G20 needs to ask the big questions

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Mike Callaghan, Director, G20 Studies Centre, Lowy Institute for International Policy

Australia needs to assess where its financial sector is heading in the post-global financial crisis world of increased regulation, continuing innovation and technological changes.

So the study by the Australian Centre of Financial Studies on Funding Australia’s Future, recently launched in The Australian Financial Review, is timely and welcome.

But Australia does not have to be passive in accepting the implications of the international regulatory agenda. As it chairs the G20 in 2014, it has the chance to shape the development of financial regulation. We should seize that chance.

Firstly, the international financial standards will have a major bearing on the future shape and structure of the Australian financial system. We cannot divorce ourselves from the world.

Secondly, many of the issues raised in Funding Australia’s Future have a global application. The most fundamental of these is the question of what sort of financial system we want to ensure stability and facilitate future economic growth? Surprisingly, this has still not been addressed by the G20 or the Financial Stability Board. A conference on rethinking macroeconomic policy held by the International Monetary Fund in Washington in April 2013, posed this question to the panel, on the subject of financial regulation: “Does anyone have a clear vision of the desirable financial system for the future?”

The IMF’s chief economist, Olivier Blanchard, observed if there is no agreed vision of what the future financial architecture should look like, then, by implication, there is no agreed vision as to what the appropriate financial regulation should be. Despite the absence of a shared vision, there is a major international effort to introduce new regulations over banks. In fact, strengthening financial regulation has been central to the G20 since the first leaders’ summit in 2008 and continues to figure prominently in the agenda of G20 meetings. This is not surprising.

The G20 summit was responding to a devastating global financial crisis.

No quick fixes in post-GFC world

Yet, while a vast amount of work in strengthening international financial regulations is under way, the process has not gone smoothly. This is also not surprising. Finance is a complex industry and many major reforms are being undertaken simultaneously. Furthermore, as Reserve Bank of Australia governor Glenn Stevens has noted, reforms that seemed “so simple and obvious, so bold and so sweeping in the immediate aftermath of the crisis in 2008, have turned out to be much harder to implement than first expected”.

Other problems include inconsistency across countries in the implementation of the new standards, domestic regulations having extraterritorial impacts, and regulatory fragmentation. The questions
raised in Funding Australia’s Future, such as the implications of the new regulations on the sourcing of long-term investment financing, are also being asked globally.

So how can Australia be more pro-active on financial regulation when it chairs the G20 in 2014?

It can start by not letting the G20 simply be a rubber stamp for the detailed work agenda for the Financial Stability Board, which is currently the case. Australia should ensure the G20 asks the big questions about the direction of regulation, such as: what changes in the structure of the financial system are being sought; what is the right balance between the quest for financial stability and supporting economic growth; and are there unintended consequences from the collective implementation of so many reforms. These are issues covered in the latest Lowy Institute G20 Monitor on financial regulation and the G20.

Mike Callaghan is director of the G20 Studies Centre at the Lowy Institute for International Policy. He authored a piece in G20 Monitor examining financial regulation and the role of the G20.

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