite their apparently overlapping mandates? Why did some of the ideas which emerged from the G-7's work, like some support under certain conditions for slower liberalization, or the need to impose the costs of crisis on private actors, appear to work against the powerful financial interests which seem to be driving the globalization of finance? And why was there no evidence of negotiation on the part of the emerging market states, the inclusion of which is the one of the most striking features of the developments?

This essay argues that it is necessary to go beyond above approaches to address the role of *legitimacy* if we wish to fully understanding the process through which the FSF and G-20 were created in 1999. Legitimacy can be defined as the acceptance of the exercise of power or of a set of social relationships because it is believed that these are based on a justifiable set of rules.[1] As such legitimacy plays a key role in the maintenance of social order. Many people attribute the effects of power or compliance with social rules to the deployment by the powerful of resources, especially the exercise or threat of coercive force. By contrast, those who have studied legitimacy have held that effective power and compliance can only be occur if there is a belief in their rightness. As Franck (1990: 15-16) has noted, "most contemporary legal philosophers deem coercive power necessary but insufficient to secure habitual social assent to governance...Those who claim to have identified one or more non-coercive factors in the engendering of obedience generally use the term *legitimacy* and its variant, *legitimation*, to enclose some or all of the additional or alternative (non-coercive) requisites of obedience".

Clearly legitimacy at the international level differs substantially from legitimacy in domestic polities. Everyday domestic democratic institutions, such as parties and elections, which are commonly crucial in legitimizing policies, are absent, as are other traditions and institutions which link rulers and the ruled. Nevertheless it is possible to identify specific features of the exercise of power internationally that are associated with its degree of legitimacy. In international law these have traditionally been restricted to the character of relations among states. In this essay I go beyond this state-centrism to identify features of the market economy and of bodies of technical expertise that foster or undermine legitimacy.

This essay does not suggest that power is irrelevant in the creation of the FSF and G-20. On the contrary--it is crucial. However identifying institutional characteristics that distinguish *legitimate* power from unlegitimated power enhances our ability to understand the process by which the FSF and G-20 were created. As we shall see, the concept of legitimacy draws our attention to certain normative features of power relationships and thus supplements power analyses that are based on capabilities and outcomes. We shall also see that the concept of legitimacy helps us to identify a crucial and distinctive complex of norms under conditions of high asymmetries of power that are an under recognized subset of the broader universe of norms which constructivist approaches address.

Canadian Finance Minister Paul Martin, who would shortly thereafter become head of the G-20, noted in July 1999 "It is not reasonable to expect sovereign governments to follow rules

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[1] For various definitions of legitimacy see Beetham 1991, 3; Franck, 1990: 16, 24, 150; Lipset 1984, 89; Schaar 1984, 108.

and practices that are 'forced' on them by a process in which they did not participate. Therefore, whatever form the renewed global financial architecture ultimately takes, all countries must 'buy into it' and take ownership. Only then will the framework have legitimacy" (Martin 1999). This essay suggests that this is not simply rhetoric but that it reflects the concrete significance for contemporary international institutions of legitimacy. In the remainder of the essay I shall first discuss legitimacy conceptually and then examine its relevance to the creation of the FSF and G-20.

Legitimacy in Contemporary Societies

Contemporary social scientific theorizing has gone well beyond Weber's influential identification of three types of legitimacy--traditional, rational and charismatic. Weber's approach can be criticized both for the arbitrary, incomplete, and under theorized character of this trichotomy and for his overemphasis on followers' *belief* in legitimacy at the expense of more independent criteria (Beetham, 1991: 8-9). An alternative traditional approach, which is to focus solely on legality, is also problematic since it obscures the question of why some laws continue to be accepted while others lose support. Moreover in our contemporary world there are other sources of legitimacy than formal law such as science.

Beetham (1991) usefully argues that for power to be fully legitimate "three conditions are required: its conformity to established rules; the justifiability of the rules by reference to shared beliefs; the express consent of the subordinate, or of the most significant among them, to the particular relations of power" (1991: 19). This approach subsumes more traditional emphases on belief or law but also provides more basis for critically and independently examining these. Beetham's goal is to provide an approach which is valid across time and space. This means, however, that these criteria are too abstract to be more than a useful starting point for a meaningful examination of legitimacy in particular social settings.

Other theorists have focused more directly on the specific ways in which legitimacy is produced in our contemporary world. An assumption is that there is a profound change in the shift from tradition to modernity. In traditional society order was seen as an expression of forces, such as God or nature, which were independent of human volition. However "today a very broad range of private activities and social practices must be co-ordinated by conscious means, and this extends indefinitely the range of practices and standards in need of legitimation. The conventionalization of social life thus simultaneously extends the scope of legitimation and shakes the ground upon which it seeks to stand" (Connolly, 1984a: 6). Three important post-traditional themes stand out: the economy; science; and democracy. I shall examine each in turn.

There are four related ways in which the contemporary economy can be seen as contributing to the legitimacy of political and social relations. The first is its effective performance. Connolly (1984b) has commented on the centrality of *productivity* for the American civilization which "seeks to sustain an economy of growth, so that each generation can be more prosperous, secure and comfortable than its predecessor" (p. 227). Growth supplanted other ideals in the legitimization of communist regimes as well, and its faltering has contributed to their downfall. But in liberal capitalist societies the legitimizing effects of economic growth has been linked in powerful ways to a more general commitment to "performance ideology" (Habermas, 1984: 149) (the merit principle; a pragmatic can-do orientation) and to possessive individualism (Habermas, 1984: 150) which assumes that social practices should be judged with reference to the degree to which they satisfy the needs of individual.

The second legitimizing effect of the economy is its apparent naturalness. Economic forces, because of their connection to the material world, already can be more easily characterized as natural than political institutions. Liberal economic theory, from Adam Smith's invisible hand through more sophisticated neoclassical models of market relations, have sought to identify dynamics that operate independent of conscious human will. Like traditional forms of legitimation, then, these foster acceptance of social order by making it appear to be a inevitable reflection of nature.

A third legitimizing effect of the market economy is its characterization as *private*. Fundamental to liberal ideology is the public/private distinction: the belief that private matters are of concern to the individuals involved in them only and are not the proper subject for public policy. This dramatically constricts the range of activities which require legitimation. In the 1970s Habermas argued that the increased involvement of the state in the economy posed a challenge to the state's legitimacy but subsequently the state's withdrawal could be seen as easing this potential problem.

A fourth legitimizing effect of the market economy is its characterization as fair. Market transactions are seen as voluntary exchanges of items of equal value. They are seen as open to all participants, as rewarding participants appropriately for effort expended, and, due to the convergence of competitive prices, including that of labour, as fostering equality. Thus both the process and outcomes of market interactions are characterized as fair. Problems such as monopoly, predatory behaviour, or exploitation are seen as aberrant distortions of the underlying pure market forces.

These four features of contemporary economies do not just legitimize economic relations, but political relations as well. The responsibility of the state for the economy, and thus its need for legitimacy is limited by these features. When the market economy works well the liberal state can enjoy legitimacy from association with it. Social problems, if they can be linked to the effects of market forces, can be treated as natural, inevitable, or the responsibility of individuals, not associated with power, and thereby not creating a need for legitimation.

Science and technical knowledge has also become a powerful source of legitimacy in our contemporary world. Their legitimizing effects parallel the four identified for the economy, in part because of the degree to which economics has come to be seen as a science. Science creates legitimacy as a result of its performance: its accomplishments in curing disease, in harnessing the atom and so on. It is seen as an expression or reflection of the natural world and thereby free of power and its need for legitimization. The scientific and the technical, while not private, are seen as non-political, and as matters that are properly the concern only of experts and not of the public more generally. This applies to technical expertise within the administration of the state as well as to science more generally. Due to its openness to criticism and challenge on the basis of agreed standards science is seen as reasonable and fair. More generally science enjoys its association with the production of knowledge which has always been a source of awe and authority.

The third post-traditional theme in the study of legitimacy, democracy, plays a unique role. There are numerous features of democracy that contribute to its legitimizing capacity: its foundation in an explicit set of constitutional rules; the fairness inherent in its representational aspirations; and its openness to participation and to opposition. Habermas (1998) has argued that it is the discursive dimension of democracy--its insistence that policies should be subject to open debate where proponents are required to justify them on the basis of agreed reasonable principles--that is most important. Law, which is itself central to legitimacy, is legitimized by the democratic procedures through which it is created.

These three themes, economy, science, and democracy, work together and echo each other in ways which enhance their independent legitimizing effects. All three subject powerful or authoritative actors to open challenge and appear to allow them to maintain their positions based on their performance within a set of agreed rules and against agreed criteria. All three operate relatively autonomously thereby reducing the complexity and extent of practices needing legitimation. All three involve claims that they benefit society as a whole and not just the powerful. And all three, by remaining in principle open to the involvement of all, provide opportunities for those other than the powerful, by participating, to demonstrate consent. These forms of legitimation differ sharply from traditional themes such as ascription.

There is much more that could be said about the points made above. Each of these forms of legitimation has been subject to increasing stress in late modernity. And the relevance of each, or of legitimacy in general, can be challenged by those claiming that analysis of self-interested bargaining is sufficient for understanding social relations. Rather than pursuing these questions immediately I will do so in the course of examination of the relevance of these and other features of legitimacy at the international level, a task to which I now turn.

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Legitimacy and the Governance of the Global Political Economy

The study of legitimacy at the international level has lagged far behind its study in national polities. As Franck (1990: 5-6) has commented,

> while there is a literature on the formal sources of international law--treaties, custom, etc.--this is not the same as an examination into the *reasons* why rules do, or do not obligate. The latter question is largely shunned...Many modern social scientists, moreover, quite simply do not even see any international system, let alone an international pattern of deference to systemic norms worth bothering about. Who would bother to inquire as to *why* a system of rules is obeyed when there is little evidence either of a system or of obedience?

Debate over legitimacy at the international level, then, could be seen as closely related to the larger ongoing debate in the discipline of international relations regarding the relative importance of norms as compared to self-interest. This debate in many respects is the most fundamental in the discipline, motiving vast literatures, such as the idealism-realism debate; inquiries into the relevance of regimes, or the more contemporary constructivist-rationalist debate. Since there is no evidence that this fundamental debate will be resolved, in large part because of deep-seated differences in philosophical assumptions, it is not possible to provide decisive support for legitimacy's relevance or irrelevance by pointing to a universally recognized track record of compliance or non-compliance with international norms. Any single contribution to clarifying the debate can hope, at the most, to be incremental.

One recent important contribution to clarifying the normative effect of legitimacy is Hurd's analysis of sovereignty. Hurd identifies two alternative mechanisms of social control to legitimacy, coercion and self-interest, and convincingly argues that neither explain the persistence of sovereignty and of borders. There is no evidence that states have sufficient military capacity to always defend their borders by force nor is there evidence that diplomats and policy makers even *consider* challenging sovereignty and borders to any significant degree as one would expect if they were operating out of self-interest. That exceptions are labelled "rogue states" and regarded as reprehensible deviants indicates the normative significance of sovereignty's legitimacy.

Hurd demonstrates convincingly the relevance of legitimacy to sovereignty, but, as he notes, the "process by which a particular norm, rule or norm comes to be seen as legitimate" and "the role of power (material and ideological) in making an institution legitimate" are questions that remain to be further researched. Two other approaches to understanding legitimacy in international politics are worth considering before trying to move our understanding of the issues raised by these questions into new territory. These two existing approaches, which I will address in turn, are Franck's and the Gramscian approach.

Franck (1990: 24) focuses on "generally accepted principles of right process" as the foundation of international legitimacy and identifies four: determinacy, symbolic validation, coherence and adherence. Determinacy refers to the clarity, transparency, and specificity of a legal text or of the findings of a process which has been agreed to interpret such a text. Symbolic validation involves elements such as ritual and pedigree which reinforce a rule's link to longstanding common culturally-enhanced commitments. Coherence means that "distinctions in the treatment of 'likes' be *justifiable in principled terms*" (Franck, 1990: 144). Such principled terms indicate that rules in one area can be made consistent with different rules in another area. This begins to bear on the fourth foundation of legitimacy, adherence, which refers to the embedding of rules in a set of rules about rules.

Franck's approach is very useful in identifying the way in which legitimacy operates among states. However, like Beetham's approach, its abstract focus on process is too general to capture important contemporary developments. For instance, it is difficult to think of explaining compliance with trade and financial liberalization rules or with environmental agreements simply because they meet Franck's conditions for the legitimacy of international law. Rather it is necessary to consider the legitimizing role of economics and science which were discussed in the previous section. Relatedly, Franck excludes explicitly questions of justice from his analysis which he is careful to distinguish from legitimacy. This is because he thinks that it is meaningless to talk of justice, which must relate to individuals, when talking about relations among states. This distinction, which is problematic to begin with (since one simply needs principles which specify an appropriate relationship between states and their citizens) is doubly so now as states seek to jointly regulate the conduct of actors other than states.

The Gramscian approach moves well beyond Franck's in addressing habits of obedience in the global political economy. While only occasionally using the term *legitimacy* the Gramscian approach, in its use of the concept of *hegemony*, nevertheless develops an extensive and insightful analysis of the types of normative relations to which legitimacy refers. While starting from a materialist perspective Gramscian analysis stresses the role of ideas in constituting and reproducing social structures: "the social organization of production, as aspect of the social world, is thus necessarily constitute partly by intersubjective meanings, which can be identified nd understood, however imperfectly." (Gill, 1993a: 27).

A key Gramscian principle is that domination involves a mixture of coercion and consent. As Cox comments, "to be meaningful, the notion of the state would also have to include the underpinnings of the political structure in civil society. Gramsci thought of these in concrete historical terms -- the church, the educational system, the press, all the institutions which helped to create in people certain modes of behaviour and expectations consistent with the hegemonic social order" (Cox, 1993: 51). Hegemony, then, "brings the interests of the leading class into harmony with those of subordinate classes and incorporates these other interests into an ideology expressed in universal terms" (Cox, 1993: 57).

Successful hegemonies can be projected out from national societies to create world hegemonies: "the dominant state takes care to secure the acquiescence of other states according to a hierarchy of powers within the inter-state structure of hegemony. Some second-rank countries are consulted first and their support is secured. The consent of at least some of the more peripheral countries is solicited" (Cox, 1993: 63). This general observation can be linked to more specific initiatives: one can situate "discussion of inter-state forums, international organizations and informal councils like the Trilateral Commission, in the context of the development and application of hegemonic strategies on an increasingly transnational basis" (Gill, 1993a: 34). These serve to "generate strategic consensus in order to configure what might be called the 'pyramids of privilege' in the world order structures that the G7 rulers seek to bestride." (Gill, 1993b: 7). Gill's discussion of the relationship between ontology and economics, and Gill and Cox's emphasis on rules, whether in the form of a "new constitutionalism" or an "internationalization of the state" is consistent with the stress on rules in analyses of legitimacy.

Despite the insights generated by the Gramscian approach there are four shortcomings of it for analyzing the role of legitimacy in the creation of the FSF and the G-20. First, it tends to be too broad brush to explain variations in the way in which legitimacy is created in particular issue areas. Hegemony is a very large scale concept. For instance, Arrighi (1993) identifies "the three hegemonies of historical capitalism". Certainly shifts in hegemony and in the class relations upon which it is based have been used by Gramscian analyses to explain the replacement of embedded liberalism by neoliberalism. Nevertheless it would be awkward to use this scale of analysis to explain smaller scale-changes and stresses in international institutions. Relatedly, the content and details of the mechanisms by which legitimacy is established remain vague, in part because it is assumed that such mechanisms, rather than having an autonomous and patterned logic, are instead historically variable expressions of a more fundamental compromise of interests at the level of social class. Indeed the contribution of a particular type of process to legitimacy, as opposed to the contributions of material benefits and ideological effects, tends to be underestimated. Finally, there is a tendency to identify the key normative disjuncture as lying between hegemony and a counter-hegemonic project involving civil society actors. I shall argue that the normative problems in global governance that give rise to a need for legitimacy are more complex than this.

Let us then relook at the evolution of legitimacy in the contemporary period as a broad and relatively autonomous phenomenon that is crucial for the reproduction of social order, and not one that is just an expression of underlying relations among states or social classes.

Work at the end of the 1970s by Habermas and others expressed a widespread perception that a turning point had been reached in the ability of the welfare state to legitimize itself. Legitimacy had been fostered by high levels of economic growth and by the commitment of the state to redressing the unjust effects on its citizens of market forces. However by extending its reach into society in the course of these legitimizing activities the state also made itself vulnerable to crises of legitimation if it failed to meet citizens' expectations. The growth of new social movements highlighted these problems as well as the inability of formal political and legislative procedures to sustain their role in legitimizing the state.

From the vantage point of the new millennium it is remarkable how well legitimacy crises have been avoided despite these problems. The key and unforeseen development has been the powerful legitimizing roles of globalization, private authority,[2] and technology. For states that have done unexpectedly well economically, such as the United States, the expanded role of globalization, of private authority, and of technology has had a positive legitimizing effect by sustaining the culture of productivity. For those states and individuals who have done less well, however, the expansion of globalization, private authority and technology have had an alternative powerful legitimizing effect. Rather than being a phenomenon that is associated with power and politics hardship is seen as resulting from one's failure to adjust to global economic forces, to be sufficiently entrepreneurial, to move into high-tech industries, or to master bodies of technical expertise.

This could be perceived as fair as long as it was believed that all would have their chance to play the game if they just learned and followed the rules. Three of Franck's rule-related components of legitimacy--determinacy, coherence and adherence--are evident in the increasingly complex and abstract bodies of technical and economic knowledge that shaped the world and our perceptions of it in the 1980s and 1990s. The fourth, symbolic validation, was fostered by the cultural counterpart of economic globalization, with its promotion of identities expressed through consumption, American-style individualized risk-taking, and cosmopolitan mobility. Thus the legitimacy of the state, and of social relations, was tied to both the *output* of globalized, private and technical systems, but also to the *aesthetic and ethical effect* of their formalized logics. The financial crises of the late 1990s, then, were crises not just because of the material hardship they imposed on their victims, but because of the challenge they posed to the broader global, private, and technical systems of legitimation. The Mexican crisis of 1994 and 1995 could be partly rationalized as the result of the Mexican government's failure to comply with these systems' rules: its vain attempt to fix its currency at above-market levels and the backwardness of its financial sector. The solution to the problem could also be portrayed as involving more careful use of, or compliance with, the systems' rules: using NAFTA trade rules to increase exports and using technologies to modernize the banking sector, to increase the flow of information, or to offset risks through the creation of peso derivatives markets. The return of system-threatening financial crisis a mere two years later, and in East Asia which had been applauded for its highly successful export-oriented growth, was far less easy to explain as consistent with the systems' rules, as we shall see below.

This analysis suggests, then, that legitimacy is not just something created by the interactions of states nor is it an epiphenomenon of a large-scale compromise between social classes. It is also a characteristic of systems of rules that make them appear to be logical, coherent and fair. Legitimacy can be threatened, then, not just from non-compliance by states or by a strengthening counter-hegemony, but also by contradictions and inadequacies in the systems of rules. In the next section I explore the ability of this conceptualization of legitimacy to explain the developments of 1999 relative to alternative explanations.

The Origins and First Months of the FSF and the G-20

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2 The term "private authority" here refers to the way in which market actors develop a legitimized capacity for structuring social relations and corresponds to the discussion of the legitimizing effects of the economy above. For a fuller discussion of private authority see Cutler, Haufler and Porter, 1999.

In this section I discuss the background to the creation of the FSF and G-20 before turning, in the next section, to a discussion of the role of legitimacy in this creation. These institutions' creation in 1999, while in part a response to the financial crises of the previous two years, was also the culmination of a quarter-century of institutionalization of the capacity for international financial regulation. Elsewhere I have analysed the evolution of this regime (Porter, 1993; 1999) and have argued that it has displayed considerable autonomy from nation-states. Here I start by briefly summarizing the key features of this evolution and its relationship to the FSF. I then look a second and more recent trend, the increased role of political actors in the regime, and note significance of this role in the creation of the FSF and G-20.

The roots of the FSF in the larger international regime

In 1975 the regime consisted of the G-10 Central Bank Governors with their newly formed Basle Committee on Banking Regulations and Supervisory Practices and, also newly formed, the Inter-American Association of Securities Commissions and Similar Organizations, which, in 1984, would be transformed into the globally oriented International Organization of Securities Commissions. These institutions would become the main bodies responsible for international banking and securities regulation respectively. Additionally the Bank for International Settlements produced data on and analysis of global financial markets as did the G-10's Eurocurrency Standing Committee which, like the Basle Committee, had its secretariat at the BIS.[3]

By 1998 the capacity and organizational complexity of the regime had grown dramatically. Two new Basle-based institutions had developed: the BIS's Committee on Payment and Settlement Systems and the independent International Association of Insurance Supervisors, with a secretariat also located at the BIS. Beginning in 1980 the Basle Committee established relations with eleven regional groupings of bank supervisors, some of which it had actively fostered, significantly extending its influence in most regions of the world. IOSCO had grown to become a well-established organization with 159 members from around the world. Substantial regularized collaboration between the Basle-based groups and IOSCO, the International Monetary Fund, and the World Bank had also developed. All of the institutions had generated enormous amounts of technical information, created well-established patterns of collaboration between national regulators, and generated agreement on best practices. Additionally more formal standards had been agreed, with the international oversight of the standards' national implementation, as with the Basle Committee's capital adequacy standards, and IOSCO's "Objectives and Principles of Securities Regulations."

The creation of the FSF, with representatives from all of the Basle-based regulatory groupings, IOSCO, the IMF and the World Bank, along with 21 representatives of the G-7, could be seen in part, then, as the logical outcome of this process of institutionalization of the regime for international financial regulation. It had become increasingly clear even before its formation that some mechanism for coordinating between the international regulatory bodies was needed given the intensifying linkages between the activities which each sought to regulate. The earlier

[3] A more detailed analysis of the development of the regime for international financial regulation can be found in Porter 1999. For an analysis of democracy that intersects with this essay's focus on legitimacy see Coleman and Porter, 1999.

creation, in 1993, of the Tripartite Group, bringing together representatives of the Basle Committee, IOSCO and the IAIS, and its successor, the Joint Forum, in 1996, could be seen as precursors of the FSF (Tripartite Group, 1995). The FSF's location, with a secretariat, at the BIS, along with the appointment of Andrew Crockett, BIS General Manager, as its first chair, further indicates its continuity with the Basle-based committees.

The role of increased G-7 political intervention

The strong and overt political guidance exercised by the G-7 over the FSF was a marked change from the earlier heavily technical governance of the regime. The other regulatory groupings were created and responsible to the G-10 Central Bank Governors (as with the Basle Committee and the Eurocurrency Standing Committee, which was renamed the Committee on the Global Financial System in 1998), to national regulators, as with IOSCO and the IAIS, or to the BIS central bankers, in the case of the CPSS. By contrast the FSF was created by the G-7 finance ministers, a political body itself reporting to and oversighted jointly by the G-7 leaders. At its creation, with 21 G-7 representatives out of its 35 members, including representatives from G-7 finance ministries, the ongoing political control of the FSF was further ensured. The approval of the G-20 at the Koln summit, and its launching in September 1999, was an even more dramatically political intervention by the G-7. The character of its formation, in which its initiation, mandate and membership was fully under the control of the G-7, signalled the heightened prominence of politics in the regime as did the G-20's inclusion of G-7 and non-G-7 finance ministers--political actors--and not just central bankers and regulators which had been the key actors in the pre-1999 regime for prudential regulation.

The more prominent political role of the G-7 in the international regime for financial regulation dates back to the 1995 Halifax summit which took place in the wake of the Mexican peso crisis. Of course the G-7 had earlier considered financial matters, such as the instability that followed the collapse of the Bretton Woods system which in part was one of the original reasons for the G-7's formation, or the G-7's creation of the Financial Action Task Force in 1989 to address money laundering. However beginning in 1995 the G-7 began to devote more sustained attention to financial stability, calling for and considering reports from their Finance Ministers on the topic as well as issuing their own statements.

While much of the G-7 involvement was initially limited to general statements of intention it subsequently became increasingly detailed, specific, and associated with identifiable outcomes. Thus at the 1995 summit the G-7 made vague calls for an improved early warning system, heightened cooperation and greater IMF involvement in regulatory issues, and speedier and more generous disbursement of IMF funds in crises. By the 1999 Cologne summit the G-7 could point to concrete developments in the IMF's Data Dissemination Standards, in the changing practices regarding the release of information from IMF reviews of national economies, in the Contingent Credit Line of new IMF crisis financing and in the pace at which agreed best practices were being developed in the international regulatory bodies, although the exact impact of G-7 declarations on these international bodies, which have their own momentum and are ostensibly independent of the G-7, is hard to precisely measure. As well, by Cologne, the G-7 leaders were regularly approving increasingly detailed and specific progress-reports and plans prepared by G-7 Finance Ministers and Central Bank Governors.[4]

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4 See for instance Group of 7, (1998; 1999). G-7 documents are available at www.g7.utoronto.ca.

In April 1998 the creation of the ad-hoc G-22, in a meeting with G-7 and non-G-7 countries where the US unilaterally and peremptorily set out the Group's membership, presaged the creation of the G-20. The G-22 included G-7 representatives, Australia, and 14 emerging market representatives and would, in October 1998, release three substantial reports on the international financial architecture.[5] It operated through three Working Groups, each chaired by one developed and one emerging market representative.

The actions of the G-7 in 1999 in creating the FSF and the G-20, while following logically from its previous involvement in international financial regulation, were qualitatively more forceful and explicit. While the G-7's 1989 creation of the FATF could be seen as a precedent, the FATF was a committee framed as responsible for a relatively narrow and technical sub-problem in the overall issue area of global finance. By contrast, the FSF was designed to bring together with the G-7 all the international bodies concerned with international financial regulation. The G-20's role was even more ambitious: G-7 actors indicated that the G-20 was expected to coordinate the FSF and the possibility was even noted that it might supplant the G-7.[6] Despite the dominant role of the G-7 in its creation the G-20 was a remarkable development: comparable in some respects to the unlikely possibility that the Permanent 5 on the UN Security Council would spontaneously agree to provide some type of special standing there for prominent industrializing countries.

The first months of the FSF and G-20

By the end of 1999 both the FSF and the G-20 had begun meeting and it had become apparent that their functioning corresponded largely with what one would expect given the discussion above of their origins. The FSF had met as a whole twice--on April 14, 1999 in Washington and in Paris, September 15, 1999. Three FSF working groups had been formed: on highly leveraged institutions (hedge funds); on capital flows; and on offshore financial centres. While the tone of reports on their functioning retained the technical orientation traditional in the regime for international financial regulation the topics addressed involved more politically controversial matters than would have been typical in past years of the international regulatory regime.[7] Reports on the G-20's meeting, conversely, gave the impression of an organization that, given the political origins of its members, was relatively free of politics.[8] Thus it was clear that

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5 These reports are available at www.bis.org.

6 "Ernst Welteke, Bundesbank president, has said the new Group of 20...could replace the G-7 as an informal forum. Mr. Welteke said the G20 would need to discuss at its inaugural meeting on December 16 in Berlin whether it could take over the leading global role as a discussion group" *Financial Post* (Canada) Nov. 29, 1999, "Welteke says new G20 could be top forum" from the ft.com archive. As noted below officials were subsequently more circumspect about the G-20's role.

7 On the work of the FSF see "About FSF" and other documents at www.fsforum.org.

8 See for instance the report of the *Middle East Observer* on the first G-20 meeting, which portrays the meeting as endorsing the status quo ("Improvement of Global Economy: G20" *The Middle East Observer* 22 December 1999, at www.ft.com). See also "G20 Welcome for Emerging Market States" *Financial Times* Dec. 15, 1999, at www.ft.com which notes that Martin "particularly wants to avoid meetings degenerating into a series of prepared speeches.

both institutions were drawing on the regime's technical heritage to handle potentially politically conflictual issues in an apolitical way. Moreover the FSF's and G-20's creation had been a relatively modest and low-profile affair given the severity of the preceding crisis and its first months' functioning indicated continuity with this aspect of its origins, facilitated by the easing of the financial crisis.

Legitimacy and Other Explanations of the FSF and G-20

In this section I explore the relevance of the concept of legitimacy that was discussed above for understanding the FSF and the G-20. I start by further discussing the deficiencies of three prominent approaches that seem most suited to analysing the emergence of these two new institutions which were briefly noted in the introduction to this essay. I will then turn to an analysis of legitimacy.

The Deficiencies of Prevailing Approaches

Approaches drawing on the realist emphasis on the preeminent role of powerful states in world politics would seem to have a lot to offer in analysing the emergence of the FSF and G-20. The G-7 is an organization of the most powerful states and its prominence in their emergence would seem to be consistent with these approaches. Moreover the creation of the ad hoc G-22 process which preceded the creation of the FSF and G-20 was an exemplary case of the unilateral deployment of power by the US. Whether one regards the US role as exercising leadership which benefitted the system as a whole or as arbitrarily promoting a response to the crisis which was consistent with its own interests and which allowed it to retain its dominance in global finance (by, for instance, ensuring that prudential regulation and continued financial liberalization rather than capital controls was the solution adopted) it seems clear that asymmetries of power and capabilities among states must be a key part of any explanation of the FSF and the G-20.

Yet on further examination shortcomings of this type of analysis become apparent. Power was indeed important but it is difficult to see the project which it was used to accomplish as a straightforward expression of the interests of the states exercising the power. In the case of the FSF, why would the G-7 want to encumber itself with the non-G-7 actors which were part of the Forum and which enjoy some autonomy from the G-7 since their mandate and control rests with bodies, such as the G-10 Central Bank Governors or the International Association of Insurance Supervisors, which are at least one step removed from G-7 political authorities? Why not just work through the G-7 finance ministers? In the case of the G-20, why incorporate political authorities from outside the G-7 into the governance of the regime? From a self-interested perspective this appears to be an irrational weakening by powerful states of their own political dominance.

Moreover, the FSF and the G-20 are quite unlike other institutions, like the General Agreement on Tariffs and Trade, which realist approaches such as hegemonic stability theory have been used to explain, since it is not clear how the institutions themselves directly benefit the powerful states. In the case of the GATT, commitments to trade liberalization are seen as contributing to mutually beneficial growth and to improved access to foreign markets for a country's firms. Thus the benefits for powerful supporters of the GATT are tied to the organization itself. By contrast, from an interest-based perspective, it is not clear what concrete

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'The great strengths of the G7 have always been the informality of the discussion and the fact that participants are financial ministers and central bank governors themselves'".

benefits the FSF and the G-20 provide for the G-7 that the latter grouping could not provide by itself. There are no concessions given by non-G-7 actors as a condition of membership. Rather the non-G-7 actors have had their power enhanced by being invited to play a more significant role in coordinating the governance of global finance. The officially declared benefits of the FSF and G-20--enhanced joint coordination--fall outside approaches that stress the preeminence of the most powerful states.

Neoliberal institutionalist approaches initially appear to be better suited to explaining the FSF and the G-20 if one thinks of these institutions as a way to reduce transactions costs among their members. Certain economies of scale in learning about international financial regulation can be achieved by pooling the efforts of a larger group of states than the G-7. Uncertainty associated with financial crisis increased the need for such learning. More opportunities for reciprocal monitoring offset the tendency of states to seek to attract financial flows by reducing regulations at the expense of systemic stability. Nesting the new institutions within the well-established G-7 process reduced their set-up costs.

However two features of the process by which the FSF and G-20 were created highlight shortcomings of a neo-liberal institutionalist approach. First, there is no evidence that these organizations were the outcome of a bargaining process among the actors that would come to constitute their membership. Even among G-7 members bargaining was minimal. For instance the FSF was adopted with no indication of dissensus after Bundesbank president Tietmeyer consulted with the G-7 and the international financial institutions. There was even less evidence of bargaining between the G-7 and non-G-7 states in the creation of the G-20. There were calls for broader representation in the new financial architecture discussions.[9] There was also grumbling on the part of Malaysia at its exclusion from the G-20.[10] While such statements do highlight the significance of expanded representation they were not associated with a bargaining process--there were no specific demands or concessions put forward by those who would later become members. Moreover the G-20 was put together at a time of weakness for its developing country members which further reduced their potential for bargaining.

Second, the structures of the FSF and the G-20 are not well-suited to the reduction of transactions costs. The FSF has a minimal secretariat and the G-20 has none. Thus, unlike many international organizations, their primary task will not be the production of information. Nor are they set up for another common task of international organizations: offering neutral judgements in response to problems of opportunism and lack of trust. The IMF, with its large professional staff and its ongoing effort to promote transparency and produce data, is far better suited to the types of tasks usually associated with the reduction of transactions costs. By contrast, the primary task of both the FSF and the G-20, like the G-7, is intended to be coordination and the discussion of policy.

As noted above, a third set of approaches to understanding the creation of the FSF and the G-20 are those which emphasize the mutually supportive roles of states and powerful market actors, such as Gramscian approaches. In structure the FSF and G-20 bear some similarities to the informal and interconnected network of institutions, such as the Trilateral Commission or the

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9 For instance Australian officials “argued that the membership of the Forum needed to be broadened if it was to retain credibility at the international level”, “Australia Wins Seat on New International Finance Forum”, *Australian CPA*, 69(7), August 1999, Proquest version.

10 “Malaysia Miffed at Exclusion from G-20", *Euromoney* report, 26 September, 1999, at www.euromoney.com.

Group of Thirty, which bring together top leaders in business, government and academia to forge capitalism-friendly policies for the global economy. However the creation of the FSF and the G-20 *increased* the autonomy and distance of their member states relative to business rather than increasing their linkages. Private associations, such as the International Institute of Finance, which was created by the world's largest commercial banks and involves itself in global policy matters on their behalf, played no significant role in the creation of the FSF and the G-20. Indeed two of the prominent ideas endorsed by states in their discussion of the new financial architecture which accompanied these institutions' creation were ones that were contrary to the interests of wealthy financial firms and investors: plans for private sector burden-sharing in crises[11] and a shift towards greater acceptance of slower liberalization and, under some certain conditions, the use of capital controls. Of course one could claim that states need to work against the short-term interests of capital in order to safeguard their longer-term interests in systemic stability, but this would become a non-falsifiable statement of faith about the two actors' mutual interests since the institutional linkages that would be needed to manage such long-term coordination were made more difficult rather than being strengthened.

It would also be difficult to argue that the creation of the FSF and G-20 were responses to the pressures generated by counter-hegemonic forces or global civil. Civil society actors have been vocal and well organized in some areas of global finance, such as the investment provisions of the NAFTA, the defeat of the Multilateral Agreement on Investment, or the influencing of IMF or World Bank policy on debt. However they have been notably absent from the issue area of global financial regulation and from the process by which the FSF and G-20 were created in 1999.

The Contribution of the Concept of Legitimacy

In this section it will be argued that the question of *legitimacy* is crucial in understanding the creation of the FSF and the G-20. Legitimacy here refers to the legitimizing effects of private and technical authority as well as more directly political legitimizing mechanisms. The two institutions are quite different in their relationship to these sources of legitimacy. The FSF built upon a distinctive relationship between technical and private authority that had developed over the international regime for prudential regulation's quarter century of development but supplemented with the political authority of the G-7. In contrast the G-20 was more directly political, both in the greater weight in its membership of political officials, and in its inclusion of key governments from outside the G-7.

The FSF, in the understated way in which it was created, in the institutions it linked together, and in the heavily technical orientation of the tasks it set itself, drew heavily for its legitimacy on the accumulated technical authority of the international regime for prudential regulation. Over the decades since its beginnings in the mid-1970s institutions such as the Basle Committee and the Committee on Payments and Settlement Systems have produced increasingly sophisticated technical reports which have identified problems and proposed best practices and

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11 The importance of private sector involvement was noted by G-20 Chair Paul Martin in a commentary piece on January 27, 2000: Paul Martin, "Contagion, then Complacency", *Financial Times* Jan. 27, 2000, at www.ft.com. On the conflict see "Public, Private Sector Loggerheads Bail-Ins Grow Ever More Contentious" *Euromoney* report, Sept. 28, 1999, at www.euromoney.com.

standards for addressing them. Currently a key task of the FSF and G-20 is to further consolidate these sets of standards.[12] The standards are norms and regulations but of a particular type. They obtain their legitimacy not primarily from a process of discursive interaction among states nor from a process of bargaining by democratically accountable states. Rather they are grounded in bodies of technical knowledge that foster legitimacy for the reasons set earlier in this essay: a successful performance orientation; an emphasis on practical and quasi-natural relationships in which politics is excluded; and an ostensible openness to criticism, revision and input from technically qualified individuals. The tradition of technical authority upon which the FSF drew was closely connected to the larger legitimizing contribution of private authority. Technical tasks were oriented towards reinforcing the four legitimizing effects of global finance's private character: its performance; its naturalness; its private character; and its openness and fairness. Three of the more general features of legitimacy identified by Frank; determinacy, coherence and adherence, were all strengthened by the growth in the regime's technical complexity. The fourth, symbolic validation, was fostered by the image of central bankers as prudent experts untarnished by politics..

However developments between the creation of the FSF in February 1999 and the G-20 in September 1999 indicate that the traditional legitimizing features of the international regime for prudential regulation were inadequate given the crisis and other developments of the previous two years. All the factors contributing to legitimacy which were listed in the previous paragraph were undermined. The technical and private solutions were revealed to be perform suboptimally; to require more political intervention than had been admitted; to be problematic in terms of fairness; and to possess less determinance, coherence and adherence. An initial effort to blame the crisis on factors external to the international regime--*"crony capitalism"*--a technique which had worked in earlier crises, was relatively ineffective given how recently the victims of the crisis had been held up as paradigmatic examples of the positive values of markets--and was soon downgraded as an explanation.[13] Moreover, aside from its ability to facilitate collaboration among its member-institutions the most noteworthy feature of the FSF was its heavy G-7 representation. This introduced a new political dimension to the regime which complicated legitimation. As noted above, political legitimation involves openness and rules, neither of which was a property of the informal FSF with its limited membership.

A first attempt to address this problem was to expand the membership of the FSF to include Australia, Hong Kong SAR, the Netherlands and Singapore and by indicating that non-G-7 countries would be permitted to participate in FSF working groups.[14] Moreover Tietmeyer indicated in a September 1999 article that "participation was envisaged to be extended over time to include representatives from additional national authorities able to contribute substantially to the process" (Tietmeyer, 1999b). This was followed by the more dramatic creation of the G-20 with its broader political membership from outside the G-7.

If we look then at the G-20, its utility for legitimating G-7 policies is evident. By including China, Russia, India and Indonesia it can claim to represent the world's largest and

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12 "Why are International Codes and Standards Important," in G-20 Berlin Meeting backgrounder, which lists the major standards in an annex. Available at the G-20 website.

13 This argument was made by Brian MacLean who has written an unpublished paper entitled "The Rise and Fall of the 'Crony Capitalism' Hypothesis: Causes and Consequences".

14 The title of the FSF press release is significant: "Broadening Representation in the Financial Stability Forum", 21 June, 1999, available at www.bis.org.

most populous countries and ones with, historically, very different social systems. Together the G-20 countries account for 87 percent of world gross domestic product and about 65 percent of world population.[15] Moreover officials stress the G-20's representativeness. The official backgrounder on it notes that "through broad participation by industrialized countries and key emerging markets, the G-20 will represent a range of viewpoints."[16] Tietmeyer has noted of the standards that are being developed, that "the emerging economies to which those standards would apply should be involved more closely in these processes, in order to enhance their commitment to implementing them." (Tietmeyer, 1999b). Similarly the official report on the first G-20 meeting noted of the commitments of Ministers and Governors to completing reports on standards that "this commitment will help mobilize support for measures to strengthen domestic capacity, policies and institutions".[17] The G-20 also has an advantage relative to the IMF despite the latter's more universal and formal character because of the IMF's poor performance during the 1997-98 financial crisis and its negative reputation as secretive and arrogant.

A deliberate effort by Martin to keep the G-20 focused on practical tasks[18] also evoked the more traditional technical legitimacy of the regime. Its four priority areas, stock-taking on progress in reducing financial vulnerability; assessment of compliance with international codes and standards; reports on those codes and stability assessments; and an examination of differing exchange rate regimes; while involving conflicts, also remain quite technical. Indeed Martin admitted after the first meeting of the G-20 that the meeting had mainly dealt with 'plumbing' issues.[19] Additionally, while the G-20 was promoted as an important mechanism for the involvement of non-G-7 countries, there were also limits set on the prominence of its political role. For instance the G-20 Berlin backgrounder indicates that "The G-20 will help co-ordinate the activities of other international groups and organizations, such as the Financial Stability Forum", but, after its first meeting the German and Canadian finance ministers noted that the G-20 did not want to be a decision making body.[20]

Despite these efforts to limit the politicization of the G-20 it was clear by its first meeting that there were political conflicts that were not acknowledged officially. A key line of tension was between the US on the one hand and France and Japan on the other. Reflecting earlier tensions over the G-22 process in which the US, working through the G7, drew in key developing countries and thereby created an alternative governance mechanism to the IMF in which Europe retained more influence, the French insisted that the G-20 not displace the Bretton Woods institutions while the US seemed to want to weaken the IMF, not just by creating an alternative G-20 site of authority, but also by diminishing its role in longer term financing for

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15 "First Ever Meeting of Newly Created G20 Opens in Berlin", Agence France Presses, 7 February 2000, at www.ft.com.

16 Finance Canada press release, November 1999.

17 "Finance Ministers and Central Bank Governors Meeting," G-20, December 15-16, 1999.

18 "Minister Martin said the establishment of a focused agenda is evidence that the G-20 is uniquely qualified to help make the global economy more stable"--Finance Canada press release, Dec. 16, 1999.

19 See "Developing Nations Agree to Accelerate Reforms," *Globe and Mail* December 17, 1999, p. B1, B3.

20 "G20 to Contribute to Prevention of Financial Crises," BBC Monitoring International Reports, Dec. 16, 1999, at www.ft.com.

developing countries in favour of a greater private sector role, to be regulated by the FSF-related standards. Tensions over exchange rates revealed a similar disagreement, with the US pushing for a rejection of pegged exchange rates while France and Japan, interested in EU and East Asian zones of monetary coordination respectively, were sceptical of this US campaign as are China and India.[21] In the background were prior statements of support by Japan, China and Russia for the unorthodox approaches adopted by Hong Kong and Malaysia to the Asian crisis.[22]

Despite their significance of these political conflicts for the G-20 it is unlikely that they will be managed by it. Rather, the G-20, with its once yearly meetings and lack of permanent secretariat, will in the immediate future continue to be a mechanism for upgrading the involvement of non-G-7 countries while maintaining careful limits on their political power. At the same time the G-20 is not simply a peremptory usurption of IMF prerogatives in a power play by the US. Nor, with members like China and Russia, is it a meaningless cooption of compliant US allies. Rather it is a mechanism crafted to carefully draw on and supplement the existing regime for financial regulation's technically-based legitimacy with certain elements associated with political legitimacy, which in a domestic polity we would also associate with democracy, such as openness to wider participation, to freer discussion, and, despite its lack of bureaucracy, an increase in formality and thus rule-governedness relative to the more ad hoc G-22 and bilateral consultations that preceded its formation.

The analysis of legitimacy developed earlier in this essay, in addition to highlighting factors important to the creation of the FSF and G-20, also allows us to indentify weaknesses of the existing arrangements. Despite the ways in which they can foster legitimacy which were noted above they continue to lack certain features which, in other contexts, would be associated with legitimate political institutions. First, their rule-governedness remains minimal. The principles guiding membership selection, agenda selection, and decisionmaking capacity remain undefined. Founded by the G-7, which itself lacks a foundation in a globally agreed system of rules, the FSF and G-20 remain vulnerable to charges that they are arbitary political creations. Their continued reliance on technical authority for legitimacy can always threaten to become problematic if technical solutions falter. It is unlikely that the present institutional character of the FSF and G-20 can continue without either moving towards a further expansion of legitimacy-producing processes or fading in significance.

Conclusion

Despite their deficiencies the FSF and the G-20 mark a significant development in the global political economy: the increased contemporary importance of legitimacy. Policymakers ininvolved in the process of their creation have seen elements of legitimacy, including

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21 On these rifts see "Regional Finance Right Direction for Asia, " *Yomiuri Shimbu/Daily Yomuiri* Nov. 23 1999; "Japan Reportedly to Oppose US IMF Reform Proposal", BBC Monitoring Service report from Japanese news agency Kyodo, Dec. 16, 1999; "Lively Debate at First G20 Talks," *Financial Times* Dec. 17, 1999; "Jospin Says G20 May 'Play Useful Role' if Remains an 'Instrument for Dialogue'" *AFX Europe* Dec. 16, 1999; "France and Japan United Against US over World Financial System" *Agence France Presse* Dec. 19, 1999; all at www.ft.com.

22 See report "Leading Asian nations ganged up yesterday..." 30 Sept. 99, at www.euromoney.com

representation of varied interests, as an important aspect of this process. This essay has suggested that this is not simply rhetoric and that the concept of legitimacy has something to add to prevailing approaches to international institutions such as the FSF and G-20. The FSF and G-20 are not simply the result of powerful states or business actors autonomously pursing their interest. Nor do they result from a more horizontal process of bargaining in which states collaborate for their mutual benefit. Rather they were created by powerful states to obtain the voluntary compliance of weaker states. The complexity of this unequal relationship, in which the powerful need the assent of the weak to their exercise of power, does not fit comfortably with approaches which dismiss the relevance of norms, or which treat the state-system as anarchic, or which see institutions as resulting from voluntary contracting for mutual benefit. Nor does it fit well with approaches which neglect the distinctive and specific significance of the types of process which can produce legitimacy in particular settings of power assymetries, especially where existing sources of legitimacy are in jeopardy as a result of crisis.

Scattered acknowledgements by policymakers of legitimacy-related factors in the creation of the FSF and G-20, while significant, do not by themselves allow us to fully appreciate the analytic utility of the concept. Legitimacy has been the focus of some useful scholarly analysis that seeks to identify its main characteristics. I have sought to broaden existing scholarly analyses, which tend to be state centric or focused on domestic polities, to address international legitimacy, including the contribution to it of technical and private authority. By identifying the ways in which international legitimacy is produced we can better understand international governance and criticize its deficiencies. .

The type of legitimacy issues present in the creation of the FSF and G-20, unlike existing long-standing debates on the legitimacy of international law, signify the emergence of a more complex structure of authority in global finance. Interestingly, neither NGOs nor formal international organizations have played a significant role in their creation. A focus on legitimacy such as this essay's reveals an alternative way in which powerful states end up expanding representation and participation in governance. We are likely to see more of this as the world economy becomes more integrated and complex and the complications in managing it become more severe.

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