SECTION VII

INTERNATIONAL COORDINATION

Overview

Will national regulators undertaking sweeping reforms, for example, of the type proposed in Sections V and VI of this book, succeed in restoring global financial stability? Yes, but *only* if they coordinate these reforms in some reasonable way. Many of the policy changes will prove to be ineffective – or at least have their edge severely blunted – if there is a lack of international coordination. The issue is rather important; although cross-border banking and financial flows are extensive, much of bank and financial supervision remains national. There is some consensus on prudential aspects of regulation such as capital requirements and their calculation, but there is hardly any consensus on the core set of principles driving the regulatory stance to providing guarantees and intervening in markets and banking sectors.

The primary issue is of course one of "jurisdictional shopping" by global financial institutions. Put simply, if institutions are more strictly regulated in one country's jurisdiction, they may move (their base for) financial intermediation to jurisdictions that are regulation-lite. Further, institutions that choose to be in regulation-lite countries operate in, and with institutions of, other countries, exposing all jurisdictions to their risk-taking. Individually, countries may find it attractive to be regulation-lite in order to attract more institutions and thereby jobs, especially at a time when many countries are getting regulation-heavy.

Such an outcome should be avoided at all costs. The problem is one of externalities – what one country chooses for its regulation affects all others. The case for coordination is thus compelling. The final chapter, Chapter 18 – "International Alignment of Financial Sector Regulation", proposes a concrete plan based on agreement between central banks on the core principles for prudential regulation and resolution during crises of large, complex financial institutions.