

Review Article

THE POLITICAL ECONOMY OF GLOBAL FINANCE CAPITAL

By RICHARD DEEG and MARY A. O'SULLIVAN*

- Rawi Abdelal. 2007. *Capital Rules: The Construction of Global Finance*. Cambridge: Harvard University Press, 320 pp.
- Peter Gourevitch and James Shinn. 2005. *Political Power and Corporate Control: The New Global Politics of Corporate Governance*. Princeton: Princeton University Press, 344 pp.
- Nicolas Jabko. 2006. *Playing the Market: A Political Strategy for Uniting Europe, 1985–2005*. Ithaca, N.Y.: Cornell University Press, 206 pp.
- Jonathan Kirshner, ed. 2003. *Monetary Orders: Ambiguous Economics, Ubiquitous Politics*. Ithaca, N.Y.: Cornell University Press, 319 pp.
- Timothy Sinclair. 2005. *The New Masters of Capital: American Bond Rating Agencies and the Politics of Creditworthiness*. Ithaca, N.Y.: Cornell University Press, 208 pp.
- Daniel Verdier. 2002. *Moving Money: Banking and Finance in the Industrialized World*. New York: Cambridge University Press, 311 pp.

I. INTRODUCTION

THE current global financial crisis has interrupted a long period of dramatically rising financial mobility marked by the increased integration of currency, banking, and securities markets around the world, especially in the last decade. During the 1980s and early 1990s gross international capital flows fluctuated in a range between 4 and 6 percent of global GDP; from 1995 to 2005 this figure soared to more than 16 percent.¹ Along with globalization came the related phenomenon of financialization in which the financial sector grew larger as a percentage of economic activity and expanded its influence over the rest of the political economy.

*The authors wish to acknowledge Rebecca Evans, Orfeo Fioretos, Elliot Posner, and three anonymous reviewers for their insightful comments. We retain sole responsibility for remaining errors.

¹Reserve Bank of Australia, http://www.rba.gov.au/PublicationsAndResearch/Bulletin/bu_jul06/regional_capital_flows.html.

These developments were facilitated by the emergence of a new global order in financial politics in which policies that facilitated the liberalization of monetary and financial flows were emphasized. Concurrently, within national economies there were concerted moves to promote a greater role for market mechanisms in the operation of domestic financial systems. Understanding these important developments is crucial to an analysis of world politics, and over the last quarter of a century many scholars of both international and comparative political economy have contributed to our understanding of their causes and consequences.

In this review we focus on six important books that are representative of recent thinking by political scientists on global finance. We discuss their substance and their implications, as well as some of their shortcomings, for gaining an understanding of the subject. We organize our review around three major questions at the heart of the subject. First, who are the players in the political economy of global finance? Second, what are the causal forces shaping its characteristics? Third, what are the consequences of the current political governance of global finance? Although these questions have animated the literature from its beginnings, we shall see that the most recent wave of literature addresses them in new and exciting ways.

The most important developments that we highlight in this article are (1) the move from a predominant focus on state-centered patterns of regulation to a more comprehensive understanding of the role of states and private actors in building a transnational governance regime that mixes public and private regulation; (2) the intensified effort to understand the causal forces that shape the political economy of global finance based on more complex models that allow for an interaction among interests, institutions, and ideas; and (3) increased attention to new sources of systemic risk in the global financial system, as well as a greater consideration of the consequences for domestic politics of interactions with the global financial system.

Notwithstanding these advances, there remains much to be done and we highlight questions of central concern for future research. First, although the literature has developed greatly in recognizing the importance of various nonstate actors in the constitution of the rules of global finance, we have made only limited progress in understanding the behavior of the actors who enact these rules. Second, there is more to be done to generate evidence that brings some agreement on the causes behind the globalization of finance, especially as the arguments

we make become more complex. Finally, there is a need for a more realistic assessment of the costs and benefits of financialization at the global and national levels. This last challenge is essential for a thorough understanding of the current global financial crisis.

II. THE PLAYERS IN THE POLITICAL ECONOMY OF GLOBAL FINANCE

The literature on global finance has passed through several generations in its characterization of the most influential players in shaping the politics of global finance. The early literature was preoccupied with how states and interactions among them determined monetary and exchange rate policies and managed flows of capital across borders. As the scale and complexity of global financial markets increased, however, scholars became interested in the influence of these markets on the political economy of global finance and in the private actors that shaped them. In the third, most recent generation of research, scholars moved away from sharp distinctions between states and markets to analyze the interactions between public and private actors in building governance regimes for global finance.

A number of contemporary books grapple with the roles and activities of the multiplicity of players who shape the politics of the global financial system. However, the books that we review suggest that some of the most interesting work comes from scholars who focus on a single type of actor—states, multilateral agencies, or private actors—and explore their influence on the politics of global finance in depth. As much as we acknowledge the strengths of this stream of work, we also suggest that there has been an undue emphasis on the players who *generate* rules and norms to the neglect of the players who *enact* them. In an important new challenge for the literature, moreover, the ongoing financial crisis raises important questions about the behavior of existing players in generating that crisis, as well as about their likely role in shaping financial politics in the future.

As Kirshner's volume shows, the role of the state in the political economy of global finance continues to attract great interest. The volume contributes to the long-standing consideration of the characteristics and determinants of the monetary policies of prominent advanced economies.² It also boasts a rich coverage of middle-income and devel-

² With discussions of the internationalization of the yen by William Grimes, U.S. international monetary policy in the 1960s by Francis Gavin, and Franco-German interests in European monetary integration by Michele Chang.

oping countries,³ a welcome emphasis given the recent rise to prominence in the global financial system of countries like China and many oil-producing states, as well as of pressures to involve less powerful players in the regulation of the system. Several chapters in the Kirshner volume analyze how states integrate their monetary and currency policies,⁴ a topic whose importance has of late also come into sharper focus. The need to worry about the stability of their currency, for example, has given pause to countries like Denmark that have chosen to remain outside of the eurozone.

Some of the contributions to the Kirshner volume reflect on the role of multilateral agencies, such as the International Monetary Fund (IMF), in spreading the doctrine and practice of capital mobility around the world (see the chapters by Grabel and Blyth). Two of our books, one by Nicolas Jabko and the other by Rawi Abdelal, explore the politics of multilateral agencies in greater depth and emphasize the need for more scholarly attention to players who have been discounted in much of the literature or treated as derivative of state interests. Abdelal focuses on the development and proliferation of the rules of capital mobility by three international organizations—the EU, the OECD, and the IMF. He takes issue with the conventional wisdom that casts the U.S. as the central state in defining the politics of global finance and argues, to the contrary, that it was really the Europeans, and especially a number of prominent French statesmen, who since the early 1980s have spearheaded the major initiatives at these organizations. By contrast, the U.S. pursued unilateral and bilateral initiatives to facilitate capital mobility while displaying limited interest in generating *global* rules to govern international finance.

Abdelal's emphasis on French and European policymakers as "norm entrepreneurs"⁵ resonates with Nicolas Jabko's argument that the primary engine of market integration in Europe was the politically strategic use of ideas by policy entrepreneurs. Jabko gives analytical primacy to the European Commission, which, he argues, used alternative conceptions of the enigmatic but powerful idea of the "market" to engineer proliberalization coalitions in the EU across a wide variety of market-building initiatives. In his case study of financial market integration in

³With general chapters by Eric Helleiner and Ilene Grabel, as well as a wide range of case studies by David Stasavage, Rawi Abdelal, Hector Schamis, and Hongying Wang that cover the former French colonies, the post-Soviet republics, Argentina, and China, respectively.

⁴Chapters by David Stasavage, Rawi Abdelal, William Grimes, and Michele Chang on CFA franc zone, the ruble zone, and Asian and European monetary integration, respectively.

⁵Finnemore and Sikkink 1998.

the EU from the early 1990s, Jabko acknowledges that rising global capital mobility and external pressures for reform were important background causes of the liberalization of European financial markets. However, he argues that the specific European response to these pressures was not foreordained and, moreover, that financial market reform in Europe went further than many European governments initially preferred. He explains this outcome in terms of the Commission's success in advancing the idea that the market was a "constraint" that was best met by a united, proactive European response. Similarly, the Commission promoted monetary integration as an essential complement to the realization of the single market.

These two authors represent a strand of research which asserts that international organizations or supranational institutions should be treated as causally independent actors and not simply as institutions for coordination among states.⁶ While principal-agent theorists have identified conditions under which supranational agents have some freedom from state principals,⁷ authors like Jabko and Abdelal claim considerably more autonomy for them. These authors show how supranational actors leverage their limited formal power with ideational power—gradually introducing new ideas, contesting conventional views held by powerful states, and facilitating supportive political coalitions.⁸

Both Abdelal and Jabko make the case that heroic and quotidian bureaucratic maneuvers by supranational actors can accumulate over time and have major consequences. What is less clear is how much we can generalize from the powerful but specific illustrations they provide. Clearly, there are important cases in which the weak influence of international organizations, relative to the states that constitute them, has been on display: contrary to what we might expect based on Jabko, the European response to the threatened collapse of the global banking system in the fall of 2008 was dominated by national governments, while the European Commission was an onlooker at best. If we look at the IMF, moreover, some observers argue that its influence waned in the years after the Asian crisis, as debtor countries made concerted efforts to stay outside its ambit by paying off their loans and building up their reserves.⁹ Thus, while Jabko and Abdelal deserve praise for highlighting the role of supranational actors, it is clear that the conditions under which they exert influence call for further analysis.

⁶ Barnett and Finnemore 2004.

⁷ Hawkins et al. 2006.

⁸ See also Posner 2005.

⁹ *Guardian* 2008; *Wall Street Journal* 2008d.

In recent years we have seen important regulatory initiatives in global finance by a medley of actors, including the international organizations that are the focus of these books. Of particular importance in giving impetus to this development was the establishment of the Financial Stability Forum (FSF) by the G7 in 1998 as a response to the Asian crisis. The FSF was charged with promoting the development of a comprehensive set of global financial codes to safeguard the global financial system.¹⁰ Prior to that date, the most influential example of an international financial standard was the Basel Capital Accord¹¹ and, indeed, the Basel Committee on Banking Supervision served as a model for the FSF.¹² In April 2000 the FSF announced twelve financial codes and standards (Compendium of Standards) in domains ranging from accounting and insolvency to securities regulation and insurance supervision. The compendium was a combination of existing and new codes created by various organizations, including the IMF, the International Organization of Securities Commissioners (IOSCO), and the International Association of Insurance Supervisors (IAIS), as well as by private organizations like the International Accounting Standards Board (IASB). Beyond the ambit of the FSF, there have been other important efforts to develop global standards based on private or quasi-private regulatory regimes. Some of these efforts are intended to forestall state and interstate regulation, as is evident from the maneuvering by the International Swaps and Derivatives Association to counteract the strong pressures for government regulation of the global derivatives market, especially the notorious credit-default swaps market.¹³ The organizations involved in these myriad initiatives count among their members public officials representing finance ministries, central banks, and regulatory authorities, as well as representatives of the private sector.

In response to these developments, a new wave of scholarship has flourished that emphasizes the increased significance of regulatory regimes generated through the *interactions* of public and private actors that extend across national boundaries. The formulation of international accounting standards is a particularly striking example of regulation via extensive interaction of private and public actors operating across multiple levels of politics. Beginning in 2005 all publicly listed firms in the EU were required to use International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS). These

¹⁰ Drezner 2007.

¹¹ Kapstein 1994; Herring and Litan 1995.

¹² Eichengreen 2003.

¹³ In a similar vein, see the recent commitment by U.K.-based private equity firms to a voluntary code of conduct. *Independent on Sunday* 2007; *Independent on Sunday* 2008.

standards are developed by a private standard setter, the IASB, which is funded and dominated by the accounting industry, particularly from the U.S. and the U.K. It develops its standards through a large number of committees that include representatives from the accounting and financial industry, some international organizations such as IOSCO, and a few representatives of nonfinancial interests.¹⁴ We thus have a private, self-regulatory body setting key rules for European business, although, in almost all instances, these rules become binding only once they have been endorsed by governmental authorities.¹⁵ Since the EU adopted IFRS, European and American authorities have been working toward a common global standard.

In an effort to summarize and comprehend this complicated web of public and private actors, of formal and informal rules, that shape the political economy of global finance, this literature relies heavily on the idea of “governance.”¹⁶ The concept of a transnational governance regime emphasizes the organizing, discursive, and monitoring activities that embed and reproduce rules and regulations. Scholars who study these regimes argue that compliance mechanisms are based not only on state authority but also on other mechanisms such as socialization, which is particularly important where rules are informal norms or voluntary codes.¹⁷ This literature has also recently begun to explore how normal business practices of financial enterprises such as pension funds¹⁸ and credit-rating agencies shape global capital and credit markets, whether through diffusion processes or by creating new norms and de facto standards. In this vein, Timothy Sinclair’s book takes us a long way from monetary policy and the states and international organizations that generate it to consider the global politics of “creditworthiness.”

As securities markets became more global, the scope and demand for universal ratings—ratings that are comparable across securities, issuers, and countries—grew dramatically. Sinclair describes the centralization that has taken place in the assessment of creditworthiness around the world, with a small number of rating agencies of U.S. origin increasingly assuming a task long dominated by banks. For Sinclair, rating is a fundamentally political process in which rating agencies propagate their norms across markets, corporations, and governments. Al-

¹⁴The application of accounting rules creates de facto norms or rules for measurement and disclosure by businesses; Véron, Autret, and Galichon 2006.

¹⁵Botzem and Quack 2006; Nölke and Perry 2007.

¹⁶Herring and Litan 1994; Cutler, Haufler, and Porter 1999.

¹⁷Djelic and Sahlin-Andersson 2006.

¹⁸Goyer 2006.

though rating agencies make judgments about creditworthiness based on cognitive processes that are opaque and subjective, Sinclair argues that their assessments are given the status of objective “facts” by market actors. Both issuers and buyers of rated debt ultimately bend to these rules and norms—issuers because it will enhance their debt ratings and buyers because accepting ratings as facts helps maintain the market liquidity of the debt they own. In addition, these ratings take on a regulatory function, insofar as government regulators rely on them in audits of financial firms and for monitoring financial market risk.¹⁹ Echoing arguments made about international accounting standards, Sinclair claims that the global influence of rating agencies has given a strong Anglo-American flavor to the rules of global financial capitalism.

The novelty of transnational regimes of mixed public-private governance in global finance certainly makes it essential that we understand the actors involved in shaping the character of these regimes. We should not lose sight, however, of the abiding importance of domestic rules and norms in the politics of global finance. This point is starkly illustrated by cases such as the American insurance giant AIG, which, despite its significance for the global financial system, is governed not so much by federal U.S. regulation as by state regulation. In the banking industry, too, notwithstanding the influence of the Basel rules, local rules on capital adequacy still make a substantial difference for the behavior of banks domiciled in Spain as compared with those, say, in New York State. The continued importance of national and often subnational institutions for the regulation of participants in the global financial system means that actors who are involved in the generation and sustenance of these institutions are players, unwitting or otherwise, in the politics of global finance. Two of our books, one by Daniel Verdier and the other by Peter Gourevitch and James Shinn, build on the comparative political economy literature to provide crucial insight into how such players come together to influence domestic and global financial systems.

Verdier argues that the structure of different states determines the characteristics of their domestic financial systems and, in turn, their integration into the global financial system. In decentralized states, local interests—local banks, smaller firms, and subnational governments—have the political leverage and institutional access to resist the natural tendency of capital to flow from the periphery to the core, thus limiting the growth of banks from the money center and national capital

¹⁹ Ratings of debt play a central role in prudential regulation adopted in the Basel II accords.

markets. Decentralized states beget decentralized financial systems, which, in turn, display low levels of financial internationalization. By contrast, internationalization is embraced by large money center banks (and their corporate clients) because it provides them with access to a larger pool of assets and thus enhances their ability to match liabilities with assets. Strong money center banks that tap savings from the whole country also provide a strong basis for internationalization (pp. 74–75), since these economies become more attractive to foreign investors who want to tap their money markets. Consequently, in centralized states where such banks are politically and economically dominant, we can expect a high level of financial internationalization.

Gourevitch and Shinn are also preoccupied with national varieties of capitalism, specifically with comparative patterns in corporate ownership and securities markets. Moreover, in contrast to Verdier, for whom state structure drives everything else, their theory is anything but parsimonious. Drawing on the extensive law and finance literature, they claim that corporate governance systems can be divided into two broad types distinguished primarily by whether the ownership of publicly listed companies is diffuse or concentrated and, relatedly, whether countries have large or small securities markets.²⁰ They argue that the corporate governance regime that prevails is the outcome of political conflicts and coalitional choices among three key actors in the firm—managers, owners, and workers—whose preferences can be understood by looking to the systems of production identified in the varieties of capitalism literature.²¹

Firms in coordinated market economies (CMEs) rely more on specific assets for competitive advantage in global markets and these strategies work better when capital mobility is restrained through nonmarket coordination. Corporate governance institutions in CMEs typically reflect a corporatist compromise between workers and managers and, under these conditions, investors prefer concentrated ownership. By contrast, owners in liberal market economies generally ally with managers against workers and prefer diffuse ownership and the active securities markets it fosters.

Gourevitch and Shinn speak largely to the question of convergence or divergence in national systems of corporate governance, but a logi-

²⁰ Diffuse ownership systems are associated in the law and finance literature with higher levels of minority shareholder protections and thus larger securities markets, whereas concentrated ownership systems tend to favor blockholding share owners or “insiders” over small shareholders disproportionately and thus have smaller securities markets; see La Porta et al. 1998.

²¹ Hall and Soskice 2001.

cal inference from their theory is that countries will differ in how they integrate into the global financial system because of the different preferences of their respective domestic actors. In CMES insider control by blockholders reduces the attractiveness of share ownership to minority investors and, thus, to most global portfolio investors.²² Therefore, these economies are likely to see slower growth of inward foreign investment. And even though a transformation into a diffuse ownership system—something promoted by reformers in many CMES—might increase the market value of shares held by blockholders, they may still prefer a concentrated system for the control benefits it provides (pp. 108–15). The fact that ownership concentration levels in much of Europe have declined only modestly during the past decade, despite extensive proshareholder reform, attests to the importance and durability of these preferences.²³

Overall, there seems little doubt that we have made important progress in coming to terms with the complex politics of global finance and the growing cast of players who set the rules of global finance. However, we need to learn more about the players who comply with and *enact* the rules of global finance.²⁴ There has been significant consideration in IPE of the question of why states enact rules designed by others²⁵ and these ideas permeate some of our books. Abdelal, for instance, pays close attention to the process through which the capital rules generated by international organizations diffused to different countries. Yet his arguments, which are strongly influenced by the sociological literature on institutional isomorphism, tend to privilege conformity over agency. And, as Streeck and Thelen point out, agency and even strategic action play an important role for both rule enactors and rule generators. The result is that the process of rule enactment is central to determining the actual meaning and implications of the rules that shape the political economy of global finance.²⁶ We have already mentioned the example of strategic action by former debtor countries to increase their autonomy of the IMF in the wake of the Asian crisis. Although the current crisis brought developing countries, as well as some developed countries such as Iceland, to the IMF's door for loans, their reluctance to borrow from the fund is striking.²⁷

²² Goyer 2006.

²³ European Commission 2007.

²⁴ Though the actors who generate rules are often the same ones who subsequently enact them, the processes of generation and enactment can—and should—be analyzed distinctly.

²⁵ For a review, see Simmons, Dobbin, and Garrett 2006.

²⁶ Streeck and Thelen 2005

²⁷ *Guardian* 2008; *Wall Street Journal* 2008d.

Countries that choose to adopt or reject particular rules are not the only players that need to be studied as we improve our understanding of rule enactors. Indeed, an analysis of the strategic behavior of banks and other financial institutions is even more crucial to understanding the extent and incidence of the ongoing financial crisis. The business models that banks pursued leading up to the crisis reflected their creative response to the established rules of global finance. They invested heavily in assets that Basel rules characterized as low risk yet, contrary to the principles of mainstream financial economics, generated high yields in the marketplace. Moreover, they altered how they managed and reported some of their riskiest assets, moving them off their balance sheets to insulate them from capital adequacy standards. In the ways that they chose to comply with the rules of global finance, therefore, banks effectively redefined them. We need not only to reach a better understanding of the empirical details of these processes of rule enactment but also to incorporate them into our theories.

The current financial crisis also raises some important questions about the future role of the players involved in the politics of global finance. One question is whether there will be an important shift among powerful states in their influence over the rules of global finance. In particular, will the balance of power in the political economy of global finance tilt away from the Americans and toward others, notably the Europeans but also new actors like China? It is clear that many powerful member states intend to use the G20 to ratchet up the level of global regulatory coordination and restrictions—well beyond previous efforts such as the Basel II bank regulations, the effectiveness of which has been called into question even before they have been fully implemented.²⁸ Abdelal's pointed contrast between an American vision of financial globalization and an alternative, French-inspired one seems manifestly evident in the current context. Prior to the November 2008 G20 summit, the U.S. expressed reservations about a new global regulator advocated by the Europeans, most vociferously by French president Sarkozy.²⁹

The crisis also seems certain to diminish the role of some private actors in the politics of global finance. Certainly the behavior of the rating agencies has raised serious questions about the central role that they have been assigned in the global financial system. As Sinclair notes: “[t]he most substantial challenge to the agencies’ power and authority

²⁸ *Wall Street Journal* 2008a.

²⁹ *Wall Street Journal* 2008c.

occurs when there is a failure to predict a sudden financial deterioration” (p. 156), and this is precisely what occurred with the credit crisis. Without receiving high-quality ratings—now widely pilloried for their inaccuracy—the market for mortgage-backed securities and collateralized debt obligations (CDOs)³⁰ at the heart of the crisis could never have attained the scale it did. Consequently, both American and European regulators have moved to step up regulation of the ratings agencies and made other efforts to curb their structural power.³¹

Besides the questions of *which* public and private actors will influence the future shape of global finance, we also need to consider whether there will be a shift in the balance of power between them in determining the content and application of regulation. In the early phases of the crisis, financial institutions sought to redress market failures while minimizing formal regulation and political intervention.³² As the crisis became more serious, however, this position became untenable;³³ it led not only to a renewed level of involvement by governments in their financial systems but also to a breathtaking expansion in the scope of their role in the economy. Nevertheless, if it is clear that there has been a shift in global financial governance in favor of public authority during the crisis, predicting where the future balance between public and private authority will lie is no easy task. The respectability of self-regulation by the private sector may have plummeted in these times, but the reputation of government regulation has also taken some hard knocks even if the extreme view that this is a crisis generated by a failure of central banks is worthy of derision.

In addition to understanding how actors participate in setting the future rules of global finance, analyzing the reactions of different participants in the global financial system to changes in these rules is crucial to assessing their implications. Although it is tempting to think of this crisis as a critical juncture in the politics of global finance, the new rules it spawns will promote a fundamental transformation in the way the global financial system operates only if they foster a sea change in the way banks and other financial enterprises go about their business. Therefore, looking to the ways in which banks and insurance companies and mortgage originators generate profits in the future should provide important insights into the lasting changes in the political economy of global finance that are prompted by this crisis.

³⁰ Mortgage-backed securities are securities backed by actual mortgages. In contrast, CDOs are securities backed by any number of asset-backed securities such as mortgage-backed securities, credit card-backed securities, auto loan-backed securities, and other, similar securities.

³¹ *Wall Street Journal* 2008b.

³² Institute for International Finance 2008.

III. CAUSAL FORCES SHAPING THE POLITICAL ECONOMY OF GLOBAL FINANCE

When asked what has provided the impetus for the striking shift toward the liberalization of financial markets and their integration across the globe in recent decades, many economists nominate the inexorable forces of technological change and competition. All of the books that are the focus of this review take issue with this view in arguing for the crucial role of politics in shaping the rules of global finance. Kirshner's volume, in particular, goes to considerable lengths to challenge the idea that what we have wrought was predetermined by objective forces. Taken as an integrated work, the book makes a sustained argument that monetary phenomena are always and everywhere political. The basis for this claim is that the economic consequences of the most hotly contested policy choices about monetary matters are ambiguous. Therefore, the only plausible explanation for the choices actually made, and the fervor with which they are advanced and defended, is that there is politics at stake.

This view has gained considerable ground since the crisis, but it begs the question of *how* politics has shaped the political economy of global finance. We organize the leading political explanations of this causal process into three categories, those that emphasize the role of interests, institutions, or ideas. While this is not a perfect way to categorize the wide variety of causal arguments that have been made, it does highlight the important ontological similarities across scholars operating in the distinct fields of IPE and CPE.

The early literature was dominated by an emphasis on states' pursuit of economic and political power as crucial to the development of the political economy of global finance. Hegemonic stability theory, advanced by the economic historian Charles Kindleberger and the political scientist Robert Gilpin, was initially used to explain long-run patterns in exchange rate policies.³⁴ Pointing to the historical roles played by Britain and then the United States as anchors for the global financial system, they argued that a hegemon was essential to the emergence and stability of such a system. While the need for a hegemon has subsequently been questioned,³⁵ scholars connected state interests and the politics of global finance in new ways. As Kirshner argues and as many of the contributors to his volume show, "states pursuing their inter-

³³ Giles and Guha 2008.

³⁴ Kindleberger 1973; Gilpin 1981; Gilpin 2001.

³⁵ See, in particular, Eichengreen 1989.

ests remain a key and probably the most important purposeful force in shaping monetary phenomena" (p. 21). Mark Blyth, for example, argues that the capacity of the existing international financial regime of liberalized and integrated markets to survive, despite its susceptibility to crises, can only be explained by the fact that it is supported by powerful states in pursuit of their own financial interests and those of their large financial sectors (see also the chapter by Grabel). For understanding the role of weaker states, Eric Helleiner and David Stasavage add important nuance to dependency arguments by showing how the policies of weaker countries are influenced by the types of relationships they have with specific powerful countries. Stasavage's chapter also speaks to the conditions for the maintenance of regional monetary integration, in this case the CFA franc zone, in his emphasis on the importance of the ongoing and complex relations between continuing members and France. In contrast, both Grimes's and Chang's chapters study regional integration from the perspective of the powerful, with Grimes emphasizing the links between Japan's efforts to insulate and stabilize its economy and its role in Asian monetary integration and Chang accounting for European monetary integration as a compromise between the divergent ideas and preferences of France and Germany.

Notwithstanding the continuing vigor and resonance of arguments rooted in a structural analysis of state interests, competing analyses of the causal forces that shape the political economy of global finance have also been proposed. Institutionalists, for example, take issue with the view that the arrangements that constitute the global financial order are reducible to the efforts of states to advance their relative gains. In the rationalist school of institutionalism, for instance, scholars argue that political institutions can be seen as efficient solutions to problems of market failure and that states may participate in them for the absolute gains that they promise.³⁶ Within the financial literature there is important work analyzing the conditions under which, and the ways in which, powerful states cooperate to achieve mutual advantage.³⁷ Other scholars portray the global diffusion of financial policies as a process of learning across states rather than a reflection of their competitive or coercive relations.³⁸

Notwithstanding their disagreements, both the interests and the institutionalist streams of research in IPE take the state as the crucial unit of analysis and they have both been criticized for their deficient analysis

³⁶ Keohane 1984.

³⁷ Kapstein 1994; Underhill 1995.

³⁸ For a review, see Simmons, Dobbin, and Garrett 2008.

of the determinants of states' preferences and behavior. As scholars like Peter Katzenstein pointed out long ago, one way to shed light on these issues is to open the black box of the state to understand how domestic interests and institutions shape the policy preferences and behavior of states.³⁹ In recent years, substantial progress has been made in linking "inside out" explanations with the "outside in" explanations that are more familiar in IPE.

One stream of work analyzes the role of domestic coalitions in determining state preferences with respect to monetary policy based on economic theories of production that are used to derive the economic interests and preferences of important national actors. Hector Schamis's chapter in Kirshner's book, on the evolution of exchange rate policy in Argentina over the half century until 1991, makes a related argument, but he bases his analysis not on stylized models of production but on the historical reality of Argentina's evolving class and sectoral conflicts. Others have grounded their "inside out" explanations in the comparative political economy literature, with its emphasis on variation across countries in the interests and representation of domestic coalitions. One of the strengths of this approach is that it does not assume that the same type of actor will, *ceteris paribus*, have the same policy preferences across distinct national contexts. As a result, it can explain why firms competing globally in the same industry but based in different national economies may have widely divergent preferences regarding capital mobility and global financial market regulation.

Verdier and Gourevitch and Shinn follow such an approach and suggest that there are important insights to be drawn from a deeper grounding of explanations of financial globalization in analyses of domestic interests and institutions. Verdier, for example, emphasizes the importance of deep-rooted, persistent variations in the character and role of domestic interests—understood in terms of geography and corporate class—in shaping state policies that affect the global integration of their financial systems. Local banks and economic actors dependent upon them prefer financial rules that keep savings circulating in local credit markets and resist many aspects of financial globalization.⁴⁰ Money center banks and their internationally oriented clientele prefer the opposite. For Gourevitch and Shinn, corporate governance regimes are the outcome of historical political battles and coalitional choices

³⁹ Katzenstein 1978.

⁴⁰ Thus, Verdier's analysis suggests a systematic explanation for why German SMEs continue to fight the spread of debt rating mechanisms in the use of bank credit (as Basel II entails) and the spread of IFRS/IAS, fearing that it will reduce capital availability or raise the cost of capital (also Nölke and Perry 2007).

among owners, managers, and workers. Once established, national preferences on the type of governance regime and coalitions tend to be stable (though not frozen).

Although both Gourevitch and Shinn and Verdier emphasize the role of domestic interests in their analyses, their arguments are also bound up with an institutional theory of change and stability in financial systems. In fact, in Verdier's analysis of domestic financial systems, the degree of state centralization, an institutional characteristic that he views as largely invariant over more than a century, is the central causal variable. So, too, Gourevitch and Shinn emphasize the centrality of political institutions. The translation of coalitional preferences into the policies that influence corporate governance is conditioned by the characteristics of different countries' political systems. Majoritarian systems permit large policy swings, and such uncertainty undermines coordinated systems of capitalism, thus favoring groups with an interest in diffusion and high MSP. More consensual political systems promote policy stability, thus favoring more coordinated economies and blockholding.

Until recently, causal arguments based on analyses of interests and/or institutions have held sway in studies of the politics of finance in both the IPE and the CPE literatures. However, in both fields there is growing interest in constructivist approaches. Constructivists argue that understanding the social context and the ways in which it constitutes actors' interests and identities is a crucial complement, and in some cases a corrective, to interest-based and institutional arguments.

Constructivism became an important intellectual force in international relations in the 1990s but it took longer to have an impact on IPE in general and on the analysis of global finance in particular. Notwithstanding a number of important early contributions such as McNamara,⁴¹ Benjamin Cohen noted in 2002 that "[c]ognitive variables ... have until recently played little formal part in the [international] finance literature, perhaps because they are so difficult to operationalize."⁴² However, the situation has changed significantly in recent years, as constructivist accounts of developments in global finance have become increasingly influential. Constructivists have also gained influence in comparative political economy, although we are only just beginning to see the impact their thinking might have on comparative studies that are relevant to global finance.

⁴¹ McNamara 1998.

⁴² Cohen 2002.

Constructivist arguments are particularly well represented among our books, namely, the contributions by Kirshner, Sinclair, Jabko, and Abdelal. In their causal explanations of the political economy of global finance, all of these books place a major emphasis on social interactions and their influence on how actors understand their interests and identities. Kirshner argues that what distinguishes the politics of monetary politics from other spheres of political economy is that, as Susan Strange observed, economic ideology is used to hide the conflict between special and national interests and that this “is coupled with the unique link between ideas and ‘market sentiment’ in money matters, and the overwhelming influence of that sentiment on the ability to practice macroeconomic policy” (p. 13). Kirshner’s emphasis on the importance of the ideational is echoed by a few of the other contributors to the book, to a great extent by Gabel, Abdelal, Gavin, and Blyth and to a lesser extent by Schamis and Wang.

Sinclair, in the rather different domain of credit ratings, also argues for the importance of the social construction of the knowledge that underlies ratings. He claims that a specific type of knowledge, a knowledge based on “a static, unhistorical way of thinking,” is privileged in the rating process. Notwithstanding the fact that “[r]ating involves an admixture of quantitative and qualitative data” and “is thus inherently a process of judgment” (p. 46), it is treated as if it were objective fact and has enormous influence around the world. It is powerful, Sinclair argues, because it is socially validated, and he describes three different types of power that the ratings agencies have—relational, structural, and epistemic—which explain the process through which their knowledge has become so influential. The result is the growing hegemony of what Sinclair calls “the mental framework of rating orthodoxy.” The relevance of Sinclair’s argument is readily apparent in the crucial enabling role that ratings agencies played in the U.S. subprime mortgage crisis: many sophisticated institutional investors appear to have looked no further than the official credit ratings—treating them as “fact”—when buying mortgage-backed bonds that turned out to be far riskier than their ratings suggested.

Although constructivist accounts are typically regarded as distinct from, and often opposed to, other types of causal accounts in IPE, the examples of it found in Kirshner’s volume and in Sinclair’s work suggest that this is not necessarily the case. In their stories, interests and ideas are closely intertwined: we understand the world the way we do because the powerful play a substantial role in shaping how we see ourselves and others. Blyth portrays powerful actors as using their influence

very deliberately to advance their own interests. So, too, in the books by Jabko and Abdelal we see a very self-conscious and instrumental constructivism at work, although in these books the central players are bureaucrats rather than powerful financiers or states.

Jabko uses the term “strategic constructivism” to emphasize that it was the astute use of ideas rather than the ideas themselves that were the primary engine of change in Europe’s process of market integration. The strategy emanated from Commission bureaucrats who used the market idea to reconcile those who wanted a federal Europe and those who merely wanted market liberalization. Although the two camps had opposing long-term visions for Europe, the Commission convinced each that the market strategy was the best means to their respective ends. Thus a loose coalition was formed around the market, with each side believing (or betting) that over the long term the intermediate steps that both sides agreed upon would lead to its preferred outcome.

Abdelal makes a similar set of arguments but sees French statesmen as the key protagonists, whose aim was to bring about managed globalization in the financial realm. He pays close attention to the roles that they played in the bureaucratic processes through which the world’s most powerful international organizations produced “new scripts”—both formal, written rules and informal, unwritten, rules—that shaped global finance. He also analyzes the diffusion of these scripts to different countries and, although he acknowledges the importance of material incentives for acceding countries to accept these rules, he argues for the crucial significance of the symbolic benefits of membership in encouraging acceding states to adopt capital rules without questioning their content. Overall, he underlines that the process by which international organizations developed and proliferated the new rules of global finance was one of social construction.

The integration of different strands of thinking, such as perspectives on interests and institutions that we see in Verdier and Gourevitch and Shinn and on interests and ideas in Jabko and Abdelal, as well as in Kirshner, is not confined to the books reviewed here. One sees other recent signs of a move away from sharp distinctions between interests, institutions, and ideas as alternative causal variables in analyses of the political economy of global finance. Posner, for example, explains the rapid and widespread adoption of Nasdaq-style stock exchanges in Europe during the mid-1990s as a result of European bureaucrats’ success in shaping political discourse in ways that fostered new definitions of interests and political coalitions. Yet major institutional change oc-

curred in an incremental, path-dependent fashion marked by both intended and unintended consequences and without a single actor in control of the process.⁴³

The blending of approaches, previously cast as alternatives, surely makes current academic discussions more capable of grasping the reality of the political economy of global finance. Nevertheless, the efforts to bring interests, institutions, and ideas together in the books we consider here are not entirely convincing. In particular, empirical evidence for some of their most important theoretical claims is far from compelling. There has been much criticism of the way in which constructivists go about generating and using empirical evidence. Some of this criticism is unfair, since it incorrectly assumes that most interest-based and institutional claims have been thoroughly tested and proven in empirical studies. Instead, we see a general problem of how to compare and contrast the role of different causal forces in explaining the political economy of global finance. In this regard, Sinclair's discussion of a counterfactual method in which "a rationalist account of rating agency effects is compared with a constructivist one inspired by economic sociology" seems promising but only if it is applied in a way that takes account of the complexities and subtleties of different theoretical approaches.

Of particular importance is the challenge of showing the relative weight of different causal forces in influencing the behavior of the crucial actors who generate and enact the rules of global finance. Given that states have long been the players of focus, the research agenda to understand what drives their behavior is most advanced. In large part, as we noted above, insights on the determinants of state actions have come from delving inside the state to understand how domestic actors shape its interests. Many of the resulting analyses emphasize that one size does not fit all when it comes to the politics of financial systems, a position that, as the books by Verdier and Gourevitch and Shinn show, is well substantiated by an extensive literature in comparative political economy. However, the nature of government responses to the ongoing financial crisis poses a provocative challenge to this perspective.

With the announcement of the Lehman Brothers bankruptcy in mid-September 2008, the financial crisis took a dramatic turn for the worse. On October 8, Gordon Brown announced a bold plan for his government to intervene in the British economy to recapitalize banks,

⁴³ Posner 2005. In a similarly structured study, Posner 2009 investigates how U.S. regulatory authorities became much more conciliatory toward the Europeans on securities market regulations as a result of the centralization of authority within the EU.

to guarantee interbank lending, and to extend liquidity provision on the grounds that “[t]he global financial market has ceased to function.”⁴⁴ At the end of that week other European governments, led by France and Germany, followed suit, and some days thereafter the Americans announced a similar plan. How do we explain the apparent similarity of responses to the global financial crisis from governments in countries with such diverse financial systems?

One possible answer is that, notwithstanding ongoing differences in financial interests and institutions across countries, ideas about how to regulate them display remarkable convergence. Another rather different explanation is that, on closer observation, the responses are actually less similar than they seem. This possibility is hinted at by the distinct attitudes toward the nationalization of financial enterprises on different sides of the Atlantic Ocean, however similar the appetite of governments for bailouts of these enterprises might seem to be. Clearly we need to do a better job of characterizing and explaining why states act as they do if we are to explain the flurry of political responses to the ongoing global crisis that we have already seen.

For actors whose importance in the politics of global finance has been recognized more recently, we still know too little about what drives their behavior. This problem is evident in the books by Abdelal and Jabko; despite according such prominence to strategic bureaucrats, these works offer only limited insight into their motivations and resources. When we move beyond the realm of states and supranational institutions to focus on the role of private actors in the regulation of global finance, our grasp of their motivations and behavior becomes even more tenuous. Though Sinclair’s book is a welcome contribution to the study of private financial actors, we still learn too little about the rating agencies themselves and what they believe they are trying to achieve. A similar criticism can be made as a general critique of the literature on the regulatory impact of private actors where accounting firms and investment banks appear as rather furtive characters operating in the shadows.

The challenge of adducing empirical evidence to support their theoretical claims about what leads actors to behave in particular ways is especially difficult for scholars who argue, as many of our authors do, that more than one causal force is at work. In accounts that emphasize the importance of interests and ideas, for example, one cannot escape a sense of unexplained asymmetry in the treatment of different types

⁴⁴ *Economist* 2008b.

of actors. One group—the powerful actors in accounts such as Grabel, Blyth, and Sinclair or the strategic actors in Jabko and Abdelal—have clear preferences for what they want to achieve and are relatively focused in how they go about getting what they want. Yet other players are more easily mystified, if not objectified: their interests and identities are more fluid and therefore more prone to be influenced, and even manipulated, through a process of social construction.

We see the same type of problem in Sinclair's argument that the position and influence of rating agencies derive from the epistemic power that they exercised in the global financial system. There is no doubt that the development and credibility of many new financial products is driven to a great degree by the—sometimes blind—faith in the formal theories and mathematical models that are used to create and manage them, although to date the role of formal knowledge in transforming financial markets has received little systematic study.⁴⁵ However, what this crisis, and arguably earlier ones, clearly revealed is that many of the crucial actors in the rating game treat it as just that: a game. As a former Moody's expert in securitization put it: "Every agency has a model available to bankers that allows them to run the numbers until they get something they like and send it in for a rating." In short, as one subprime analyst put it: "Gaming is the whole thing."⁴⁶

This pervasive cynicism in the financial community about something as fundamental as the measurement of risk involved in the securities they sell and buy is not something that Sinclair recognizes, but it is surely basic to understanding the political economy of global finance. How do we explain this mismatch between what practitioners really believe about the way the system works and the rational account of that system that they present to the outside world and that many policymakers and scholars swallow for long periods of time? The answer is surely bound up with some mix of interests, institutions, and ideas, but the magic is in identifying precisely what that mix is, and it arguably still eludes us.

IV. THE CONSEQUENCES OF THE POLITICAL ECONOMY OF GLOBAL FINANCE

The third major issue in the literature concerns the consequences stemming from the structure of the global financial system and the way it is politically constructed and governed. From the beginning, one of the

⁴⁵ For an exception, see MacKenzie 2006.

⁴⁶ Lowenstein 2008.

primary issues has been the stability of global monetary and financial systems. Today it may sound almost tongue in cheek to ask whether the way global finance has been constructed in the post-Bretton Woods era has enhanced or undermined that stability, but it is important to reflect on the evolution of conventional thinking on this issue.

As capital markets became more open and cross-border capital flows rapidly increased, the fortunes and fates of different countries' monetary and financial systems became more closely entwined. The specific character of global financial flows, moreover, fostered different types of systemic interdependence. The rise of foreign bank lending to both sovereigns and corporations generated the most important form of systemic interdependence after the collapse of Bretton Woods. It continues to be extremely important as foreign bank lending and deposits remain the largest single category of cross-border capital flows.⁴⁷ Given the predominance of short-term lending in cross-border banking, rapid changes in these flows can generate major problems for countries with high levels of external borrowing.⁴⁸ This problem regularly rears its ugly head.

New sources of systemic risk, beyond bank lending, also emerged over the last two decades due to the enormous growth in cross-border investment in debt and equity securities. This type of investment has grown nearly equal to cross-border bank lending, largely due to rapid growth in portfolio investment flows in the last decade.⁴⁹ Of particular significance has been the dramatic expansion in the scale of cross-border investment in derivatives. The notional value of all derivatives outstanding globally reached \$470 trillion by the end of 2006 with the overwhelming majority traded in unregulated over-the-counter markets. While the net credit exposure or assets at risk underlying this number was estimated to be "only" \$1.7 trillion,⁵⁰ the actual risk exposure of investors engaged heavily in derivatives markets is difficult to ascertain. Derivatives create intricate—and often obscure—chains of financial interdependencies. When market confidence in the solvability of counterparties falters, liquidity may evaporate and cause severe crises in derivatives markets and far beyond, in ways demonstrated so vividly in 2008 and 2009.⁵¹

⁴⁷ Farrell et al. 2008, 58.

⁴⁸ Notable examples include the Latin American debt crisis of the early 1980s and the Asian crisis of the late 1990s.

⁴⁹ Farrell et al. 2008, 55–58.

⁵⁰ Farrell et al. 2008; and author calculations.

⁵¹ The best example of this would be the huge losses taken by financial institutions in the U.S. and Europe due to losses in credit default swaps tied to subprime mortgages in the U.S. In other words, losses accrued not only to those who held mortgage-backed securities but also to those who "insured" those investors through these swaps.

Concerns that the growing importance of derivatives might be a major source of systemic risk for the global financial system were raised at least as early as 1998, when the failure of Long Term Capital Management (LTCM), a hedge fund heavily engaged in derivatives markets, fueled fears of systemic collapse and prompted the Federal Reserve to step in to save it. Nonetheless, powerful advocates of financial deregulation, such as Alan Greenspan, argued that more, not fewer, derivatives were the key to enhancing the stability of the financial system because they transferred risk from those less able to manage it to those better able to do so.⁵² He was not alone in this view. Various efforts in the 1990s and 2000s to regulate derivatives markets were thwarted in the U.S. by powerful actors on both sides of the aisle, including Republican senator Phil Gramm, but also Clinton's treasury secretary Robert Rubin and his deputy Larry Summers.⁵³

Viewed from today's perspective, the political commitment to limit the systemic risks associated with the global financial system seems puny. Not only did it fly in the face of the evidence of the growing scale and complexity of the systemic interdependence that characterized the global financial system but it also downplayed the significance of the financial crises that the system experienced: the current financial crisis may be the worst since the 1930s but it is far from the first major crisis of the post-Bretton Woods era of globalized finance. To the contrary, as Bordo, Eichengreen, Klingebiel, and Martinez-Peria show, the era from 1973 to 2000 was marked by a frequency of financial crises that was double that of the Bretton Woods and gold standard eras and close to that of the 1920s and 1930s. As they put it, "[h]istory confirms that there is something different and disturbing about our age" (p. 72), a conclusion they reached even before the current crisis hit!

While financial crises were concentrated in developing countries, defenders of liberalization and globalization argued that they were localized in their impact and could be resolved by the IMF, in conjunction with large lenders and dominant states. Moreover, crises were commonly attributed to policy mistakes, to weaknesses of particular financial systems and sometimes to cronyism in national systems of capitalism, rather than to general characteristics of the global finan-

⁵² In 2004 Greenspan said, "Not only have individual financial institutions become less vulnerable to shocks from underlying risk factors, but also the financial system as a whole has become more resilient" (quoted in *New York Times* 2008). But Greenspan also presciently commented that in a financial crisis the widespread use of derivatives would amplify that crisis and spread it at a faster pace, though he held such a dire scenario to be only a remote possibility.

⁵³ *New York Times* 2008.

cial system.⁵⁴ As these problems were corrected, the optimists claimed, the global financial system would go from strength to strength. Martin Wolf, the prominent *Financial Times* journalist, identified this view as one he held until recently: “Until last August [2007], I comforted myself with the thought that many of the crises of the past quarter-century occurred in relatively backward financial systems, even if institutions of the first world played a part in ‘seducing minors.’ So things might, I hoped, be getting better. That is no longer a plausible view.”⁵⁵ As Wolf’s quote suggests, the current financial crisis made such a convenient interpretation untenable, not only because of the unprecedented scale of the crisis but also because it emanated not from the periphery but from the very core of the system, especially the U.S. By the end of 2008 writedowns by financial institutions had already reached an estimated \$1 trillion, with about 70 percent of that coming in the U.S. and most of the rest in Europe (while writedowns in Asia have been comparatively minor).⁵⁶

The current crisis has certainly ended the erstwhile complacency about the systemic risks associated with the current political governance of global finance. It has also stimulated a new skepticism about the benefits that a liberalized regime was supposed to bring. Champions of financial liberalization and globalization were fervent in advancing their claims that, despite the occasional “hiccup” the overall benefits of global capital mobility, not least for developing countries, were too large to forgo. As Kirshner points out, there were always those, within the economics profession and beyond, who challenged these views,⁵⁷ and in the wake of the Asian crisis even mainstream economists began to raise questions about the economic benefits of financial globalization. Perhaps the greatest paradox of the current regime is that it has facilitated flows of funds from poor countries to rich countries, rather than in the opposite direction. It also allowed the accumulation of dramatic external imbalances in cases as diverse as the U.S. and Iceland. This evidence renders suspect the claims that financial liberalization promotes an efficient allocation of capital across the global economy. These days, a more prevalent view is that it promoted an unsustainable situation in which households in rich countries indulged an addiction for spending and consumption that developing countries fueled with

⁵⁴ Blyth, in Kirchner (p. 242).

⁵⁵ Wolf 2008.

⁵⁶ Martinuzzi 2008.

⁵⁷ Of particular interest is a rich body of literature in languages other than English. See, for example, Chesnais 2004.

massive exports of cheap goods and huge investments in foreign currency.

If the current financial crisis has transformed the debate about the global costs and benefits of the current governance regime for global finance, it has also had a major influence on debates in particular countries about the domestic consequences of their engagement with it. Concerns about the stability of national currencies and financial systems and even about the solvency of entire states rose to extraordinary levels. Moreover, they were focused not only, or even primarily, on developing countries but also on developed economies like Iceland and Ireland and Spain that were thought to have left such worries behind. Lurking in the background, moreover, are questions about the giants of the global economy and, in particular, the trillion-dollar question of whether the U.S. dollar can avoid collapse. For now, it seems, the logic of *faute de mieux* is working in its favor. As a prominent Chinese official said to the *Financial Times*: “Except for US Treasuries, what can you hold? Gold? You don’t hold Japanese government bonds or UK bonds. US Treasuries are the safe haven. For everyone, including China, it is the only option.” He added, “We hate you guys. Once you start issuing \$1 trillion—\$2 trillion ... we know the dollar is going to depreciate, so we hate you guys but there is nothing much we can do.”⁵⁸

Along with concerns about the risks to the stability of national economies has come a questioning of the domestic impact of the current regime. There are a variety of aspects to the domestic effects of a country’s integration within the global financial system. Over the years scholars have paid considerable attention to the influence of capital mobility and financial liberalization on the policy autonomy of national governments in terms of monetary, tax, and fiscal policies, with questions about convergence coming to the fore. One of the conclusions drawn by Cohen in his earlier review of the global finance literature was that increased capital mobility clearly imposes some constraints on a state’s policy autonomy but that such constraints are far from absolute.⁵⁹

Subsequent research sustains Cohen’s general conclusion. In our view, some of the most interesting and novel work on the domestic consequences of financial globalization explores them using the concept of institutional complementarity. Complementarity means that the presence of one institution enhances the utility or functionality of another

⁵⁸The official was Luo Ping, a director-general at the China Banking Regulatory Commission, and he was quoted in *Financial Times* 2009a.

⁵⁹Cohen 1996.

institution for a given actor (or set of actors). The concept is central to many contemporary theories of national capitalist systems.⁶⁰ We can see its application, for example, in recent work on the much-debated question of whether globalization undermines extensive welfare states. Starting from the position that welfare states, labor-market institutions, and firm production strategies are complementary institutions,⁶¹ Iversen argues that intensified globalization in product and financial markets, on balance, is intensifying *differences* among nationally distinct “welfare production regimes.”⁶² The essential argument is that coordinated market economies rely on highly skilled labor and asset-specific production for competitive advantage in global markets and that social policy can promote and protect the investments by firms and workers in skills and specific assets.⁶³ Thus, Iversen constructs a view somewhat at odds with the prevailing orthodoxy that financial globalization undermines welfare states.⁶⁴

The book by Gourevitch and Shinn is firmly rooted in this “varieties of capitalism” paradigm with its emphasis on institutional complementarities across what previously were analyzed as distinct domains. The blockholding pattern in corporate governance that continues to prevail by and large in most coordinated market economies is explained in part by the very same incentive structure that leads these countries to sustain protective welfare and labor-market policies. Thus institutional complementarities inhibit convergence in corporate governance systems, despite the widespread belief that the demands of global investors are leading in this direction.

Gourevitch and Shinn also point to the firm-level consequences of financial globalization, an area of growing attention in political economy where there has been particular interest in the process of financialization. Nölke and Perry divide the process of financialization into two components.⁶⁵ Of these the first is *profit* financialization, which itself consists of two subtypes. The first is the relative growth in profitability of the financial sector; in the U.S., for example, the financial sector’s share of all profits rose from 10 percent in the early 1980s to 40 percent in 2007.⁶⁶ The second subtype is the growing proportion of profits that *nonfinancial* firms are—or were—making from financial transactions

⁶⁰ Deeg and Jackson 2007.

⁶¹ Iversen and Soskice 2006; see also Mares 2003.

⁶² Iversen 2005.

⁶³ Mares 2003.

⁶⁴ For example, Korpi 2003.

⁶⁵ Nölke and Perry 2007.

⁶⁶ *Economist* 2008a, 79; Krippner 2005.

and investments rather than from the sale of goods or services. Some studies suggest that in the 2000s as much as 40 percent of nonfinancial corporate sector profits were derived from financial activity—a quadrupling of the 10 percent share during the 1950s and 1960s.⁶⁷ Other studies suggest similar trends across OECD countries.⁶⁸ The second dimension of financialization is *control* financialization. It refers to “the process by which the maximization of shareholder value [sv] has become the primary objective of firms’ managers.”⁶⁹ With greater financialization, managers begin to view the firm as a collection of assets, with the primary criterion for managing those assets being the maximum returns they can extract for shareholders. The implication, for critics of financialization, is that corporate managers are now guided overwhelmingly by financial considerations and inexorable pressures to raise profitability—including direct and indirect pressures stemming from the ratings process, as Sinclair aptly highlights. As a result, they are often willing to make choices that compromise the interests of other stakeholders, especially when their own incentive packages allow them to participate in the gains from financialization.

From the perspective of broader debates about alternative forms of national capitalism, financialization is associated by many with corrosive pressures on coordinated systems of capitalism.⁷⁰ In contrast to the view that complementarities sustain cross-national differences, this argument holds that the “patient capital” that undergirded coordinated approaches to production and innovation is diminishing due to the transformation of financial markets and that this will eventually undermine coordinating institutions in other domains.⁷¹ Yet others argue that actors can either resist some elements of financial market liberalization or adapt to them in ways that preserve existing institutions and complementarities.⁷²

The degree of financialization varies to a great extent both within and across national economies, as the work of Gourevitch and Shinn suggests. Certainly it is most developed in the United States and, across economies, in the financial sector. Precisely because of the patterns in its incidence, the process of financialization has been implicated as an important contributing cause of the financial crisis. In particular, the extraordinary financial incentives awarded to banking executives and

⁶⁷ Krippner 2005; Duménil and Lévy 2004.

⁶⁸ Epstein and Jayadev 2006; Duménil and Lévy 2004.

⁶⁹ Nölke and Perry 2007, 8; Lazonick and O’Sullivan 2000; O’Sullivan 2000.

⁷⁰ For example, Beyer and Höpner 2003.

⁷¹ Lane 2005.

⁷² Höpner 2005.

other employees who generate large profits for the banks have been blamed across the world for banks' willingness to pursue aggressive strategies without due attention to the attendant risks.

Clearly an important question for the future is what will happen to financialization trends. Profit financialization surely will be slow to recover from its 2008 collapse. Financial institutions are struggling to survive in the short term, and in the medium term they will have to rework and perhaps even replace their business models. It seems highly unlikely that we will soon see them generate the phenomenal profits that they enjoyed in recent years. So too nonfinancial enterprises, like the U.S. automobile companies or General Electric, which relied so heavily on profits from their financial activities, are going to have to live or die without the fillip that these profits provided to their industrial activities.

It is more difficult to say what will happen to control financialization. On the one hand, the problems at financial and nonfinancial enterprises may exhort institutional investors to greater involvement in the governance of these corporations. As the *Economist* recently noted, an analysis of bank governance is crucial to understanding how banks ended up in the mess in which they find themselves: "Shareholders have suffered in the crash, but why didn't they and their boards step in, rather than egg the bankers on? How did the apparatus of risk managers and board committees allow them to err so badly? Britain has initiated a review of bank governance. Others should follow."⁷³ By contrast, the recent travails of U.S. hedge funds, which face huge redemption demands from investors at home, have reportedly gutted the activist investor movement in Japan to the reported delight of many Japanese managers.⁷⁴

V. CONCLUSION

It is the best of times and the worst of times for scholars who work on the political economy of global finance. It is the best of times because we are living through a moment that has put the "political" back at the very heart of the subject. It is also the worst of times for students of the political economy of global finance since everything one says risks being rendered obsolete by the vagaries of the ongoing crisis. All of the

⁷³ *Economist* 2009.

⁷⁴ *Financial Times* 2009b.

books we review herein were written long before that crisis raised its head and, in reviewing them, we have emphasized what we believe is important and enduring in what their authors argue.

Taken together, we believe that the six books offer a rich sense of recent developments in the analysis of the political economy of global finance. They build on and contribute to previous efforts to shift the focus from state-centered patterns of regulation. As we observed, this shift does not negate the role of public regulation, but it does require us to understand the role of private actors in the development of transnational governance regimes that combine public and private regulation. These books also highlight a tendency to move away from monocausal explanations to incorporate interests, institutions, and ideas in more complex causal models. Finally, we emphasized important developments in the analysis of the consequences of the political economy of global finance, especially in the consideration of the interaction between global finance and domestic institutions such as labor markets and corporate governance.

For all of these advances, we pointed to areas of weakness in our understanding of the political economy of global finance. First, although the literature has developed greatly in recognizing the importance of actors in the constitution of the rules of global finance, our understanding of the actors who *enact* these rules remains rather limited, despite its importance for understanding the current crisis. Moreover, our capacity to distinguish between the different causal forces that shape the political economy of global finance is still modest. Finally, we call for greater attention to the consequences of the political economy of global finance, especially new types of systemic risk for the global financial system and the national systems that it comprises, as well as for the character of national systems of capitalism.

Although in reviewing the six books that are the focus of this review it would have been unfair to read them entirely through the murky light of the ongoing crisis, we have nevertheless endeavored to highlight the questions that the crisis raises for the basic issues they address. Our discussion also suggests a more general question that the crisis poses for students of the political economy of global finance: how it is that false illusions of the global financial system's operation and consequences were conferred with sufficient legitimacy to deafen alternative views and stymie real reform? One need not be a cynic to think that answers to this question are likely to be relevant for understanding not only the past but also the future of the political economy of global finance.

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