BOOK REVIEWS

Global Governance of Financial Systems. The International Regulation of Systemic Risk By Kern Alexander, Rahul Dhumale, and John Eatwell [OUP Oxford New York 2006 320 pp ISBN 9780195166989 £26.99 (h/bk)]

This book is the most recent outcome of Professor Lord Eatwell's research project on the international legal and regulatory framework for controlling systemic risk in global financial markets. Dr Alexander (a legal scholar) and Dr Dhumale (an economist) have been core members of Professor Eatwell's interdisciplinary research group. The group has made important contributions to scholarship and policy discussion. The book sums up some of their most important work so far, with interesting conclusions, both for policy-makers and the directions that further research should take.

The authors conclude that current efforts at international regulation are inefficient, fragmented, and lack political legitimacy. The current structure of international financial regulation cannot manage systemic risk in an efficient manner. The social cost of bank risk-taking in globalized financial markets has not been adequately managed by international institutions and national regulators. There are too many break-downs with too high a cost: we do not have an international financial system that promotes adequate economic growth and financial development. The negative externalities are not only operating at the level of the individual banks but are the basis for assumptions about systemic risk. The authors argue that the existing framework, based on the supervision of individual banking institutions, fails to take adequate account of the negative macro-economic consequences that may flow from the financial failures of particular institutions. One example is that the Basel II guidelines for minimum bank capital may actually increase systemic fragility by making financial institutions more homogeneous in their behaviour. The new Basel II capital rules are more risk sensitive and may undermine financial stability in both developed and developing countries, and increase the cost for private sector borrowers in developing countries.

The original 1988 Basel Accord (Basel I) allowed States that were members of the OECD (developed countries) to borrow money at far cheaper regulatory capital costs (0 per cent risk weights) than States outside the OECD (100 per cent weights). For most non-OECD countries, this regulatory tax lacked economic justification. Indeed, the determination of these risk weights was not solely based on economic criteria. For instance, the US achieved the inclusion of Saudi Arabia in the 0 per cent risk weighting—the same as OECD countries—in order to allow the Saudi Arabian Government (a US ally) to raise capital more cheaply in the aftermath of the first Gulf war in the early 1990s. The risk weights may seem rational and fair, but only seen from London or New York, and much less so seen from Beijing, Mumbai, Cape Town, or Nairobi.

The authors argue that the embryonic international financial standard-setting system that we have does not adequately respond to the needs of political accountability. This applies in relation to developing countries in particular, but also in relation to the political process in the developed countries. The informal and 'self-regulatory' nature of the decision-making has as one result the very effective side-stepping of the formal international cooperation that is necessary for States to control systemic risk within a coherent framework of international economic law. The authors show that the justification for this side-stepping, a high degree of efficiency, does not obtain. There are serious deficiencies with the extensive system of new committees and their rules and guidelines that have emerged to govern and manage the international financial system. In the course of their analysis, the authors cover the relevant functions of the International Monetary Fund, the Basel committees on banking, the Asian financial crises, bankruptcy, the legal aspects of the system for settlement of payments and provide much other interesting material. They also propose a viable multilateral framework treaty to address the problems of accountability and legitimacy in international financial standard-setting.

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The authors set out the economic rationale for international financial regulation and analyse the role of international economic law in achieving financial stability objectives. There are many uncertainties remaining at a very fundamental level, and they point out that there is need for further critical research in this field. They turn to the role that international regulation can play in more effectively managing systemic risk and providing more accountability for States subject to such regulation.

There is further support for the authors' conclusions in current scholarly discourse. Dr Lazaros Panourgias in his book on *Banking Regulation and World Trade Law* (Hart Publishing Oxford 2006) adds further to the analysis of the financial services systems of the World Trade Organization and the European Union, including the role of the European Central Bank. Both books conclude by discussing how one best can design a new international financial architecture. The problem here is the political process. There is no international political structure that today can support the establishment of a world financial authority. Even within the European Union the establishment of a European regulator has proved to be difficult. The EU has adopted legislation to deal with consolidated supervision of financial conglomerates and of cross-border banking, investment, and insurance groups, and is moving towards more centralized supervision structures. The regulators are seeking to exercise their financial supervision competence in a way that is consistent with the business organization of international financial institutions. The BCCI dispute involved complex issues of cross-border bank supervision and depositors rights and provided a good incentive for a pan-European solution. But national regulators resist any move towards the European regulator which seems to be the only logical outcome. This is similar to the process various countries have been through in establishing a single financial regulator, and in many countries (including the US) there is still a highly fragmented and inefficient regulatory structure in place. What has brought about the unified structure with a single regulator at the national level has usually been a crisis that demonstrated, at a large cost, the inefficiency of the fragmented structure. This is what one now is waiting for at the EU level. It may also be that one needs a more serious crisis than the Asian and Latin American crises of the 1990s.

The authors are right that this may be a very high price to pay. So is the ongoing cost of inefficient regulation while we are waiting for that crisis. We have here the classic example of market failure that requires regulation and of national regulatory failure that requires international regulation. It is difficult not to agree with the argument of the authors or with their policy proposals. But no matter how classic the failures are, they may still not be enough to spur big power politicians to take action. The utility of having the thoughtful analysis of the authors of this book at hand in a frenzied post-crisis reform period, whenever we reach that inevitable stage, will be considerable.

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The Creation of States in International Law (Second Edition) By James Crawford [OUP Oxford 2006 lxxii+870 pp ISBN 0-19-826002-4 £80]

This is the second, expanded edition of D Phil student James Crawford's celebrated work (published in 1979), which itself was an abbreviated version of his thesis. Whewell Professor Crawford's new edition, almost twice the length of the first, brings the story up to 30 June 2005. As the author says in the preface, '[s]ince the first edition, much has happened in international relations and international law, not least in relation to the subject matter of this book.' There is a great deal of new material—and not just updating, though there is of course much of that. The new material includes issues omitted from the first edition (not least an extended treatment of the State of Israel and the 'existence or non-existence' of a State of Palestine), as well as many developments since 1977, most notably the upheavals in Central and Eastern Europe. In completing this encyclopaedic work, the author acknowledges a particular debt to his former doctoral student, Dr Tom Grant.